Imperatives for Reducing the Cost of Living in Kenya

KENYA ECONOMIC REPORT 2012

Kenya Economic Report 2012

Imperatives for Reducing the Cost of Living in Kenya

Nairobi, Kenya
2012

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Foreword

The Kenya Institute for Public Policy Research and Analysis (KIPPRA) was established under the KIPPRA Act No. 15 of 2006 to provide advisory and technical advice on public policy issues to the Government of Kenya, government agencies and other stakeholders. The Institute serves as a central source of information and advice on public policy issues.

The Kenya Economic Report (KER), which is produced annually, is one of the many publications by KIPPRA that aid in the realization of the Institute's mandate. The broad areas covered in the Kenya Economic Report 2012 include macro and socio-economic performance, performance of selected key sectors of the economy, medium-term prospects, and interventions for reducing the cost of living. The report provides valuable insight to the performance of the Kenyan economy and its likely trajectory over the medium term period 2012/13-2014/15. Moreover, it identifies emerging policy issues across various sectors as well as key drivers of the cost of living. It further proposes commensurate policy interventions to address the emerging issues.

Although Kenya's economic growth has remained relatively strong, it is still below the growth target of 10 per cent envisaged in the Kenya Vision 2030. Economic performance has been affected by, among other factors, the global economic recession, unstable energy prices and rising food prices. The resulting increase in final prices, especially food prices, led to forms of social unrest not only in Kenya but also across the globe. Thus, the theme of the report, *Imperatives for Reducing the Cost of Living in Kenya,* is quite timely.

We hope that this report will help inform the ongoing debate on how to manage the cost of living and create a more stable nation. Stability will in turn be important for further investments and growth. The Kenya Economic Report 2012 will certainly be useful to policy makers, legislators and other stakeholders in their efforts to make the country realize its development objectives, including the Kenya Vision 2030.

Hon. Wycliffe Ambetsa Oparanya, EGH, MP
Minister of State for Planning, National Development and Vision 2030

Preface

The Kenya Economic Report 2012 is the fourth in a series of annual reports on the Kenyan economy prepared by the Kenya Institute for Public Policy Research and Analysis (KIPPRA). The report was prepared in consultation with the Ministry of Planning, National Development and Vision 2030; Ministry of Finance; and the Central Bank of Kenya in conformity to the KIPPRA Act No. 15 of 2006. It was prepared against a backdrop of generalized upward spiral in the cost of living across the globe, which led to social unrest in many countries, and hence the theme *Imperatives for Reducing the Cost of Living in Kenya.* The report targets policy makers, legislators, and anyone interested in understanding Kenya's economy.

The Kenya Economic Report 2012 has four parts, which can be read independently. Part I covers the macro and socio-economic performance of the economy. It incorporates discussion on governance, population, the labour market, poverty and inequality, health, and education. Part II of the report covers performance in selected sectors and policy issues. These sectors include agriculture, manufacturing, micro and small enterprises (MSEs), tourism, financial services, foreign policy, and infrastructure and economic services. Part III presents medium term prospects, with discussion of current trends across sectors and focus on a three-year projection of key macroeconomic variables, including growth and inflation, poverty, education, health, agriculture, tourism, and energy. Part IV discusses the imperatives for reducing the cost of living in Kenya. This part also provides conclusions and policy recommendations.

The growth of Kenya's economy slowed down in 2011 to 4.4 per cent down from 5.8 per cent recorded in 2010. The slow-down is attributed to various factors, including severe drought, high international oil prices, weak global economic performance and structural constraints such as low productivity, under-absorption of the development budget, and low levels of investment and savings. Inflation rose to about 19.7 per cent in November 2011 up from about 5.4 per cent in January 2011, and the Kenya shilling depreciated rapidly during the third quarter of 2011.

There was mixed performance across various sectors of the economy. Growth in agriculture and manufacturing slowed down to 1.5 per cent and 3.3 per cent, respectively, in 2011. The key challenges facing agriculture were lack of competitiveness and low productivity, while manufacturing was affected by rising inflation, which affected local demand for manufactured products. Depreciation of the Kenya shilling also increased the cost of imports of raw materials. The financial services sector expanded

in terms of number of financial institutions and product variety. However, the sector recorded a lower growth of 7.8 per cent in 2011 compared to 9.0 per cent in 2010.

In the medium term, the Kenyan economy is expected to get on a recovery path through 2014. Economic growth is projected at 5.8 per cent and 6.3 per cent in 2013 and 2014, respectively. Whereas the national poverty headcount ratio is projected to decline slightly from 49.6 per cent to 49.3 per cent between 2012 and 2014, the number of poor people is projected to rise. The national poverty gap is projected to decline from 19.5 per cent in 2012 to 19 per cent by 2014.

The overall Consumer Price Index (CPI) was analyzed vis-a-vis its key sub-components, namely, food and non-alcoholic items index, the price index for energy products and the price index for transport. The results indicate that the energy price index has the highest contribution to the aggregate CPI, followed by transport price index and food and non-alcoholic items price index. The effect of prices of food and non-alcoholic items take a shorter time to drive aggregate prices in the economy compared to energy and transport prices, which take slightly longer.

Despite several interventions put in place over the years, the cost of living is still high, with the level of inflation remaining above the desired target of 5 per cent. The runaway inflation experienced in 2008 and 2009 sparked citizen protests that signalled the ineffectiveness of interventions.

This report gives several policy recommendations. In the labour market, the report proposes the institutionalization of an integrated wage policy to address the problem of falling real wages, and improvement of productivity in the informal sector partly through enhancement of skills. In order to address the problem of high variability of crop prices within the production season and across successive years, the government should establish commodity markets where hedging and "synthetic storage" approaches have been applied; adopt warehouse receipt systems by private warehouse operators; and reduce post-harvest losses by encouraging farmers to adopt on-farm storage. There is also need to promote and empower livestock traders through cooperatives.

With regard to energy, Kenya needs to fast-track investments that will reduce the economy's dependency on petroleum. In addition, the country should fast-track the importation of cheaper power from neighbouring countries. The government should also increase funding for geothermal and wind power projects. Liquefied Petroleum Gas (LPG) cylinders should be zero-rated to make the initial costs of acquiring them affordable to the poor.

Enhanced use of non-motorized (NMT) modes of transport, such as walking and cycling, should be mainstreamed into the country's infrastructure development agenda in order to reduce the cost of living. Promotion of efficient, mass rapid transport systems will also help households to reduce their cost of living. In housing, the government should hasten the process of reviewing the regulatory framework, including land titling. Land banks should be created in order to ease speculation on land, and promote micro financing in the housing sector to boost housing supply, especially in the low-end market.

Dr Eric A. Aligula
Executive Director
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Chair, Board of Directors
KIPPRA

Acknowledgments

KIPPRA's main objective is to satisfy the consumer of the information and policy recommendations contained in the Kenya Economic Reports. Considerable time and effort went into putting together the Kenya Economic Report 2012 and others before it.

We are grateful to the KIPPRA Board of Directors for facilitating the preparation of the Kenya Economic Report 2012 and for the valuable comments on the write-up. Other stakeholders who also gave comments on the write-up, including Office of the Prime Minister; Ministry of Planning, National Development and Vision 2030; Ministry of Finance; Central Bank of Kenya; and the National Economic and Social Council are highly acknowledged. Their valuable comments helped improve the quality of this report.

Immense appreciation goes to the former Executive Director of KIPPRA, Dr Moses Ikiara, Dr Eric Aligula who acted as Director in the interim period, and the current Executive Director Dr John Omiti for directing the process of preparing the report. We are grateful to all research Heads of Divisions: Dr Augustus Muluvi (Trade and Foreign Policy), Eldah Onsomu (Social Sector), Dr Eric Aligula (Infrastructure and Economic Services), Dr Jacob Chege (Governance), Dr John Omiti (Productive Sector) and Prof. Joseph Kieyah (Private Sector Development) for guiding the processes and participating in writing this report. We appreciate the support of various Heads of Divisions, including Maina Njoroge (Finance and Investment); Dennis Kimanzi (Human Resources); Peter Munene (Procurement) and Felix Murithi (Knowledge Management and Communications) for their roles in ensuring a smooth production process.

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KIPPRA acknowledges the generous financial support from the Government of Kenya, African Capacity Building Foundation (ACBF), and the Think-Tank Initiative of IDRC over the years.

To you the readers, we appreciate any feedback that will enable us make future reports more valuable.

Abbreviations and Acronyms

ACBF	African Capacity Building Foundation
A-I-A	Appropriations-in-Aid
APR	Annual Progress Report
ARD	Agriculture and Rural Development
ASAL	Arid and Semi-Arid Lands
ASDS	Agricultural Sector Development Strategy
BMI	Body Mass Index
BMI	Business Monitor International
BOOT	Build, Operate, Own and Transfer
BPO	Business Process Outsourcing
BRIC	Brazil, Russia, India, China
BRRU	Business Regulatory Reform Unit
CAADP	Comprehensive Africa Agriculture Development Programme
CBK	Central Bank of Kenya
CBR	Central Bank Rate
CDF	Constituency Development Fund
CDR	Crude Death Rate
CFS	Container Freight Stations
CIDCs	Constituency Industrial Development Centres
CMA	Capital Markets Authority
COFEK	Consumer Federation of Kenya
COMESA	Common Market for Eastern and Southern Africa
CPI	Consumer Price Index
CPR	Contraceptive Prevalence Rate
CPST	Centre for Parliamentary Studies and Training
CRB	Credit Reference Bureau
DANIDA	Danish International Development Agency
DFID	Department for International Development
DFZ	Disease Free Zone
DHS	Demographic and Health Survey
DLTLD	Division of Leprosy Tuberculosis and Lung Diseases
DOMC	Division of Malaria Control
DPM	Directorate of Personnel Management
DWT	Dead Weight Tonnage
DTM	Deposit Taking Micro-Finance
EAC	East African Community
EACC	Ethics and Anti-Corruption Commission
EACL	East African Conference Lines
ECA	Economic Commission for Africa
ECB	European Central Bank
ECDE	Early Childhood Development and Education

ECCOS Ethics Commission for Cooperative Societies
ECOWAS Economic Community of West African States
EDI Electronic Data Interchange
EPPs Emergency Power Producers
ERC Energy Regulatory Commission
ESP Economic Stimulus Package
EU European Union
ETFs Exchange Traded Funds

FAO Food and Agriculture Organization
FDI Foreign Direct Investment
FOSA Front Office Savings Activities
FTA Free Trade Area
FTSE Financial Times and Stock Exchange
FY Fiscal Year

GDP Gross Domestic Product
GER Gross Enrolment Rate
GII Gender Inequality Index
GJLOS Governance, Justice, Law and Order Sector
GMDSS Global Maritime Distress Signalling System
GNI Gross National Income
GOK Government of Kenya
GPI Gender Parity Index
GTI Government Training Institute

HCDA Horticultural Crops Development Authority
HDI Human Development Index
HDR Human Development Report
HF Housing Finance
HRH Human Resources for Health

ICCA International Congress and Convention Association
ICDC Industrial and Commercial Development Corporation
ICESCR International Covenant on Economic, Social, and Cultural Rights
ICT Information and Communications Technology
IDC Industrial Development Centres
IDRC International Development Research Centre
IEA Institute of Economic Affairs
IFPRI International Food Policy Research Institute
ILO International Labour Organization
IMF International Monetary Fund
IPAR Institute of Policy Analysis and Research
IPOs Initial Public Offers
IPPs Independent Power Producers
IRA Insurance Regulatory Authority
ISTC International Standards for Tuberculosis Care
ITM Insecticide Treated Mosquito nets
JICA Japan International Cooperative Agency
JSC Judicial Service Commission
JTI Judicial Training Institute

KACC Kenya Anti-Corruption Commission
KARI Kenya Agricultural Research Institute
KBA Kenya Bankers Association
KBS Kenya Bus Services
KDHS Kenya Demographic and Health Survey
KENAO Kenya National Audit Office
KeNHA Kenya National Highways Authority
KeRRA Kenya Rural Roads Authority
KICC Kenyatta International Conference Centre
KIE Kenya Industrial Estates
KIHBS Kenya Integrated Households Budget Survey
KIPPRA Kenya Institute for Public Policy Research and Analysis
KNBS Kenya National Bureau of Statistics
KOPIA Korea Project on International Agriculture
KPA Kenya Ports Authority
KRA Kenya Revenue Authority
KRB Kenya Roads Board
KSG Kenya School of Government
KTB Kenya Tourist Board
KTDC Kenya Tourist Development Corporation
KTMM KIPPRA Treasury Macro Model
Kwh Kilowatt hours

LAPSET	Lamu Port -South Sudan and Ethiopia Transport
LPG	Liquefied Petroleum Gas
LTWP	Lake Turkana Wind Power
MCD&M	Ministry of Co-operatives Development and Marketing
MDAs	Ministries, Departments and Agencies
MDG	Millennium Development Goal
MFD	Ministry of Fisheries Development
MFIs	Micro-finance Institutions
MICE	Meetings Incentives Conferences and Exhibitions
MICS	Multiple Indicator Cluster Survey
MIPs	Medical Insurance Providers
MLD	Ministry of Livestock Development
MMR	Maternal Mortality Rate
MoA	Ministry of Agriculture
MOL	Ministry of Lands
MPHS	Ministry of Public Health and Sanitation
MSE	Micro and Small Enterprises
MSID	Micro and Small Industries Development
MSME	Micro, Small and Medium Enterprises
MSMED	Micro, Small and Medium Enterprises Development Act
MT	Metric Tonnes
MTP	Medium Term Plan
MW	Megawatts
NAAIAP	National Accelerated Agriculture Input Access Programme
NASI	Nairobi All Share Index
NASEP	National Agriculture Sector Extension Policy
NCAPD	National Coordinating Agency for Population Development
NCC	Nairobi City Council
NCIC	National Cohesion and Integration Commission
NCPB	National Cereals and Produce Board
NEPAD	New Partnership for Africa's Development
NER	Net Enrolment Rate
NESC	National Economic and Social Council
NFNP	National Food and Nutrition Policy
NHC	National Housing Corporation
NHSSP	National Health Sector Strategic Plan
NICs	Newly Industrialized Countries
NPLs	Non-Performing Loans
NPSC	National Police Service Commission
NSE	Nairobi Securities Exchange
NSSF	National Social Security Fund
NTB	Non-tariff Barriers
OBI	Open Budget Initiative
OECD	Organization for Economic Co-operation and Development
OMCs	Oil Marketing Companies
OPEC	Oil Producing and Exporting Countries
OTS	Open Tender System
OVCs	Orphaned and Vulnerable Children
PAYE	Pay As You Earn
PEPFAR	President's Emergency Plan for AIDS Relief
PLWHA	People Living with HIV/AIDS
PPOA	Public Procurement Oversight Authority
PPP	Public Private Partnership
PTR	Pupil Teacher Ratio
REA	Rural Electrification Authority
RICS	Roads Inventory Conditions Survey
RMLF	Road Maintenance Levy Fund
RoO	Rules of Origin
ROSCAS	Rotating Savings and Credit Associations
RSIP	Road Sector Investment Plan
RTA	Regional Trade Agreements
RV	Rotavirus
SACCO	Savings and Credit Co-operative Organizations
SADC	Southern Africa Development Cooperation
SASRA	Sacco Societies Regulatory Authority
SEZ	Special Economic Zones
SSA	Sub-Sahara Africa
TEAMs	The East African Marine System
TEU's	Twenty-foot equivalent units
TFR	Total Fertility Rates
TI	Transparency International

TIVET	Technical, Industrial, Vocational and Entrepreneurship Training
TOE	Total Energy Consumption
TOT	Turnover Tax
TWh	Terawatt-hour
UAE	United Arab Emirates
UFI	Global Association of the Exhibition Industry
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UNGASS	United Nation General Assembly Special Session
UNICEF	United Nations Children's Fund
UNWTO	World Tourism Organization
UPAL	Urban and Peri-Urban Agriculture and Livestock Policy
USAID	United States Agency for International Development
VAT	Value Added Tax
VAR	Vector Auto Regression
VTMS	Vessel Traffic Management System
WEF	World Economic Forum
WESP	World Economic Situation and Prospects
WHO	World Health Organization
WTO	World Trade Organization

Executive Summary

Macroeconomic Performance

The growth of Kenya's economy slowed down in 2011 to 4.4 per cent down from 5.8 per cent recorded in 2010. Economic growth has not reached the pre-crisis level of 7 per cent registered in 2007. The slowdown in 2011 was largely due to drought, high international oil prices, and weak global economic performance. These factors, coupled with an expansionary domestic monetary and fiscal policy, brought about risks of macroeconomic instability that resulted in double digit inflation and exchange rate volatility in the latter half of 2011. The Central Bank of Kenya responded appropriately by putting in place a tight monetary policy that helped restore exchange rate stability and rate of inflation.

The growth of the economy was largely driven by increases in domestic expenditure, especially household consumption and domestic investment expenditure. The contribution of net exports to economic growth declined in 2011. About 56 per cent of growth in GDP in 2011 emanated from the services sector, with main drivers of growth being wholesale and retail sub-sectors, transport and communications, financial intermediation and education. Agriculture performed poorly due to adverse weather conditions. This weak performance affected agro-processing. Consequently, growth of the manufacturing sector declined to 3.3 per cent in 2011 compared to 4.5 per cent in 2010.

There is need to focus policy attention on structural problems that hamper the achievement of high standards of living. These include low employment absorption and labour productivity, a growing import-export gap, vulnerability of the agricultural sector, and low savings rate. Employment absorption in the modern and informal sector has stagnated at about 5.3 per cent and 23 per cent, respectively, during the last three years. While the government is facing fiscal pressure to sustain infrastructure and social spending, and accommodate the implementation of the Constitution, it is critical to safeguard macroeconomic stability.

Governance

To fulfil the government's fundamental role of providing quality and efficient public services, the Constitution of Kenya 2010 defines offices and allocates powers to the three arms of government. It distinguishes among the legislative, executive and judicial arms of government.

Internationally, the country's performance has been rated poorly mainly due to executive monopolistic

power over the legislature and the judiciary. According to the Mo Ibrahim 2010 Index report, Kenya's performance in governance declined from position 23 out of 53 countries in 2005 to position 27 in 2009. Both institutions became the executive's channels of sustaining highly centralized power, resulting in poor governance. Kenya's score has been below average in all six governance indicators, namely: Voice and Accountability, Rule of Law, Control of Corruption, Political Stability/Absence of Violence, Regulatory Quality and Government Effectiveness. Nevertheless, the country has recorded some improvement. Better results, however, can be achieved if emphasis is put on full implementation of the Constitution, handling of internal and external security threats, management and equitable allocation of national resources, and uniting the country.

The poor performance of the judiciary, which contributed to a backlog of cases, was associated with inadequate staff, lack of integrity among the staff and low capacity. The judiciary needs to enhance its capacity building by training, and employment of more magistrates to reduce the ratio of population to magistrate. This, together with the provisions in the Constitution on judicial integrity, will enhance performance.

The legislature has also been rated poorly internationally (Mo Ibrahim, African governance report, and Global Integrity). There is, however, improvement on the number of motions brought to parliament, and women representation, which reflect the fact that members of parliament are more active and gender-sensitive. To improve on performance, such participation should be emphasized, since public views would be fully represented in parliament. In addition, building capacity through training at the established Centre for Parliamentary Studies or any other appropriate college will prepare legislators to execute their roles effectively. Better performance is also expected through devolution of legislative activities to county assemblies, which will pave way for better governance and increased democracy.

On the Executive, though the Constitution of Kenya 2010 has articulated the principles of public service and established the Public Service Commission to enforce the mandates, it has not yet met the target. The PSC has initiated several reforms for capacity building especially in government institutions that offer professional training to civil servants. However, there is need to fast-track capacity building and create an efficient workforce that will ensure smooth transition to county governance.

Population Dynamics and socio-economic performance

The 2009 Kenya Population and Housing Census enumerated about 38.6 million people, representing an increase of about 35 per cent from the 1999 census. Kenya's population growth rate rose steadily from about 2.5 per cent per annum in 1948 to around 3.8 per cent per annum in 1979. Since then, the growth rate has declined to an average of 2.9 per cent per annum. Kenya's population is estimated at about 41 million people in 2011 (Government of Kenya, 2011).

Kenya's population is predominantly young. For example, 43 per cent of the population is below age 15, while those aged 15-35 years are approximately 36 per cent of the total population. This structure creates a powerful momentum for future population growth even if fertility declines rapidly among the next generation of parents (Government of Kenya, 2011). Given the declining fertility rate, the country's dependency ratio will decline as the young adults enter the working population. This can boost economic performance if the working-age population optimally participates in the economy, particularly in labour markets. There is also an opportunity for the country to benefit from a likely demographic dividend. A demographic dividend can be realized if the country puts in place measures to address the effectiveness of family

planning interventions. In particular, it is important to increase coverage of family planning services, enhance commodity security, and promote a family planning culture in the country. Kenya has a time-limited opportunity to reduce fertility and to invest in the capabilities of the young population before it reaches non-working age. This is particularly the case for investments in areas of education, health, and job creation.

Labour Market

Job creation is an important policy aim if Kenya is to attain the objectives of the Kenya Vision 2030. The increasing pressure on the labour market to create jobs can be deduced from the doubling of the labour force in the past two decades. Wage employment in the modern sector has been slow, and most employment was created in the informal economy, whose share was about 80 per cent of total employment in 2011. Average real earnings in both public and private sector declined during the 2006 to 2010 period by about 21 per cent and 3.5 per cent, respectively.

Poverty and Inequality

The poverty situation has worsened over time despite government efforts to contain it. The prevalence of poverty was about 46 per cent as reported by Kenya Integrated Household Budget Survey (KIHBS) (2005/6). Estimated poverty indices show that between 2005/6 and 2008, both rural and urban poverty increased but declined slightly in the years thereafter. Poverty remained high (over 50%) in the rural areas. It is estimated that about 20.3 million people were poor in 2011. Poverty alleviation is hampered by the rising cost of living.

Kenya has one of the highest indicators of unequal income distribution among low-income countries. In 2005/6, the Gini coefficient for Kenya was 0.38 and 0.45 for rural and urban areas, respectively. A high degree of unequal income distribution can have negative effects on growth and poverty reduction efforts. Addressing inequality in income distribution should therefore be a priority for the government.

Health

A country's productivity is highly dependent on the health status of its citizens. It is also important to recognize that guaranteeing good health to all is costly. A healthy nation must spend efficiently on health and aim to save on health cost. Maintaining good health for a country requires both preventive and curative health.

Kenya's health indicators, including child and maternal mortality rates, have been on a constant downward trend and are below the MDG targets. There is need for interventions to deal with the main child killer diseases, enhance appropriate vaccinations, and prevent transmission of HIV from mother to child to achieve MDG4.

Education

Although tremendous progress has been made in the education sector, Kenya faces challenges with regard to equity, quality and weak linkages between education and the labour market. Wastage across levels and low transition rates are major challenges. To attain sustainable development and Vision 2030 targets, it will be critical to increase transition to tertiary education and ensure appropriate skills development. Currently, the tertiary education gross enrolment rate is estimated at 4.1 per cent, which is relatively low compared to the average gross enrolment rate for middle-income countries of over 20 per cent. The rising cost of schooling is also a challenge for both households and government. Although the free primary education and free day secondary education programmes are in place, there is need to establish the actual unit cost of schooling in order to reduce the cost burden of schooling in the country.

Agriculture

The agriculture sector grew by 6.4 per cent in 2010 but slowed down to 1.5 per cent in 2011. Per capita agricultural production has been on the decline since 2007, but recovered in 2011. Some of the reasons attributed to declining food production include falling world food stock, drought, and rising fuel prices. On the demand side, increasing food prices are a major cause of worsening food insecurity, especially among poor households.

Increasing productivity will ensure there is adequate supply of food from the domestic supply, thus reducing the deficit that will be met by trade and by extension the food import bill. Focus should shift to promotion and implementation of existing technology and best practices along the value chain. Distribution is important for food access and availability. Therefore, focus should be on empowering the producers, facilitating market linkages and expanding/developing agricultural market information systems.

Manufacturing

The performance of the manufacturing sector is observable in its growth, employment creation and contribution to the country's overall output and exports. In 2011, the three major manufacturing sub-sectors were food manufacturing, non-metallic mineral and petroleum products.

The growth of the manufacturing sector declined from 4.0 per cent in the first quarter of 2011 to 2.5 per cent in the second quarter, which was significantly lower than the average sector's growth of 4.5 in 2010. Overall, the Gross Domestic Product also experienced a slow down, with its value added growing at 4.9 per cent and 4.1 per cent in the first and second quarter of 2011, respectively. This possibly suggests that factors beyond the sector drove the declining performance of manufacturing firms. However, the sector's growth picked up in the third quarter, recording growth of 4.4 per cent in the fourth quarter of 2011. Rising inflation and depreciation of the Kenya shilling in 2011 contributed to the poor performance of the manufacturing sector.

The share of the sector's employment to overall formal employment has been declining in the last three years. Largely, this phenomenon points to stagnation of the sector's growth. However, several other factors may possibly explain the declining share of manufacturing employment. Issues related to labour productivity, capital intensiveness, and preference for casual labour engagement may have contributed to the declining share of manufacturing employment. Food manufacturing, metal, textile and clothing products were the important sectors in employment creation, and therefore any challenges facing the sub-sectors should be addressed. The contribution of manufacturing sector to overall Kenya's exports has stagnated at 37 per cent over the last three years, suggesting that the East African market is getting relatively small to catalyze massive expansion of manufacturing establishments.

For the sector to generate employment and facilitate economic growth and exports, it requires interventions on both supply and demand sides. Structurally, the size and growth of the sector has not progressed to desirable levels to accommodate the unemployed people. Similarly, the level of investment is low, compromising the capacity of the sector to play a catalytic role in economic growth. Further, the country is experiencing high influx of counterfeit and substandard goods, which slice the market share of existing legally established firms.

To address these challenges, the country requires a drastic policy shift that focuses on selective import substitution strategy. In the short run, Kenya has to search for new markets. Transforming her industry structure into high-value-addition products is the key strategy in the long run.

Micro and Small Enterprise (MSE)

The Micro and Small Enterprise (MSE) sector in Kenya, like in many developing countries, is an important source of employment, services and innovation. Eighty (80) per cent of the working population operates in the informal sector, majority of who run MSEs. MSEs also operate formally and contribute to 42 per cent of employment in modern/formal enterprises, and represent 74 per cent of all modern establishments.

A review of the recent performance of the sector reveals growth in employment from MSEs between 2008 and 2010. However, the growth rate is lower than that of large enterprises. Like in previous years, majority of MSEs operate in the services sector, with only 9 per cent involved in manufacturing. There has been an increase in turnover tax in 2010/11 compared to 2009/10. This, however, seemed to coincide with a reduction of value added tax (VAT) revenue amongst MSEs during the same period. There has, however, been a steady increase in income tax over the last four years.

The introduction of e-licensing by the Business Regulatory Reform Unit (BRRU) has seen the introduction of 440 e-licenses from 51 regulatory agencies. The system is, however, not yet fully automated as businesses can download the form but cannot complete or submit it electronically, neither can they make the payments electronically. The Government should, therefore, prioritize full automation to provide a mechanism where licensing can be undertaken electronically, including making the licensing fee payments.

Over the years, it has been observed that MSE support is undertaken by numerous government ministries and agencies, and thus the need for better coordination through a single authority mandated to promote and develop MSEs. This has not yet been possible. One area MSEs urgently require support is in market access. With the enactment of the *Public Procurement and Disposal (Preference and Reservations) Regulations, 2011,* it is expected that public procurement opportunities amongst MSEs will increase. The challenge identified with this new provision, however, is that only MSEs that operate formally will benefit; majority operate informally. The state of informality amongst majority of MSEs is an outstanding challenge. The government needs to address this problem through strategic and co-ordinated approach aimed at improving the business environment.

Some MSEs are not registered due to the heavy regulatory obligations. To ensure that MSEs operate in a regulatory environment that does not over-burden them, the government should identify statutory requirements that can be relaxed or subsidized for MSEs to reduce the regulatory burden on MSEs and to institutionalize regulatory impact assessments. Given the multiplicity of registration and licensing authorities, a one-stop-shop where MSEs can access different agencies should be introduced. This will reduce costs and time loss associated with locating the relevant authorities. This is in line with the Kenya Vision 2030, which aims to improve the business environment and lower the cost of doing business.

Tourism

Tourism is an important sector of Kenya's economy. It contributes about 5 per cent of the country's Gross Domestic Product (GDP), approximately 11.6 per cent of foreign exchange, and 9 per cent of the modern wage sector. The sector registered record performance in 2011 of 1.82 million visitors in arrivals and Ksh 98 billion in receipts (13% and 33% growth, respectively). This is attributed to efforts made to diversify source markets by venturing into emerging economies and enhanced partnerships with international travel and leisure organizations and airlines. To keep up this trend, more funding should be availed to the Kenya Tourist Board (KTB) to enhance investment in market-specific advertising/missions, joint marketing with tourism trade partners, public relations activity and participation in travel and tourism exhibitions.

International tourist arrivals to Kenya account for about 3.2 per cent of total inbound tourists to Africa, and only 0.2 per cent share of global tourism market. Kenya's tourism receipts, on the other hand, account for 0.1 per cent of the global total. Majority (72%) of international visitors come to Kenya for holiday, 12 per cent come on business mission (includes those attending international conferences), while 15 per cent are visitors on transit. In 2011, tourism performance from traditional source markets slackened. This was attributed to the Euro zone economic crisis, a slow US economy, and border insecurity/ terrorism threats in Kenya.

Although Kenya's Meetings Incentives Conferences and Exhibitions (MICE) sub-sector is placed at position four in Africa (based on number of international meetings held), it accounts for a paltry 0.2 per cent of the global market. There is need to grow this market niche through strategic development of the sub-sector in terms of both enhancing utilization of the capacity of the Kenyatta International Conference Centre (KICC) to higher than the current 45 per cent, and developing modern MICE facilities at each county. In addition, for policy and planning purposes, there is need to empirically measure the contribution and impact of MICE events to the Kenyan economy.

In the hotel sub-sector, bed night occupancy improved in 2011 to 40.3 per cent from 38.8 per cent in the previous year. However, it failed to return to the 2007 level of 47.2 per cent. Domestic tourists accounted for over one-third (37%) of all bed-nights occupied in the country in 2011. There is potential for growth in domestic tourism through development of tourism facilities and products that are affordable and attractive to low-medium income Kenyans. In 2011, Kenya achieved the highest average length of stay (13.4 days) in a decade, which was a 2.3 per cent improvement over the previous year. For the tourism sector to achieve the high targets on revenue and arrival set in the Vision 2030, tourism product development and marketing efforts should target source markets with high per capita income and higher length of stay.

The rising cost of living (caused by rising inflation) impacts negatively on tourism demand. This is mainly through inflation in tourism commodities, and reduction in real income. The major categories of tourism commodities are transportation (air and automobile fuel), accommodation, food and beverage, recreation and travel services. Furthermore, depreciation of the domestic currency relative to foreign hard currencies would encourage inbound tourism because Kenya would be regarded as a cheaper tourist destination (relative to competing destinations). Therefore, rise in inflation can affect occupancy rates, capacity utilization and, ultimately, profitability in the hotel industry. In addition, rise in cost of agricultural production would also affect prices of food and beverages served in tourist hotels.

From 2010, the overall national inflation (at 14%) was higher than that of tourism goods (10.5%) and non-tourism goods (7.7%). Overall, rising inflation rate for key tourism-related commodities, notably automotive fuel, room rates (for high-end hotels), air travel fares, and other supporting services reduce inbound tourist inflows, length of stay and revenue per tourist. Despite this, tourist arrivals and receipts have continued to rise, implying that Kenya is still perceived as an affordable long-haul destination.

With regard to medium term prospects, it is assumed that the macroeconomic environment will remain stable during the period 2012-2015. In addition, the general election of 2013 is not expected to affect performance in the tourism sector negatively due to the recent constitutional, institutional and legislative reforms in the country. The economic crisis in the Euro zone may have an impact on Kenya's tourism industry in the short-term, because the major source markets are European. Despite this, Kenya anticipates growth in arrivals from Russia, China, the UAE and Scandinavian countries, Canada, Tanzania, Oceania (Australia and New Zealand),

USA and India. All factors remaining the same, tourist arrivals and receipts are predicted to reach the 2 million tourists and Ksh 116 billion earnings, respectively, in the 2012/2013 period.

In order to minimize the impact of the Euro zone economic downturn on Kenya's tourism inflows, Kenya should upscale promotion of tourism in domestic and regional markets, along with expanding regional trade. In this regard, there is need to fast-track removal of tariff and non-tariff barriers (NTBs) to free movement of labour and capital within the East African Community (EAC) to enhance tourism.

Trade

Trade (domestic and international), which contributes about 66.3 per cent of Gross Domestic Product (GDP), is expected to play a crucial role in helping Kenya to realize its Vision 2030 goals. Domestic trade encompasses wholesale and retail trade and involves the distribution of goods and services. E-commerce is also important. It involves buying and selling of products or services over electronic systems such as the Internet and other computer accessories.

As regards external trade, the main tradables are derived from the agricultural, manufacturing and services sectors. Their share in total exports is 47.5 per cent, 39.9 per cent and 12.5 per cent, respectively. The main export commodities, which are also primary in nature, include tea, horticulture, coffee, articles of apparel and clothing accessories, iron and steel. Kenya's main imports are industrial machinery, petroleum products, crude petroleum, road motor vehicles, iron and steel, wheat, rice and maize. At present, the value of imports is almost three times the value of exports. This is because Kenya exports mainly primary commodities and imports high value commodities. Consequently, Kenya may continue experiencing balance of payment difficulties until the export structure is changed.

Kenya has benefited significantly from regional integration efforts through the East African Community (EAC) and the Common Market for Eastern and Southern Africa (COMESA). For example, in 2011, the EAC and COMESA absorbed 14.8 per cent and 35.5 per cent of Kenya's exports, respectively. Most of the goods exported to these regional blocs are manufactured. This contrasts with exports to the European Union (EU) and the United States (US). The EU and the US are important export destinations for Kenyan goods outside Africa.

Kenya is yet to fully exploit the opportunities arising from regional integration. This is because trade is still constrained by tariffs, non-tariff barriers (NTBs), quotas and institutional and regulatory barriers. Kenya should work with other regional partners in addressing the overlapping membership problem by harmonizing regional economic groupings. Efforts should also be made to reduce or remove NTBs and to promote cooperation in implementation of joint infrastructural projects to facilitate trade.

Foreign Policy

In recent times, Kenya's foreign policy orientation has mainly focused on economic diplomacy. Economic diplomacy entails the promotion of economic growth and sustainable development by strengthening existing economic ties and exploring new opportunities in emerging economies.

Agriculture is an important fundamental in Kenya's economic development, contributing 35 per cent of GDP and constituting 40 per cent of export earnings. Agriculture also contributes immensely to constant food supply and food security for the population. Despite its contribution to the economy, the agriculture sector still faces a myriad of problems. This affects food production significantly. Since a large portion of the country (more than 80%) consists of arid and semi-arid lands (ASALs), rain-fed agriculture can no longer be relied on for adequate food production. In the

developing world, agriculture has become a critical variable in international relations, as states search for means of cooperation in sharing agro-technologies to boost food production. International cooperation in acquisition of agro-technologies has contributed to the emergence of agricultural diplomacy in which agriculture and food production take centre stage in the foreign policy agenda of some countries. As Kenya strives to enhance economic diplomacy, it is critical that the scope be broadened to integrate agricultural diplomacy. Such efforts will enable Kenya's economic foreign policy to achieve its agriculture diplomacy objectives.

Currently, Kenya has cordial relations with Israel, South Korea, Brazil and other countries with advanced agro-technologies. For Kenya to benefit from these countries' agro-technologies and experiences, there is need to link economic growth and development with food security, so that harnessing affordable and appropriate technology may not only contribute to the realization of economic diplomacy objectives, but also agricultural diplomacy goals. Kenya should also establish a national agriculture research institution with a mission to coordinate all agriculture research institutions in the country. Such national agriculture research institutions could liaise with their counterparts in Israel, South Korea and Brazil to deepen agricultural diplomacy.

Financial Services

The financial sector has a key and critical role of mobilizing savings and investments required to achieve the Kenya Vision 2030 objectives. Although the sector witnessed several transformational policy changes, it recorded a decelerated growth rate of 7.8 per cent in 2011 compared to 9.0 per cent in 2010. However, the sector's contribution to the GDP expanded to 6.4 per cent from 5.6 per cent in the same period.

As at 2011, the sector comprised 43 commercial banks, one mortgage finance company, six deposit taking micro-finance institutions, four representative offices of foreign banks, 118 foreign exchange bureaus and two credit reference bureaus (Central Bank of Kenya, 2012). In the same period, there were 45 licensed insurance companies and two reinsurance companies. As at 2011, there were 6,570 registered SACCOs. Of these, 2,168 were active and 216 operated Front Office Savings Activities (Sacco Societies Regulatory Authority).

While the banking sector's assets expanded by 20.4 per cent, deposits grew by 20.2 per cent. The use of agents by banks, expansion of outreach and opening of new branches (bank branches increased by 9.2%) contributed to increased mobilization of deposits. Mobile phone money transfer service usage also increased. As at 2011, over 18 million Kenyans were using mobile phone platforms to make payments and send remittances.

Lending rates in Kenya remain high. Consequently, the interest rate spread has also remained high at about 10 per cent. Aspirator countries such as Korea, Malaysia, Thailand and Singapore had interest rate spread of below 6 per cent. The high rate of interest spread in Kenya is attributed to the positive relationship between lending and deposits rates, as commercial banks continue to reap from the high interest rate spreads. For example, interest income from loans and advances as a total of banks' income increased from 49.0 per cent in 2010 to 55.4 per cent in 2011. The high interest rate spread is a pointer to inefficiency in the sector.

The stock market performance indicators deteriorated in 2011. The NSE 20 share index decreased by 27.7 per cent to close at 3,205 points from 4,432.6 points in 2010. This is an indication that the market slumped after a recovery in 2010. Similarly, the Nairobi All Share Index (NASI), which was launched in 2008, decreased by 30.4 per cent to close at 68 points from 97.8 points in 2010. Market capitalization also recorded a decline to Ksh 868.2 billion in 2011 from Ksh 1166.992 billion in 2010. This is a decrease of 25.6 per cent.

Technological advances, while necessary, have made banks' businesses more vulnerable to fraud. As systems become more complex, the opportunities for fraud increase. As a starting point, the Central Bank of Kenya should adopt and enforce international credit card security standards.

Capital markets are crucial in enhancing long-term resource mobilization for investment. Poor corporate governance in listed companies threatens to further erode investor confidence at the NSE. The governance issues at Cooper Motor Corporation (CMC), for example, once again exposed the weak corporate governance rules in Kenya. There is need to improve corporate governance in the country.

Infrastructure and Economic Services

Infrastructure is critical to determining and shaping factors that impact on the cost of living. Development of physical infrastructure contributes to economic development. Through its backward and forward linkages, infrastructure facilitates growth. Social infrastructure, including water supply and sanitation, sewage disposal, education and health, affect the quality of life. Not only does under-development of infrastructure make life difficult, but it also raises the cost of living, which affects the poor and the middle-class the most. The dearth of infrastructure and poor state of maintenance contributes to the high cost of living and discourages the development of industries and investments.

Expenditure on physical infrastructure in Kenya rose by 52.4 per cent between 2007/08-2009/10. This indicates the importance accorded to the sector under the Kenya Vision 2030. However, even with this level of expenditure, resource allocation is still inadequate. This was a major setback in the infrastructure sub-sectors where development and donor-funded expenditure on transport recorded a decrease in the same period. For instance, there was a shortfall of Ksh 63.4 billion in development compared to Ksh 10.2 billion under-funding in the recurrent vote in the 2011/12. Low absorption rates of financial resources in the sector over the years reflect resource use inefficiency and works against increasing budgetary allocations. Between 2007/08 and 2009/10, the average under-utilization of development expenditure was a significant 20 per cent, which was double the average under-utilization rate recorded for recurrent expenditure over the same period. This notwithstanding, financial allocation to the energy, housing and transport sub-sectors has increased significantly. The contribution of these sectors to Kenya's GDP is substantial. It is noteworthy that changes in these infrastructure sub-sectors affect the Consumer Price Index, thus severely affecting Kenyans.

According to the Rural Electrification Authority (REA), only 28 per cent of Kenyan households were connected to electricity by 2011. These included 15 per cent rural households and about half of urban households. This means that Kenya is still far from meeting the anticipated demand for adequate and affordable power supply. Geothermal generation is the preferred core generation strategy in the country, as reflected in resolutions of the series of national energy conferences held in the country. The unit cost of electricity from geothermal generation is much lower currently, estimated at 7 US cents per kWh against the 13 US cents per kWh cost of electricity in 2011.

Implementation of projects for importation of cheaper non-diesel based power from neighbouring countries is recommended. Secondly, the government should increase funding for geothermal and wind power projects as well as innovative open-ended funding for green energy projects to reduce over-reliance on weather-dependent hydro power.

The total value of outputs transported grew from Ksh 383 billion to Ksh 585 billion in 2011. Road transport took the highest value at Ksh 388 billion followed by air transport at Ksh 99 billion. Marine transport stood at Ksh 22 billion, with the least being rail transport at Ksh 2 billion. Services incidental to

transport stood at Ksh 59 billion in 2011. The total value of outputs as a per cent of GDP increased from 29 per cent in 2007 to 38 per cent in 2011.

To mitigate the adverse effect of transport cost to the high cost of living, recommendations include the use of non-motorized transport (NMT) modes, such as walking and cycling, which is mainstreamed in the infrastructure development agenda. The government should also enhance development and promotion of mass rapid transport and encourage the concept of mixed-use high density development. To solve the inefficiencies and bottlenecks witnessed, the government should review the current portfolio of transport infrastructure and services.

Performance in the housing sector has recorded general improvement in the last seven years as indicated by the index of completed buildings. In the private sector, the index increased by 88 per cent between 2007 and 2009, and 68 per cent in the public sector for the same period. The total number of new residential buildings has also increased steadily between 2003 and 2010. However, affordability of housing remains a problem particularly in Kenya's urban areas, where majority (73%) of people are tenants.

To address the rising cost of living attributed to the cost of housing, recommendations include affordable high-density housing in close proximity to mass transit networks and linked to job distribution;. This should be accompanied by development of new spatial initiatives to ease pressure on the capital and other major cities. Further, the government should view informality as a 'natural, market-led' response to the restricted formal access to adequate and affordable housing by low-income segments of the population. This should be addressed by promoting micro financing in the housing sector, and fast-tracking review of the housing regulatory framework.

Imperatives on the Cost of Living

In the recent past, Kenya has struggled to contain an upward spiral of the cost of living. In this report, we use the CPI and inflation to assess changes in the cost of living and the relevant policy implications. Inflation is the persistent increase in the level of general prices of goods and services, as measured by the CPI over a given period. The highest rates of inflation were recorded in May 2008 at 31.5 per cent and November 2010 at 19.7 per cent. Rising prices have led to a 3.6 per cent annual decline in real wages between 2004 and 2011. Similarly, real minimum wages in Kenya have been on the decline since the 1970s, suggesting that the purchasing power of minimum wages has been eroded by inflation over time. The decline in real earnings has provided the impetus for trade unions to agitate for higher wage demands in the country.

The key drivers of the cost of living in Kenya are prices of food and non-alcoholic items, price of energy and price of transport. The energy price index has the highest contribution to the aggregate CPI, followed by transport price index and food and non-alcoholic items price index. However, fluctuations in food prices influence the CPI faster. When the food price index increases by 100 per cent, the aggregate CPI will increase by 2 per cent within one month. A 100 per cent increase in the energy price index takes two months to increase the aggregate CPI by 87 per cent. A 100 per cent increase in the transport price index increases the aggregate CPI by 64 per cent within three months. It is evident that prices of food and non-alcoholic items drive aggregate prices in the economy within a shorter time, compared to energy and transport prices, which take slightly longer. There are also feedback effects.

The item "food and non-alcoholic beverages" has a weight of 36 per cent in the consumer basket of goods and services. The connection between the rising food prices and poverty is that poor people spend a substantial proportion of their income on food. Thus, any factor that affects food prices also affects the poor and people who are vulnerable

to poverty. According to the Kenya Integrated Household Budget Survey (KIHBS) 2005/6, expenditure on food by rural households accounts for 62.3 per cent of total household expenditure, while urban households spend 39.6 per cent of their budget on food. Fluctuations in the nominal prices for various food commodities have varied from year to year, with the highest increase being experienced between 2007/2008 and 2008/2009 for most of the items. In 2007/2008, the price of dry beans increased by 49 per cent, maize flour 45 per cent, rice grade II 45 per cent, cooking fat 40 per cent, maize grain 40 per cent and kale 38 per cent. Between 2008 and 2009, the price of maize grain increased by 34.7 per cent, maize flour 25 per cent, refined sugar 22.7 per cent, green grams 22 per cent, and kale 18.9 per cent. There is high variability of price within the production season and between successive market years, making price stabilization critical.

Among the commercial fuels in Kenya, the price of electricity increased by the highest margin of 19.6 per cent during the period February 2009 and November 2011. Kerosene, diesel and LPG followed, with petrol having the least increase of 1.06 per cent. Increase in the price of electricity can be attributed to heavy dependence on hydro electricity generation, adverse weather conditions with prolonged dry periods, use of oil for thermal generation in the face of increasing world crude oil prices, and a volatile exchange rate.

Demand for petroleum products in Kenya has been rising over the last decade. The prospect is that demand will continue rising to meet the demand for the Vision 2030 projects, in addition to the demand created by the new devolved government. Although prices of all petroleum products increased, kerosene and LPG prices had the highest increases of 65 per cent and 50 per cent, respectively. Notably, the price increases persisted even after the onset of regulation in December 2010. This implies that the pressure from international crude prices and the dollar exchange rate kept the prices high.

The most important transport items in the CPI are public transportation fares, petrol and country bus fares, respectively. The three components have witnessed varying degrees of inflation. *Matatu* fares experienced the sharpest rise in inflation between November 2009 and January 2010 (6%) and between March and April 2011 (7%). Country bus fares witnessed erratic inflationary behaviour, recording a high of 6.58 per cent between February and March 2011. Inflation in petrol was less erratic, with the highest point being 1.83 per cent between June and July 2011. A comparison between *matatu* fares and the price of diesel reveals that between January 2011 and November 2011, increases in *matatu* fares corresponded with increases in diesel prices. Although this behaviour was not sustained for the entire analysis period, it could be argued that since majority (67%) of *matatus* use diesel fuel, a rise in the price of diesel would lead to an increase in the fares charged to passengers for the operators to cover the extra cost.

To address the problem of rising cost of living in the country, interventions in the labour market will seek to develop and institutionalize an integrated wage policy. The policy should link workers' welfare concerns to macroeconomic policy (especially inflation policy), social justice, and democratic participation. This way, wages would be adjusted to reflect both productivity increases and cost of living, while considering the consequences of wage increases on global competitiveness. To address the problem of high variability of crop prices within the production season and across successive years, the government should establish commodity markets (international futures and options) and markets where hedging and "synthetic storage" approaches have been applied.

In the livestock sector, stakeholders should mobilize resources and develop livestock market centres that offer minimum infrastructure, especially in livestock production areas. There is also need to promote and empower livestock traders' cooperatives. This will facilitate the development of processing plants

and slaughter/abattoirs in livestock production areas. In the energy sector, public policy should prioritize investments that reduce the economy's dependency on petroleum. The country should fast-track the importation of cheaper hydro power from neighbouring countries. This includes the Kenya-Tanzania 400kV and the Kenya-Ethiopia interconnection. In addition, the government should increase funding on geothermal and wind power projects to reduce over-reliance on weather-dependent hydro power generation. Additionally, LPG cylinders should be zero-rated to make them affordable to the poor.

In the transport sector, policy interventions should actively promote mass rapid transport systems. Efforts to this end include a Feasibility Study for Mass Transit in Nairobi Metropolitan Region by the Ministry of Transport, the development of commuter train services, and development of a bus rapid transit system. However, what is lacking is a detailed plan of how the current public transport system comprising *matatus* and buses will be integrated into the new system in order to offer world class services.

PART I

MACRO AND SOCIO-ECONOMIC PERFORMANCE

Chapter 1

Macroeconomic Performance

1.1 Economic Growth

Kenya's economy slowed down in 2011 to 4.4 per cent, down from 5.8 per cent recorded in 2010. The factors that contributed to the weak performance include severe drought, high international oil prices and weak global economic performance. In addition, expansionary monetary and fiscal policy caused macroeconomic instability, with inflation rising to about 19.7 per cent in November 2011 up from about 5.4 per cent in January 2011. The Kenya shilling also depreciated rapidly during the third quarter of 2011. To mitigate inflation and stabilize the exchange rate, the Central Bank Rate (CBR) was raised.

While growth in Kenya's real Gross Domestic Product (GDP) per capita increased by 1.5 per cent in 2011 compared to 3.7 per cent in 2010, various structural problems hampered the achievement of high standards of living in Kenya, as shown in Table 1.1. A decomposition of GDP per capita into employment absorption (employment-population ratio) and labour productivity provides more insight into the various structural problems. As a ratio of total population, employment absorption in the modern and informal sector has stagnated at about 5.3 per cent and 23 per cent, respectively, between 2009 and 2011.

The large share of employment in the informal sector raises important policy questions about the quality of employment, given the lack of a well-developed social security system. Kenya's working poor population is estimated at about 33 per cent of total employment (KIPPRA, 2009), compared to an average of 39.1 per cent in 2010 in Sub-Saharan Africa (International Labour Organization–ILO, 2012). The working poor comprise employees who earn, on average, US$ 1.25 or less. When the threshold definition of the working poor is increased to US$ 2.00, the percentage in total employment increases to about 62 per cent for Sub-Saharan Africa. Kenya must confront this structural problem to attain high per capita income.

Additionally, real GDP per worker has stagnated at about Ksh 134,000 between 2011 and 2013. Higher labour productivity is critical to supporting high standards of living. According to the official employment statistics, Kenya's employment absorption (employment-population ratio) is estimated at about 29 per cent. About 50 per cent of the population is below 18 years. This means the

population dependency ratio is high, estimated at about 86 per cent.

Table 1.1: Real GDP per capita decomposition

	2009	2010	2011
GDP per capita (Ksh)	36,962	38,332	38,925
GDP per capita growth (%)	0.1	3.7	1.5
Real GDP per worker (Ksh 000s)	133.4	134.6	134.1
Total recorded employment population ratio (%)	27.8	28.4	29.0
Modern sector employment population ratio (%)	5.3	5.3	5.4
Informal sector employment population ratio (%)	22.3	22.9	23.4

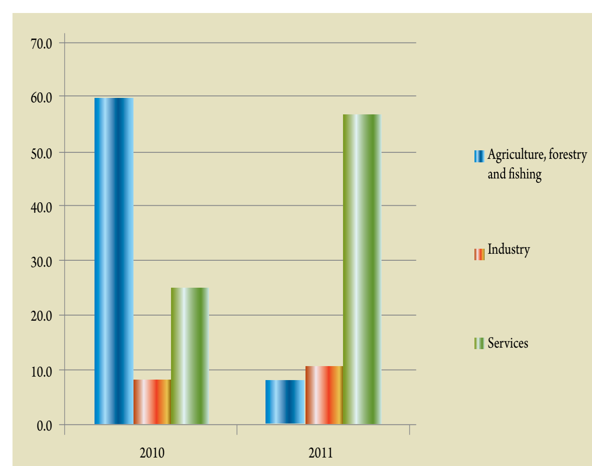
Source: Author's computation

1.2 Sources of Growth

In 2011, increases in domestic expenditure, especially household consumption and domestic investment expenditure, largely drove the economy's growth. Household consumption and gross fixed investment increased by 2.8 per cent and 12.5 per cent, respectively. The contribution of net exports to economic growth declined in 2011. Growth in exports and imports at 6.7 per cent and 15.6 per cent, respectively, reflected this. As a result, the import-export gap as a percentage of GDP increased from 12 per cent to 17 per cent between 2010 and 2011. This explains the decline of the current account deficit.

Analysis of growth of sectors reveals that the services sector is the largest, accounting for more than 50 per cent of GDP at basic prices, and contributing about 56 per cent of growth in GDP in 2011. The main drivers of growth are wholesale and retail sub-sectors (17.4%), transport and communications (12%), financial intermediation (7.3%) and education (6.5%). The contribution of the agricultural sector declined to 7.6 per cent down from about 24.0 per cent in 2010. This was largely due to weak performance of the agricultural sector in 2011. Factors such as drought and high cost of production during the year caused the weak performance. Consequently, production of key commodities such as maize, tea and coffee performed poorly relative to 2010. Chapter 4 discusses some of the key challenges facing the sector. Weak performance in the agriculture sector affected agro-processing, thus leading to overall weak performance of the manufacturing sector, which grew by 3.3 per cent in 2011 compared to 4.5 per cent in 2010.

Figure 1.1: Sectoral sources of growth (%)

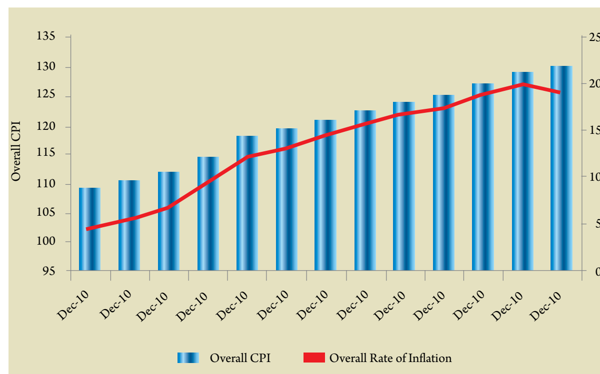


Source: Kenya National Bureau of Statistics (2012)

1.3 Inflation

The monetary policy's overall goal is to maintain price stability. During the fiscal year 2011/2012, the government's objective was to maintain inflation at around 5 per cent. The Central Bank of Kenya (CBK) was thus expected to formulate and implement a monetary policy to contain inflation within the 2 per cent band around the 5 per cent target.

Figure 1.2: Overall Consumer Price Index (CPI) and inflation

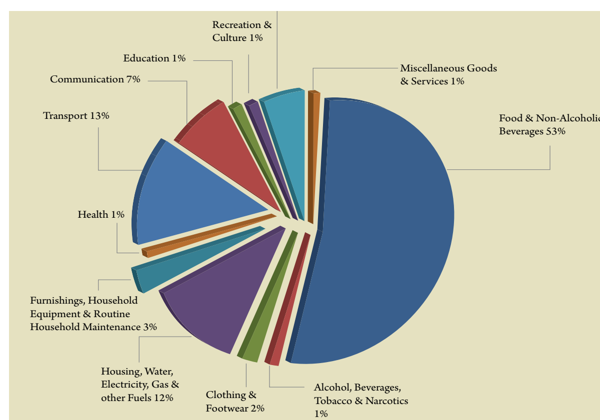


Source: Data sources from Kenya National Bureau of Statistics (2012)
NB: The chart shows income groups in Nairobi only

1.3.1 Inflation by commodity group

An analysis of the CPI commodity groups shows that the main drivers of inflation were food, energy and transport (Figure 1.3). About 53 per cent of inflation was largely due to increases in food prices. The other key drivers were transport (13%), housing and water, electricity and fuel (12%). The development of Information and Communications Technology (ICT) infrastructure and fierce competition in the communication sector resulted in lower consumer communication charges in 2011 compared to 2010 (Figure 1.3). In this regard, food prices and fuel inflation are major challenges to Kenya's price stability.

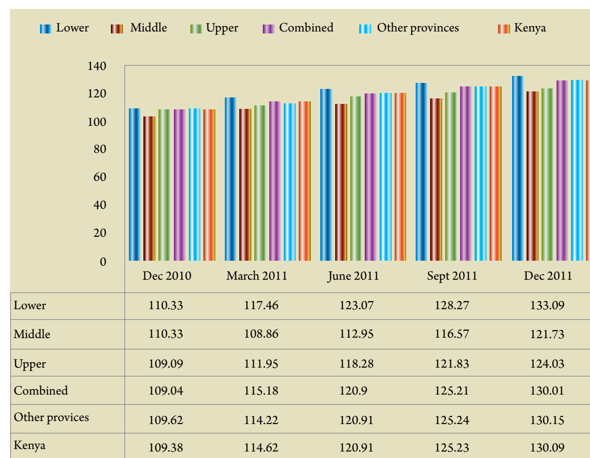
Figure 1.3: Contributions to inflation in 2011



Source: Data sources from Kenya National Bureau of Statistics (2012)

Analysis of inflation by income groups reveals that the lower income group is relatively disadvantaged (Figure 1.4). This is perhaps because the largest expenditure in low-income households is food and transport. These commodity items in the household 'basket' recorded the highest rates of inflation.

Figure 1.4: Quarterly CPI by income groups



	Dec 2010	March 2011	June 2011	Sept 2011	Dec 2011
Lower	110.33	117.46	123.07	128.27	133.09
Middle	110.33	108.86	112.95	116.57	121.73
Upper	109.09	111.95	118.28	121.83	124.03
Combined	109.04	115.18	120.9	125.21	130.01
Other provinces	109.62	114.22	120.91	125.24	130.15
Kenya	109.38	114.62	120.91	125.23	130.09

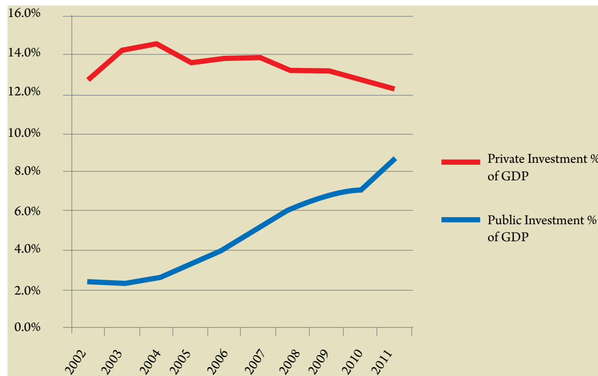
Data Source: Kenya National Bureau of Statistics (2012)
NB: the chart shows income groups in Nairobi only

1.4 Savings and Investment

Kenya's medium term target for investment and savings rate is above 32 per cent and 29 per cent, respectively. Recent performance remains substantially below this target, and especially in savings. The rate of domestic savings has stagnated at about 13 per cent. While public investment increased from about 3.3 per cent in 2005 to about 8.7 per cent in 2011, private investment has stagnated at about 13 per cent. The political uncertainty after the post-election violence of 2007/08 and the weak economic performance due to external shocks, especially the global financial and economic crisis, drought and high oil prices have contributed to the weak private sector investment response since 2007. Implementation of the relevant legal reforms necessary for execution of key Vision 2030 projects was also delayed. These include policy and supporting legal frameworks for Public-Private

Partnerships (PPPs) and Special Economic Zones (SEZs).

Figure 1.5: Public and private investment as a percentage of GDP



Source: KIPPRA Treasury Macro Model (KTMM)

1.5 Fiscal Policy and Performance

The key goal of the fiscal policy in 2011 and 2012 was to support growth within a stable macroeconomic environment. To ensure macroeconomic stability, the government aimed to reduce fiscal deficit to about 5 per cent of GDP over the medium term from 7.2 per cent in 2009/10. It aimed to bring down the debt-to-GDP ratio to about 45 per cent level, which is the threshold for ensuring debt sustainability.

The government also aimed to increase revenue mobilization. It emphasized implementation of the Constitution of Kenya 2010 and increased resources to infrastructure and social services development to support growth and job creation. According to the Budget Policy Statement (2012), budget implementation is a challenge. Other challenges include overall under-performance in revenue collection, expenditure pressures towards implementation of the Constitution, salary awards, military intervention in Somalia, and low absorption of the development budget.

1.5.1 Revenue

Total revenue collection for 2010/11, including Appropriations-In-Aid (A-I-A), was Ksh 667,539 billion (24.2% of GDP). This was below the target by Ksh 18.9 billion (Table 1.2). Ordinary revenue collection amounted to Ksh 609.2 billion (22.1% of GDP) against a target of Ksh 605.9 billion, resulting in an over-performance of Ksh 3.3 billion. Over the

Table 1.2: Fiscal outturn

Fiscal Outturn (% of GDP)	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10*	2010/11**
Total revenue	21.55	20.49	21.63	22.02	21.80	22.30	24.18
Revenue	19.76	18.66	19.72	20.20	20.37	20.65	22.07
A-I-A	1.79	1.83	1.92	1.82	1.43	1.65	2.11
Expenditure and net lending	22.56	25.20	24.33	27.25	26.62	29.50	29.40
Recurrent expenditure	19.01	20.18	17.80	20.55	19.46	20.77	21.46
Development expenditure	3.39	4.46	4.66	6.70	7.16	8.73	7.95
Deficit excluding grants (commitment basis)	-1.01	-4.71	-2.70	-5.23	-4.82	-7.21	-5.23
Grants	1.11	1.32	0.90	1.30	0.81	1.27	0.68
Deficit including grants (commitment basis)	0.10	-3.39	-1.78	-3.93	-4.01	-5.94	-4.55
Deficit including grants (cash basis)	0.54	-2.40	-2.10	0.39	-5.23	-7.09	-4.30
Financing	-0.54	2.40	2.10	-0.39	5.23	7.09	4.30
Foreign financing	-0.05	0.08	-0.14	0.32	1.84	0.93	1.03
Domestic financing	-0.50	2.32	2.24	-0.71	3.39	6.16	3.27

same period, A-I-A recorded under-performance of Ksh 22.2 billion. The A-I-A, especially income from public universities' private students' fees, had not been captured in the 2010/11 expenditure returns.

According to the Kenya Revenue Authority (KRA), tax policy changes and the changed economic environment in 2010/11 adversely affected several tax heads. These included excise duty on oil, airtime, and cigarettes, and domestic Value Added Tax (VAT). Thus, future performance of the KRA is expected to improve due to ongoing reforms in tax and customs administration. The modernization of VAT legislation is expected to simplify tax collection and enhance the revenue yield.

1.5.2 Expenditure

Between 2007/08 and 2010/11, government spending as a share of GDP increased from 27 per cent to about 29 per cent (Table 1.2). Total government expenditure and net lending for 2010/11 was Ksh 811.8 billion (29.4% of GDP), against a target of Ksh 918.1 billion. The shortfall of Ksh 106.2 billion was attributed to lower absorption recorded in both recurrent and development expenditures. In particular, recurrent expenditure amounted to Ksh 592.4 billion (21.5% of GDP), compared with a target of Ksh 611.6 billion. Development expenditure amounted to 219.4 billion (7.95% of GDP) against a target of 306.4 billion.

In 2010/11, expenditures by the Ministries of Education, Higher Education, Science and Technology, Medical Services and Public Health and Sanitation accounted for 41.0 per cent of total recurrent expenditure. An analysis of development expenditure indicates that the Ministry of Roads accounted for the largest share of total development expenditure (24%), followed by the Ministries of Energy (13.2%), Water and Irrigation (9.7%) and Planning and National Development (7.9%). Expenditure pressure in 2010/11 and 2011/12 relates to stepped up infrastructure spending, implementation of the Constitution, drought mitigation measures for food security, security intervention in Somalia, and salary awards (Ministry of Finance, 2012).

1.5.3 Fiscal deficit

At the end of 2010/11, overall fiscal deficit (on a commitment basis and excluding grants) totalled Ksh 144.3 billion (5.2% of GDP) against a targeted deficit of Ksh 187.9 billion (6.8% of GDP). In 2009/10, the fiscal deficit was Ksh 177.1 billion (equivalent to 7.2% of GDP). In addition, the fiscal balance (on a commitment basis), including grants, recorded a deficit of 4.6 per cent of GDP against a targeted deficit of 6.8 per cent of GDP. The deficit

*Table 1.3: Central government's public debt (Ksh million)***

	2007	2008	2009	2010	2011
Domestic debt (Ksh million)	404,706	430,612	518,339	660,268	764,223
External debt (Ksh million)	396,564	439,967	499,988	565,452	727,266
Total debt	801,270	870,579	1,018,327	1,225,720	1,491,489
GDP (Ksh million)	1,833,511	2,107,589	2,366,984	2,549,825	3,024,782
Population (million)	35.8	36.7	37.7	38.5	39.5
Debt per capita	22,382	23,721	27,011	31,837	37,759
Domestic debt as a % of GDP	22.1	20.4	21.9	25.9	25.3
External debt as a % of GDP	21.6	20.8	21.1	22.2	23.2
Total debt as a % of GDP	**43.7**	**41.3**	**43.0**	**48.1**	**49.3**

Source: Kenya National Bureau of Statistics (2010) and Central Bank of Kenya (2011b)
Notes: **Domestic debt is reported on gross basis; *** Includes public and publicly guaranteed foreign currency loans, end of period exchange rate

was lower than expected probably due to the low absorption rate recorded on the expenditure side.

1.5.4 Overall public debt

The overall gross public debt increased from Ksh 1,100.2 billion as at the end of 2010/11 to Ksh 1,350.7 billion at the end of 2011/12. This comprised 48.8 per cent external debt and 51.2 per cent domestic debt as a share of GDP (Table 1.3). The stock of domestic debt increased by Ksh 103.9 billion from Ksh 660.3 billion in June 2010 to Ksh 764.1 billion in June 2011, while external public debt increased by US$ 1,190.0 million from US$ 6,902.9 million in June 2010 to US$ 8,093.0 million in June 2011.

The total cumulative actual debt service payments to external creditors amounted to Ksh 28.5 billion at the end of 2010/11. This comprised of Ksh 22.7 billion (79.9%) principal and Ksh 5.7 billion (20.1%) interest. The net domestic borrowing for 2010/11 was Ksh 90.4 billion (equivalent to 3.3% of GDP).

Kenya's overall fiscal performance compares well with other countries such as India, Ghana and Egypt (Table 1.4). Countries such as the Republic of Korea and Singapore recorded fiscal surpluses over the 2007-2009 period, while Chile and Thailand had fiscal surpluses in 2007 and 2008. However, these countries had fiscal deficits in 2009. In 2009, many countries had larger than normal deficits due to implementation of various fiscal stimulus packages to counter the effects of the global financial crisis.

1.5.5 Fiscal policy and devolution

The immediate task for Kenya over the medium term is to implement devolution in compliance with the Constitution of Kenya 2010. The objectives include promoting social and economic development, local democracy, improving access to public services, and ensuring equity. The introduction of 47 county governments will bring a new fiscal challenge. Currently, the main concerns are the likely cost of counties, the design of appropriate public expenditure management institutions to enhance fiscal discipline, efficient allocation and utilization of public resources, and equity-related issues.

According to the Constitution, revenue raised nationally will be shared equitably among the county governments to enable them provide services based on the devolved functions. A minimum of

Table 1.4: Cross country fiscal indicators

	Revenue, excluding grants (% of GDP)			Expense (% of GDP)			Cash surplus/deficit (% of GDP)		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
Chile	27.41	25.78	20.37	17.24	19.53	22.95	8.80	4.75	-4.52
Egypt, Arab Rep.	27.12	27.62	26.92	29.34	30.32	30.08	-4.56	-6.36	-6.56
Ghana	15.67	15.69	15.42	17.87	20.55	18.03	-4.69	-5.87	-5.65
India	14.19	13.01	11.87	14.99	17.16	16.19	-0.47	-4.68	-4.89
Kenya	18.74	19.37	19.67	19.48	21.35	20.87	-2.98	-4.07	-5.32
Korea, Rep.	24.21	24.03	23.05	20.14	20.60	21.85	2.32	1.64	0.02
Mauritius			22.84			21.03			0.58
Singapore	19.64	20.87	18.06	12.40	14.83	15.15	11.34	7.80	1.66
South Africa	31.73	30.73	28.37	30.36	30.92	33.17	1.08	-0.46	-4.94
Thailand	19.44	20.12	18.63	17.62	18.24	19.67	0.13	0.50	-3.05
Tunisia	26.97	29.16	28.52	26.17	27.31	27.18	-1.99	-0.61	-1.55
Uganda	12.85	13.25	12.58	16.46	15.35	13.87	-2.36	-1.36	-0.92

Source: World Bank (2011)

15 per cent of revenue will be transferred to county governments. Further, 0.5 per cent of revenue will go to the equalization fund to provide basic services to marginalized areas. According to the Budget Policy Statement (Ministry of Finance, 2012), the projected total revenue transfers for counties in 2012/13 are estimated at Ksh 166.7 billion (including Constituency Development Fund–CDF). The equalization fund is estimated at Ksh 3.6 billion for the same period. This amount is above the minimum 15 per cent stipulated in the Constitution. As an explicit revenue sharing formula between counties is finalized, the cost of delivering assigned functions in each county will be used in the transition stage. The new revenue sharing formula is expected to break from historical funding patterns. Therefore, there will emerge a redistribution of resources, which will reflect an equitable provision for services provided by counties.

1.6 External Sector Performance

In 2010/11, Kenya's current account position deteriorated due to faster growth of imports relative to exports of goods and services. The current account as a percentage of GDP increased from 5.2 per cent in 2009 to 9.8 per cent in 2011. The key imports were industrial supplies, fuel and lubricants, machinery and capital goods. Industrial supplies, fuels, and lubricants accounted for about 60 per cent of imports. The value of crude oil imports grew from Ksh 74.8 billion to Ksh 128.4 billion between 2010 and 2011. Rapid growth in imports translated to growth of trade deficit from a deficit of Ksh 330.4 billion (or 18% of GDP) in 2007 to Ksh 804.6 billion (27% of GDP) in 2011. The export-import cover ratio declined from 45.4 per cent to 38.8 per cent during the same period. This largely reflected the widening import-export gap.

From a national accounting perspective, the current account is equivalent to the difference between savings and investment. In this context, the high current account reflects the low level of savings relative to investment. National savings rate is estimated at about 13 per cent, against an investment rate of about 20 per cent. The high current account deficit may, therefore, be an opportunity for Kenya to access foreign capital to finance domestic investment. However, Kenya's absorption of foreign capital is low, and sustainability must be considered on the current account deficit.

Kenya's current account has been widening. The government identified it as one of the factors responsible for the exchange rate volatility in 2011 (Parliament of the Republic of Kenya, 2012). Kenya should therefore assess the sustainability of its current account to establish the macroeconomic policy implications. In addition, Kenya must reduce the import-export gap by enhancing production, value addition and productivity in areas of comparative advantage, such as in production of tea, coffee, tobacco, cement and textiles. The country should also diversify exports and exploit opportunities for competitive import substitution in products such as animal and vegetable fats, plastics and sugars (KIPPRA, 2011). A study to assess Kenya's potential to accelerate production for export markets and competitive import substitution is recommended.

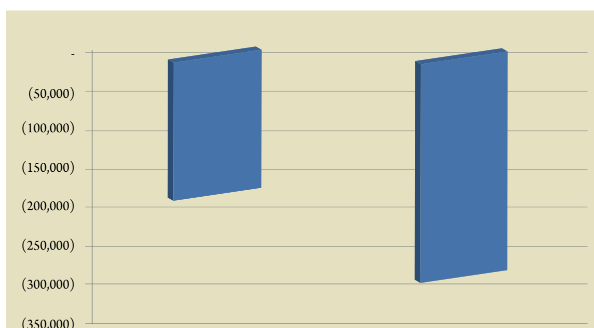
Services balance in the current account has consistently remained in surplus. This is mainly due to strong performance in transport, tourism receipts and remittances. Kenya's potential in transport services is large. The country could exploit this by improving the efficiency of the port of Mombasa to serve the regional economies, especially the landlocked countries. In tourism, Kenya is yet to meet the Medium Term Plan targets.

1.6.1 Remittances

External remittances to Kenya have increased steadily. They grew from US$ 338.3 million in 2004 to US$ 891 million in 2011. Several countries have mobilized remittances through issuance of diaspora infrastructure bond(s), enhanced flows through the banking system, mobile encryption technology for

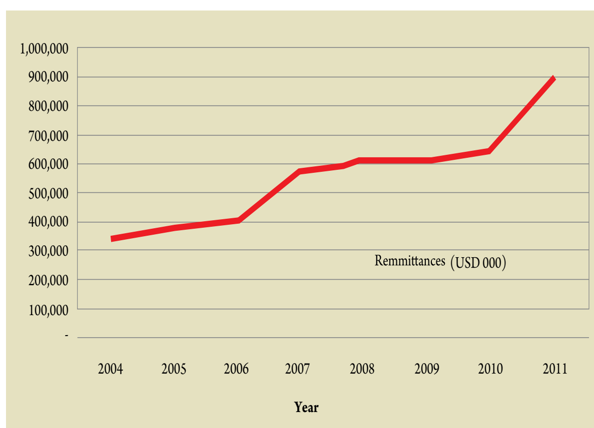
money transfer, and improved reporting (Ketkars and Ratha, 2007; KIPPRA, 2009). Kenya issued an infrastructure bond with a diaspora component in September 2011. However, the bond was under-subscribed. The uncertain macroeconomic environment characterized by high inflation and volatile exchange rate, together with weak global economic performance could have caused the poor performance.

Figure 1.6: Current account balance (Ksh millions)



Source: Data from Kenya National Bureau of Statistics (2012)

Figure 1.7: Foreign remittances (US$ '000)



Source: Central Bank of Kenya (2012)

1.7 Implications of a Weak Global Economy on Kenya

Developments in the global economy have implications on the performance of Kenyan's economy through various channels, including trade in goods and services. The after-shocks of the economic and financial crisis still affect the global economy. Most notable recent concerns are the Euro zone crisis stemming from the countries' inability to repay or refinance public debt. The impact of the crisis on developing countries is evident in reduced exports, declining portfolio flows, cancelled or postponed investment plans, and falling remittances and aid flows (Kennan et al, 2012).

The financial crisis exposed the structural weaknesses and shortcomings in the regulation of financial services. Kenya's financial sector was not highly integrated with the international financial system in terms of borrowing and lending, and therefore the effects were not severe (Mathenge et al, 2009). The world economy's recovery remains weak and unbalanced, and is associated with risks and uncertainties (International Monetary Fund, 2012). This weak performance has resulted in a poor growth outlook for the developed countries. The key linkages through which the Kenyan economy is affected include reduced demand for Kenyan export goods and services, aid flows and other private capital. It is therefore important for Kenya to continue monitoring developments in the world economy and act appropriately when necessary.

1.8 Challenges and Policy Recommendations

- Structural constraints hamper rapid growth in Kenya in terms of low productivity and low employment absorption in the modern sector of the economy. Policy makers need to re-focus their attention on policies that encourage economic transformation.

- While devolution poses fiscal expenditure pressure, it provides the opportunity to reform public expenditure management consistent with constitutional principles for public finance, including transparency, accountability, participation and equity. Kenya should develop comprehensive reporting on general

government, including the devolved system, to have a sound oversight over potential fiscal risks

- Under-absorption of the development budget is a persistent problem. Proper measures should be implemented to improve project management especially in procurement planning and absorption of donor funds.

- While security interventions in Somalia are important for national and regional security, the government should pursue support from the international community vigorously to minimize the cost of the military operations in Somalia on the Kenyan economy.

- Investment and savings performance is below the medium term target. Therefore, relevant policy reforms should be fast-tracked. These include establishment of special economic zones, institutional reforms for public-private partnerships, and pension reforms.

- Despite the fiscal pressures on the government, maintenance of macroeconomic stability is vital to enhancing investor confidence and fiscal credibility. The government should also support smooth implementation of the Constitution of Kenya 2010.

Chapter 2

Governance

2.1 Introduction

To fulfil the government's fundamental role of providing public services, the Constitution of Kenya 2010 defines offices and allocates powers to the three arms of government. It distinguishes the legislature, executive and judiciary arms of government. By convention, the responsibilities of enacting and enforcing the rule of law rest on the legislature and executive branches, respectively. The judiciary mainly upholds the rule of law through interpretation of laws.

In the past, Kenya's rating in governance has been poor. This was mainly due to the executive's monopolistic power over the legislature and the judiciary. According to the Mo Ibrahim Index Report (2010), Kenya dropped from position 23 out of 53 countries in 2005 to position 27 in 2009. Both institutions became the executive's channels of sustaining its highly centralized power. This resulted in poor governance. The ramifications of poor governance, such as corruption and political patronage, led to the call for constitutional reforms.

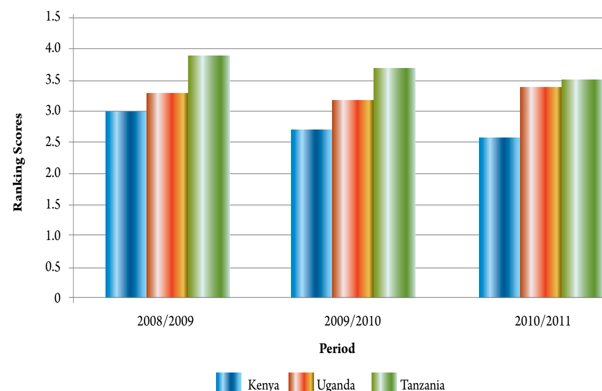
2.2 Judiciary

For most of her post-independence period, Kenya's judiciary has performed below average. A report of the Advisory Panel of Eminent Commonwealth Judicial Experts concluded that the public had no confidence in Kenya's judiciary. The panel ranked it among the most corrupt and inefficient in Africa (International Commission of Jurists, Kenya Chapter 2005). It also found that the administration of justice and the judiciary remained a major impediment to the rule of law in Kenya. Previously, a report of the Integrity and Anti-Corruption Committee of the Judiciary of September 2003 had confirmed corruption as a root cause of ineffectiveness of the judiciary in Kenya.

2.2.1 Judicial independence

Judicial independence means lack of undue external political interference on the operations of the judiciary. It also encompasses the ability of individual judges and magistrates to make independent decisions in particular cases without jeopardizing security of tenure in office. Based on the Global Competitiveness Index, judicial independence in Kenya has been on the decline since 2008 (Figure 2.1). Kenya's performance in judicial independence has been the worst in East Africa.

Figure 2.1: Judicial independence ranking



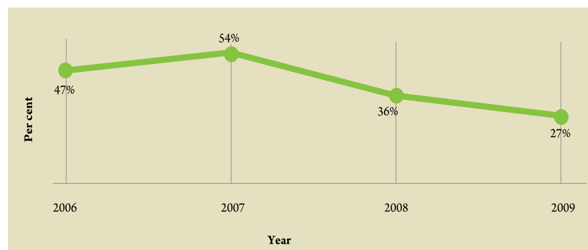
Source: World Economic Forum (2008/2009, 2009/2010, 2010/2011)

The Judicial Service Commission (JSC) was created to promote and facilitate the independence and accountability of the judiciary and efficient, effective and transparent administration of justice. The JSC comprises a Supreme Court Judge, a Judge of the Court of Appeal, one High Court Judge, the Attorney General, two Advocates, two members of the public and one person nominated by the Public Service Commission to run judicial matters. In pursuit to the above, the Judicial Service Act (2011) was enacted.

2.2.2 Public confidence

According to Cho (2012), Kenyans' public confidence in the judiciary is low compared to other Sub-Saharan countries (Figure 2.2). Public confidence on the judiciary has also declined since 2007 (Figure 2.3).

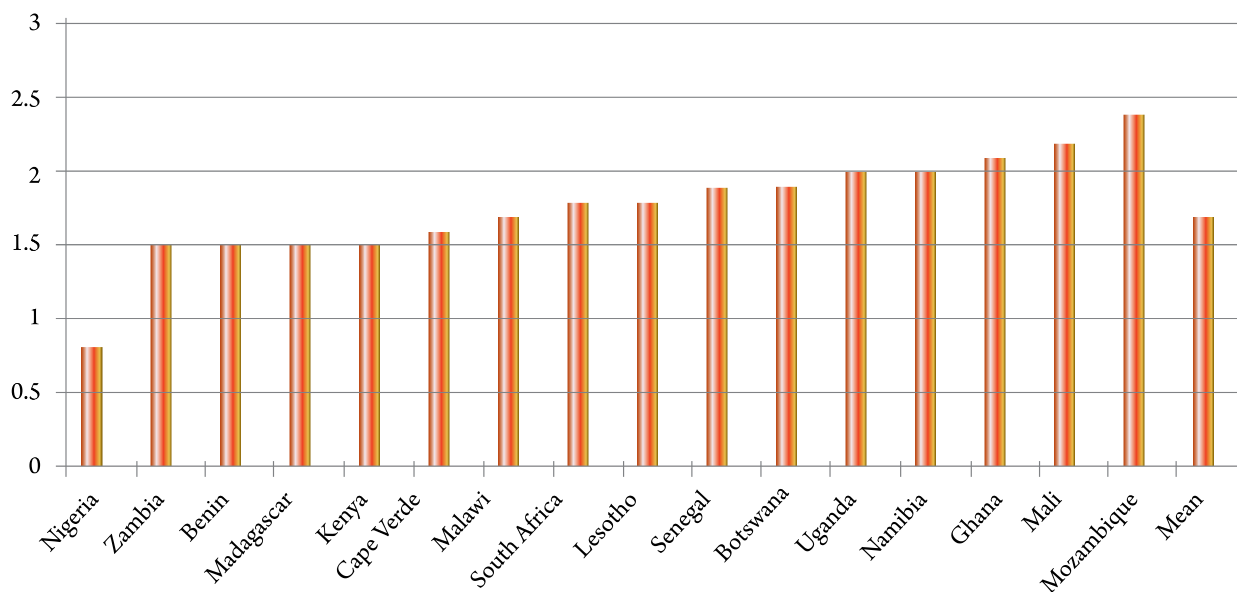
Figure 2.3: Kenya's confidence (%) in the judicial system



Source: Crabtree and Tortora (2009)

To improve on public confidence, the Constitution of Kenya 2010 recommends key changes in the judiciary. Among them are public appointment and vetting of the Chief Justice and Deputy Chief Justice through public interview and vetting process. In addition, the Chief Justice will no longer oversee

Figure 2.2: Public trust in the legislature in some Sub-Saharan countries



Source: Cho (2012)

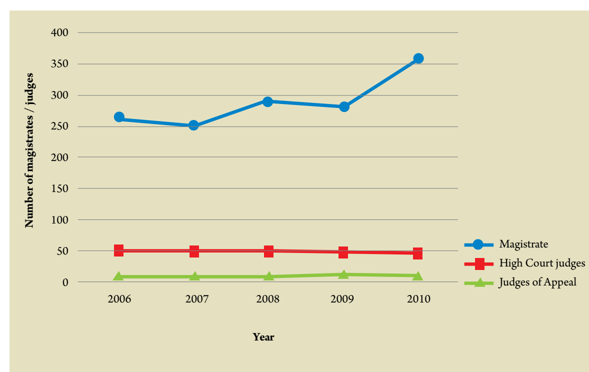
all the courts. The Supreme Court and Court of Appeal both have Presidents, while the High Court has a Principal Judge. This has decentralized power from the office of the Chief Justice. It is expected to improve supervision and management of the courts. The Constitution also provides a mechanism for vetting of magistrates and judges to assess their suitability in holding judicial offices. The vetting process aims to create a strong and independent judiciary, and to restore public trust in the judicial system. To achieve this, the Vetting of Judges and Magistrates Act (2011) was enacted.

2.2.3 Judicial efficiency

Judicial efficiency is the ability of a judicial system to process cases without unreasonable delays and backlogs (Economic Commission for Africa, 2009). As Figure 2.4 shows, cases, especially those handled by the magistrates' courts, have increased since 2008.

The increased number of magistrates and budget allocation to the judiciary during the same period could have caused the improved case disposal since 2008, as reflected in Figures 2.5 and 2.6.

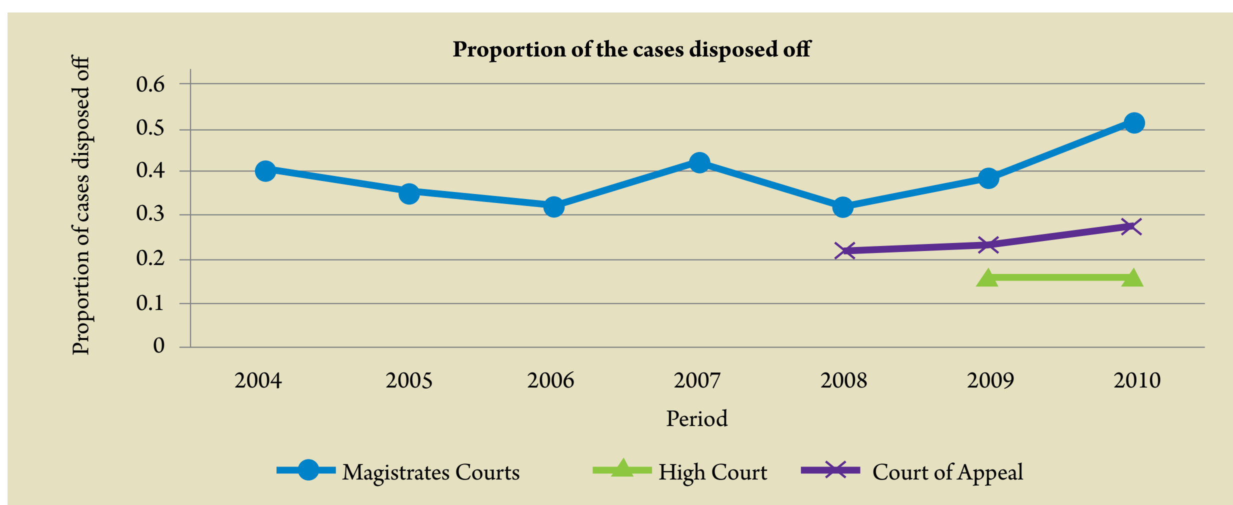
Figure 2.5: Number of magistrates/judges in the judiciary



Source: Kenya National Bureau of Statistics (2011)

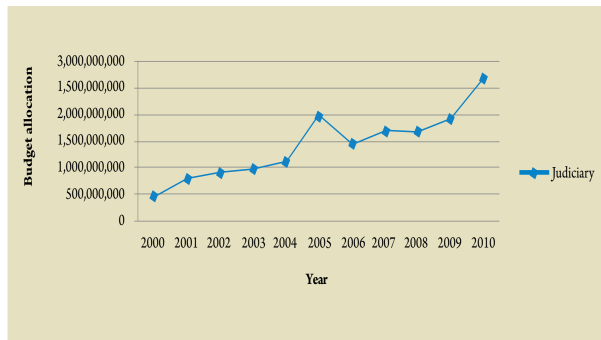
While the number of High Court and Court of Appeal judges has remained the same, magistrates have increased from 287 in 2008 to 358 in 2010. The reduced ratio of population per magistrate has improved the rate of annual case disposal and the efficiency of the judiciary. The 2009 census revealed a ratio of 1.035 judicial officers per 100,000 persons. Kenya's judiciary, when compared to middle-income countries, is understaffed. In Singapore, for example, the ratio is 8.96 officers per 100,000 persons (World Bank, 2011).

Figure 2.4: Disposed off cases



Source: Kenya National Bureau of Statistics (2011)

Figure 2.6: Budget allocation (Ksh) in the judiciary



Source: Kenya National Bureau of Statistics (2011)

Budget allocation to the judiciary increased from Ksh 0.5 billion in year 2000 to Ksh 2 billion in 2005. It then dropped slightly to Ksh 1.5 billion in 2006, and rose to Ksh 2.6 billion in 2010. For a judiciary to be considered independent, it must have some level of financial autonomy. Article 173 of the Constitution created a Judiciary Fund that will be used for administrative expenses and other important purposes in the judiciary. These funds will be paid from the Consolidated Fund. This will remove executive interference in allocation of funds to the judiciary. Increase in budget allocation will enable the judiciary improve performance through capacity building. Initially, non-governmental agencies in collaboration with the Judiciary Training Committee trained judicial officers. The Judiciary Training Institute (JTI) is now responsible for training.

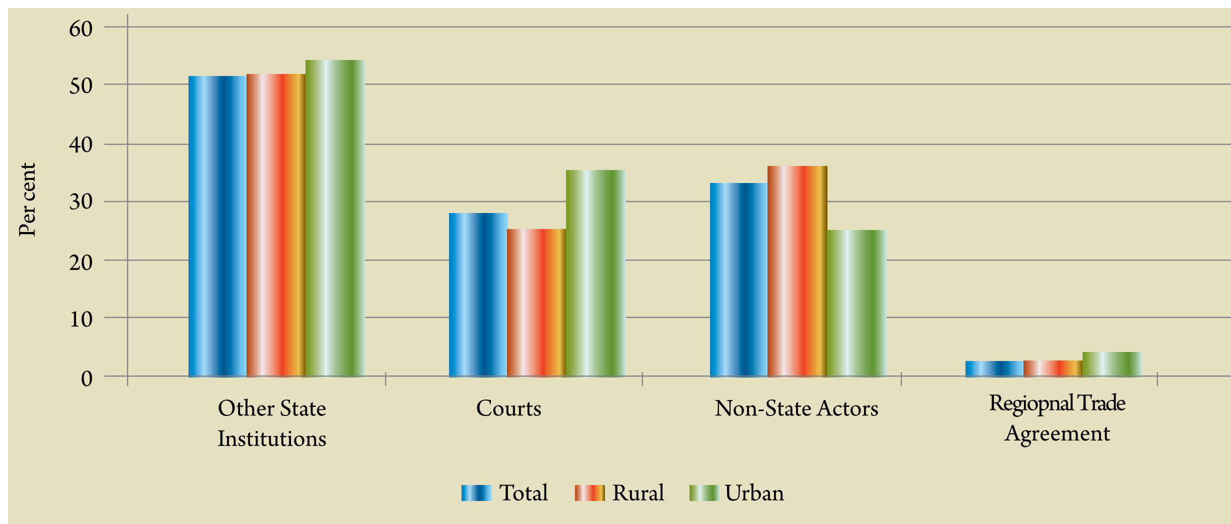
2.2.4 Judicial accessibility

A baseline study conducted by the Governance, Justice, Law and Order Sector (GJLOS) showed that majority of people preferred other means of settling disputes besides the court system (Government of Kenya, 2006). According to the study, only 26 per cent used the court system for dispute settlement. About 50 per cent preferred other mechanisms (Figure 2.7). This is due to corruption and case delays in courts.

2.2.5 Corruption

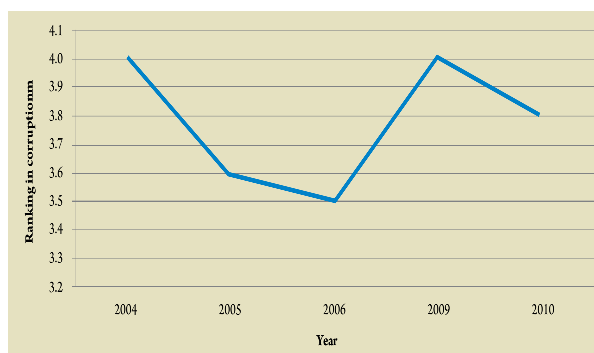
According to Transparency International–TI (2010), Kenya's judiciary is corrupt. Furthermore, the country scores low in the corruption integrity index, which measures the actions taken to fight corruption. As Figure 2.8 indicates, Kenya corruption integrity index declined from 4 out of 10 in 2009 to 3.8 in 2009.

Figure 2.7: Preferred avenue for dispute settlement



Source: Government of Kenya (2006)

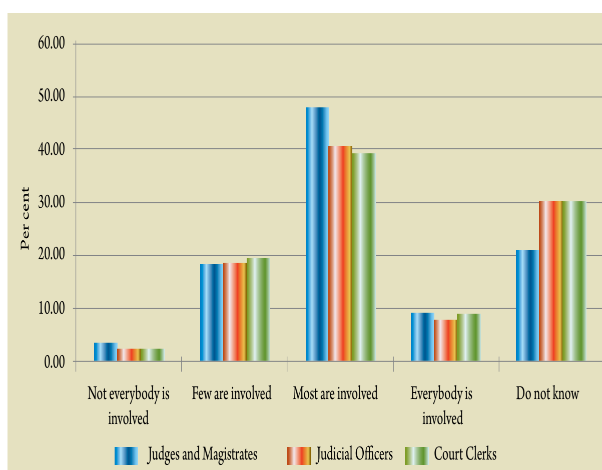
Figure 2.8: Corruption levels over years



Source: Transparency International (2010)

The Kenya Anti-Corruption Commission (KACC, 2011) also established that most judicial officers were corrupt (Figure 2.9).

Figure 2.9: Perception of corruption in the court system



Source: Kenya Anti-Corruption Commission (2011)

The East Africa Bribery Index studies conducted by TI recorded high corruption incidences in 2008-2010. However, corruption decreased slightly in 2010. The judiciary moved from the top 10 to 27 most corrupt institutions in East Africa in 2010.

2.3 Executive

For Kenya's executive to be effective, it must be vested with requisite powers. It must also have the appropriate institutional capacity (Economic Commission for Africa, 2009). According to the Constitution of Kenya 2010, the executive comprises of the President, the Deputy President and the Cabinet. The composition of the national executive is expected to reflect regional and ethnic diversity of the people of Kenya.

2.3.1 Government effectiveness

Government effectiveness captures the following:

- Perceptions of the quality of the civil service;
- The degree of its independence from political pressure;
- Quality of policy formulation and implementation; and
- Credibility of the government's commitment to such policies (World Bank, 2011).

One of the government's top priorities is efficient and effective service delivery. Improvement of governance processes through strengthening of institutions is critical to accelerated growth and development. Figure 2.10 shows how Kenya performs when compared with Uganda, Tanzania, Ghana, Botswana and South Africa. The governance index reflects the statistical compilation of responses on the quality of governance given by enterprise, citizen and expert survey respondents in industrial and developing countries. This was reported by research institutes, think-tanks, non-governmental organizations, and international organizations.

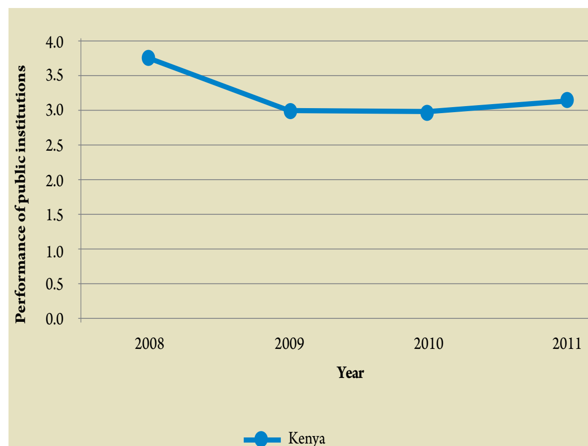
Kenya's rating on government effectiveness remains low. The country has continually performed poorly, averaging about -0.5 in 1996-2009. South Africa was one of the best countries with a positive rating in government effectiveness in the last decade. While performance of Ghana was the worst among selected countries in the late 1990s, the trend has since changed. Currently, Ghana's rating is better than Kenya's. Ghana improved civil freedoms and government effectiveness, reduced corruption and

sustained political stability (World Governance Indicators, 2011). Kenya should emulate this.

2.3.2 Performance of public institutions

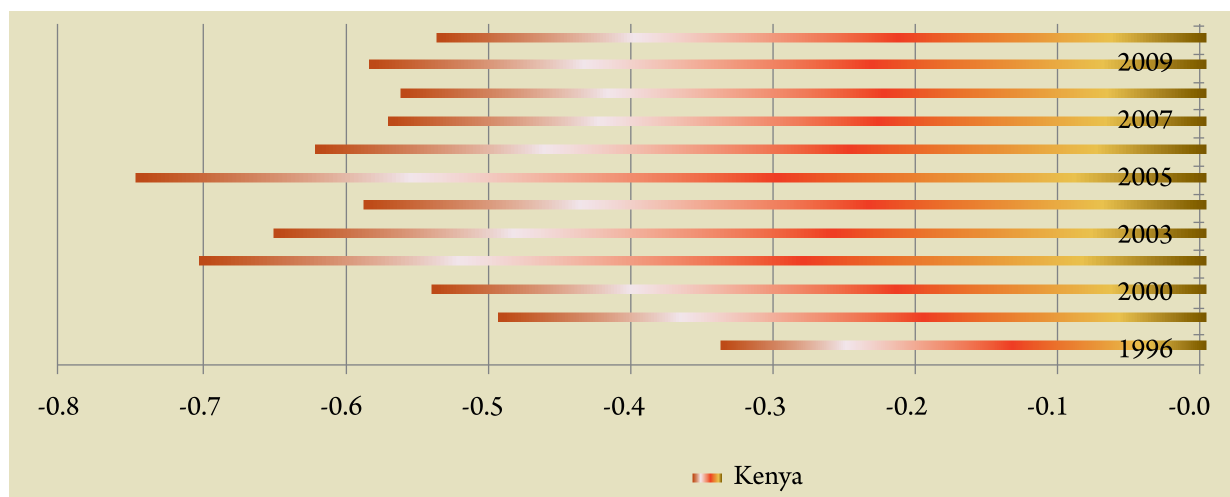
The legal and administrative framework within which individuals, firms, and governments interact to generate income and wealth in the economy determines the institutional environment. The structure and conduct of public institutions largely determines their performance. These are often characterized by excessive bureaucracy, over-regulation and corruption, lack of transparency and trustworthiness and political patronage. Kenyan institutions have performed below average (Figure 2.11).

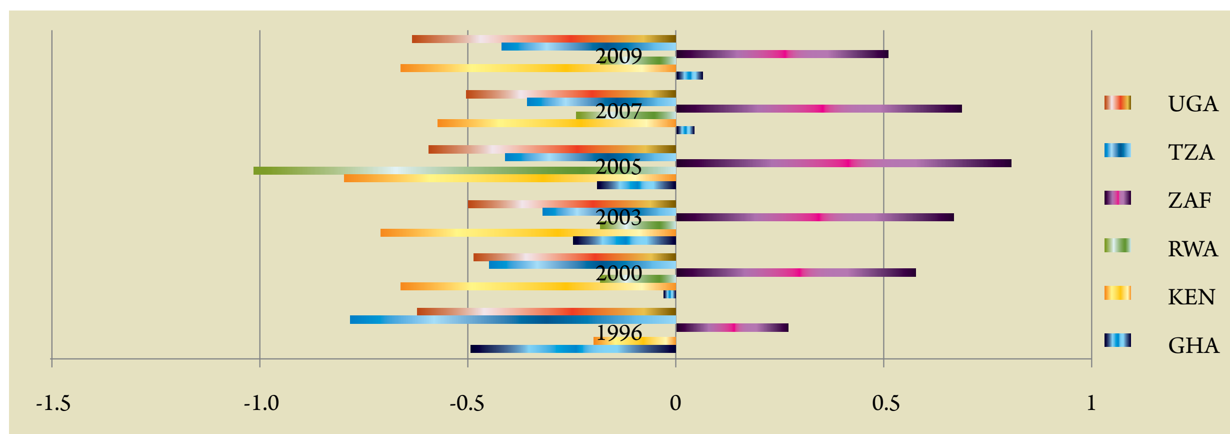
Figure 2.11: Performance[2] of public institutions in Kenya



Source: World Economic Forum (2008-2011))

Figure 2.10: Government effectiveness performance rating[1]





Source: World Bank (2011)

2.3.3 Public service performance contracting

To improve the performance of public service, performance contracting was introduced in all public institutions. This has yielded benefits to the country by permitting Ministries, Departments and Agencies (MDAs) to refocus and realize their core mandates.

According to the National Anti-Corruption Perception Survey (Kenya Anti-Corruption Commission, 2010), the public service achieved below 50 per cent in most of their mandates (Figure 2.12), thus access to public services is difficult. Public services include processing of important documents such as title deeds, birth and death certificates, police help and provision of household amenities such as piped water and electricity.

Accessibility, reliability and affordability of public services are important indicators of a country's quality of life. Kenya's poor performance means a lower quality of life for its citizens.

The Ministry of State for Public Service conducted an employee audit survey (2011) that aimed to establish the human resource capacity in the civil service. The survey showed that majority of government employees had low educational qualifications as shown in Table 2.1.

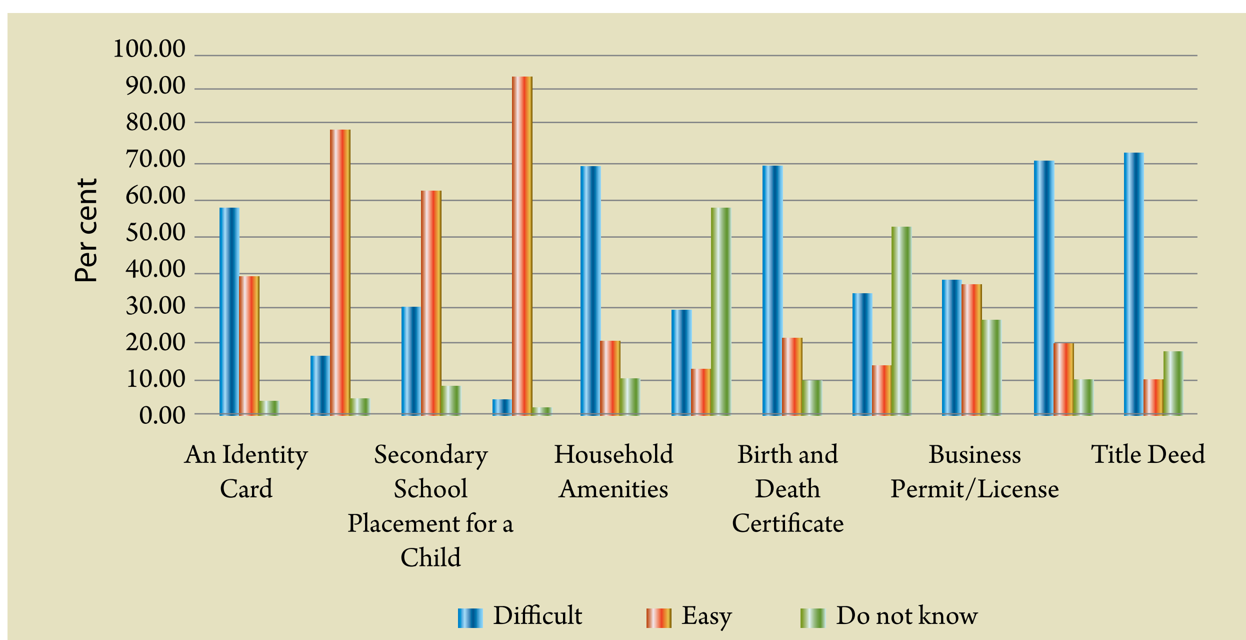
Table 2.1: Education qualification of the civil service employees

Qualification level	No. of employees
PhD	136
Masters	1,743
Undergraduate	18,042
Secondary and primary	169,535
No formal certificates	3, 379

Source: Ministry of State for Public Service (2011)

Through the Directorate of Personnel Management (DPM), civil servants are trained through government institutions, donor funding, and self-training.

Figure 2.12: Performance of public service on their mandate



Source: Kenya Anti-Corruption Commission (2010)

2.4 Legislature

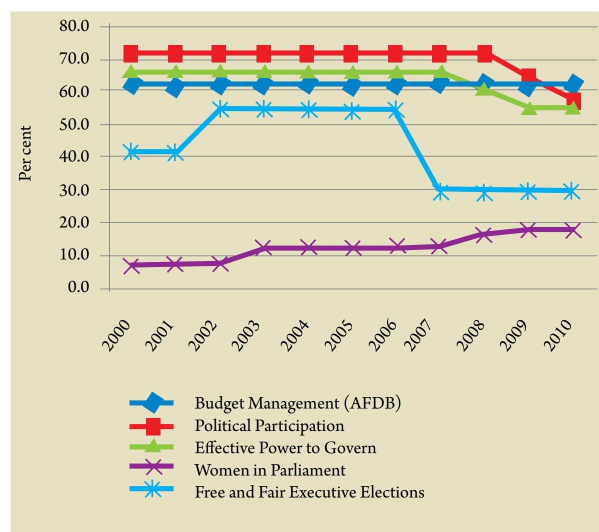
Parliament is the supreme law making body. It performs three functions: representation, legislation, and oversight. Thus, parliaments plays an important role in ensuring accountability, participation and transparency in government.

In exercising its legislative powers, the National Assembly passes bills, which become law upon Presidential assent. Parliament executes its mandate through various committees.

2.4.1 Performance of Kenya's parliament

According to Mo Ibrahim (2011), Kenya's parliament has performed poorly. The report notes that while budget management has remained the same, factors such as public participation, effective power to govern, and free and fair elections have deteriorated in Kenya. The level of women participation in parliament has, however, increased (Figure 2.13).

Figure 2.13: Performance of Kenya's parliament



Source: Mo Ibrahim (2011)

Kenya's legislative strength based on legal authority of the legislature to approve budgets is rated as moderate. However, as Figure 2.14 shows, parliament is among the weakest institutions in controlling the powers of the executive (Economic Commission for Africa, 2009).

The performance of Kenya's legislature is average when compared to countries such as Uganda, Egypt and Malawi (Figure 2.15). Furthermore, a weak parliamentary opposition means democratic governance cannot be sustained because of lack of checks and balances in the government system.

2.4.2 Bills and motions

In 2010, 16 government-sponsored bills and 10 private bills were brought to the floor of parliament. Eight (8) out of the 15 government-sponsored bills were passed and seven were pending. Out of the 10 private bills, only three (3) were passed and seven (7) were pending. In 2011, 44 of the government-sponsored bills were discussed in parliament. Of these, 24 were passed and 20 were left pending. Private bills introduced by the Members of Parliament have increased over years from two (2) in 2008 to 18 in 2011. Out of the 18, only two were passed and 16 were left pending (Table 2.2).

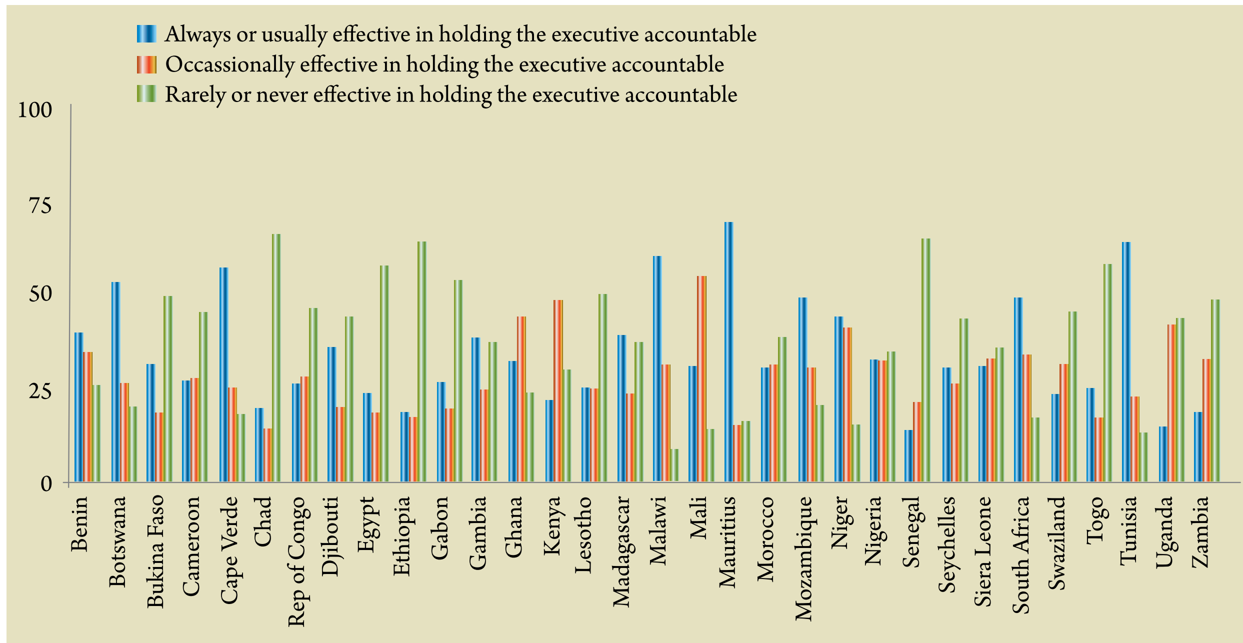
Table 2.2: Bills received in parliament

Bills between 2008-2010	2008	2009	2010	2011
Bills received in Parliament	20	19	25	65
Private bills introduced by the Members of Parliament	2	8	10	18

Source: Government of Kenya Parliament of Kenya website (2008-2011)

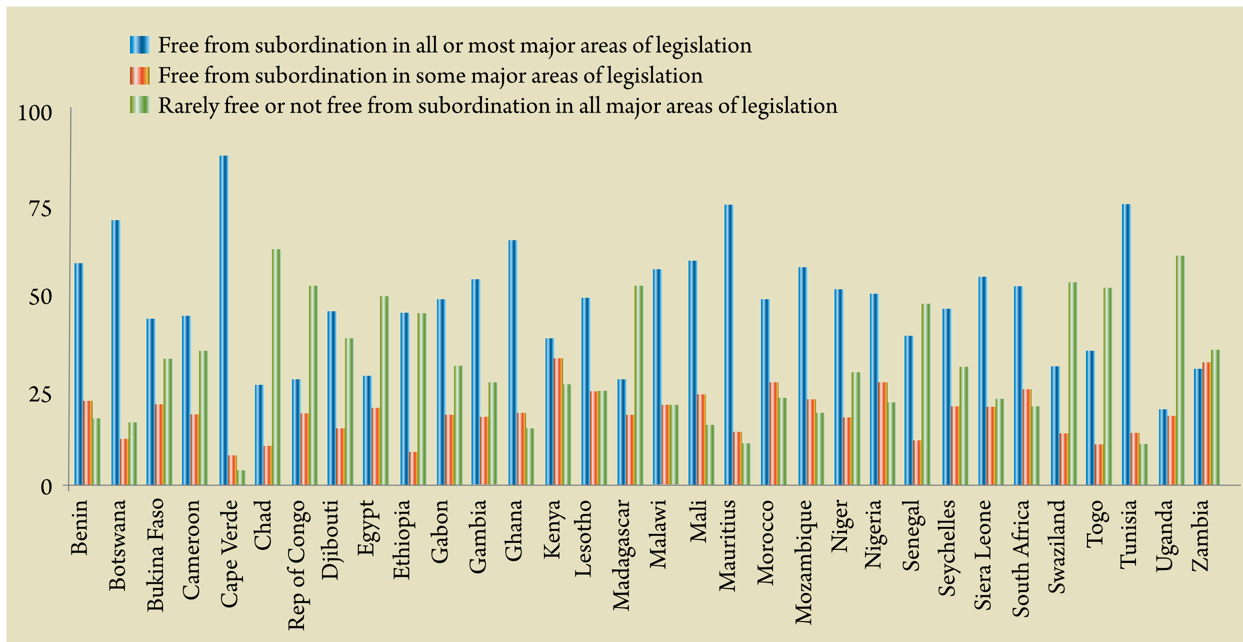
Motions are policy proposals or suggestions presented to parliament by individual members. Members of Parliament (MPs) brought 90 motions to parliament in 2008, 102 in 2009, 145 in 2010 and 154 in 2011. This shows a progressive increase in motions introduced in parliament every year (Figure 2.16).

Figure 2.14: Expert opinion on the extent of legislative control of the executive



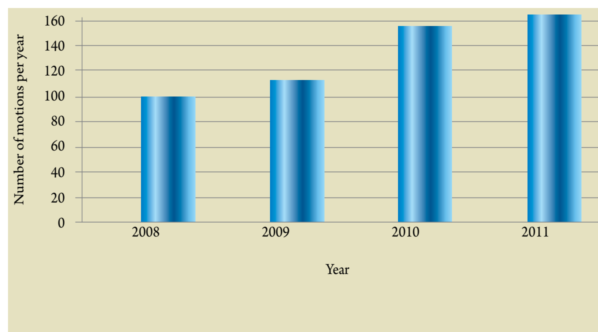
Source: Economic Commission for Africa (2009)

Figure 2.15: Expert opinion on the extent of legislative effectiveness



Source: Economic Commission for Africa (2009)

Figure 2.16: Motions brought to parliament per year



Source: Government of Kenya, Parliament of Kenya website (2008-2011)

2.5 Policy Implications

Although Kenya has recorded improvement in all branches of government, better results can be achieved through timely implementation of the Constitution of Kenya 2010, credible elections, addressing internal and external security threats, and management and equitable allocation of public resources. The Kenya government should unite the country by addressing existing tribal and class divisions.

2.5.1 Judiciary

Several challenges affect the performance of the judiciary in Kenya. These include low public confidence, and inadequate capacity. The ongoing reforms in the judiciary are commendable. Reforms include the formation of Judicial Service Commission, recruitment and vetting of judges and magistrates, increased budget allocation, integration of Information and Communication Technology (ICT) in judicial operations, and expansion of court infrastructure. Given the crucial role the judiciary is expected to play in achieving the goals of the Kenya Vision 2030, these efforts need fast-tracking.

2.5.2 Executive

Kenya should address excessive bureaucracy, red tape and inadequate capacity building to improve the executive's performance. Since the enactment of the Constitution in 2010, the government has enacted the Public Service Commission Act (2012) to streamline staffing in the civil service. It has facilitated the formation of constitutional offices such as the National Cohesion and Integration Commission (NCIC), National Police Service Commission (NPSC), Independent Policing Oversight Authority, and the Ethics and Anti-Corruption Commission (EACC) to facilitate smooth transition and enhance service delivery. Further, restructuring of the Kenya School of Government (KSG) is underway to improve skills capacity in public service. There is also need for full enforcement of performance contracting in all areas of government service.

2.5.3 Legislature

The low quality of Kenya's legislature contributes significantly to its low performance. While the Constitution has stipulated some minimum academic qualifications, and requirements for women representation, this does not seem to adequately safeguard the character of the legislature in the National Assembly and Senate.

The oversight and legislative role of parliament is important, yet often complex. To be effective, parliament needs qualified personnel, especially for it to participate in the budget process. Moreover, there is need for a legislature that has the capacity to engage at a higher level with citizens.

Technical capacity programmes in Kenya for parliamentarians are at best *ad hoc*. This means they are provided on demand or only when needed. In 2008, however, the Parliamentary Service Commission was mandated to establish a centre to build relevant capacity to Members of Parliament. The Centre for Parliamentary Studies and Training (CPST) will also offer training to staff of the parliamentary service. This process should be fast-tracked to build technical capacity and improve on parliament's performance.

END NOTES

1. The governance indicators are measured in units ranging from -2.5 to +2.5, with higher values corresponding to better governance outcomes.

2. Scores for public institutions on a scale of 1-10, with 10 being the best performance.

Chapter 3

Population Dynamics and Socio-Economic Performance

3.1 Introduction

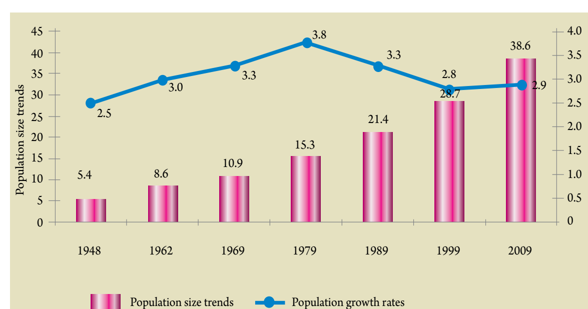
This chapter deals with population dynamics, labour market, poverty, health and education. The issues analysed relate to social sector performance, and the chapter also provides some policy implications.

3.2 Population Dynamics

Population dynamics refer to the mechanisms by which the population changes over time. The three elements of population dynamics are fertility, mortality and migration. Interaction of these elements determines population size and growth.

Kenya's population has been changing in terms of size, structure, and distribution. The 2009 Kenya Population and Housing Census enumerated about 38.6 million people. This represented an increase of about 35 per cent from the 1999 census. Kenya's population previously increased from 5.4 million persons in 1948 to 10.9 million in 1969, 15.3 million in 1979, and 21.4 million in 1989. The population is growing at about 1.2 million persons per year. By 2011, the population was about 41 million.

Figure 3.1: Population growth trends



Source: Government of Kenya (2011b)

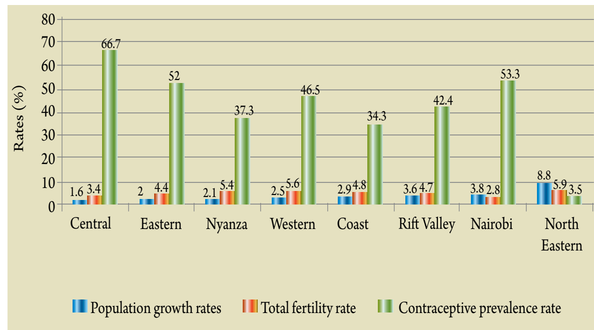
3.2.1 Population growth

Kenya's population growth rate rose from about 2.5 per cent per annum in 1948 to around 3.8 per cent per annum in 1979. The growth rate then declined to an average of 2.9 per cent per annum.

Population growth rate by region shows that in 2009, North Eastern Province had the highest population growth rate of 8.8 per cent. Central Province had the lowest growth rate of 1.6 per cent. The population growth rates go hand in hand with Total Fertility Rates (TFR) and Contraceptive Prevalence Rates (CPR). Therefore, the province with the highest CPR (Central Province) had the lowest TFR and the lowest population growth rate. The same case

applies to the province with the highest growth rate. North Eastern Province had the lowest CPR, the highest fertility rate and the highest population growth rate.

Figure 3.2: Population growth, fertility and contraceptive prevalence rates by province, 2009



Source: Kenya National Bureau of Statistics and ICF Macro (2010), Government of Kenya (2011)

3.2.2 Population structure

Population structure is important because people's social and economic behaviour and needs vary at different ages. This affects socio-economic development in several ways. The age structure of the population should be the key factor informing a country's strategies to address the needs of different social groups. Figure 3.3 shows Kenya's population pyramid for 2009 by age and sex.

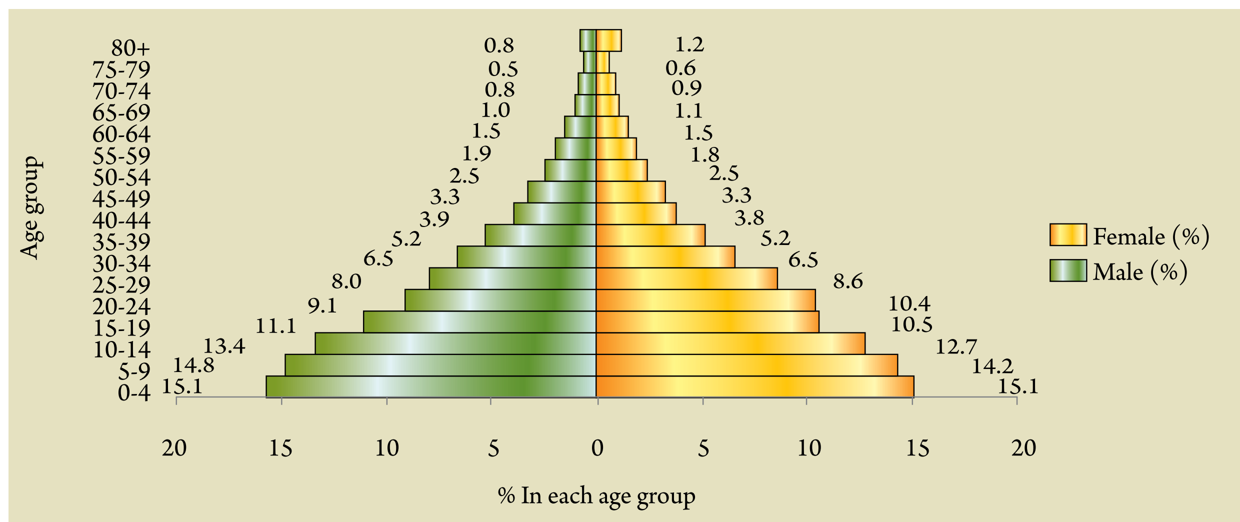
Kenya's population is predominantly young. For example, 43 per cent of the population is below age 15, while those aged 15-35 years are approximately 36 per cent of the total population. With all other factors constant, the young age cohort creates a strong momentum for future population growth, even if fertility declines rapidly among the next generation of parents (Government of Kenya, 2011b).

With a youth bulge, the country's dependency ratio declines as the young adults join the working population. Where there is an increase in the working population relative to the dependent population, a country could benefit economically, provided there are policies and programmes that enable this working-age population to participate optimally in the economy, particularly in labour markets. However, if a large cohort of young people cannot find gainful employment, the youth bulge will become a potential source of social and political instability.

3.2.3 Demographic transition

This refers to the transition from high birth and death rates to low birth and death rates. It can happen without industrialization. Demographic transition involves four stages (Figure 3.4). In stage

Figure 3.3: Population pyramid of Kenya, 2009

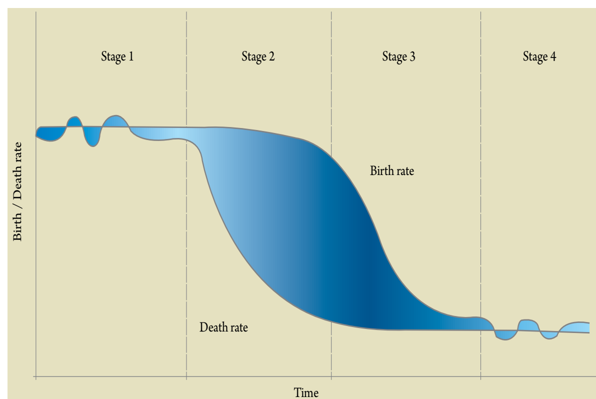


Source: Government of Kenya (2010a)

one, death rates and birth rates are high and roughly in balance, that is birth and death rates both tend to be very high. For that reason, population growth is typically very slow.

Stage 2 is characterized by low death rates because of improvement in food supply and sanitation, which increases life spans and reduces disease incidence. In the third stage, birth rates fall due to family planning, better education, lower infant mortality rate, urbanization, industrialization, ambition, higher social status, and education of women, among other factors. At stage four, both birth and death rates are low.

Figure 3.4: Stages of demographic transition



Source: Haub and Gribble (2011)

Kenya is in the second stage of demographic transition. In 2011, crude birth rate was 37.34 per 1,000 persons per year, while crude death rate was 10.30 per 1,000 persons per year. As fertility declines, life expectancy rises and the youthful population reaches the working age, a dramatic, favourable change occurring in the dependency ratio. In particular, the proportion of the working-age population will grow much faster than the young and the elderly population groups that depend on the working age.

3.2.4 Demographic dividend

Demographic dividend occurs when falling birth rates change the age distribution so that fewer resources are needed to meet the consumption needs of the youngest age groups. This avails the resources for social and economic development (Magongo and Motimele, 2011; and Lee and Mason, 2011). The demographic dividend has two parts.

The first demographic dividend lasts between 30 and 50 years. It is, however, inherently transitory in nature. As the ageing population begins to dominate demographic trends, the share of the working population declines. The first dividend turns negative as the dependency ratio increases due to a larger ageing population. Eventually, the share of the population in the working ages may be the same as before the dividend period began (Lee and Mason, 2011).

The second demographic dividend occurs when a significant population of older workers have invested in their financial security for retirement to lower reliance on their families or governments in old age.

Unless sustained policies and prudent decisions in the areas of health, education and labour markets are made, realizing a demographic dividend is not automatic in any country.

Can Kenya benefit from the demographic dividend? A large share of Kenya's population consists of young people who are yet to complete their education. The poor quality of education, inability of the economy to absorb the growing labour force and the rate of unemployment amongst the youth limits the ability of the country to extract demographic dividend.

In contrast, Kenya's fertility rate is lower compared to most countries in Sub-Saharan Africa (SSA). Life expectancy is also higher. Kenya is yet to earn the demographic dividend because measures to address the effectiveness of family planning are yet to be implemented. In particular, it is important to increase coverage of family planning services, enhance commodity security, and promote a family planning culture in the country.

3.2.5 Conclusion and policy actions

Drawing from the experience of East Asia and other developing regions, several factors may determine if a country benefits from a demographic dividend. These include strong public health systems to improve child survival and health in general, widespread availability and social acceptability of family planning, rapid and steady decline of birth rate, improved quality and enrolment in education, and stable economic conditions conducive to growth and job creation.

Expansion of family planning information, services and commodities is necessary. This should deliberately target the poor and marginalized segments of the population. Broad based initiatives call for strong government commitment and involvement of community leaders. There is also need to address the weak distribution system of medical supplies, especially from the district headquarters to dispensaries and health centres (levels 2 and 3). This is a major bottleneck to delivery of supplies to the community level (level 1). To address the over-reliance on donors, the government needs to allocate sufficient funds to family planning programmes to ensure their sustainability.

Gender issues are important in addressing the problems in family planning. In many communities, male partners control couples' reproductive decisions. Therefore, male involvement in discussions about family planning is key to its success. The media has an important role to play in counteracting rumours and myths concerning family planning methods, and encouraging male partners to get involved in family planning matters.

Kenya has a time-limited opportunity to reduce fertility and to invest in the skills of the young population before it reaches non-working age. The government should, therefore, implement the policies required to catalyse and accelerate the demographic transition. Because policy design and implementation is a time consuming process, planning units should be established to accomplish this. Kenya must invest in education, health, and job creation as an immediate measure. Delaying this may affect future growth prospects and social stability. It may lead to extremely high unemployment rates, many social problems and old age poverty. Therefore, the key to achieving development goals is to confront demographic challenges through inclusive and systematic approaches. The government is well placed to catalyze, initiate or coordinate such approaches.

3.3 Labour Market

Kenya aspires to become a middle-income country by the year 2030. Human resources remain a major asset that Kenya possesses, while job creation remains an important policy aim if the Kenya Vision 2030 objectives are to be attained. Even with a declining population growth rate, demographic pressure will continue to be felt in the labour market. By 2009, Kenya's population was more than one and half times more than that of 1990 (Table 3.1). Another demographic feature is the high youth dependency ratio, estimated at 78 per cent.

Table 3.1: Age distribution of the population (%)

	1990	2009
Total population (millions)	23.4	39.8
Population (0-14) (%)	-	43.0
Population (15-64) (%)	-	55.0
Population (65+) (%)	-	3.0
Youth dependency ratio (% of working-age-population)	-	78.0
Elderly dependency ratio (% of working-age-population)	-	5.0

Source: World Bank (2011)

Population growth in the last two decades, which doubled the labour force, means the pressure on the labour market to create jobs is higher. Table 3.2 shows that the labour force grew from over 9 million persons in 1990 to more than 18 million persons

in 2009. The share of women in total labour force has remained around 46 per cent, while female labour force participation rate is around 75 per cent compared to about 90 per cent for males.

Table 3.2: Labour force participation in Kenya

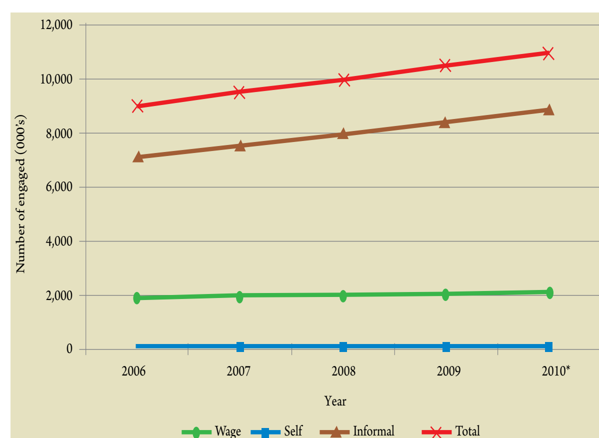
	1990	2009
Male labour force participation rate (%)	90.0	88.0
Female labour force participation rate (%)	75.0	76.0
Labour force (millions)	9.8	18.7
Female labour force(%)	46.0	46.7

Source: World Bank (2011)

3.3.1 Employment and earnings

With sluggish economic growth, wage employment in the modern sector has also been slow. Figure 3.5 shows trends in recorded employment in the past five years. The informal sector created 440,000 new jobs between 2009 and 2010, compared to about 60,000 new jobs created in the formal sector. Self-employment in the formal sector remains relatively small.

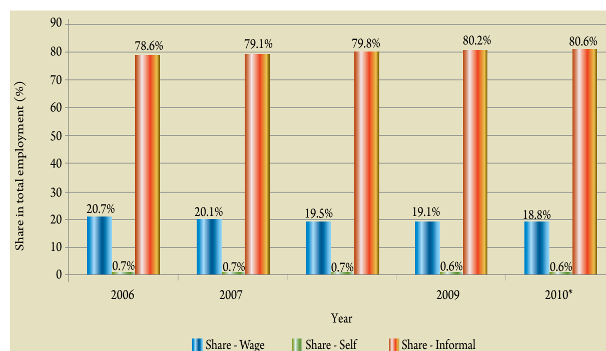
Figure 3.5: Total recorded employment in Kenya (000s)



Source: Kenya National Bureau of Statistics (2011) and KIPPRA Computations
*provisional

There was little structural change in the composition of recorded employment in Kenya between 2006 and 2010. Figure 3.6 shows the share of the labour force in wage employment, self-employment and informal sector employment computed from the Kenya National Bureau of Statistics (KNBS) data. Only small shifts occurred as informal sector employment share remained at around 80 per cent of total employment. Formal employment share was around 19 per cent.

Figure 3.6: Sectoral distribution of employment by sector



Source: Kenya National Bureau of Statistics (2011) and KIPPRA Computations

3.3.2 Sectoral distribution of employment

Overall, the industry shares in total wage employment did not change markedly in the 2006-2010 period. The largest source of wage jobs was the community, social and personal services sector at 41 per cent of total wage employment in 2010, followed by agriculture and forestry. However, the share of wage jobs in agriculture and forestry declined steadily by 1.3 per cent from about 18.0 per cent in 2006 to 16.7 per cent in 2010. During the same period, the share of manufacturing declined by 1 per cent, while that of wholesale and retail increased by 1 per cent.

The annual growth in shares of wage jobs across sectors has changed in recent years. For example, the share of jobs created in building and construction industry increased by only 1.8 per cent in 2007 (Table 3.3). In 2008, the growth rate in share of jobs in this industry grew to 4.3 per cent and 10 per cent

in 2009. The share of wage jobs in transport and communication grew by 17 per cent in 2007. The rate of growth, however, declined to less than 5 per cent.

Table 3.3: Annual growth rates in sectoral shares of wage employment

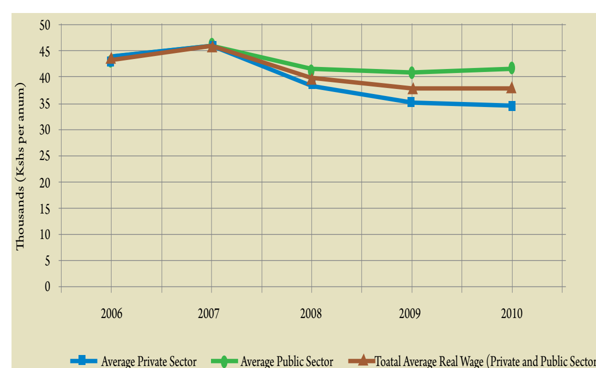
	2007	2008	2009	2010
Agriculture and forestry	1.6	0.2	-0.1	1.0
Mining and quarrying	5.0	4.8	-1.5	1.5
Manufacturing	2.1	-0.3	0.9	0.6
Electricity and water	-3.1	1.6	1.6	0.0
Building and construction	1.8	4.3	10.1	8.4
Wholesale and retail trade, restaurants and hotel	5.3	3.4	6.5	5.3
Transport and communications	17.4	2.3	-7.0	3.3
Finance, insurance, real estate and business services	1.1	1.3	2.9	2.2
Community, social and personal services	0.9	2.5	5.6	3.2
Total (Public and Private)	2.8	1.8	2.9	3.0

Source: Kenya National Bureau of Statistics (2011) and KIPPRA Computations

3.3.3 Wage earnings

Average real earnings in both the public and private sectors declined in the 2006-2010 period. In the private sector, estimated average real wage earnings were about 21 per cent lower in 2010 than in 2006. The corresponding decline in the estimated public sector average real wage earnings was 3.5 per cent (Figure 3.7).

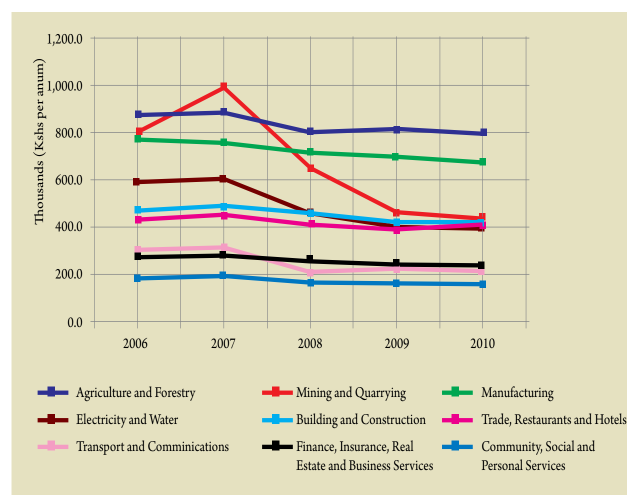
Figure 3.7: Real wage earnings per employee



Source: Kenya National Bureau of Statistics (2011) and KIPPRA Computations

Average real wages declined in both the public and private sectors. Relative to the 2006 real wages, the largest decline was in the electricity and water sector at 46 per cent (Figure 3.8). The real wage declined by 35 per cent in trade, restaurants and hotels sector. The lowest real wage decline was recorded in the finance, insurance, real estate and business services sector at 9 per cent.

Figure 3.8: Real wage earnings per employee (private sector)

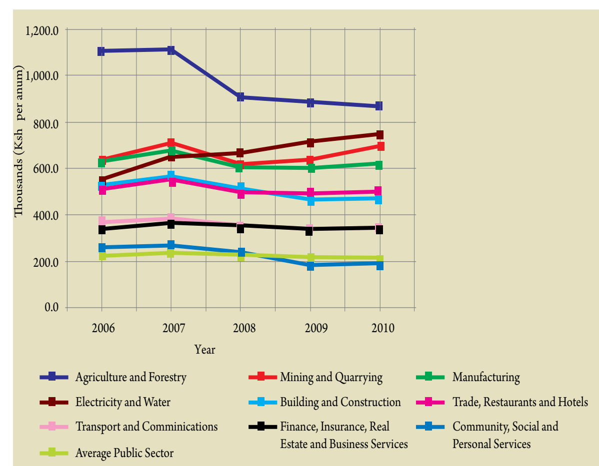


Source: Kenya National Bureau of Statistics (2011) and KIPPRA Computations

Within the public sector, the highest decline in real wages was recorded in mining and quarrying (27%) and finance, insurance, real estate and business services (22%) relative to 2006 real wage. Several other industries within the public sector recorded real wage decline (relative to 2006 wages). The exception was the transport and communications

sector, which recorded an increase of 36 per cent in real wage, and the trade, restaurants and hotels sector in which real average wages rose to about 10 per cent (Figure 3.9).

Figure 3.9: Average real wage earnings per employee (public sector)



Source: Kenya National Bureau of Statistics (2011)

3.3.4 Labour market efficiency

Table 3.4 presents several indicators of labour market efficiency in Kenya. Most indicators did not change significantly between 2008/09 and 2010/11. However, Kenya's ranking in the global economy on most measures changed.

Flexibility in wage determination hardly changed over the period considered. The score remained at 5. Despite this, Kenya's ranking worsened. This suggests that other countries' labour markets became relatively more flexible in wage setting.

Rigidity in employment decreased, meaning that the extent to which workers were allocated to their most efficient use in the economy improved. The indicator of employment rigidity declined (improved) from 27 to 17. Nevertheless, Kenya's ranking worsened. Consistent with less rigid employment, hiring and

Table 3.4: Labour market efficiency for Kenya

Indicator	Definition	Score 2008/09	Rank /134	Score 2009/10	Rank /134
Cooperation in labour-employer relations	Labour-employer relations in your country are (1 = generally confrontational, 7 = generally cooperative)	4.3	85	4.2	83
Flexibility of wage determination	Wages in your country are (1 = set by a centralized bargaining process, 7 = up to each individual company)	5.1	70	5.0	81
Rigidity of employment	Index (0–100) – 100 is worst	21.0	27	17	37
Hiring and firing practices	Hiring and firing of workers in your country? [1 = impeded by regulations; 7 = flexibly determined by employers]	4.7	21	4.9	12
Firing costs	Weeks of wages	47	78	47	81
Pay and productivity	Pay in your country is (1 = not related to worker productivity, 7 = strongly related to worker productivity)	4.5	48	4.0	67
Reliance on professional management	Senior management positions in your country are (1 = usually held by relatives, 7 = held by professional managers chosen based on superior qualification)	4.9	56	4.2	79

Source: World Economic Forum (2010; 2011)

firing became more flexible. The indicator of hiring and firing flexibility rose from 4.7 to 4.9. There was notable improvement in Kenya's ranking in this dimension of flexibility from 21 to 12. Incentives for workers to give their best effort in their jobs weakened. The score measuring the degree to which pay is linked to productivity declined from 4.5 to 4.0. This took Kenya from position 48 to 67 in the global rankings.

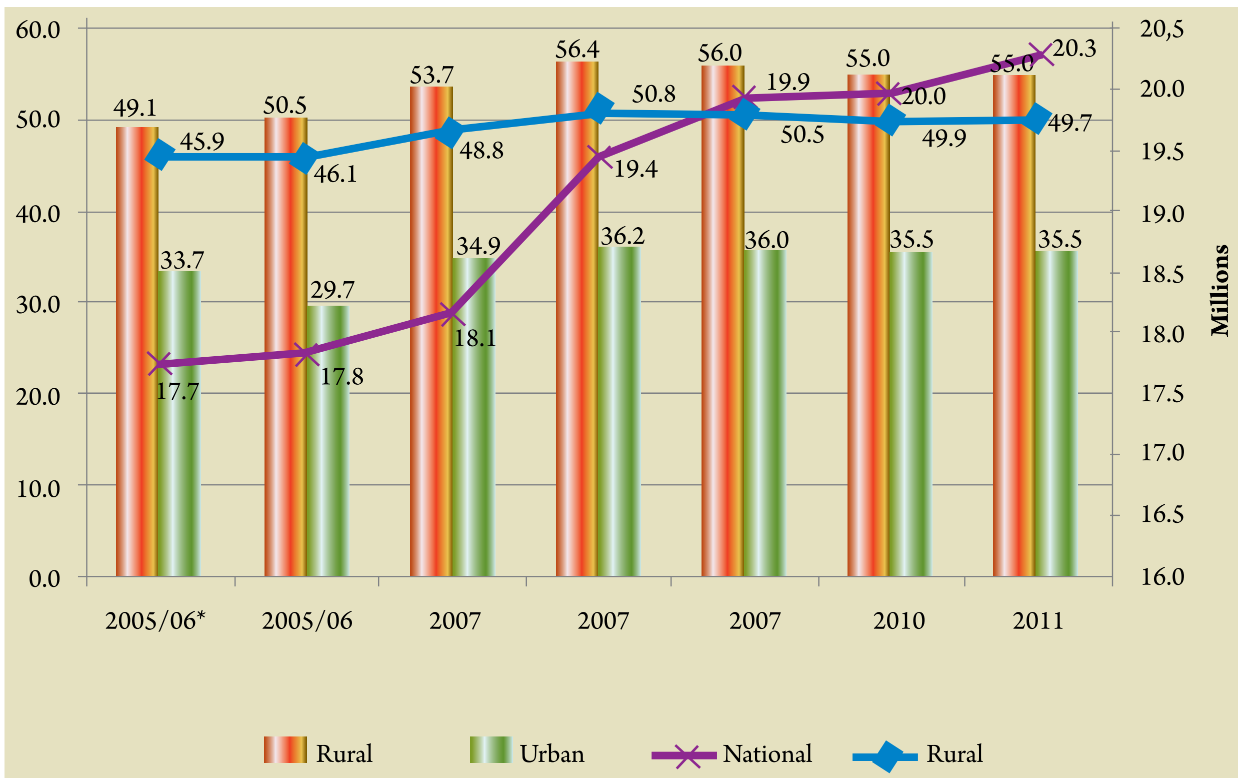
3.4 Poverty and Inequality

Poverty refers to lack of basic necessities of life and opportunities for development. An individual is absolutely poor when he or she cannot raise income to purchase a bundle of basic needs. An individual is relatively poor when he or she cannot purchase a bundle of basic needs available to a reference social group, for example people within the median income bracket.

Poverty can manifest itself in the form of malnutrition, high mortality rate and illiteracy, lack of access to basic education, drinking water, health facilities or decent shelter. Income inequality refers to disparity in income within or across populations. In Kenya, poverty has worsened despite the government's efforts to contain it. The prevalence of poverty is about 46 per cent as reported by the Kenya Integrated Household Budget Survey (KIHBS) (2005/06).

Estimated poverty indices show that between 2005/06 and 2008, both rural and urban poverty increased. It, however, declined slightly in subsequent years. Poverty remained high (over 50%) in the rural areas. This seemed to prove the notion that poverty is a rural phenomenon. Analysis of people in poverty in the respective years indicates that more people fell into poverty. Poor people increased from 18.1 million in 2007 to 19.4

Figure 3.10: Predicted poverty and population numbers, 2005/6-2011



Source: KIPPRA projections computed from Kenya Integrated Household Budget Survey (KIHBS) 2005/06

million in 2008 (an increase of 1.3 million people). This is most likely because of the 2007/2008 post-election violence. The analysis shows that poverty is increasing every year with the rising cost of living. For instance, it is estimated that about 20.3 million people were poor in 2011.

The rising cost of living hampers poverty alleviation efforts. The success of economic growth in alleviating poverty depends on several factors, among them being translating the growth to higher income of the poor, and progressive changes in the distribution of income. A high degree of unequal income distribution can have negative effects on growth and poverty reduction efforts.

Kenya has one of the highest indicators of unequal income distribution among low-income countries. The most widely used measure of inequality is the Gini coefficient, which ranges from 0.3 to 0.6 for most developing countries. In 2005/06, the Gini coefficient for Kenya was 0.38 and 0.45 for rural and urban areas, respectively.

3.5 Health

3.5.1 Overview

Health is the complete state of well being and not merely the absence of disease or injury (World Health Organization, 1948). A country's productivity depends on its citizens' health. It is also important to recognize that guaranteeing good health to all is costly. Health expenditure goes to human resources, health facilities, equipment and medication. Much as it is not given central focus in health discussions and expenditure analysis, provision of water and sanitation is also important for people's health. A healthy nation must spend efficiently on health while aiming to save on health costs. Maintaining good health for a country requires both preventive and curative health. Below are health indicators that need monitoring to facilitate evaluation of health sector performance.

3.5.2 Mortality rates

Table 3.5 shows mortality rates over the period 2005-2010. Mortality rates have declined in recent years. This could indicate improvement in medical services and other interventions such as increased immunization and vaccination services/campaigns, health education campaigns, better treatment in more and improved medical facilities, among others. However, the rates are still within unacceptable levels going by the Millennium Development Goals (MDGs).

Neonatal Mortality: Neonatal mortality varies widely within and across regions in Kenya. For example, trained birth attendants attend to about 80 per cent of births in Nairobi compared to only

Table 3.5: Selected mortality rates and MDG targets

Mortality Rate/Year	1990	2005	2006	2007	2008	2009	2010	2015 MDG* Target
Neonatal Mortality Rate (NMR)	31	30	30	29	29	28	27	10
Infant Mortality Rate (IMR)	64	61	60	59	57	56	55	21
Under Five Mortality Rate (U5MR)	99	98	95	92	89	87	85	33
Maternal Mortality Rate (MMR)	600	409	399	388	378	368	358	150
Adult Male Mortality Rate (AMR)		435	423	410	400	390	380	
Crude Death Rate (CDR)		12	12	12	11	11		

Source: World Bank Database (2012)
Note: * 2015 MDG targets for NMR, IMR and U5MR = one third while MMR = a quarter of the 1990 level

about 10 per cent in North Eastern Kenya. This brings the national average to 44 per cent (Table 3.6). Neonatal mortality lowers with increased level of mothers' education. The rates of antenatal clinic visits and professionally assisted deliveries are also higher among mothers with education.

Of the women receiving antenatal care from a medical professional, 72 per cent are uneducated, 91 per cent have incomplete primary education, and 96 per cent have higher education (UNICEF, 2010). There is need to inform expectant mothers about the benefits of using antenatal services, delivering at a health facility, infants immunization, and proper nutrition, which includes exclusive breast feeding for the first six months of life. To facilitate exclusive breast feeding and hence reduce neonatal and infant morbidity and mortality, employers should give nursing mothers flexible work hours. In this regard, some employers are providing day care facilities within the office environment.

Table 3.6: Antenatal and delivery care (%)

Year	Attendance During Pregnancy	Attendance During Delivery
1989 (DHS)	77	50
1993 (DHS)	95	45
1998 (DHS)	92	44
2000 (MICS)	76	43
2003 (DHS)	88	42
2008-09 (DHS)	92	44

Source: Countdown to 2015 (2010)

Table 3.6 shows the percentage of women aged 15-49 years, attended to at least once by a skilled health provider during pregnancy and at delivery. This rate peaked in the early 1990s, then dropped in 2000 and rose again to over 90 per cent by 2010.

Infant Mortality: This is the number of infants that die before the age of one year per 1,000 live births. Pneumonia is the leading cause of infant mortality in Kenya. It kills over 30,000 children under the age of five, majority of them under one year of age (GAVI Alliance, 2011). Pneumonia accounts for the death of about 16 per cent of children under 5, after diarrhoea (20%) and Malaria (11%). In early 2011, a vaccine was introduced in Kenya to combat pneumonia and meningitis. It was expected to lower infant mortality from about 61 deaths per 1,000 in 2005 to about 55 in 2010 (Table 3.7). In addition to immunization programmes, Vitamin A supplementation and oral rehydration therapy can further reduce infant mortality. Coverage of under five year old children given Vitamin A supplements was 27 per cent in 2008, rising to 51 per cent in 2009.

Under Five Mortality: This is the number of children per 1,000 live births who die before the age of five years. The major causes of death are pneumonia, diarrhoea, malaria, measles, and HIV/AIDS. In Kenya, under 5 mortality rate was 85 deaths per 1,000 live births in 2010. The MDG 4 target is 33 deaths per 1,000 live births. The average rate of reduction has been 0.8 per cent between 1990 and 2010 (Table 3.7), which is below MDG 4 target of 4 per cent.

From Table 3.7, Kenya has notably been overtaken by countries such as Tanzania and Ghana, which started with a higher rate of under five mortality but had a higher rate of reduction (3.6 and 2.5, respectively) such that by 2010, their rates were lower. These countries are relatively closer to achieving MDG 4. There is need for interventions to deal with the main child killer diseases, enhance appropriate vaccinations and prevent transmission of HIV from mother to child.

Maternal Mortality: This is the number of women who die during pregnancy or at childbirth per 100,000 live births. In 1990, the global maternal mortality ratio (MMR) was 430 per 100,000 live births. Kenya's MMR was 600. Although this declined to 368 per 100,000 live births by 2009, it was still much higher than the MDG 5 target of 147 per 100,000 by 2015. In Kenya, maternal mortality

Table 3.7: Under five infant and neonatal mortality rates: Kenya and comparator countries

	Under 5 Mortality			Infant Mortality		Neonatal Mortality	
	1990	2010	% Fall	1990	2010	1990	2010
South Africa	60	57	0.3	47	41	18	18
Kenya	99	85	0.8	64	55	31	28
Botswana	59	48	1.0	46	36	22	19
United States	11	8	1.6	9	7	6	4
South Korea	8	5	2.4	6	4	3	2
Ghana	122	74	2.5	77	50	38	28
Uganda	175	99	2.8	106	63	36	26
United Kingdom	9	5	2.9	8	5	5	3
Tanzania	155	76	3.6	95	50	40	26
Germany	9	4	4.1	7	3	4	2
Malaysia	18	6	5.5	15	5	9	3

Source: UNICEF et al (2011)

accounts for 15 per cent of all deaths of women aged 15-49 years. Further, women below age 20 and above 40 years are at a higher risk than those within the 20-40 age bracket.

Maternal deaths are largely due to low attendance by skilled birth attendants, and lack of essential obstetric care. The highest percentage of deaths is caused by haemorrhage (34%) followed by hypertension (19%) (Countdown to 2015, 2010). Women are encouraged to attend antenatal clinic and give birth in medical facilities for prevention of mother to child transmission of HIV, and safe delivery. In areas with poor coverage of medical facilities, community birth attendants are trained to assist in deliveries.

Adult Mortality: This is the number of deaths per 1,000 adults. Table 3.8 shows adult mortality in Kenya and other comparator countries since 2008.

Table 3.8: Adult mortality rate: Kenya and comparator countries

Country/Year	2008	2009
Botswana	533.7	545.3
South Africa	538.1	539.5
Uganda	408.4	400.5
Kenya	389.1	379.0
Tanzania	375.3	363.9
Nigeria	390.4	384.6
Ghana	250.2	245.1
Indonesia	198.7	192.9
Egypt	117.2	114.8
Chile	92.4	91.2
Korea	73.8	70.3
Germany	78.2	

Source: World Bank (2011)

Table 3.9 shows the main causes of death in Kenya by region, with malaria, pneumonia, AIDS, tuberculosis and cancer taking the lead in that order.

3.5.3 Morbidity and burden of disease

The KIHBS 2005/06 showed that on average, 27.4 per cent (30% of females and 24% of males) reported illness. Mortality figures for Nyanza and Western were above average, with 36.9 per cent and 39.5 per cent of the population, respectively, reporting illness. This correlates closely with the prevalence of malaria in the two regions despite the high use of insecticide-treated mosquito nets in Nyanza at 45.1

Table 3.9: Causes of death by region in 2010

Cause of Death	Nairobi	Central	Western	Coast	Nyanza	Eastern	North Rift	South Rift	North Eastern	Total
Tuberculosis	1,391	1,304	1,523	866	2,799	1,696	374	784	52	10,789
Cancer	1,070	1,644	1,796	567	1,832	1,526	724	890	64	10,113
Malaria	983	1,663	8,481	1,694	8,565	4,621	1,263	1,234	156	28,660
Meningitis	823	431	380	289	902	433	508	389	10	4,165
Anaemia	543	972	1,509	865	1,538	1,118	376	508	51	7,480
Heart Disease	616	1,262	448	198	600	603	399	455	24	4,605
Pneumonia	2,131	3,750	2,169	1,095	3,046	3,605	1,417	2,236	59	16,508
AIDS	911	1,482	1,813	946	2,253	2,163	893	1,248	7	11,716
Road Traffic Accidents	904	6,488	167	293	478	504	576	498	8	4,076
Other Accidents	1,656	522	166	225	425	568	474	383	16	4,435

Source: Kenya National Bureau of Statistics (2011)

per cent of the population (Government of Kenya, 2008).

Table 3.10 shows the burden of disease over the period 2006-2010. Again, Malaria has the largest burden, causing about 30 per cent morbidity. Diseases of the respiratory system, which cause about 25 per cent of morbidity, follow closely.

Table 3.10: Incidence of disease (%)

	2006	2007	2008	2009	2010*
Malaria	28.6	30.8	32.8	31	29.7
Diseases of the respiratory system	22.4	24.5	24.1	25	25.5
Diseases of the skin	5.8	6.1	7	7	7.1
Diarrhoea	4.4	4.7	4.9	5	4.8
Intestinal worms	4.1	4.3	1.2	1	1.1
Pneumonia	2.8	3	3.5	3	2.8
Accidents	2.2	2.4	2	2	1.9
Rheumatism	1.7	1.9	1.7	2	1.7
Urinary tract infections	1.6	1.8	2.3	2	1.7
Eye infections	1.5	1.6	1.7	2	1.7
All other diseases	24.9	18.5	18.8	21	22.1
Total	100	100	100	100	100

Source: Kenya National Bureau of Statistics (2011)

Malaria: Malaria is the main killer disease in the tropics. It causes nearly 30 per cent of morbidity in Kenya. Nyanza and Western regions bear the greatest burden (Table 3.9 and 3.10). The key intervention for reducing morbidity and mortality from Malaria includes provision of free insecticide-treated nets (ITNs), especially for pregnant women (40% coverage) and children under 5 (39% coverage) (WHO, 2009). Fifty-four per cent (54%) of households in Kenya own at least one treated mosquito net (UNICEF, 2010). Other interventions include artemisinin-based combination therapy (ACTs), and the Haemophilus influenza type B (Hib) vaccine.

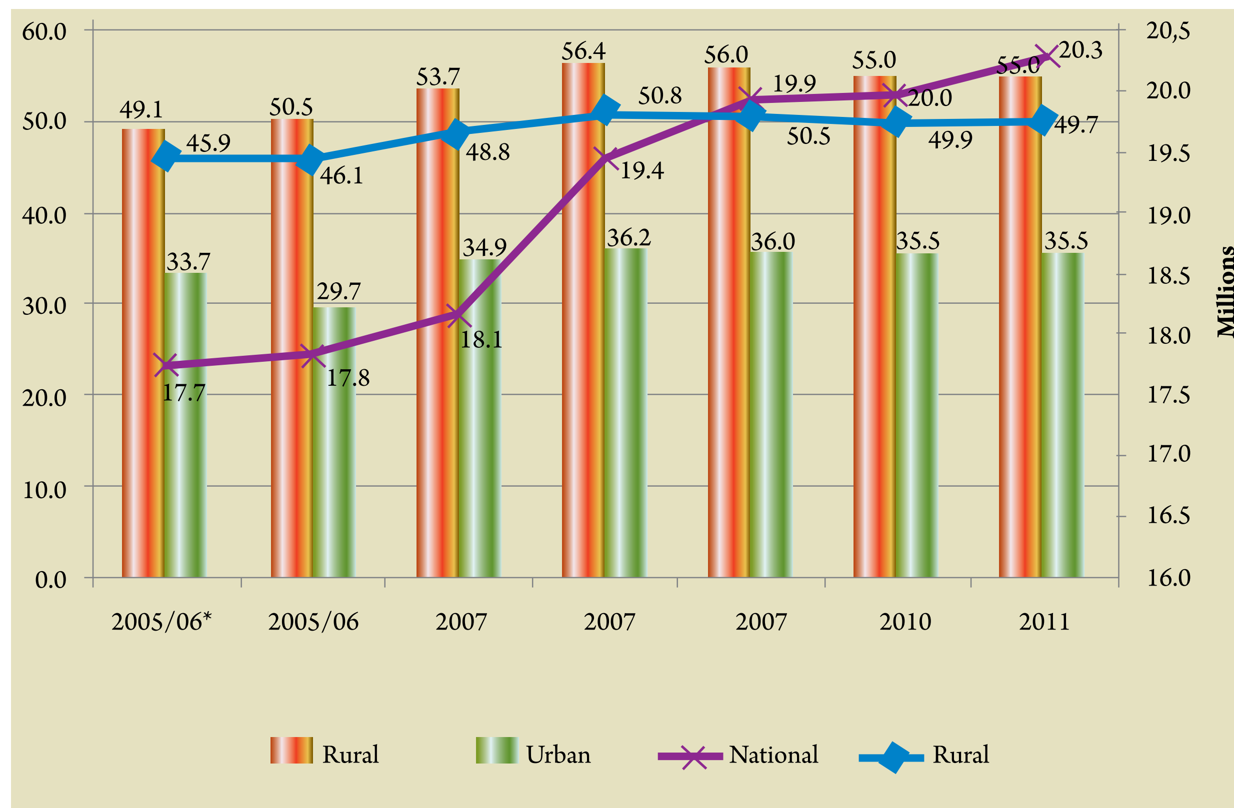
Tuberculosis (TB): There are several types of TB. The most prevalent affects the respiratory system. In Kenya, respiratory diseases are responsible for 25.5 per cent of morbidity, coming second to

Malaria (Table 3.10). TB prevalence is about 319 per 100,000 of the population. Globally, Kenya ranks 13th among the 22 high burden countries that contribute about 80 per cent of TB cases. In Africa, Kenya ranks 5th (USAID, 2009). Between 1987 and 2009, prevalence rose from 51 to 326 cases per 100,000 of the population, mostly due to HIV related infections. Rising poverty levels also contributed to this. Notably, there were many new infections in low-income urban neighbourhoods. Trends in case notifications show a general increase in TB prevalence (Figure 3.11).

To achieve MDG 5, the government must sustain the progress it has made and continue detecting up to 70 per cent of new infections and cure 85 per cent of detected cases annually. Promoting the integration of the International Standards for Tuberculosis Care (ISTC) implemented in Kenya in 2008 is a key part of TB control programmes.

HIV/AIDS: About 1.3-1.6 million Kenyans are HIV positive. Of adults aged 15-64 years, rural prevalence of HIV/AIDS is lower at 6.7 per cent compared with urban prevalence of 8.4 per cent. In 2009, there were about 100,000 new infections. About 22,000 of these were children. Married people are at a higher risk of contracting HIV. They contribute nearly 44 per cent of new infections (UNGASS/Government of Kenya, 2010). Compared to men, women are at a higher risk of contracting the virus. Prevalence of the disease in women is about 8.4 per cent and 4.3 per cent in men (KNBS, 2010). The prevalence is higher for 15-24 year old women (5.6%), which is four times higher than that of male youth of the same age. Homosexuals and prisoners, female sex workers and their clients and injecting drug users are also at a high risk. Prevalence rates are 15 per cent for homosexuals and prisoners, 14 per cent for female sex workers and their clients, and 3.8 per cent for injecting drug users.

Figure 3.11: TB case trends in Kenya



Source: Ministry of Public Health and Sanitation (2010)

Kenya depends heavily on external funding for HIV programmes. With funding from the Global Fund, Kenya has substantial resources for HIV programmes. This funding amounts to nearly Ksh 30 billion, Ksh 4 billion of this is allocated to NGOs in the health sector and about Ksh 25.6 billion allocated to service provision in government health facilities. The country can apply for additional funding in 2014 after preparing a concept note in accordance with the new system of application requirements. Kenya should emulate middle-income countries such as China, India, Mexico and Brazil, which no longer rely on the Global Fund.

Between 2008 and 2009, the uptake of ARVs (Table 3.11) improved greatly for adults. The ARV uptake for children, which was already low at 26 per cent, declined. Uptake is high among pregnant women at over 70 per cent. Kenya has improved testing during antenatal visits and education on prevention of mother to child infections. Treatment and care programmes are also integrating nutritional supplements. However, under-nutrition in People Living With HIV/AIDS (PLWHA) is a major concern because many have a body mass index (BMI) of less than 18.5. The aim of the ARV programme is to provide PLWHA *inter alia*, with therapeutic supplemental food and dietary commodities. Adult under-nutrition varies from 15-65 per cent, while that of children is 30 per cent (Government of Kenya, 2008).

About 6.3 per cent of men have multiple partners in their lifetime compared to 2.1 per cent of women. This explains why women are at a higher risk of contracting HIV/AIDS because one infected man may infect up to ten women in his lifetime. Condom usage has increased significantly, with 61.5 per cent of the men and 35 per cent of the women reporting using one in their last intercourse according to the 2008/09 Kenya Demographic and Health Survey–KDHS (UNGASS/Government of Kenya, 2010). Improved availability and access to condoms by the sexually active population may reduce the rate of new infections.

In addition to the ongoing preventive measures, Kenyans should make documentaries of advanced cases of HIV/AIDS and life experiences of children orphaned by AIDS. The number of orphans was about 1.2 million in 2009. Images of misery from the disease and its repercussions may play a deterrent role against careless sexual behaviour.

Diarrhoeal Diseases: Children under the age of five and adults in advanced stages of HIV/AIDS are particularly vulnerable to these diseases. Globally, the rotavirus (RV) causes the most cases of diarrhoea and dehydration. This virus is more prevalent in poor developing countries, and is also more common in some seasons. A RV vaccine has been on trial in Kenya and other countries. It has prevented a significant number of severe diarrhoea

Table 3.11: ARV uptake in Kenya

Social group		2008		2009	
		Number	%	Number	%
Percentage of adults and children with advanced HIV infection receiving anti-retroviral therapy	Adults	230,059/416,000	55.3	308,610/ 438,000	70.4
	Children	20,576/ 78,000	26.4	28,370/ 117,000	24.2
Percentage of HIV-positive pregnant women who received anti-retroviral drugs to reduce risk of mother-to-child transmission		59,601/ 81,000	73.6	58,591/ 81,000	72.3

Source: UNGASS (2010)

episodes among vaccinated children (GAVI Alliance, 2010) with less severe re-infection, during which immunity is reinforced.

Road Accidents: The rate of traffic accidents in Kenya is extremely high. Traffic accidents resulted in more than 4,000 deaths in 2010, and many more cases of permanent disability. Many accident victims suffer injuries and are admitted in hospitals. This translates to increased pressure on health facilities and high medical bills.

3.5.4 Public expenditure on health

The key objective of the government is to make health care services accessible and affordable to all Kenyans. In line with this objective, Ksh 64 billion of the national budget was allocated to the health sector in 2011/12. Of this, Ksh 903 million was allocated to ARVs, Ksh 534 million to rehabilitation of health facilities and Ksh 150 million to acquisition of modern medical equipment. The government was especially keen on purchasing equipment for screening breast and cervical cancers. About Ksh 6.6 billion was allocated to immunization programmes, which indicates a strong commitment to preventive health care in government (Government of Kenya, 2011).

While the public health system is mainly financed from the national budget, private-not-for-profit facilities rely on a variety of income sources such as user fees, contributions from donors, partners and government. For funding, private health facilities rely mainly on user fees.

In 2008/09, total health expenditure was about Ksh 84 billion (Table 3.12). This was approximately 4 per cent of GDP. The 2011/12 budget allocation to health was Ksh 64 billion because development partners were financing health services directly rather than through the budget. About 56 per cent of the health expenditure is off-budget, meaning it is financed directly by partners or donors. Most of the central government spending goes to curative care, while off-budget spending mainly supports preventive and promotive health services.

When Kenya's per capita government expenditure in 2008/9 of US$ 13.00 is compared with per capita expenditure of US$ 7,164 for USA, Germany's US$ 3,922, Canada's US$ 3,864, UK's US$ 3,222, Korea's

Table 3.12: Health sector expenditure (Ksh billion)

	2005/6	2006/7	2007/8	2008/9	2009/10
Central Government	23.00	30.20	32.80	36.10	39.90
On-budget, donors	0.53	2.63	3.10		
Off-budget, donors				42.70	56.40
Constituency Development Fund	0.65	0.88	0.79		
Local Authority Transfer Fund	1.32	1.35	1.54	1.63	
US Government				42.70	45.70
Clinton Foundation					6.90
Department for International Development, UK					3.80
Hospital fees		1.57	2.35	2.35	
Other sources	1.47	1.42	1.57	1.80	
Total Health Spending	26.97	38.05	42.15	84.58	96.30
Per cent of GDP	1.90	2.30	2.30	4.00	4.40

Source: Government of Kenya (2010)

Table 3.13: Government health spending per capita and as a percentage of GDP

Expenditure	2003/4	2004/5	2005/6	2006/7	2007/8	2008/9
Government health spending (Ksh billion)	16.80	19.50	23.0	30.20	32.80	36.10
Health per capita Ksh (current prices)	461.38	477.16	653.51	706.09	814.77	945.35
Health per capita Ksh (constant prices)–base is 2003)	461.38	445.42	581.54	628.62	640.11	656.74
Health per capita (US$)	5.80	6.30	9.10	10.50	11.60	13.40
Health spending as percentage of GDP	1.31	1.25	1.58	1.51	1.65	1.70

Source: Government of Kenya (2010b)

US$ 1,806, Singapore's US$ 1,833, Ghana's US$ 114, Uganda's US$ 112, and Tanzania's US$ 57, the Kenya's health sector is clearly grossly under-funded (WHO, 2011).

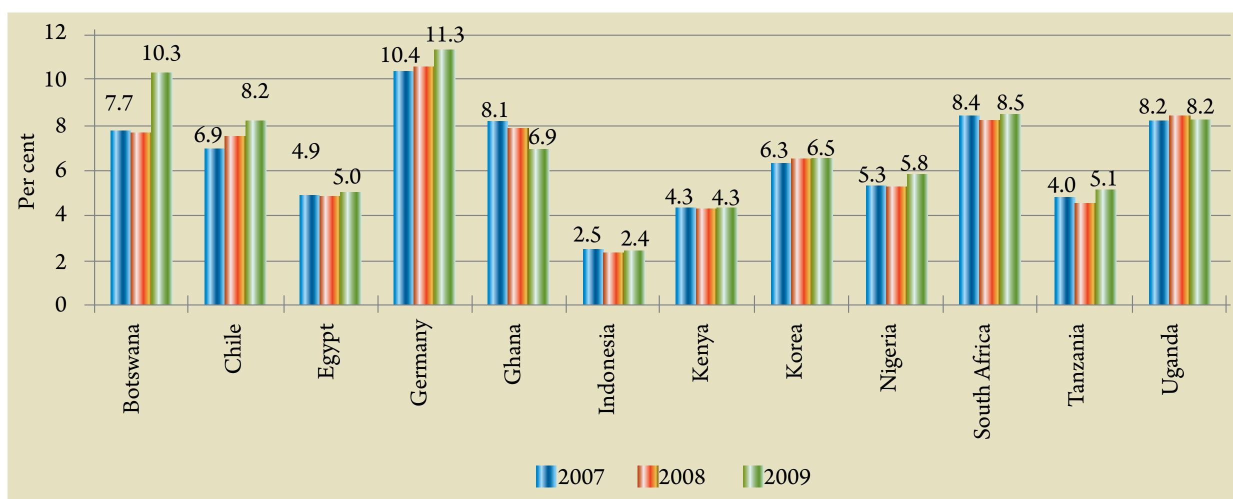
Kenya should increase expenditure on health to reduce prevalence of diseases that cause morbidity and mortality.

Figures 3.12 and Table 3.14 show the GDP per capita (in ascending order), the proportion of the GDP spent on health care, and health expenditure in per capita international dollars in comparator countries for the period 2007-2010. Except Botswana, South Africa, Ghana and Uganda, the per capita health expenditure in African countries is negligible compared to developed and emerging economies. Governments should increase expenditure on health to increase human capital productivity.

Table 3.14: Health expenditure per capita, PPP (constant 2005 international $): Kenya and comparator countries

Country/Year	2007	2008	2009
Botswana	1,025.7	1,052.6	1,340.7
Chile	955.8	1,088.5	1,172.3
Egypt	249.2	261.4	285.2
Germany	3,706.3	3,922.0	4,128.6
Ghana	110.2	113.9	103.8
Indonesia	92.8	90.6	99.2
Kenya	66.6	65.7	68.2
Korea	1660.3	1805.9	0.0

Figure 3.12: Health expenditure (% of GDP): Kenya and comparator countries



Source: World Bank (2011)

Country/Year	2007	2008	2009
Nigeria	105.1	112.7	136.2
South Africa	824.7	843.2	861.6
Tanzania	57.1	57.4	67.5
Uganda	97.4	112.5	114.9

Source: World Bank (2011)

3.5.5 Child health

Immunization programmes

Immunization coverage is 76 per cent, but this is still much lower than the MDG target of at least 90 per cent coverage at the national level and at least 80 per cent at the district level (UNICEF, 2010). Common diseases against which basic immunization is given include tuberculosis, polio, tetanus, rubella, mumps, whooping cough, and diphtheria. Table 3.15 shows immunization coverage rates for one-year-old children in Kenya.

Of the 42 per cent of the health budget allocated to preventive and promotive care, a substantial component goes to immunization programmes. Routine immunization expenditure was US$ 4.8 million in 2006, US$ 8.2 million in 2007 and US$ 83,435 in 2008. According to WHO immunization profile, US$ 249 million was spent on the routine immunization programme in Kenya in 2010, with the government contributing 54 per cent. Another 22 per cent came from sub-national governments. The major funding partners for immunization include GAVI, WB, UNICEF, WHO, DANIDA, DfID and JICA. Preventive activities in areas of vaccination and nutrition require a greater focus in financial allocations in order to reduce infant and child mortality in accordance with MDGs.

Life expectancy

Life expectancy is the number of years a newborn child is expected to live if current mortality patterns prevail over its life time. The HIV/AIDS epidemic brought down life expectancy in Kenya and other Sub-Saharan countries. However, with the introduction of ARVs and counselling on positive living, PLWA (People Living With AIDS) are living longer. This is lengthening life expectancy. There is also a decline in mortality rates in Sub-Saharan Africa (SSA), mostly due to improvement in immunization and basic health services. A rise in HIV/AIDS is associated with a reduction in life expectancy by at least 10 years. Figure 3.13 shows total HIV prevalence and life expectancy, while Figure 3.14 shows life expectancy with and without HIV/AIDS.

Life expectancy without HIV has been improving gradually. However, life expectancy for both males and females with HIV declined through the 1990s, then improved in mid 2000s. This was mostly due to ARV uptake and improved health services. Life expectancy with and without HIV was the same in 1980-1990 but diverged thereafter.

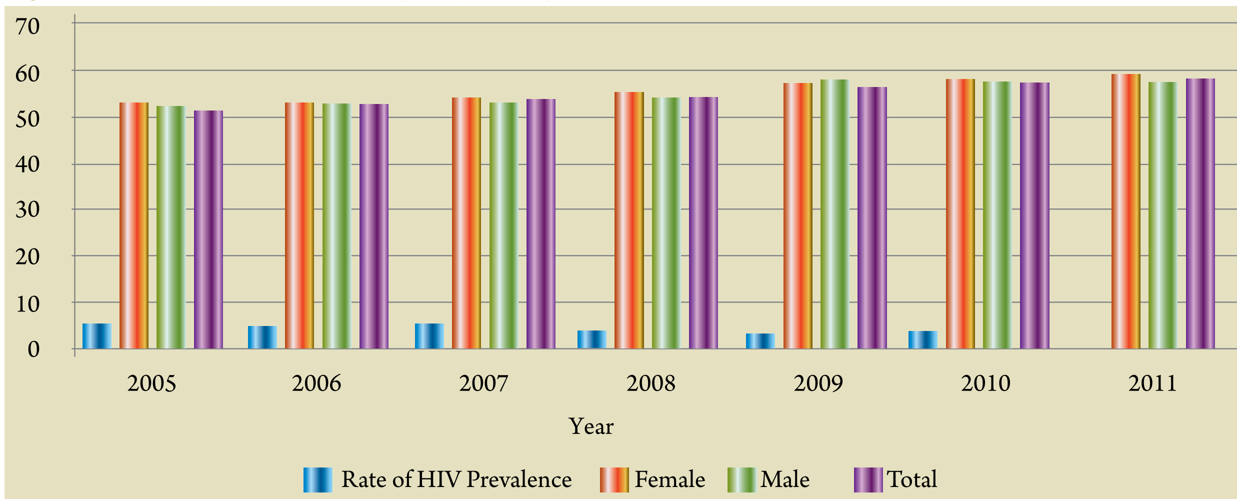
Kenya compares fairly with other SSA countries. However, Kenya is behind countries such as Chile, Korea and Germany (Figure 3.15). Notably, countries that allocate a relatively large proportion

Table 3.15: Immunization coverage for one year olds, Kenya

Vaccine	2002	2003	2004	2005	2006	2007	2008	2009	2010
Measles	78	72	73	69	77	80	90	88	86
DPT3	84	73	73	76	80	81	85	84	83
HipB3	84	73	73	76	80	81	85	84	83
BCG	91	87	87	85	92	92	95	97	99
Polio	83	75	73	70	77	76	84	84	83

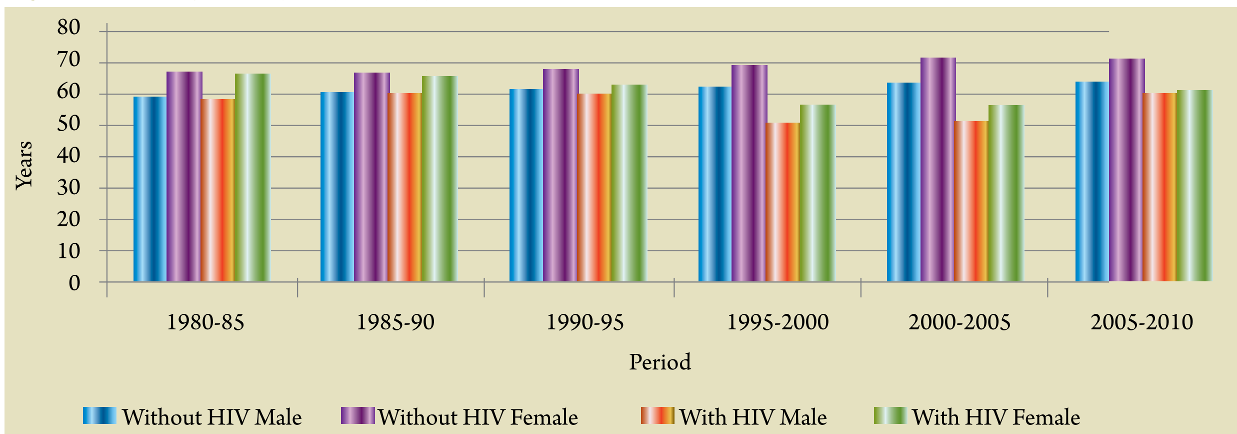
Source: World Health Organization–WHO (2011)

Figure 3.13: HIV prevalence and life expectancy at birth



Source: World Bank (2010); WHO (2011); Population Reference Bureau (2011)

Figure 3.14: Projected life expectancy with and without HIV



Source: Kenya National Bureau of Statistics (2011)

of their GDP on health care have a higher life expectancy. Developing countries, and especially countries in SSA, need to emulate this to improve health outcomes and life expectancy.

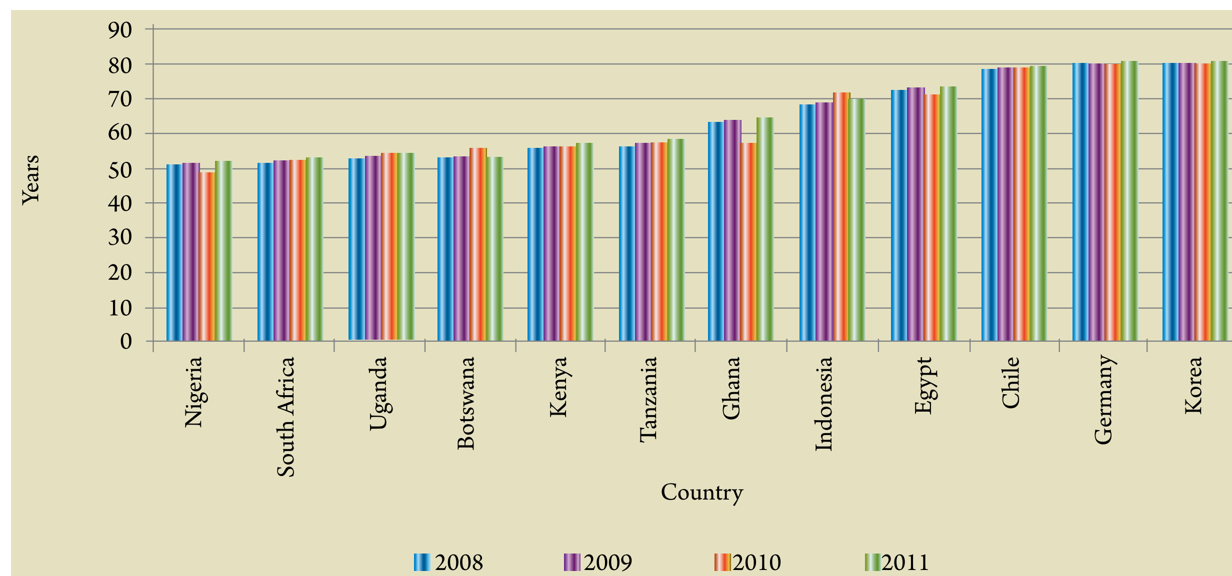
3.6.6 Human resources for health

The WHO recommends at least 23 doctors, nurses and midwives per 10,000 people. Kenya has one doctor, 12 nurses and midwives per 10,000 people. Although Kenya trains enough personnel for the health sector, many migrate to Botswana, South Africa, OECD countries and North America for better remuneration and working conditions. Doctors in Kenya went on strike at the end of 2011 protesting poor pay, poor working conditions and being overworked. The government should take proactive measures to reduce migration of locally trained health personnel by improving financial benefits and working conditions. The USAID is working with Pathfinder International and the Ministry of Health to enhance human resources for health and capacity to cope with the rising HIV/AIDS case load.

Health facilities

Table 3.16 and 3.17 lists the number of facilities by type and ownership as at 7th February, 2012. Most

Figure 3.15: Life expectancy at birth, years



Source: World Bank (2011), UNDP (2010 and 2011)

of the listed facilities are public. Several private and faith-based health facilities are also listed.

Table 3.16: List of health facilities by type

Type of Facility	No. of Facilities Listed
Dental Clinic	11
Dispensary	4,003
Eye Centre	5
Funeral Home (Stand-alone)	2
Health Centre	896
Health Programme	7
Health Project	3
Laboratory (Stand-alone)	32
Maternity Home	39
Medical Centre	5
Medical Clinic	2,216
National Referral Hospital	3
Not Listed	26
Nursing Home	160
Other Hospital	215
Provincial General Hospital	9
Radiology Unit	4
Regional Blood Transfusion Centre	1
Rural Health Training Centre	1
Sub-District Hospital	127
Training Institutions (Stand-alone)	2
VCT Centre (Stand-Alone)	109
Total	7,876

Source: eHealth-Kenya (2012)[1]

Table 3.17: Number of health facilities by type of ownership

Owner	No. of Facilities
Central Government	3,794
Ministry of Health	3,697
Armed Forces	23
State Corporation/Parastatal	10
Other Public Institutions	64
Local Government	111
Local Authority	106

Owner	No. of Facilities
Local Authority Transfer Fund (LATF)	5
Community	245
Communities	119
Community Development Fund	44
Company Medical Service	82
Faith-Based/NGO	1,205
Christian Health Association of Kenya	365
Kenya Episcopal Conference - Catholic Secretariat	359
Non-Governmental Organizations	212
Supreme Council for Kenya Muslims	12
Other Faith-Based Institutions	257
Private	2611
Private Enterprises (Institutions)	1,384
Private Practice - Clinical Officers	281
Private Practice - General Practitioners	108
Private Practice - Medical Specialists	76
Private Practice - Nurses/ Midwives	651
Private Practice–Unspecified	96
Academic (if registered)	15
Others	30
Total	8,005

Source: eHealth-Kenya (2012)

Table 3.18 shows health facilities by county, and the population density per facility. On average, one health facility serves about 4,836 people. Mandera and Bungoma are outliers with very high population per facility. Facilities in Nyeri, Lamu, Mombasa and Kirinyaga counties serve fewer people.

Table 3.18: Number of medical facilities listed by county

S No.	Counties	Number of Facilities Listed	Popula-tion	Popula-tion per Facility*
1.	Baringo	183	555,561	3035.9
2.	Bomet	146	724,186	4960.2
3.	Bungoma	136	1,630,934	11992.2
4.	Busia	84	488,075	5810.4
5.	Elgeyo Ma-rakwet	123	369,998	3008.1
6.	Embu	140	516,212	3687.2
7.	Garissa	104	623,060	5991.0
8.	HomaBay	185	963,784	5209.6
9.	Isiolo	41	143,294	3495.0
10.	Kajiado	209	687,312	3288.6
11.	Kakamega	209	1,650,651	7897.9
12.	Kericho	150	758,339	5055.6
13.	Kiambu	418	1,623,282	3883.4
14.	Kilifi	232	1,109,735	4783.3
15.	Kirinyaga	241	528,054	2191.1
16.	Kisii	162	1,152,282	7112.9
17.	Kisumu	145	968,909	6682.1
18.	Kitui	277	1,012,709	3656.0
19.	Kwale	94	649,931	6914.2
20.	Laikipia	85	399,227	4696.8
21.	Lamu	43	101,539	2361.4
22.	Machakos	271	1,098,584	4053.8
23.	Makueni	181	884,527	4886.9
24.	Mandera	69	1,025,756	14866.0
25.	Marsabit	83	291,166	3508.0
26.	Meru	343	1,356,301	3954.2
27.	Migori	180	1,028,579	5714.3
28.	Mombasa	346	939,370	2714.9
29.	Murang'a	243	942,581	3878.9
30.	Nairobi	508	3,138,369	6177.9
31.	Nakuru	327	1,603,325	4903.1
32.	Nandi	166	752,965	4535.9
33.	Narok	148	850,920	5749.5
34.	Nyamira	102	598,252	5865.2
35.	Nyandarua	127	596,268	4695.0
36.	Nyeri	383	693,558	1810.9
37.	Samburu	68	223,947	3293.3

S No.	Counties	Number of Facilities Listed	Population	Population per Facility*
38.	Siaya	156	842,304	5399.4
39.	Taita Taveta	82	284,657	3471.4
40.	Tana River	58	240,075	4139.2
41.	Tharaka-Nithi	93	365,330	3928.3
42.	Trans Nzoia	85	818,757	9632.4
43.	Turkana	137	855,399	6243.8
44.	Uasin Gishu	172	894,179	5198.7
45.	Vihiga	80	554,652	6933.2
46.	Wajir	104	661,941	6364.8
47.	West Pokot	86	512,690	5961.5
	Total	8005	38,711,526	4835.9

Source: eHealth-Kenya (2012); TISA[2] *Computation by author

3.5.7 Conclusion and recommendations

Conclusion

The government must invest a significant percentage of its GDP and the budget on health to give its people a complete state of well-being and high human capital productivity. Although Kenya fares well on main health indicators such as mortality and morbidity rates compared with other SSA countries, the country is still far from reaching the levels of newly industrialized countries such as South Korea and developed countries such as Germany.

When Malaria and Pneumonia vaccines are used fully, the burden of disease will reduce significantly because the two are the leading causes of morbidity in Kenya. Malaria, respiratory diseases, TB, pneumonia, AIDS and cancer impart the greatest disease burden and are also the major causes of death. Preventive measures can free resources for other health needs. Maternal and neonatal mortality can be reduced significantly if skilled health workers attend to mothers during delivery.

Between 1.3 million and 1.6 million Kenyans are HIV positive. Annually, about 100,000 new infections are reported, majority of these being young women. Risky behaviour such as having multiple partners exposes women to the highest risk of infection.

International development partners such as USAID have helped Kenya to enhance healthcare through capacity building of human resources for health.

Recommendations

There is need for interventions to deal with the main causes of infant mortality and to enhance appropriate vaccinations and prevent transmission of HIV from mother to child to achieve MDG 4. Such interventions may include employers allowing nursing mothers flexible hours of work, and/or providing baby-care facilities within work premises to facilitate prolonged breast feeding, and therefore reducing neonatal and infant morbidity and mortality.

More focus must be placed on preventive health care such as immunization and vaccination, and campaigns that include hand washing and treatment of drinking water. These can effectively reduce diarrheal diseases. Positive living, including proper nutrition and regular exercise, should be encouraged in order to improve curative health care as well as health indicators such as mortality, morbidity, life expectancy at birth, among others.

Kenya must reduce and reverse HIV infections by up-scaling availability and access of condoms by the sexually active population. In addition, airing documentaries of advanced cases of HIV/AIDS, and life experiences of children orphaned by AIDS as deterrence to careless sexual behaviour is recommended. Screening for HIV should be mandatory for couples (both men and women) during antenatal clinics to enhance uptake of ARVs, leading to higher life expectancy, increased productivity of the infected, and reduced need for

care. Counselling helps newly diagnosed patients to cope with the news, and to adjust and live positively.

Road accidents contribute significantly to morbidity and death in Kenya. For this reason, relevant authorities should retrain drivers on road safety and First Aid, considering that drivers are usually among the first to arrive at accident scenes.

Risky habits such as drunk driving, lack or improper use of safety belts, driving vehicles that are not roadworthy, and riding motorbikes without safety gear such as helmets must be outlawed. Instant fines should be levied on offenders. Reduced accidents and related injuries would directly affect health care expenditure and save on human and other resources.

The government must take proactive measures to reduce loss of locally trained health personnel to other countries. Such interventions should include improved financial benefits and working conditions, as well as incentives such as improved opportunities for further training, and dual practice in which trained professionals can serve in government institutions when required as they run private practice. Clearly set out fees and easy fee claim system should be put in place to prevent corrupt practices and pilferage of medical materials and equipment, and time wastage.

3.6 Education

3.6.1 Overview

The Government of Kenya has invested in education and training to promote sustainable human resource development, and attain national development goals, including the Kenya Vision 2030 objectives. However, low schooling levels are an obstacle to achieving these objectives. According to the KIHBS 2005/06 and the population census of 2009, the average years of schooling is 8.4. Only about 15.5 per cent of persons aged 15 and above have attained secondary education and above. Whereas Kenya's education level is close to the Sub-Sahara Africa's average, the average years of schooling are low compared to newly industrialized countries (NICs) such as Korea and Malaysia.

Moreover, Kenya is yet to meet the national target of 12 years of compulsory basic education for children aged between 6 and 17 years. Internal efficiency in the education system is low as evidenced by low completion and low progression to tertiary education and labour market. The quality of education is also wanting.

3.6.2 Provision of education services

Table 3.19 presents data on the number of education and training institutions in the country in the period 2008-2010. Overall, education institutions increased by 4 per cent from 71,590 institutions in 2008 to 74,408 institutions in 2010. Pre-primary education schools increased from 37,954 in 2008 to 38,523 in 2010. Enrolment also increased from 1.7 million to 2.2 million children. Primary schools increased from 26,206 to 27,489, and enrolment increased from 8.6 million to 9.4 million pupils. Schools increased from 6,566 in 2008 to 7,308 in 2010, and enrolment increased from 1.4 million to 1.7 million.

Table 3.19: Number of education and training institutions, 2008-2010

School category	2008	2009	2010
Pre-primary	37,954	38,247	38,523
Public	23,783	23,823	23,980
Private	14,171	14,424	14,543
Primary	26,206	26,667	27,489
Public	18,130	18,543	19,059
Private	8,076	8,124	8,430
Secondary	6,566	6,971	7,308
Public	4,454	5,019	5,296
Private	2,112	1,952	2,012

School category	2008	2009	2010
Pre-primary teacher training colleges	34	71	125
Public	21	20	20
Private	13	51	105
Primary teacher training colleges	96	105	110
Public	21	20	21
Private	75	85	89
Secondary diploma colleges	2	3	3
TIVET institutions	704	807	818
Youth polytechnics	654	754	765
Institutes of technology	23	24	24
Technical training institutes	24	22	22
National polytechnics	3	5	5
Polytechnic university colleges	-	2	2
Universities	28	31	32
Public	7	7	7
Private	21	24	25
Total	71,590	72,902	74,408

Source: Kenya National Bureau of Statistics (2011)

With the expansion of primary and secondary education, tertiary education remains the next sub-sector for expansion through infrastructure and equipment, including ICT, which are critical to skills development. At the TIVET level, enrolment has declined from 85,200 in 2008 to 104,173 in 2011. In 2008, the Kenya Polytechnic and Mombasa Polytechnic were converted to university colleges. The Eldoret and Kisumu polytechnics remained as the only national polytechnics. In 2010, there were 22 technical training institutes, 24 institutes of technology and 765 youth polytechnics, 21 public primary teacher training colleges, 89 private primary teacher training colleges, and 3 secondary teacher training colleges. Enrolment in teacher training colleges increased from 24,228 in 2008 to 28,466 (14,427 male and 14,039 female) in 2010 (Table 3.19).

In 2009, most of the public and private universities were in Nairobi (13). Provinces with the fewest universities were Coast and Western (2). North Eastern Province had no university.

Private universities increased from 21 in 2008 to 25 in 2010, while public universities expanded their constituent colleges and campuses across the country. Mainstream universities, however, remained the same at seven over the review period. Enrolment has grown from 118,239 (70,775 male and 47,464 female) in 2007/08 to 180,978 (111,050 male and 69,928 male) students in 2010/11 academic year.

The government should focus on expansion, management and financing of education infrastructure to accommodate the rising demand for education. It should also refocus the curriculum to the Kenya Vision 2030 objectives and labour market needs at the national and county levels.

Private educational institutions increased across all levels. The private Early Childhood Development and Education (ECDE) learning centres grew from 14,171 in 2008 to 14,543 in 2010. Private primary schools increased from 8,076 to 8,430 in 2010. Primary private teacher training colleges increased from 13 to 105, and private universities increased from 21 to 25 in 2010. However, the number of private secondary schools decreased from 2,112 in 2008 to 2,012 in 2010. In 2008, primary school children in private institutions numbered 924,192, representing 10.8 per cent of total primary school enrolment. About 171,097 secondary school

children were in private secondary schools, representing 12.3 per cent of total enrolment. In 2010, about 21 per cent of the 180,978 university students were in private universities. Students in private universities increased from 19 per cent of the 118,239 university students in the 2007/08 academic year.

3.6.3 Public spending on education

Public education and training grew between 2008/09 and 2010/11. Education sector financing at nominal prices increased by 44 per cent from Ksh 137.8 billion in 2008/09 to Ksh 198 billion in 2010/11 (Table 3.20). A large share of education expenditure (92.8%) is spent on recurrent education costs, leaving 7.2 per cent for the development budget. The introduction of Free Primary Education in 2003 and Free Day Secondary Education in 2008 is the likely cause of increased spending on education.

A substitution effect in the financing of education is evident (Table 3.20). Although spending on primary education sub-sector in absolute terms increased during the review period, the share of spending on the sector decreased as total spending increased. This was possibly because of the increase in secondary, university and TIVET education. The primary education sub-sector received the highest budget allocation of 39 per cent in 2010/11. The rate declined from 50 per cent in 2008/09. The proportionate allocation to secondary, technical and university education increased over the review period.

Variations in expenditure across levels suggest that the government may need to ensure sustained

Table 3.20: Education expenditure by sector, recurrent and development (%)

	Recurrent			Development			Total		
	2008/9	2009/10	2010/11	2008/9	2009/10	2010/11	2008/9	2009/10	2010/11
General Adminis-tration and Planning	7.43	7.6	6.16	47.12	31.82	47.12	7.34	12.95	8.76
Primary Education	49.04	49	41.57	31.38	12.59	31.38	49.96	46.62	38.64
Teacher Education	0.17	0.16	0.11	0.23	0.5	0.23	0.29	0.17	0.15
Special Education	0.47	0.15	0.31	0	0	0	0.43	0.13	0.28
Early Childhood Education	0.18	0.14	0.22	0.23	0.26	0.23	0.18	0.15	0.22
Secondary Education	26.5	27.36	27.17	2.39	14.35	2.39	24.69	23.98	25.87
Technical Education	4.16	4.51	2.95	6.09	25.42	6.09	4.81	4.72	5.23
University Education	12.06	11.07	21.5	12.55	15.07	12.55	12.3	11.27	20.85
Total (Ksh billion)	125,557	138,764	178,043	12,255	21,701	20,053	137,812	160,465	198,096

Source: Government of Kenya, Kenya National Audit Office, Audited Appropriation Accounts (various)

financing of basic education. Increased allocations to inputs that have direct impact on the quality of education outcomes and on post-primary education is necessary. Teacher training, special needs education and early childhood development also require increased expenditure allocation.

Per capita spending by level

The per capita spending on public education across the various levels of education has increased. Data provided in Table 3.21 shows estimated recurrent government spending per student enrolled in the respective levels of education. The per capita spending on public primary education increased from Ksh 7,831 in 2008/09 to Ksh 8,537 in 2010/11 at current prices. The unit spending for secondary education (Ksh 32,507) was 3.8 times that of primary education in 2010/11. University and technical education public unit spending (Ksh 69,505 and Ksh 120,525) were 8.1 times and 14 times that of primary education, respectively.

Table 3.21: National per-capita spending by level of education

Nominal per capita expenditure	2008/09	2009/10	2010/11
Primary (Ksh)	7,831	8,306	8,537
Secondary (Ksh)	29,411	33,207	32,507
Technical (Ksh)	53,565	64,436	69,505
University (Ksh)	137,707	106,975	120,525
GDP per capita (Ksh)	52,012	55,581	56,971
Per capita expenditure as percentage of GDP per capita (%)			
Primary	15.06	14.94	14.98
Secondary	56.55	59.74	57.06
Technical	102.99	115.93	122.00
University	264.76	192.47	211.56

Source: Government of Kenya, Kenya National Audit Office, Audited Appropriation Accounts (various) and authors' computations

In 2010, total public expenditure on education as a percentage of GDP was relatively high (7.4%) in Kenya compared to South Africa's (5.1%). South Africa had a Gross National Income (GNI) per capita of US$ 9,812. Public spending on education as percentage of GDP was, however, close to Botswana's level of spending (8.1%). Kenya's GNI per capita at the time was estimated at US$ 1,628 while that of Botswana was US$ 13,204.

3.6.4 Performance of the education sector, issues and challenges

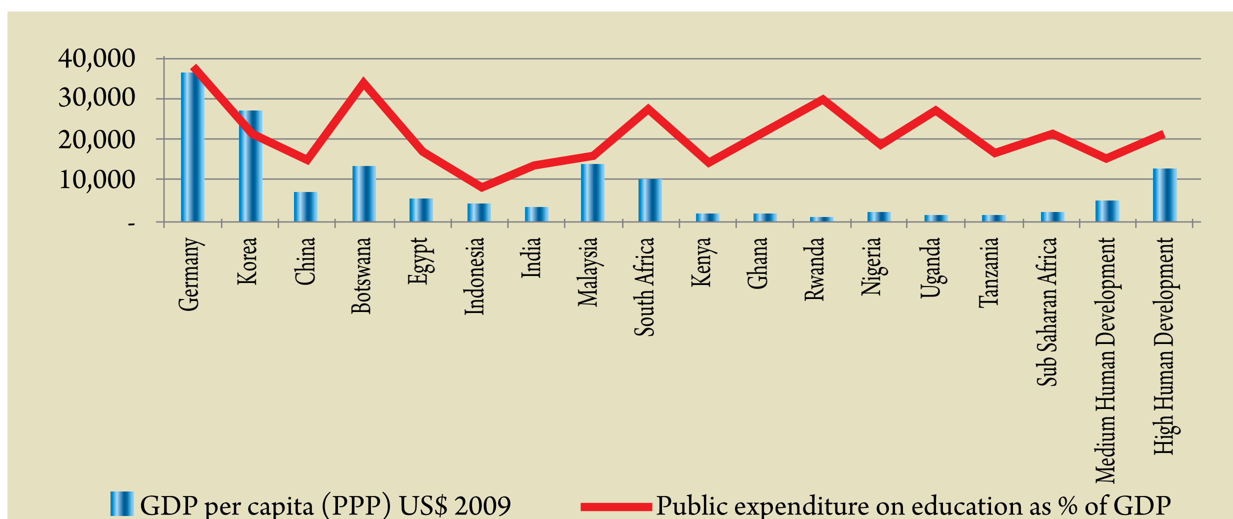
Access and participation

Compared to the target of universal access, ECDE level in Kenya is relatively low. The ECDE net enrolment rate increased from 49 per cent in 2009 to 50 per cent in 2010. The fact that ECDE is not compulsory and is yet to be integrated into basic education may explain the relatively low access rates. Gross and net enrolment rates in ECDE were 60.6 per cent and 49.0 per cent in 2009 and 2010, respectively.

Overall, gross enrolment rate in primary education was 109.8 per cent net in 2008 while net enrolment was 92.5 per cent. In 2010, gross enrolment rate was 109.8 per cent while net enrolment was 91.4 per cent. In general, primary school net enrolment rate for boys was higher than that for girls. Secondary school gross enrolment rate increased from 42.5 per cent in 2008 to 47.8 per cent in 2010. The net enrolment rate rose from 28.9 per cent in 2008 to 32 per cent in 2010 (Government of Kenya, 2011).

Kenya's Net Enrolment Rate (NER) at primary and secondary school levels are above the Sub-Sahara Africa (SSA) averages of 74.0 per cent and 29.5 per cent, respectively (Figure 3.19). However, Kenya's secondary school NER of 32 per cent in 2010 was lower than Korea's (96.4%) and South Africa's (71.9%). The average for medium human development countries was 57 per cent. Although Kenya has made considerable progress in primary

Figure 3.16: Public spending on education as % of GDP and GDP per capita, PPP, 2009/10



Source: UNDP (2011)

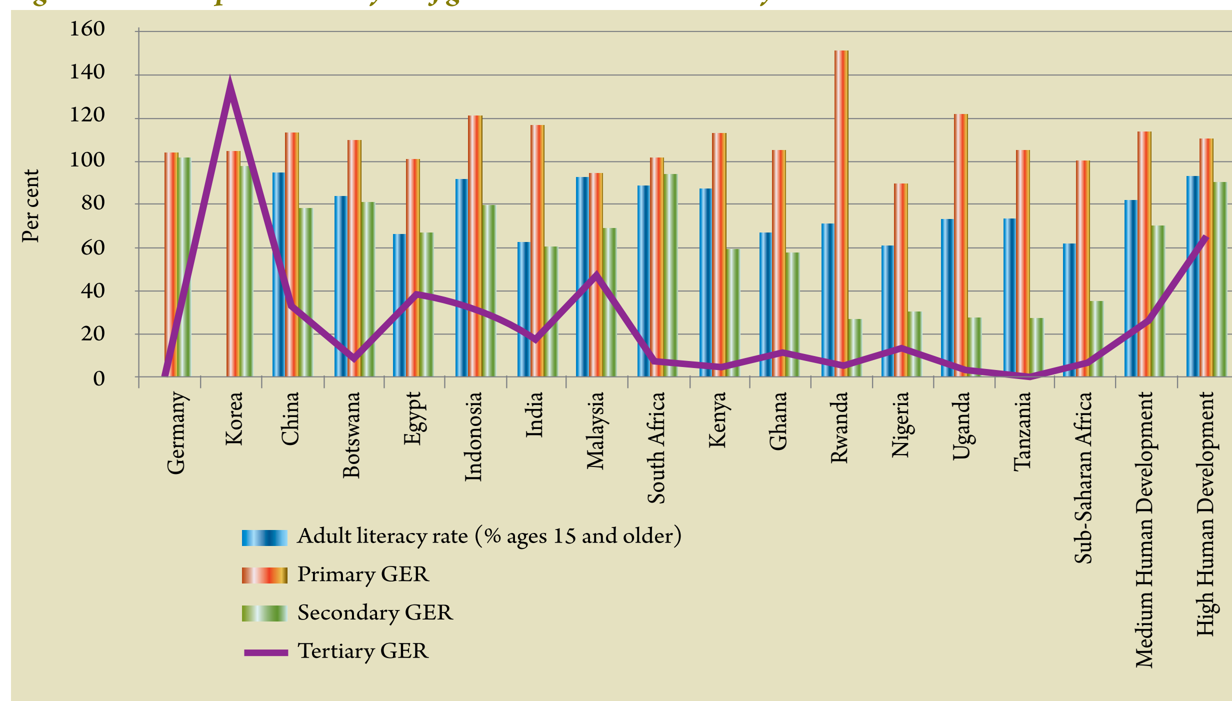
Table 3.22: Gross enrolment rates and net enrolment rates

School Level	Enrolment type	Gender	2008	2009	2010
Pre-Primary	Gross Enrolment Rate	Both sexes	59.8	60.6	60.9
	Net Enrolment Rate	Both	43.0	49.0	50.0
Primary	Gross Enrolment Rate	Male	112.2	112.8	109.8
		Female	107.3	107.2	109.9
		Both	109.8	110.0	109.8
	Net Enrolment Rate	Male	94.6	93.6	90.6
		Female	90.5	92.1	92.3
		Both	92.5	92.9	91.4
	Primary completion rate		79.8	83.2	76.8
	Transition rate from primary to secondary		64.1	66.9	72.5
Secondary	Gross Enrolment Rate	Male	46.3	49.0	50.9
		Female	38.8	41.8	46.3
		Both	42.5	45.3	47.8
	Net Enrolment Rate	Male	29.8	36.5	38.0
		Female	27.9	35.1	38.9
		Both	28.9	35.8	32.0

Source: Government of Kenya (2010)

education participation, access to post-secondary education should be enhanced. In 2010, for instance, only 15.5 per cent of Kenya's population aged 25 years and above had attained at least secondary education. Compared to the levels in countries such as South Africa (57.9%) and Korea (24.7%), this was relatively low.

Figure 3.17: Comparative analysis of gross enrolment and literacy levels



Source: UNDP (2011)

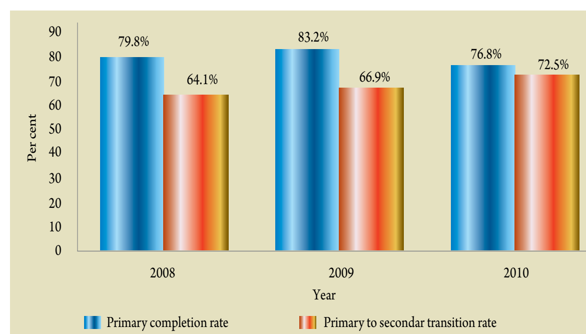
Internal efficiency

The rate of primary education completion in Kenya declined between 2008 and 2010. However, transition rate increased in the same period. The primary education completion rate declined from 79.8 per cent in 2007 to 76.8 per cent (79.2% for boys and 74.4% for girls) in 2010. In 2009, completion rates improved slightly to 83.2 per cent (88.3% for boys and 78.2% for girls).

Transition rate from primary to secondary education increased from 64.1 per cent in 2008 to 66.9 per cent in 2009 (64.1% for male and 69.1% for female) and 72.5 per cent in 2010 (Figure 3.18).

Factors such as lack of capacity and low educational attainment among standard 8 pupils, affects transition rates. Low education attainment means that some pupils fail to meet the minimum requirements to join secondary school. Compared to transition from primary to secondary education, transition rates from secondary to university education are relatively low, with the highest rate achieved recently being 6.5 per cent in 2008/09.

Figure 3.18: Primary completion and transition to secondary education (%)



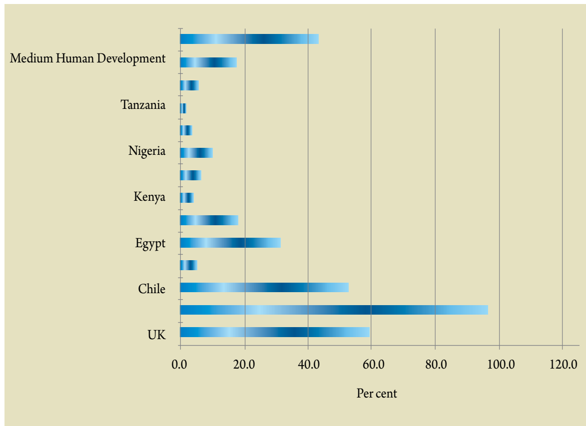
Source: Kenya National Bureau of Statistics (various)

Access to tertiary education

Tertiary education gross enrolment rate for Kenya was 4.1 per cent in 2007-2010. This was lower than that of South Africa (5.5%), Egypt (31.2%) and the Republic of Korea (96.1%) (Figure 3.19). Analysis reveals that the relatively low percentage of females enrolled in Kenya's tertiary education institutions (36% in 2010) is a challenge. Low access rates at secondary and tertiary education levels imply that boosting access to post-secondary education is key

to improving supply of skilled human resource for key sectors of the economy.

Figure 3.19: Average tertiary gross enrolment rate (% of tertiary school age population)



Source: UNDP (2010)

Inequalities in access to education

Inequality in access to education can be defined in terms of gender, income, and locality differences. Gender inequity refers to the extent to which the traditionally disadvantaged social groups, such as females at different ages, have had opportunities to access various levels of education, have succeeded in education, and made use of education as an asset for enhancing their opportunities in life, such as in employment.

Income related inequality focuses on the extent to which the financially disadvantaged groups have had access to various levels of education. Locality related inequalities mean that people living in disadvantaged regions, such as marginalized rural areas, slums and urban informal settlements are the most affected.

Gender equity

The Gender Parity Index (GPI) measures equity across gender in human resource development. It is a composite index capturing loss in achievements due to gender differences in three dimensions of human development, namely health, empowerment (including attainment at secondary and university education) and labour market participation. The Human Development Report for 2010 shows that Kenya's GPI was estimated at 0.74. This means that the male population is advantaged in terms of the three dimensions mentioned above, relative to their female counterparts. This level was similar to that of Egypt and Sub-Saharan Africa's average, but higher than Korea's index (0.31) and Chile

Figure 3.20: Gender Inequality Index, 2008 and 2011

Source: UNDP (2010 and 2011)

(0.51) (Figure 3.20). The factors contributing to high gender inequality index in Kenya include the disadvantaged position of women in access to secondary and tertiary education, and low labour force participation.

School sizes

Using the most recent data from the county level, the average primary school size was 458 students with a minimum of 215 pupils and a maximum of 1,414 students in 2007. The average primary school population density (total primary school population divided by the number of schools) was 574, with a maximum of 3,510 children per school and a minimum of 90 pupils per school. This means there is a high potential to increase enrolment without necessarily building more schools in some parts of the country.

The average public secondary school size was 236 students with a minimum of 215 students and a maximum of 901 students. The average secondary school population density was 1,433 with a maximum of 9,232 secondary school age children per school and a minimum of 296 children per school. The large deviation in secondary school population density confirms the problem of uneven provision of secondary schools in the country. This has partly contributed to the low participation levels.

Table 3.23: School density and school sizes, 2007

	Average	Maximum	Minimum
Primary school population density	574	3,510	90
Primary school size	458	1,414	215
Primary class size	35	56	24
Primary school Pupil Teacher Ratio (PTR)	34	56	26
Secondary school population density	1,433	9,232	296
Secondary school size	263	901	107
Secondary PTR	16	22	12

Source: Ministry of Education (2007)

The number of students per class was 35:1 at the primary school level, which is lower than the national average of 50:1, but varied between a maximum of 56:1 and a low of 24:1. Clearly, many larger than average classes exist alongside small classes in Kenya.

Pupil-teacher ratio

Teacher distribution across counties is unequal. Using the 2007 disaggregated data set, the national average pupil-teacher ratio (PTR) in primary schools was 34 pupils per teacher, with a minimum of 26:1 and a maximum of 56:1. At secondary school level, the maximum PTR was 21:1 with a minimum of 12:1 and a national average of 16:1. This situation can perhaps be explained by the fact that teacher utilization at the primary school level has improved since the introduction of free primary education in 2003. Consequently, the PTR is close to the optimal or targeted ratio of 40:1. Low teacher utilization at secondary school education level needs to be addressed.

Generally, many teachers prefer to work in urban areas because of better access to amenities such as water, electricity, security, housing and transport relative to rural areas. This may explain the challenges in teacher deployment and distribution that results in teacher shortage in the rural and marginalized areas. Employment of additional teachers, therefore, may not solve the problem of teacher shortages. Teacher redistribution interventions should be accompanied by careful planning of teacher supply. This should take into account an assessment of spatial distribution of learning institutions, socio-economic factors that affect retention of teachers in under-served areas, and ensuring teachers are not only present in schools but also in class rooms according to teaching schedules.

According to the 2011 data, the level of teacher absenteeism in schools is high. In 2011, primary schools teacher absenteeism was about 13 per cent. Assuming the primary school teacher wage bill was

Ksh 86 billion in 2009/10, if 13 per cent of the teachers were absent, this translated to wastage of approximately Ksh 11 billion.

Largely, teacher absenteeism exacerbates the acute teacher shortage and the low level of curriculum coverage in most public schools. As the country addresses the teacher shortage problem, it is important to ensure efficient utilization of existing teaching staff by first addressing the acute teacher absenteeism.

The pupil teacher ratio is used as a measure of quality of education. Currently, the policy target is to attain a pupil teacher ratio of 40:1 (40 pupils per teacher). This could be increased to 45:1 for high potential areas and decreased to 25:1 for low potential areas, (Government of Kenya, 2010). In 2007, primary PTR was about 34:1, while class size was 35:1. This is an indication that small class sizes exist alongside large class sizes in some schools across the country (Table 3.23). The lowest PTR is found in developed economies such as Germany (18:1) and emerging economies such as Indonesia (21:1), countries that also have high human development indices.

Human Development Index

Kenya's Human Development Index (HDI) in 2011 was relatively low. It was 0.509 compared to South Africa (0.619), Indonesia (0.617) and Botswana (0.633). The respective indices for Korea (0.905), China (0.687), Germany (0.905) and overall average for countries with high human development (0.741) are all above 0.70. The average in Sub-Saharan Africa was 0.463.

3.6.5 Key issues in education, training and skills development

Equity, quality and weak linkages between educational institutions and the labour market are challenges in the education sector, more so wastage across levels and unsatisfactory transition rates. Although about 70 per cent of pupils who complete primary education are admitted to secondary schools, many fail to transition due to low performance and adverse socio-economic factors. In 2010, Form 1 enrolment in proportion to enrolment in standard eight was about 48 per cent.

Improving transition to tertiary education and appropriate skills development is critical to attaining

Table 3.24: Human Development Index

	2005	2009	2010	2011	Average annual growth (HDI) 1980-2011	1990-2011	2000 - 2011
Germany	0.895	0.900	0.903	0.905	0.69	0.62	0.43
Korea	0.866	0.889	0.894	0.897	1.13	0.91	0.72
China	0.633	0.674	0.682	0.687	1.73	1.62	1.43
Botswana	0.601	0.626	0.631	0.633	1.14	0.30	0.71
Egypt	0.611	0.638	0.644	0.644	1.5	1.24	0.88
Indonesia	0.572	0.607	0.613	0.617	1.23	1.19	1.17
India	0.504	0.535	0.542	0.547	1.51	1.38	1.56
Malaysia	0.738	0.752	0.758	0.761	1.00	0.90	0.69
South Africa	0.599	0.610	0.615	0.619	0.30	0.03	0.05
Kenya	0.467	0.499	0.505	0.509	0.62	0.52	1.27
Ghana	0.484	0.527	0.533	0.541	1.10	1.23	1.66
Rwanda	0.376	0.419	0.425	0.429	1.44	2.97	2.92
Nigeria	0.429	0.449	0.454	0.459	-	-	-

	2005	2009	2010	2011	Average annual growth (HDI) 1980-2011	1990-2011	2000 - 2011
Uganda	0.401	0.438	0.442	0.446	-	1.93	1.65
Tanzania	0.420	0.454	0.461	0.466	-	1.35	2.27
Sub-Saharan Africa	0.431	0.456	0.460	0.463	0.77	0.90	1.31
Medium Human Development	0.587	0.618	0.625	0.630	1.31	1.30	1.28
High Human Development	0.716	0.734	0.739	0.741	0.61	0.64	0.70

Source: UNDP (2011)

sustainable development and the Kenya Vision 2030 objectives. Currently, tertiary education gross enrolment rate is about 4.1 per cent, which is relatively low. The average gross enrolment rate for middle-income countries is over 20 per cent, which means that a substantial proportion of youth in high-income economies has access to quality tertiary education (96% in Korea).

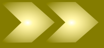
Inequality in access to education constrains Kenya from attaining the MDG on universal access to primary education by 2015. For instance, a cross county analysis shows a low net enrolment rate of 24 per cent in Turkana and a high of 93 per cent in Nyeri.

The balance between improved access to schooling and quality of the education is weak, and this calls for focus on improvement of the quality of teaching and the learning process in the classroom, creating a conducive learning environment in classrooms, institutionalizing parent-teacher-pupil interactions and participation in the learning process, institutionalizing continuous teacher development programmes across all levels of education and integrating pre-primary education into basic education.

The cost of education is rising, and is thus a burden to many households and the government. Although the free primary education and free day secondary education programmes are in place, there is need to establish the actual unit cost of education to reduce the cost burden of schooling in the country. India and Korea have accomplished significant improvement in their education sectors by providing high quality yet affordable education. Strong partnerships are required in the financing and provision of tertiary education and training.

There is need to improve access to post-primary education, and also improve internal efficiency. This will require capacity building for education management and service delivery, prioritizing education programmes and inter-sector linkages, enhancing linkage between education and training and the labour market, identifying training needs, and addressing specific skills shortages.

Kenya should view education and training as investments that are fundamental to sustainable development. Developed countries prioritize investment in education, poverty reduction and health and quality job creation in their national development agenda. In particular, Kenya should treat tertiary education and skills development as imperatives for development because a pool of high-level skills is required in the labour market in order to meet the Kenya Vision 2030 objectives, especially in production of high technology outputs and skill-intensive services.



END NOTES

1. http://www.ehealth.or.ke/facilities/facilitytypes.aspx?mst=fty (7th February, 2012).

2. The Institute of Social Accountability - http://www.tisa.or.ke/countdown-to-counties/kenyas-47-counties/

PART II

SECTORAL PERFORMANCE

Chapter 4

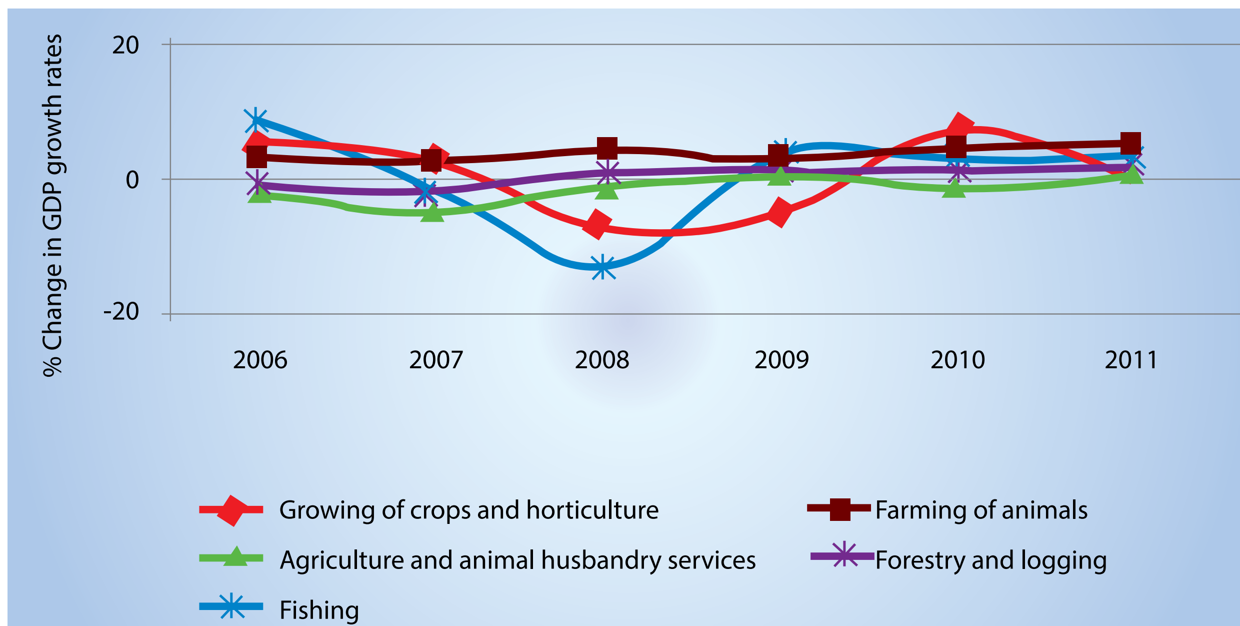
Agriculture

4.1 Overall Performance

The agriculture sector grew by 6.4 per cent in 2010 but slowed down to 1.5 per cent in 2011. Figure 4.1 shows the percentage change in GDP growth in the different sub-sectors in agriculture. There seems to be a general recovery trend since 2007/08, excluding crops and horticulture sub-sectors, which recorded no change in growth in 2011.

The challenges in the agriculture sector are broadly classified into two, namely: lack of competitiveness and low productivity. Inadequate and inconsistent information management systems within the sector, weak linkages between stakeholders, research and extension have contributed to lack of competitiveness. Consequently, actualizing innovations takes a long time. On the other hand, low adoption of technology, minimal or no use of

Figure 4.1: Percentage change in GDP growth for sub-sectors in agriculture



Source: Kenya National Bureau of Statistics (2011)

farm inputs due to the cost of inputs, and lack of information that is critical for productivity all lead to low productivity (Annual Progress Report, 2011; Agricultural Sector Development Strategy, 2009).

The Kenya Vision 2030 blueprint envisions agricultural growth rate of 7 per cent to contribute to the projected overall economic growth of 10 per cent. The Vision outlines key initiatives that drive the growth of the sector, which include but not limited to better yields in key crops, increased smallholder specialization in the cash crop sector (2-3 crops per plot), utilization of a million hectares of currently uncultivated land, and cultivation of up to 1.2 million hectares of newly-opened lands.

The specific strategies include transforming key institutions in agriculture, livestock and fisheries to promote household and private sector agricultural growth; and to increase crop and livestock productivity. According to the third Annual Progress Report (APR) of the first medium term plan (2008-2012), the progress made so far includes:

Consolidation of the agricultural sector: The Agriculture Bill 2011, Crops Bill 2011 and Livestock Bill 2011, and a comprehensive sector-wide consolidated bill 2011 were prepared and presented in the 10th parliament.

Fertilizer cost reduction initiative: In 2010/2011, the Ministry of Agriculture and the National Cereals and Produce Board (NCPB) used Ksh 3,840 billion to procure fertilizer, to provide subsidized seed and facilitate distribution. Subsequently, the price of fertilizer dropped and stabilized. For instance, the price of a 50 kg bag of DAP fertlizer dropped from Ksh 6,400 to Ksh 2,200. In addition, plans are underway to establish a regional fertilizer plant. However, reforms in the fertilizer market need closer analysis especially as regards conduct of business transactions in the fertilizer market as well as the welfare effects on different actors along the supply chain.

Establishment of disease free zones in the ASAL region: Kenya has established four livestock disease free zones (DFZs) in the Coast, Laikipia, Isiolo and the North Rift regions. While efforts have been made to initiate a disease free zone, the high cost (about Ksh 10 billion per disease free zone) is a challenge. Three draft contingency plans for Rinderpest, Rift Valley Fever and Mad Cow disease were developed.

Legislative reforms: As outlined in the Constitution, Kenya has made progress in legislative reforms for devolution of the county government. The Ministry of Agriculture drafted eight (8) policy documents, namely: the National Food and Nutrition Policy (NFNP), National Agriculture Sector Extension Policy (NASEP), National Seed Policy, Urban and Peri-Urban Agriculture and Livestock (UPAL) Policy, Root and Tuber Crops Policy, Pyrethrum Sessional Paper and the Sugar Industry Sessional Paper. The National Seed Policy was launched in June 2011. In addition, Cabinet approved the National Agriculture Sector Extension Policy and National Food and Nutrition Policy.

The Cabinet also prepared and approved the National Dairy Policy, Poultry Policy and the Beekeeping Policy under the Ministry of Livestock. The Veterinary Surgeon and Veterinary Para-Professional's Bill awaits presidential assent.

Under the Ministry of Fisheries, Kenya developed the Aquaculture Extension Manual and Aquaculture Communication Strategy (2010-2015) to standardize extension products and to provide clear direction on fish promotion and marketing. The National Oceans and Fisheries Policy was approved in December 2008.

The SACCO Act 2008, which falls under the the Ministry of Co-operatives Development and Marketing, was enacted. A Cabinet memo and Sessional Paper on the Co-operative Development Policy was drafted and the SACCOs Regulatory Act and Legal Framework was developed. Plans were

initiated to establish the Ethics Commission for Co-operatives (ECCOS).

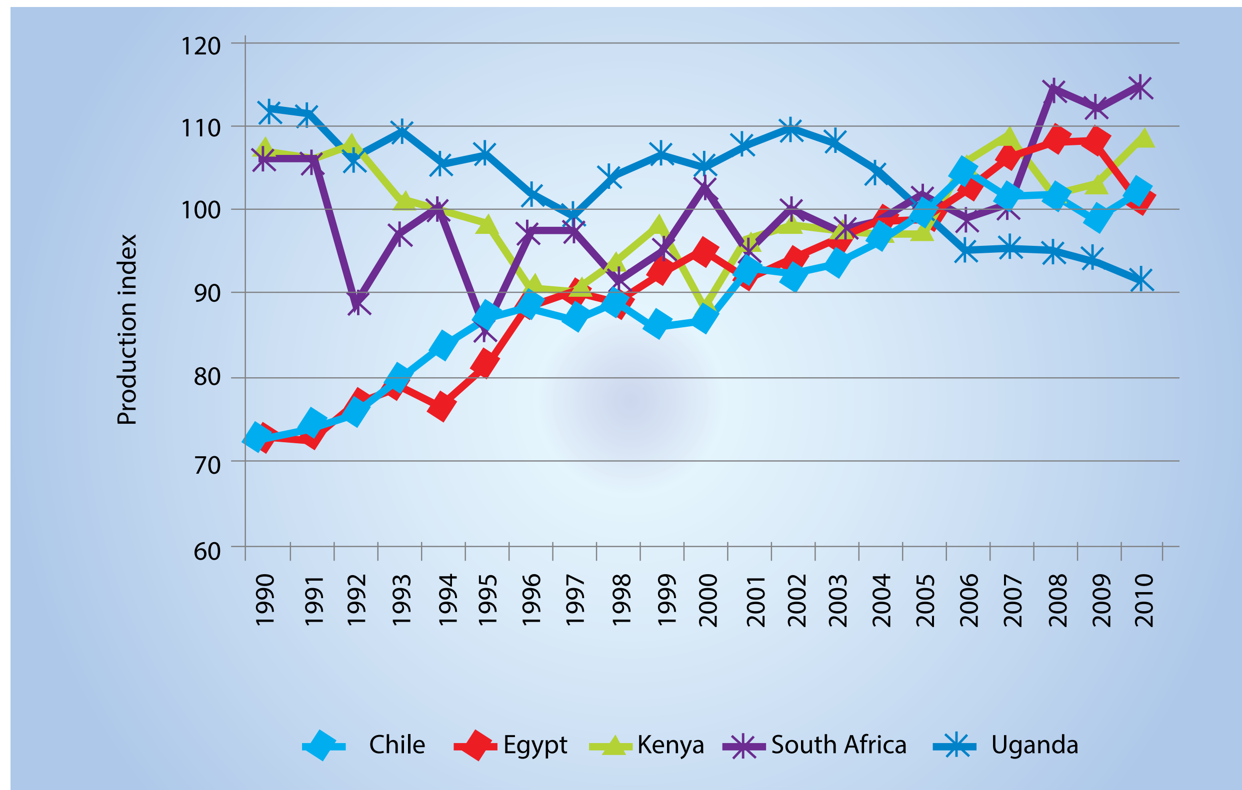
4.2 Food Security

Food security is achieved when all people, at all times, have physical and economic access to sufficient, safe and nutritious food to meet their dietary needs and food references for an active and healthy life (FAO, 1996). It encompasses availability, accessibility, stability, and utilization. Kenya enacted the National Food and Nutrition Security Policy in July 2011 in order to build synergies and to assist in the implementation of policies and strategies that focus on assuring food nutritional security. The government's initiative to revive the economy and the agricultural sector are in line with its international commitment and declaration to end hunger and extreme poverty. Kenya's commitment is evident from its compliance and participation at forums, including at the World Food Summit of 1996, the United Nations Millennium Development Goals (MDGs), and the Comprehensive Africa Agriculture Development Programme (CAADP) of the New Partnership for Africa's Development (NEPAD).

The Food and Nutrition Policy takes into account the constitutional right of citizens, including basic human rights, child rights, women's rights and the universal 'Right to Food.' This includes sufficient supply of calories and nutritious diet that guarantees health, growth and development at all stages of life and for all citizens.

The Constitution of Kenya 2010 also requires annual reporting to the National Assembly on progress in fulfilling international obligations related to agriculture, food and nutrition security. Progress reporting on domestication of international and regional treaties and conventions related to agriculture and nutrition is also required.

Figure 4.2: Growth trends in per capita agricultural production



Source: FAOSTAT (2012)

4.2.1 Food availability and accessibility

Kenya's per capita agricultural production has declined since 2007. However, it recovered in 2011 (Figure 4.2). Factors such as falling world food stock, drought, rising oil prices and increasing demand for a varied diet especially from the transitional economics contribute to declining food production. Rising food prices are a major cause of worsening food insecurity, especially in poor households.

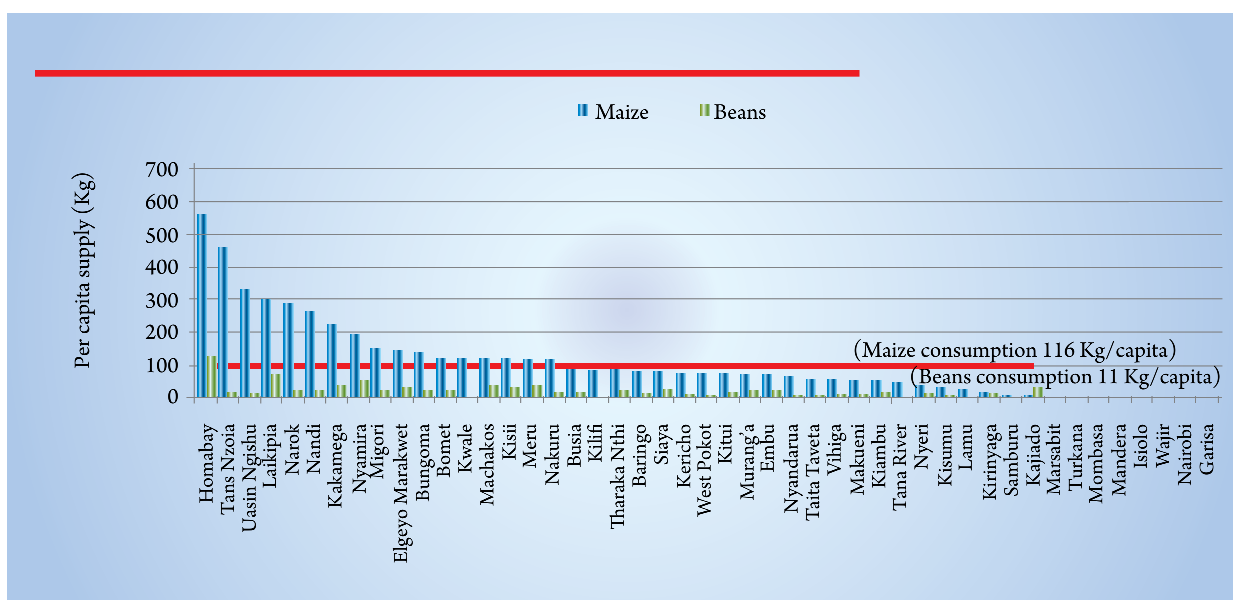
Growth trends in agriculture in per capita production indices in some comparator countries show that from the year 2000, Uganda's growth declined. In 2009, Chile and South Africa recorded decline in growth, while Egypt maintained steady growth up to 2010 (Figure 4.2).

Maize production in Kenya increased from 27 million to 44 million bags between 2010 and 2011, perhaps due to increased access to subsidized fertilizers and use of certified seed. Indigenous crops contributed a significant portion of the total crop produced annually (Ministry of Agriculture, 2012). Figures 4.3 and 4.4 show that some counties in Kenya produce abundant supply of certain food crops, while others record deficits. Only 17 out of the 47 counties produce enough domestic supply of maize to meet their consumption needs. In bean production, 22 counties meet their consumption needs. Only 12 counties produce a surplus of Irish potatoes. About 15 counties produce enough bananas to meet the county's consumption needs plus surplus (Figure 4.4), implying that inter-county trade is critical to complementing domestic food supply.

Tea, coffee and horticulture are Kenya's leading agricultural foreign exchange earners, yet, these recorded a decline in production in 2011. However, depreciation of the Kenya shilling raised the value of the exports. Horticulture, tea and coffee earnings increased by 8 per cent, 17 per cent and 50 per cent, respectively. Horticulture was second after tourism among the leading foreign exchange earners. Table 4.1 shows the contribution of the different sub-sectors in horticulture in terms of volume and value. Only 4 per cent of horticultural produce is exported, with the other 96 per cent consumed locally (Ministry of Agriculture, 2011).

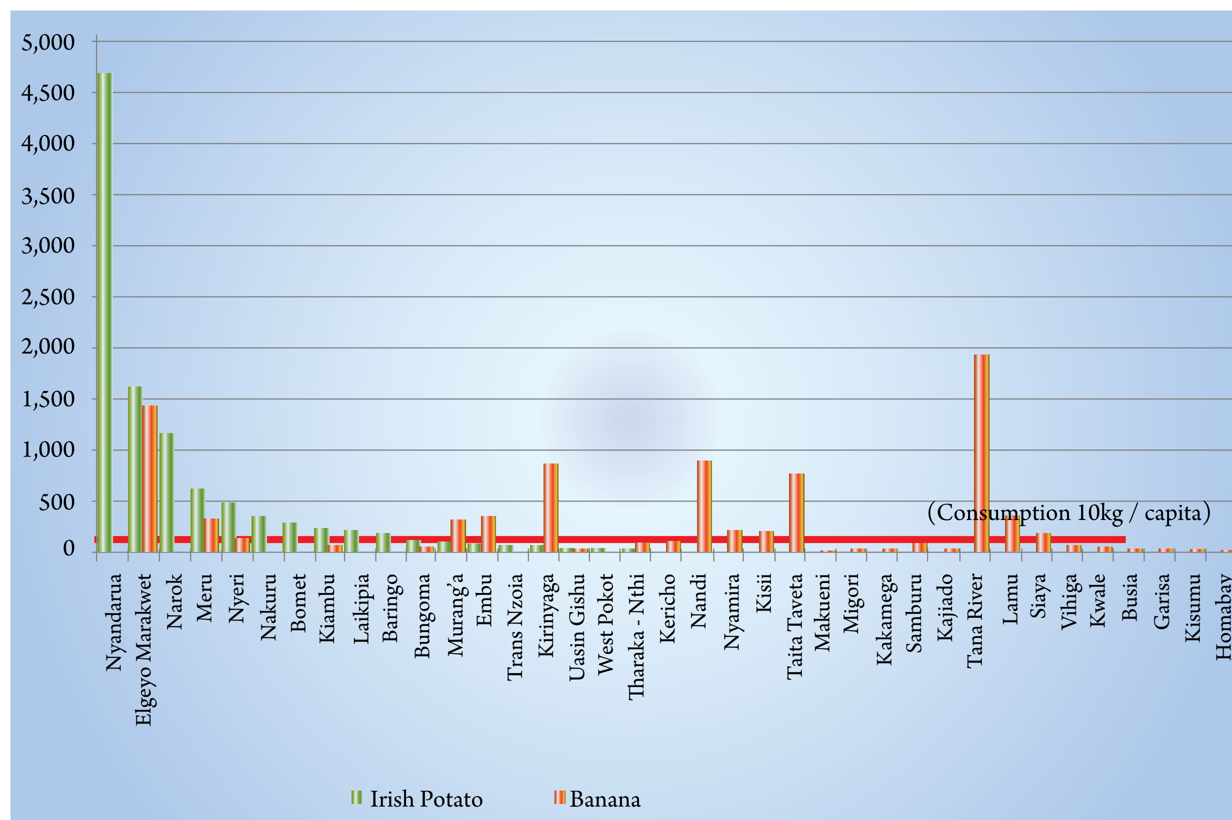
4.2.2 Livestock Production

Figure 4.3: Per capita domestic production of selected food crops by county



Data Source: Ministry of Agriculture (2012)

Figure 4.4: Per capita domestic production of selected horticultural crops by county



Data Source: Ministry of Agriculture (2012)

Table 4.1: Volume and value of horticultural exports

	Volume (Metric Tonnes)				Value (Ksh billions)			
Year	**2008**	**2009**	**2010**	**2011**	**2008**	**2009**	**2010**	**2011**
Flowers	93.7	87.0	120.2	121.9	39.9	30.8	35.6	44.5
Vegetables	82.4	72.5	75.6	68.1	24.0	16.3	18.6	20.0
Fruits	145.3	72.5	44.2	37.1	2.1	2.3	2.8	3.6

Source: Horticultural Crops Development Authority (2012)

Two livestock censuses were conducted in Kenya in 1969 and 2009 (Table 4.2). The livestock sector has experienced tremendous growth. In 2000, the annual per capita milk consumption was 78 litres and production was 70 litres. Ten years later, production increased. The average annual per capita milk consumption is 87 litres, while per capita production is 92 litres (Kenya National Bureau of Statistics, 2011). Nonetheless, more statistics on breeds, numbers, locality, production systems and the management skills of stock owners, breeders and producers are needed.

Table 4.2: Livestock census reports, 1969 and 2009

Livestock	1969	2009
Cattle	8,176,000	17,467,774
Sheep	3,955,000	17,129,606
Goats	4,945,000	27,740,153
Camels	n.a	2,971,111
Donkeys	n.a	1,832,519
Pigs	51,000	334,689
Indigenous chicken	10,000,000	25,756,487
Commercial chicken		6,071,042

Livestock	1969	2009
Beehives	n.a	1,842,496

Source: Kenya National Bureau of Statistics (2011): n.a-not available

Camel production

The potential for camel rearing is high especially in the arid and semi-arid lands (ASALs). Camel is important in addressing food security due to its ability to tolerate drought and remain productive in harsh conditions. However, despite the high nutritional value of camel milk, market outlets are limited due to traditional consumption preferences in Kenya. Therefore, to improve the livelihoods of ASAL communities, there is need to popularize camel milk and meat consumption in other regions.

Fish production

The harvest from inland fisheries (from lakes) has decreased from about 128,000 metric tonnes in 2007 to about 123,000 MT in 2010. Fish farming has increased from 4,000 metric tonnes in 2007 to 12,153 metric tonnes in 2010 (Table 4.3). About 40,800 fish ponds were constructed in 160 parliamentary constituencies under the Economic Stimulus Package (ESP). In addition, about 160 shallow wells were constructed in the same constituencies to harvest water for fish farming. Currently, tendering for six cold storage facilities is complete, and construction work is ongoing in Kakamega, Meru, Nyeri and Rongo. This is expected to reduce post-harvest losses.

Table 4.3: Volume of fish production (metric tonnes)

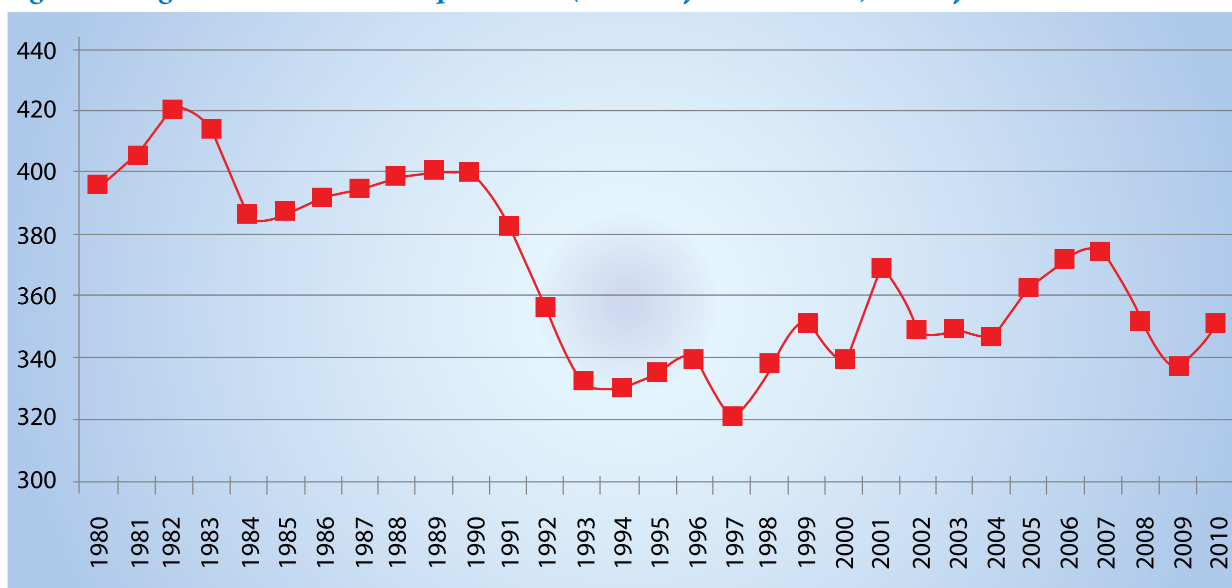
Year	Fish farming	Inland Fisheries	Marine fish
2007	4,245	128,888	6,355
2008	4,452	126,672	7,561
2009	4,897	136,529	7,811
2010	12,153	123,631	7,600

Source: Ministry of Fisheries Development (2011)

4.3 Agricultural Productivity and Employment

One of the measures of agricultural productivity is value added per worker. Over the last 30 years, this value has fluctuated between US$ 420.69 in 1982 and US$ 319.47 in 1997, showing a general decline. In 2010, it was about US$ 351.19 (Figure 4.5).

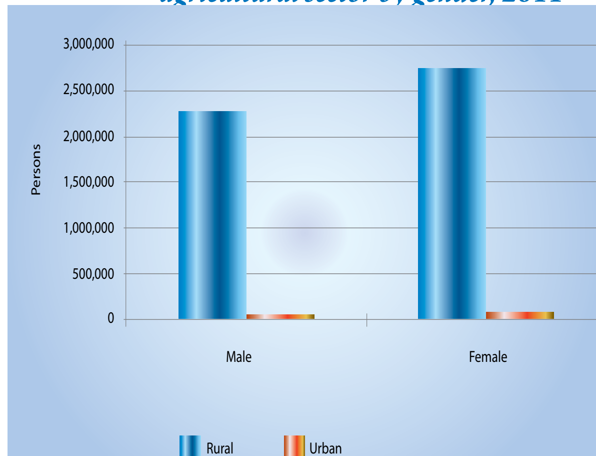
Figure 4.5: Agricultural value added per worker (constant year 2000 US$) in Kenya



Source: World Bank (2012)

Agricultural production is generally carried out in rural areas. Majority of the workers are female (Figure 4.6).

Figure 4.6: Number of persons involved in the agricultural sector by gender, 2011



Data Source: Kenya National Bureau of Statistics (2012)

Agriculture is a major employer in Kenya across different sectors (Table 4.4). The table shows that participation has marginally increased over the years for all sectors, except the tea plantations which have recorded reduction since 2008. The adoption of tea plucking machines may have contributed to this decline.

4.4 An Overview of Budget Execution

Resource allocation to the agriculture and rural development (ARD) sector has averaged at about 4 per cent per annum of national expenditure between 2008 and 2012. Spending increased between 2006/07 and 2009/10 from Ksh 16.9 billion to 23.9 billion (Ministry of Finance, 2011). Table 4.5 shows that most of the ministries are not able to absorb their recurrent budgets. This is largely attributed to procurement procedures and late disbursement of funds.

Low budgetary execution leads to increase in pending bills. The sector's total portfolio of pending bills as at 2009/10 was Ksh 705.1 million. Recurrent budget pending bills was at Ksh 160.9 million and development budget at Ksh 544.2

Table 4.6 shows the pending bills for some agriculture-related ministries. Development budget pending bills increase in subsequent years, perhaps because of lack of a budget despite the allocation (Ministry of Finance, 2011).

Table 4.4: Number of persons involved in different sub-sectors in agriculture and forestry

Agriculture and Forestry	2006	2007	2008	2009	2010
Coffee plantations	64,683	66,451	66,311	69,458	71,125
Tea plantations	88,630	90,790	90,511	86,181	86,245
Sugar plantations	28,697	29,115	29,083	30,152	30,705
Sisal plantations	15,483	15,224	14,752	13,990	14,074
Mixed farming	43,049	43,890	43,768	44,705	45,113
Ranches	18,681	18,884	19,295	19,360	19,609
Other agricultural activities	28,970	30,555	32,095	30,768	31,190
Processing cooperatives of small farms	7,398	7,610	7,614	7,579	7,642
Agricultural services	17,933	17,556	17,389	17,576	17,570
Hunting, trapping and game propagation	3,722	3,525	3,579	3,647	3,640
Forestry	15,961	14,807	14,856	15,415	15,309
Logging	939	994	997	1,015	1,042
Ocean and coastal fishing	200	207	217	235	249
Inland water fishing	242	244	247	259	265

Source: Kenya National Bureau of Statistics (2012)

Table 4.5: Budget absorption capacity (%) in the agricultural sector, 2007-2010

Ministries	Development budget			Recurrent Budget		
	2007/08	2008/09	2009/10	2007/08	2008/09	2009/10
Agriculture	134	96	101	110	106	84
Livestock Development	111	96	86	40	48	59
Lands	109	101	96	77	54	232
Co-operatives and Marketing	99	97	71	80	59	57
Fisheries Development	93	96	93	91	53	83
Overall	117	97	94	82	84	92

Data Source: Ministry of Finance (2011)

Table 4.6: Trends in pending bills (Ksh millions)

Sub-Sector	Recurrent			Development		
	2007/08	2008/09	2009/10	2007/08	2008/09	2009/10
MOA	127.2	250	69.3	0.0	181	541.1
MCD&M	6.0	2.54	19.4	0.6	14.9	23.2
MFD	7.7	0.0	2.3	20.0	0.0	0.0
MOL	39.9	12.96	11.2	0.0	22.5	3.1
MLD	15.6	4.4	35.7	27.7	35.3	0.0
Total	196.4	269.9	160.9	48.3	253.7	544.2

Key: MOA=Ministry of Agriculture; MCD&M=Ministry of Cooperative Development and Marketing; MOL=Ministry of Lands; MLD=Ministry of Livestock Development
Data Source: Ministry of Finance (2011)

4.5 Policy Directions

4.5.1 Production

Increasing productivity is critical to ensuring adequate domestic food supply. This reduces the deficit that trade meets. Consequently, the country can invest the savings made from reduced food importation in other sectors of the economy. Focus should be on promotion and implementation of existing technologies, knowledge and best practices along the value chain. This would ensure that linkages between and with the different actors at stages along the chain are adequate. Specifically, investment should focus on removing crippling bottlenecks at the different stages.

4.5.2 Marketing and value addition

Distribution is important for availability and access to food. Markets play an important role in facilitating this linkage. Focus should therefore be on empowering food producers, facilitating market linkages, and expanding and developing agricultural market information systems. Adherence to high quality standards and best practices in packaging, quality, handling, labelling and health standards is needed. Moreover, establishing effective and efficient frameworks and mechanisms for surveillance and enforcement is important in facilitating food security.

Chapter 5

Manufacturing

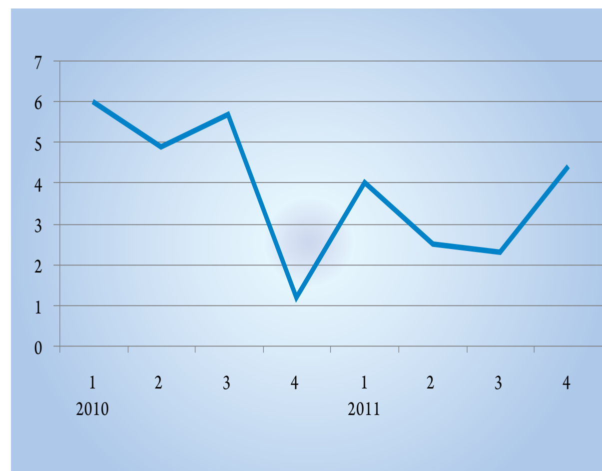
5.1 Overview of Recent Performance

The performance of the manufacturing sector is measured in growth, employment creation and contribution to the country's overall output and exports. Growth in the manufacturing sector declined from 4.0 per cent in the first quarter of 2011 to 2.5 per cent in the second quarter (Figure 5.1), which was significantly lower than the average growth of 4.5 in 2010.

Overall, the 2012 second quarter statistical release from the Kenya National Bureau of Statistics (KNBS) showed that Gross Domestic Product slowed down. Manufacturing value added grew at 4.9 and 4.1 per cent in the first and second quarter of 2011, respectively, possibly suggesting that factors beyond the sector drove the declining performance of manufacturing firms. However, the sector's growth picked up in the third quarter, recording growth of 4.4 per cent in the fourth quarter of 2011.

In its 2011 second statistical release, the Kenya National Bureau of Statistics attributed the poor sector performance in the first two quarters of 2011 to rising inflation, which slowed the local demand on manufactured products, particularly non-food items. However, unprecedented depreciation of the Kenya shilling probably affected the sector more negatively given the high levels of imports in the sector. During the March 2011 to October 2011 period, the Kenya shilling depreciated from Ksh 83 to Ksh 107 to the US$. Imported raw materials became expensive, and the cost of borrowing rose drastically after commercial banks adjusted interest rate upwards in line with increase in Central Bank Rate that reached 18 per cent by December 2011.

Figure 5.1: Percentage growth of manufacturing sector



Source: Kenya National Bureau of Statistics (2012): 2nd Quarter Statistical Release 2012

The share of manufacturing sector's employment to overall formal employment is, on average, 13 per cent. This share declined between 2009 and 2012 (Table 5.1). Indeed, fewer employees were in manufacturing sub-sectors between 2006 and 2010. This phenomenon largely points to stagnation of the

sector's growth. However, several other factors may possibly explain the declining share of employment in manufacturing. If labour productivity increases or firms become more capital intensive, the number of employees in the sector may remain constant or even decline over time. Similarly, manufacturing firms may opt to engage casual labour to reduce labour costs.

Table 5.1: Performance of the manufacturing sector

Indicators	2008	2009	2010	2011
% contribution to GDP	12.0	9.0	10.0	9.44
% contribution to employment	13.6	13.3	13.0	12.96
% growth	3.6	1.3	4.5	3.30
% contribution to merchandize exports	36.5	36.6	34.7	-

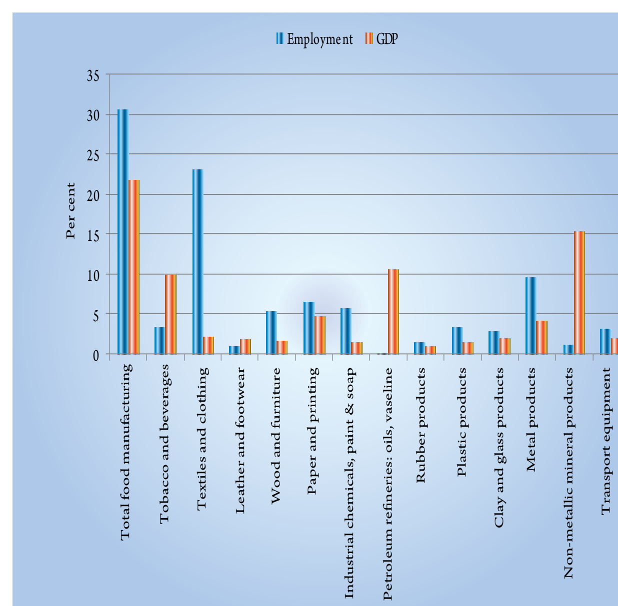
Source: Kenya National Bureau of Statistics (2009-2012), Economic Surveys; and World Bank (2012)

Further, the manufacturing sector in Kenya contributes about 37 per cent of Kenya's merchandise exports (Kenya National Bureau of Statistics, 2011), mainly to the East African market. The near-constant contribution of manufacturing sector to overall Kenyan exports suggests that the East African market is becoming relatively small to catalyse massive expansion of manufacturing establishments. Beyond the challenges of the export market, the rate of investment in manufacturing may be declining, possibly because the business environment is not attractive enough for new investments, or the micro and small firms that form more than 70 per cent of establishments are unable to marshal substantial funds to the sector.

5.2 Performance of Manufacturing Sub-sectors

Agro-processing industries dominate the manufacturing sector. The three major sub-sectors are food manufacturing, non-metallic mineral and petroleum products, which contributed 21.8 per cent, 15.5 per cent and 10.6 per cent, respectively, to overall manufacturing value added in 2010. However, most of the major sub-sectors employ relatively few employees compared to other sub-sectors whose contribution to manufacturing GDP is smaller.

Figure 5.2: Sub-sector contributions (%) to manufacturing value added and employment, 2010



Source: Authors computations from Kenya National Bureau of Statistics (2011)

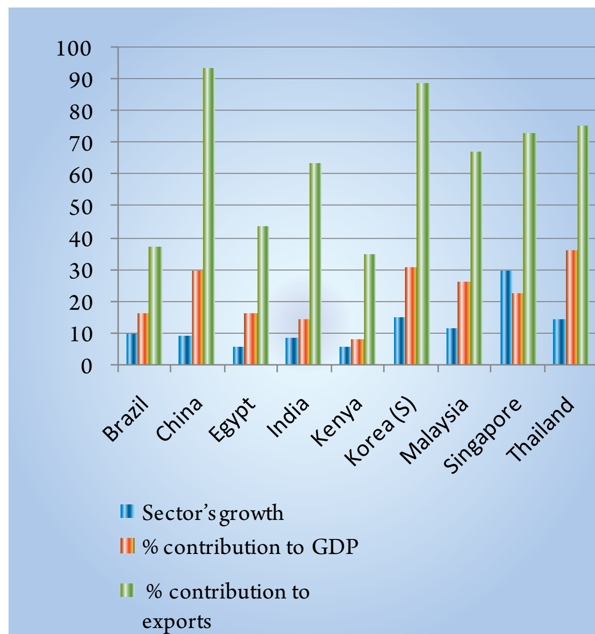
The food manufacturing sub-sector absorbs the largest share of manufacturing employment. In 2010, tobacco and beverages, non-metallic mineral and petroleum products industries only absorbed 3.26 per cent, 0.09 per cent and 1.19 per cent, respectively, of total manufacturing sector employees (Figure 5.2). Textile and clothing employed 23.14 per cent of the employees in the manufacturing sector, but contributed only 2.16 per cent of manufacturing GDP. Metal, paper and printing employed 9.5 per cent and 6.6 per cent, respectively, of manufacturing, suggesting that food manufacturing, metal, textile and clothing products are important sectors for employment creation, any challenges facing the sub-sectors should be addressed.

5.3 Sector's Performance within the International Context

Kenya's Vision 2030 envisages a middle-income economy that compares to economic status of newly industrialized countries such as China, South Korea, Malaysia and Singapore. The manufacturing sector is envisaged to propel the economy to a 10 per cent growth rate, in addition to creating more job opportunities and earning foreign exchange (Government of Kenya, 2007).

The importance of the manufacturing sector in facilitating competitiveness and growth of an economy to reach middle-income status is underlined in the sector's contribution to the country's GDP and exports. For instance, in 2010, manufactured products constituted more than 25 per cent of GDP value added in China, South Korea and Malaysia, and contributed 94 per cent, 89 per cent and 67 per cent, respectively, to merchandize exports (Figure 5.3).

Figure 5.3: Manufacturing sector performance for selected countries in 2010



Sources: World Bank (2011)

The contribution of Kenya's manufacturing sector to both GDP value added and exports is smaller relative to South East Asian countries, thus the sector must achieve major growth milestones for Kenya's economy to reach the envisaged middle-income status. This requires the sector to grow at a relatively higher rate than the current rate.

5.4 Challenges and Policy Options in the Manufacturing Sector

For the sector to generate employment, facilitate economic growth and exports, it requires interventions on both the supply and demand sides. Structurally, the size and growth of the sector has not progressed to desirable levels to reduce unemployment rates. Similarly, the level of investment remains low, which compromises the capacity of the sector to catalyze economic growth.

Several challenges explain the inherent weakness of the manufacturing sector in providing gainful employment and low priced products. First, the sector relies heavily on imported raw materials (except agro-processing), intermediate products, machinery and plant equipment. In 2010-2011, for instance, the main imports to Kenya were industrial machinery, petroleum products and motor vehicles. The sector is therefore vulnerable to maladjustments in the foreign exchange market.

When the Kenya shilling depreciates against major currencies, import bills go up. The extra cost is passed to consumers through higher prices of commodities. Deteriorating foreign exchange rate negatively affects the transformation of firms to efficient production methods because most of the new technology is sourced externally. Consequently, any inefficiency in operations of manufacturers is passed on to consumers, resulting in subdued demand, which is a disincentive for further investment.

Second, the consumption bundle in Kenya largely consists of processed foods, particularly maize meal, pasteurized milk, wheat flour and sugar. The value chains of these products reflect a non-

competitive market environment where production and processing of the products is partially regulated. For this reason, market mechanisms in addressing disequilibrium in resource and product markets is often curtailed. Therefore, high prices of related inputs and specific products persist for relatively longer periods, thus affecting both the consumers' purchasing power and growth of the food sub-sectors, and compromising the country's capacity to create employment.

Third, the performance of the manufacturing sector is dependent on an enabling macro environment in form of efficient communication, transport networks, and access to cheap energy sources. Whereas road and communication infrastructure has improved since 2008, manufacturers continue to incur huge energy bills leading to higher retail product prices. This stifles the level of local demand, making some firms to divest from the country.

Fourth, the influx of counterfeits and substandard goods in Kenya is still high, thus reducing the market share of existing legally established firms. Although the Anti-Counterfeit Act was established in 2008, its implementation has been weak due to inadequate human resource capacity and low political motivation to address counterfeiting.

To address these challenges, Kenya requires a drastic policy shift that focuses on fast-tracking export growth and reducing the high importation in the manufacturing industry. Kenya needs to prioritize interventions in the following areas:

Selective import substitution strategy

Kenya imports most of the machinery she uses. Past incentives that indirectly supported firm incubation through institutions such as the Industrial and Commercial Development Corporation (ICDC), Kenya Industrial Estates (KIE), District Joint Loans Boards, and the Kenya Tourist Development Corporation (KTDC) need to be revisited and remodelled to create capacity for production of intermediate goods and light machinery.

Overall, experiences of industrial pathways in newly developed economies such as China, South Korea and Malaysia show that growth in manufacturing has been due to reform efforts undertaken by the respective governments. At the onset was the strengthening of institutional governance., where top technocrats in these countries were assigned enforceable performance targets, which were backed by adequate resources. More importantly, to inspire investors' confidence, the respective governments addressed political uncertainty as safeguards against frequent and unpredictable alteration of the regulatory environment. The promulgation of the Constitution of Kenya 2010 is likely to form the basis for renewed efforts to reduce investor uncertainty.

Size factor and increased investment

The micro and small-scale firms constitute more than 72 per cent of industrial development in Kenya. Yet, small-firm clusters remain locked in low-quality products and low-income markets with little innovation to attract foreign demand. Given the limited large-scale establishments in the country, small enterprises are expected to increase employment. Innovation growth in small enterprises is normally limited to the apprenticeship process, leading indigenous technology progress to a dead-end. Investment is a key factor in providing the basis for economic growth because it serves as a channel for technological transfer, which stimulates innovative activities, thus allowing firms to improve and develop new products.

To address the problem of low investment related to firm size factor, the government should support large-small firm sub-contracting through fiscal incentives, thus encourage technology transfer and higher productivity. Similarly, the government should promote selective affordable

credit to enhance innovation among small-scale manufacturers.

Drive to improve the business environment

Incentives such as quality infrastructure, attractive fiscal package and minimal regulations promote investment. Thus, the development model of government that includes creating special economic zones (SEZs), as envisioned in the Kenya Vision 2030, should attract both local and foreign investments. For example, the 2030 flagship project to establish an industrial park at Dongo Kundu in Mombasa has potential multiplier effects. Kenya can leverage her coastal location for petroleum refinery from Uganda and South Sudan.

The government should also accelerate SEZs and industrial parks by enhancing urban planning, creating land banks and enacting a proper operational framework of projects under the public-private partnership.

Market expansion

Kenya exports her manufactured products mainly to Eastern African countries. However, these countries are rapidly widening their industrial establishment. Consequently, the regional market for products from Kenya is diminishing, thus negatively affecting investment decisions by the local exporters of manufactured goods.

In the end, Kenya must transform her industry structure to high value-addition products to increase her world market share of manufactured products. However, keeping the manufacturing sector in Kenya more vibrant in the immediate future requires a search for new markets, particularly in neighbouring countries such as South Sudan and Ethiopia, which have huge growth potential. To achieve this, the government should be more aggressive in bilateral arrangements and partnerships that will facilitate access by local manufacturers.

Chapter 6

Micro and Small Enterprises (MSEs)

6.1 Introduction

The Micro and Small Enterprise (MSE) sector in Kenya, like in many developing countries, is an important source of employment, services and innovation. The sector is growing, and it is increasingly contributing to the social and economic development of the economy. According to statistics from the Kenya National Bureau of Statistics (KNBS), the informal sector currently employs over 80 per cent of the working population, up from 40 per cent in the early 1990s.

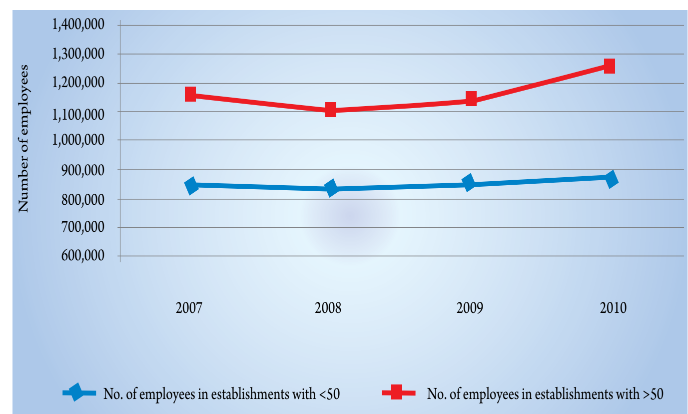
The exact definition of the MSE sector in Kenya is still unclear due to data and definitional challenges. For example, various policy documents use the term MSE and informal sector (or *Jua Kali*) interchangeably. This is perhaps because the majority of MSEs operate informally. In this report, MSEs are defined as formal and informal enterprises employing 1-50 people.

6.2 Recent Performance

6.2.1 Employment

Employment in MSEs in Kenya grew between 2008 and 2011 (Figure 6.1). The growth rate was, however, lower compared to large enterprises that contributed almost 60 per cent of the new jobs between 2009 and 2010 (Figure 6.2). In 2010, about 70 per cent of the formal enterprises in Kenya were MSEs. They employed 42.6 per cent of the population in the formal employment.

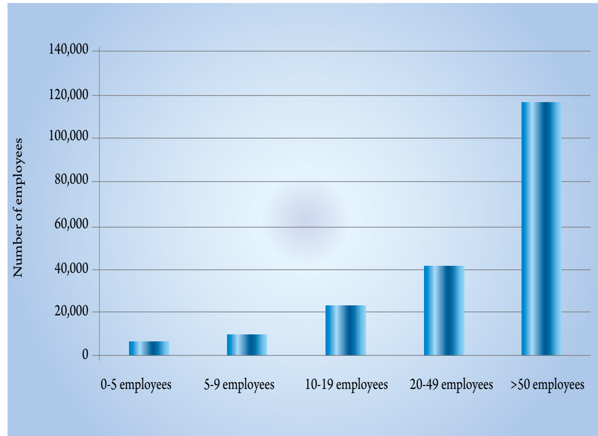
Figure 6.1: Employment figures



Source: Kenya National Bureau of Statistics (2011)

In 2010, 41 per cent of the new jobs were created in MSEs (Figure 6.2).

Figure 6.2: Number of new jobs (2010)

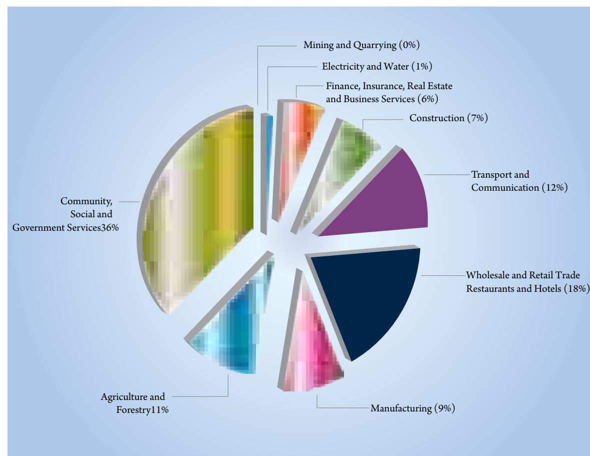


Source: Kenya National Bureau of Statistics (2011)

6.2.3 MSE establishments

MSEs are heterogeneous, covering all sectors of the economy. Majority of them operate in the service sector (Figure 6.3).

Figure 6.3: Number of establishments per sector (2010)



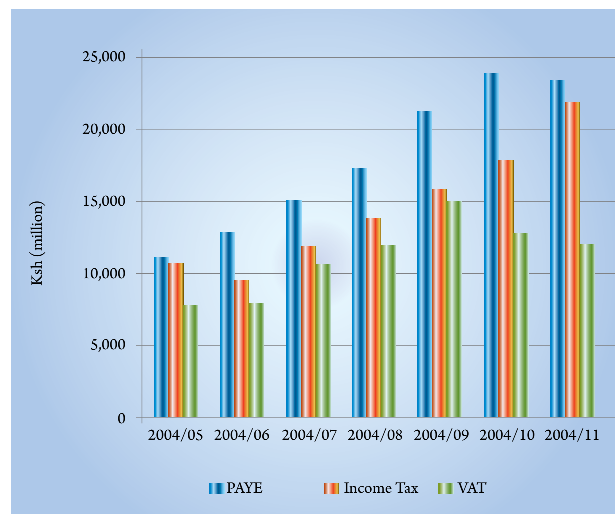
Source: Kenya National Bureau of Statistics (2011)

6.2.4 Tax performance

The introduction of Turnover Tax (TOT) gives small businesses with turnover of lower than Ksh 5 million but more than Ksh 500,000 the option to register for TOT. Businesses, however, are not obligated to apply for TOT as they have the option to remain in the normal tax regime on application to the Kenya Revenue Authority (KRA).

Other than the Turnover Tax (TOT), informal MSEs do not pay any other specific tax. However, formal MSEs are required to meet their tax obligations as provided in the Income Tax Act, like any other large business, including income tax, Pay as You Earn (PAYE) and Value Added Tax (VAT).

Figure 6.4: Tax performance for MSEs



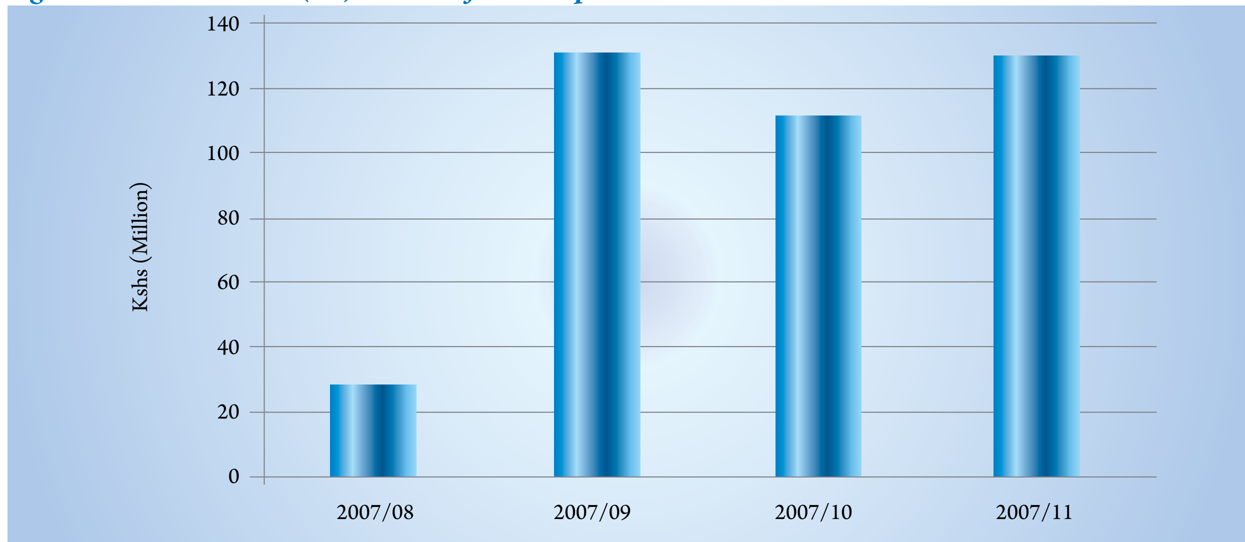
Source: Data obtained from the Kenya Revenue Authority (KRA)*

The reduction of VAT revenue illustrated above is attributed to the introduction of TOT, which was between Ksh 100 million and Ksh 130 million between 2008 and 2011 as illustrated in Figure 6.5.

6.2.5 Licensing

All businesses are required to obtain relevant licences from the different regulatory authorities. The government established the Business Regulatory Reform Unit (BRRU) under the Ministry of Finance in 2007. Its key mandate is to prevent arbitrarily introduction of licences (Musau, 2007). The BRRU also acts as the depository of licences in Kenya and has established an electronic registry of licences. As at June 2012, it hosted 440 licences from 51 regulatory agencies. Given licensing is scattered in the different regulatory agencies, this development has improved licensing of businesses.

Figure 6.5: Turnover tax (tot) revenues from inception



Source: Data obtained from the Kenya Revenue Authority (KRA)*

Business operators may not physically visit the respective agency for information on the licensing requirements and for the relevant application form. According to BRRU, there are plans to automate this function fully to facilitate electronic license applications, including payment. Currently, one can access and download the application forms but cannot complete or submit the licenses electronically.

6.2.6 Procurement

The Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises for Wealth and Employment Creation for Poverty Reduction subscribes that the government allocates or reserves at least 25 per cent of its procurement requirements to the sector. This provision was not implemented immediately due to lack of a legal provision to facilitate it, despite the enactment of the Public Procurement and Disposal Act (2005) (Cap 412C). Enactment of the Public Procurement and Disposal (Preference and Reservations) Regulations 2011 now addresses this. A major concern amongst stakeholders was that MSEs did not benefit from the Act. Lack of a definition of what constitutes MSEs may have been a contributory factor. These regulations now define micro, small and medium enterprises in terms of the number of employees and annual turnover. The regulations also provide the criteria for those who can benefit from the preference, which include: Copy of certificate of incorporation/registration; Personal Identification Number (PIN) certificate; VAT registration certificate; and Bank statements.

Much as this 'market access' support is only accessible to formal MSEs, it is a welcome development.

6.3 Institutional and Regulatory Framework for MSEs in Kenya

The key role of the government is to provide an enabling business environment for MSEs. Several government ministries and agencies undertake this, for example the ministries of Labour, Trade, Industry, Housing and Local Government which provide infrastructural support (Table 6.1).

Table 6.1: Infrastructural support for MSEs

Ministry/Agency	Infrastructural support
Ministry of Labour	Ministry of Labour has developed and upgraded 132 MSE worksites countrywide
Ministry of Industrialization	Under the Micro and Small Industries Development Programme (MSID), the Ministry is establishing Constituency Industrial Development Centres (CIDCs) under the Economic Stimulus Programme (ESP). Out of the 210 constituencies, 188 were identified, 112 completed and 47 upgraded to Industrial Development Centres (IDCs), of which two will be further developed into SME parks
Ministry of Housing	The Kenya Slum Upgrading Project under the Ministry of Housing identifies the promotion of the development of MSEs through: • Markets: To date, two markets have been developed; one in Nyeri with 12,000 beneficiaries and one in Kisumu with 10,000 beneficiaries • Kiosks systems: Fifteen kiosks established in Nairobi with 8,000 beneficiaries • Two skills enchantment centres in Kibera
Kenya Industrial Estates (KIE)	KIE has established 660 industrial sheds throughout the country since the 1960s. The majority are in Nairobi (68 sheds) and Kakamega (63 sheds)

Authors Compilation: Data and information obtained from the Ministry of Labour, Ministry of Industrialization, Ministry of Housing, and Kenya Industrial Estates (KIE)

6.4 Outstanding Challenges

Government support to MSEs is scattered amongst different ministries and government agencies as evidenced in infrastructural support to the sector. This contributes to implementation and coordination difficulties, thus policy implementation weaknesses. It creates overlapping and duplication of activities and wastage of resources.

A major challenge of the MSEs is their state of informality. A KIPPRA and Ernst and Young (2008) survey on MSEs revealed that only 28 per cent of firms sampled were registered. The reasons for non-registration included:

- Numerous registration requirements
- The business registration procedure is time consuming
- The long distance to Nairobi (the Registrar of Companies is based in Nairobi)
- Registration exposes the business to the authorities

Informality places MSEs at a disadvantage because they are often unable to access finance and contracts from the public sector. Gitonga (2008) established that MSEs that are involved in sub-contracting are more likely to grow. Linking with the public sector through sub-contracting can be very beneficial to the sector.

In Japan, the government is legally obligated to place a specific number of orders with SMEs (SMEA, 2002). In India, the government also identifies and preserves sourcing of certain goods exclusively from the micro, small and medium enterprises (Micro, Small and Medium Enterprises Development Act - MSMED, 2006). Kenya has now introduced similar support with respect to reservation in procurement through the Public Procurement and Disposal Act 2005 (Cap 412C).

Another challenge is that the process of starting either a small or a large business is the same, and

statutory obligations are also the same. Thus, incentives to MSEs to formalize are lacking.

Limited access to infrastructure is also a challenge for MSEs. The government has intensified efforts to provide worksites but efforts are scattered amongst different ministries and agencies, and the supply is yet to meet demand.

Best practice on support provided to MSEs in India

India has a vibrant MSE sector that makes significant contributions to output, employment and exports. The Government of India provides the sector with significant support through incentives, schemes and programmes. For instance:

- India reserves some items for use in manufacturing and production of certain products by small enterprises registered under the MSMED Act 2006.
- Deductions are allowed for small enterprises of 25 per cent of profits for 10 years as of April 2000. Furthermore, state government can offer additional incentives to small-scale enterprises, including tax holidays.
- The MSMED Act 2006 also introduced simplified business registration procedures to address the previous complicated registration regime (Ravi, 2009). Much as the registration of SMEs is voluntary, incentives are provided to those who register. The incentives provided in the statute include credit guarantee schemes, financial support, reduced customs duty, power tariff subsidies, and certain tax exemptions.

6.6 Recommendations and Conclusions

The recent support from the government towards the MSE sector seems focused on modern formal enterprises despite the fact that a large proportion of MSEs currently operates informally. It is therefore critical for the government to introduce incentives and mechanisms that promote enterprise graduation from informal to formal. In particular, there is need to:

- Identify statutory requirements that can be relaxed or subsidized for MSEs to reduce the regulatory burden.
- Institutionalize regulatory impact assessments to ensure that the regulatory environment is suitable to encourage the formalizing of MSEs, and ensure the sector is not over-regulated.
- Introduce a one-stop-shop where MSEs can access different agencies in order to reduce the cost and time loss associated with business registration and licensing. This is in line with the Kenya Vision 2030s' aim of improving the business environment and lowering the cost of doing business.
- The government has made significant progress in introducing e-licensing. It should prioritize its full automation to provide a mechanism where licensing can be completed, submitted, paid for and subsequently obtained electronically.
- Develop proper mechanisms for coordination and implementation of infrastructural projects. Kenya should consider establishing a single authority mandated to promote and develop MSEs to improve sector coordination.

Chapter 7

Tourism

7.1 Introduction

Tourism is important to Kenya's economy. It contributes about 5 per cent of the country's Gross Domestic Product (GDP). In the first five-year medium term plan (2008-2012) of the Kenya Vision 2030, tourism is one of the six sectors earmarked to accelerate overall growth of the economy to an annual average rate of 10 per cent between 2012 and 2030.

The overall target of the tourism sector between 2008 and 2012 is to increase the national tourism earnings from Ksh 52.7 billion in 2008 to over Ksh 200 billion in 2012. Other goals of the sector for the period include: raising the number of international visitors from 1.8 million in 2007 to 3 million; raising the average spending per visitor from Ksh 40,000 to at least Ksh 70,000; increasing hotel beds from 40,000 to about 65,000; and developing niche products as well as business and conference tourism (Government of Kenya, 2007). This chapter assesses the performance of the tourism sector to date against the above-mentioned targets, and projected performance for 2012-2014.

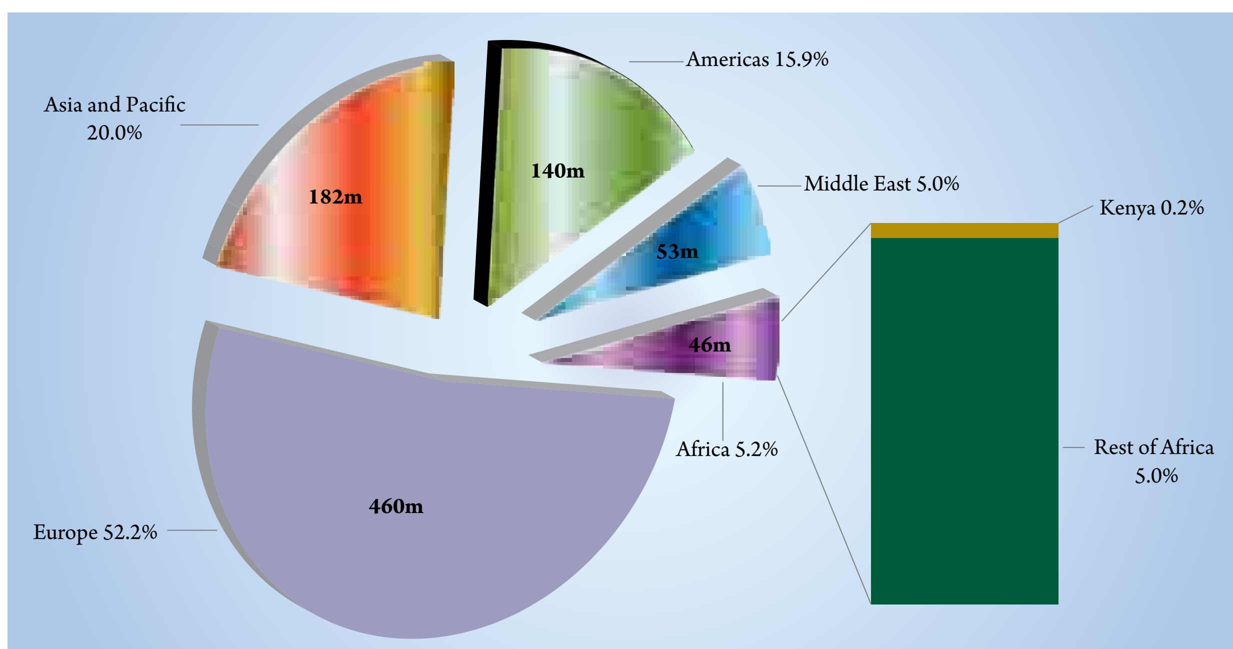
According to the latest UN World Tourism Organization's (WTO) *World Tourism Barometer*[1], international tourism arrivals expanded by 4 per cent in 2011, setting a new record of 980 million (Table 7.1). The decline from 924 million in 2008 to 881 million in 2009 was due to the global financial crisis. International tourist arrivals to Kenya account for about 3.2 per cent of total inbound tourists from Africa (that is, 1.49 million out of 46 million in 2009) and only 0.2 per cent share of global tourism market (Figure 7.1). Moreover, Kenya's tourism receipts account for 0.1 per cent of the global total.

7.2 Recent Tourism Sector Performance

7.2.1 Tourist arrivals and revenue

Building over previous year's achievements, the tourism sector registered positive results in 2011. During the period January-October 2011, arrivals closed at 1,039,852 compared to 896,228 for the same period in 2010, accounting for 16 per cent growth. By the end of 2011, total arrivals were 1.82 million, registering a 13 per cent growth over the previous year (Table 7.1). The efforts to diversify source markets by venturing into emerging economies contributed to this growth, which is higher than the global and regional rate of 4.5 per cent and 4 per cent, respectively. Consequently, the estimated tourism receipts for the period ending 2011 closed at a record Ksh 98 billion, a 33 per cent

Figure 7.1: Global market shares for tourism arrivals, 2009



Source: Computed from World Tourism Organization-UNWTO (2009)

growth over the previous year (Ministry of Tourism, 2012; Kenya National Bureau of Statistics, 2012).

Although tourism performance in 2011 recorded some growth, the traditional markets performed less than anticipated. The Euro Zone crisis, a slow US economy and border insecurity/terrorism threats to Kenya contributed to this low performance. The emerging markets drove total growth, with most of these recording above 40 per cent growth. These included Hungary (42.1%), Russia (46.6%), UAE (46.8%), Poland (62.9%) and Czech Republic (51.6%). Among visitors from Africa, Uganda led with 36,030 visitors, South Africa 31,355, and Tanzania with 28,435 visitors–a growth of 36.5 per cent, 13 per cent and 11 per cent, respectively, over the period (Ministry of Tourism, 2012; Kenya National Bureau of Statistics, 2012).

Table 7.1: Inbound tourist arrivals and revenue, 2008-2011

Performance Indicator	2008	2009	2010	2011
International arrivals (No. millions)	1.20	1.49	1.61	1.82
Growth in arrivals (%)	-33.79	23.86	7.99	13.04
Tourism earnings (Ksh billions)	52.70	62.50	73.68	97.90
Growth in earnings (%)	-19.17	18.60	17.89	32.87

Source: Kenya National Bureau of Statistics (2009), and Ministry of Tourism (2011)

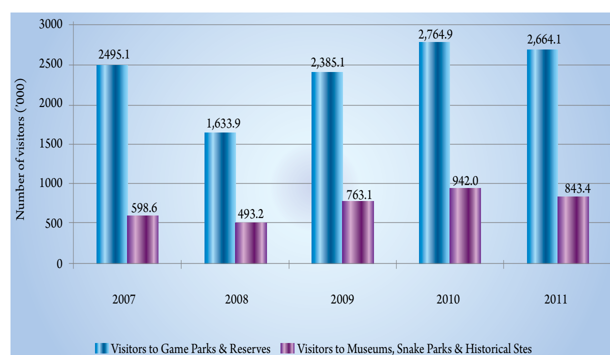
The tourism sector's growth followed aggressive marketing campaigns by the Kenya Tourist Board (KTB), which targeted emerging tourist markets. The KTB enhanced partnerships with international travel and leisure organizations and airlines, invested in market-specific advertising, market missions, joint marketing with tourism trade partners, public

relations activities, and participated in travel and tourism exhibitions (Ministry of Tourism, 2012).

7.2.2 Visitors to parks and museums

Improved volume in local and international tourist arrivals translated to more visitors to museums, snake parks and historical sites. This expanded by 23.67 per cent in 2010. The number of visitors, however, declined by 10.47 per cent in 2011. Visitors to game parks and reserves increased by 15.67 per cent in 2010, but declined by 3.65 per cent in 2011 (Figure 7.2). Increased road construction works around Nairobi may have caused this decline.

Figure 7.2: Visitors to game parks and reserves, 2007-2011



Source: Calculations from Kenya National Bureau of Statistics (2007-2012)

7.2.3 Conference tourism

Conference tourism development is part of the Meetings Incentives Conferences and Exhibitions (MICE) sub-sector. The MICE is one of the six sub-programmes that the Ministry of Tourism runs. With the exception of Kenyatta International Conference Centre (KICC), most of the other conference and meeting facilities are within hotels, rooming and other lodging facilities such as guest houses and lodges, institutions of higher learning, think tanks and religious institutions. The MICE sub-sector has a high multiplier effect. It generates jobs through shopping, travelling, accommodation and amusement through forward and backward linkages with other sectors of the economy.

In 2011, international conferences and delegates decreased by 20 per cent and 82 per cent, respectively. Domestic conferences and delegates increased by 29 per cent but decreased by 28 per cent, respectively (Table 7.2). Trade fairs recorded the highest growth in events (100%), while exhibitions recorded the highest growth in number of delegates (323%). Overall, events increased by 11.5 per cent but registered a decline in participants (11.6%).

Table 7.2: Conference tourism–Number of events and delegates

Type of Meeting / Event	2009		2010		2011		Growth (2010-2011) %	
	Events	Delegates	Events	Delegates	Events	Delegates	Events	Delegates
International conferences	20	19,695	15	14,937	12	2,698	-20.0	-81.9
Domestic conferences	13	6,250	17	11,550	22	8,360	29.4	-27.6
Trade fairs	10	1,670	8	1,442	16	1,580	100.0	9.6
Exhibitions	28	4,334	27	1,111	20	4,702	-25.9	323.2
Corporates	74	70,910	69	83,352	103	89,543	49.3	7.4
NGO and Special	64	15,554	60	21,004	29	6,842	-51.7	-67.4
Ministries	178	42,375	149	49,888	173	38,821	16.1	-22.2
Parastatals	91	18,525	102	22,609	102	22,082	0.0	-2.3

Type of Meeting / Event	2009		2010		2011		Growth (2010-2011) %	
	Events	Delegates	Events	Delegates	Events	Delegates	Events	Delegates
Banquets	34	20,920	30	20,607	27	14,940	-10.0	-27.5
Special Events and Others	-	-	-	-	28	60,390	-	-
Total	512	200,233	477	226,500	532	249,958	11.5	10.4

Source: Kenyatta International Conference Centre - KICC (2011 and 2012)

Kenya's position in the global MICE industry

According to the International Congress and Convention Association (ICCA) and the Global Association of the Exhibition Industry (formerly known as the Union des Foires Internationales (UFI)), 400,000 conferences and exhibitions are held world-wide annually at an outlay of over US$ 30 billion. Cumulatively, in 2007, annual MICE industry output value reached US$ 1.16 trillion. Some countries rely heavily on the MICE segment – 30 per cent of Singapore's tourism revenue is from MICE, while Malaysia is specifically targeting the MICE market, running schemes such as the *Meet and Experience campaign*.[2] MICE is, therefore, a reliable source of enormous economic benefit to countries and cities.

Although Kenya's MICE sub-sector is fourth in Africa (based on number of international meetings it hosts), it accounts for a paltry 0.2 per cent of the global market (ICCA, 2009). Consequently, Kenya's MICE industry is over Ksh 3.59 billion annually[3] (Table 7.3). However, this needs to be verified empirically through further research.

Table 7.3: Estimated conference tourism market share by region, 2005-2009

Region / Country	Estimated Value (US$ million)	Market Share (%)
Europe	17,400.0	58.00
Asia	5,400.0	18.00
North America (United States and Canada)	3,150.0	10.50
South America	2,100.0	7.00
Australia	1,200.0	4.00
Africa	750.0	2.50
Total	30,000.0	100.00
Market share within Africa		
South Africa	328.5	1.10
Egypt	87.8	0.29
Morocco	64.5	0.22
Kenya	47.3	0.16
Others	222.0	0.74
Sub-total	750.0	2.50

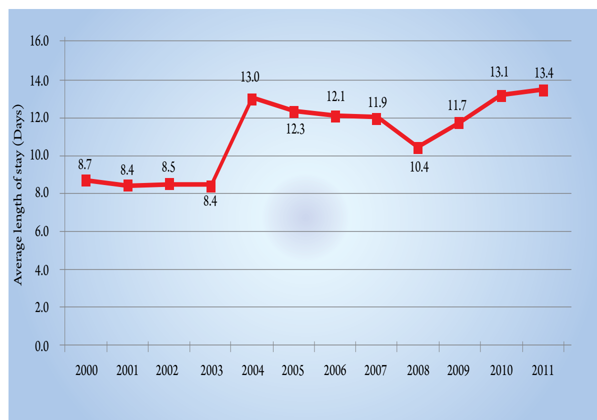
Source: International Congress and Convention Association–ICCA (2009)

According to the World Economic Forum (2010), business and conference travel is Kenya's third major tourism product line. While Africa has a relatively small share of growing global convention and conference demand, Kenya's largest conference centre, the Kenyatta International Conference Centre (KICC), can hold up to 5,000 attendees in a single event. KICC MICE facilities now receive over 450 events and 200,000 delegates annually (Table 7.2). There is need to boost the occupancy rate of KICC from the current level of 45 per cent to develop additional conference facilities to host bigger events and to establish facilities in key towns in counties. In addition, for policy and planning purposes, Kenya needs to empirically measure the contribution and impact of MICE events to the Kenyan economy.

7.2.4 Average length of stay

Some of the key determinants of per capita spending in tourism are length of stay or the number of nights spent at a destination. In 2011, Kenya achieved the highest average length of stay (13.4 days) in a decade. It improved by 2.3 per cent more than 2010 (Figure 7.3). The strategies used to achieve this trend should be sustained and enhanced. Opportunities should also be enhanced to increase per capita tourist spending for the tourism sector to achieve the high revenue targets set in the Kenya Vision 2030. In this regard, tourism product development and marketing efforts should target source markets with high per capita income, and visitors who tend to stay longer. For instance, in 2009, tourists from China spent an average of 28 nights compared to only four spent by tourists from the Middle East.

Figure 7.3: Trend in average length of stay (days) for international visitors, 2000-2011

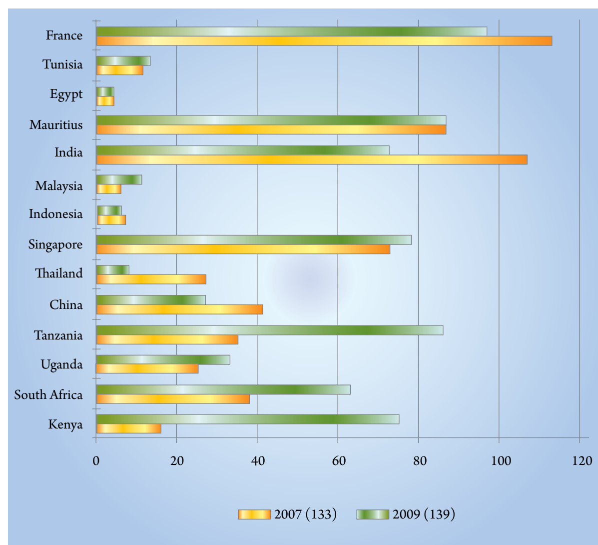


Source: Kenya National Bureau of Statistics (2001-2011)

7.2.5 Hotel Price Index

This index, developed by the UN World Tourism Organization, measures the average price in US dollars of first-class hotel accommodation in each country. The index is calculated by using the average room rate achieved by first-class hotels in each country over a 12-month period from January through December to mitigate the impact of any seasonality fluctuations. Among the sampled countries, Tunisia, Egypt, Malaysia and Indonesia were the cheapest. France, Mauritius, India and Tanzania were considered most expensive in 2009/10 (Figure 7.4). Between 2007 and 2010, the room rates in Kenya rose by 51 per cent. These were the highest among selected countries. The sharp increase was partly due to the post-election crisis, insecurity, macroeconomic uncertainty, and the global financial crisis.

Figure 7.4: Hotel price index for selected countries



Source: World Economic Forum (2010 and 2011)

Note: Rank in 2006/07 is out of 133 countries while that of 2008/09 is out of 139 countries

7.2.6 Hotel bed nights and occupancy rates

In 2011, bed-night occupancy improved to 40.3 per cent from 38.8 per cent in 2010. However, it failed to return to the 2007 level of 47.2 per cent. Domestic tourists accounted for over one-third (37%) of all bed-nights occupied in the country in 2011 (Table 7.4), an improvement of 2 per cent more than the previous year. In terms of bed-nights occupied, visitors from five traditional markets included the United Kingdom (10.9%), Germany (9.7%), Italy (7.1%), USA (4.0%) and France (3.4%). However, their performance over the previous year was marginal (Kenya National Bureau of Statistics, 2011). The potential for growth in domestic tourism is high and can be exploited by developing tourism facilities and affordable products that are attractive to low-medium income Kenyans.

Table 7.4: Domestic tourism share of total bed nights

Year	Total bed-nights available ('000)	Total bed-nights occupied ('000)	Occupancy rate (%)	Bed-nights occupied by Kenyans ('000)	Occupied by Kenyans (%)
2005	10,845.6	4,476.6	41.28	1,129.6	25.23
2006	13,003.5	5,922.1	45.54	1,374.8	23.21
2007	14,711.6	6,939.4	47.16	1,869.8	26.94
2008	14,233.6	3,699.0	25.99	1,566.6	42.35
2009	17,125.3	6,242.8	36.45	2,150.9	34.45
2010	17,161.8	6,661.9	38.82	2,348.9	35.26
2011	17,419.6	7,015.3	40.27	2,603.4	37.11

Source: Compiled from Kenya National Bureau of Statistics (2006-2012)

Although the coast region accounted for 50 per cent of all bed-nights, its share decreased by 4 per cent to other regions between 2010 and 2011 (Table 7.5). This was a significant improvement in regional dispersion of tourism. Kenya should enhance this through development of tourism infrastructure in other less-visited regions of the country.

Table 7.5: Distribution of hotel bed-nights in Kenya by region (%)

Region	2007	2008	2009	2010	2011
Coast - Beach	54.3	44.44	48.24	48.68	44.83
Coast - Hinterland	3.03	2.54	3.38	1.8	4.05
Coast - Other	2.21	3.19	2.44	2.27	1.17
Nairobi - High class	14.82	19.36	18.65	16.87	16.47
Nairobi - Other	4.36	6.07	7.98	6.16	7.50
Maasai-land	7.49	6.27	5.01	7.09	9.74
Central	5.6	6.9	5.57	6.96	5.97
Nyanza	3.55	5.01	3.42	4.52	4.30
Western	3.38	6.07	5.11	5.47	5.34
Northern	1.24	0.15	0.21	0.19	0.63
Total Occupied	100.0	100.0	100.0	100.0	100.0

Source: Computed from Kenya National Bureau of Statistics (2006-2012)

Development of proposed tourist resort cities will generate significant demand for hotel rooms and related facilities over the next decade (e.g., conference facilities, shopping and entertainment facilities, and other value added products such as spas and medical tourism). Kenya needs to enhance the investment climate for the development and expansion of tourism infrastructure.

7.3 Policy Implications and Recommendations

The Kenya tourism sector registered impressive performance in 2011 following aggressive marketing campaigns by the Kenya Tourist Board, and enhanced partnerships with international travel and leisure organizations and airlines. However, the economic crisis in the Euro zone may have an impact on Kenya's tourism industry in the short-term, because Europe is one of Kenya's main source markets. To keep up the great performance and mitigate the effects of economic downturn in Europe, there is need for:

i) More funding to KTB (and the sector) to step up destination-specific promotional activities

(including advertising, joint marketing with trade partners, public relations and participation in travel and tourism exhibitions) in emerging markets such as BRIC countries (Brazil, Russia, India, China), UAE and Scandinavian countries. Apart from attracting tourists from high-income markets, product development efforts should target high spending tourists who stay longer and business travellers who visit for brief periods such as for MICE events.

ii) Kenya and other EAC member states should upscale promotion of tourism in domestic and regional markets, along with expanding regional trade. Potential products include cheap group package tours, medical and sports tourism. In this regard, there is need to fast-track removal of tariff and non-tariff barriers to free movement of labour and capital within the EAC, and review taxes to enhance tourism. Kenya should negotiate with Tanzania to abolish the levy imposed on tour vans crossing the border from Kenya into Tanzania in order to enhance intra-EAC tourism.

iii) Address regional security issues to counter terrorism threats, for example by building the capacity of the tourism and border patrol police units.

Lastly, given the importance of the MICE sub-sector to the country, there is need to grow this market niche through strategic development and by enhancing the capacity of KICC to higher than the current 45 per cent, and developing modern MICE facilities at each county. In addition, for policy and planning purposes, the contribution and impact of MICE events to the Kenyan economy should be measured empirically.

END NOTES

1. The UNWTO World Tourism Barometer is a regular publication of the Market Intelligence and Promotion Department of UNWTO, http://media.unwto.org/en/press-release/2012-01-16/international-tourism-reach-one-billion-2012

2. ICC website: www.iccaworld.com; UFI website: www.ufi.org; http://www.onecaribbean.org/content/files/MICE.pdf

3. Using exchange rate of 1US$:Ksh 75.82 as at 31/12/2009; http://www.centralbank.go.ke/forex/default.aspx

Chapter 8

Trade

8.1 Introduction

Kenya identifies trade as one of the key sectors in economic development because the sector links production and consumption. According to the Kenya Vision 2030, both of these are expected to expand substantially. The trade sector plays a crucial role towards the attainment of national development objectives, particularly those envisaged in the Vision 2030 and the Millennium Development Goals (MDGs) 1 and 8. Moreover, trade is a major contributor to the GDP; it accounted for 66.3 per cent in 2011 and also accounts for 10 per cent of formal employment. Trade can be classified broadly into domestic and international trade.

8.2 Domestic Trade

Domestic trade encompasses wholesale and retail trade. These involve distribution of goods and services. Trade in services is one of the most important sectors of Kenya's economy both in terms of GDP and employment creation. Between 2000 and 2010, the average annual growth rate of the sector was generally high compared to other sectors. Whereas in 1990 the sector accounted for 49.4 per cent GDP, this increased to 63 per cent and 66 per cent in 2010 and 2011, respectively. In employment, trade contributed a share of about 68 per cent. More importantly, the sector has always had an overall surplus in the current account in Kenya's balance of payments (KIPPRA, 2010). The most important sub-sectors include tourism, transport, travel, communication, insurance, royalties and licenses and fees.

Electronic trade, commonly known as e-commerce, involves the buying and selling of products or services over electronic systems such as the Internet and other computer accessories. Electronic commerce draws on such technologies as electronic funds transfer, supply chain management, Internet marketing, online transaction processing, electronic data interchange (EDI), inventory management systems, and automated data collection systems.

E-commerce is a relatively new means of trade. It is evolving rapidly and providing impetus to trade development. Currently, the government is focusing on developing policies that recognize the electronic aspects of trade in the transformation of the economy into a modern market-oriented one. The arrival of The East African Marine Systems (TEAMS) fibre optic cable heralded a new era of better and faster Internet connection. Business expectations are higher, too. The growth of e commerce has great potential to expand markets, productivity and competitiveness. Therefore, collecting the increased

revenue arising from e-transactions through taxation is an emerging challenge for the government.

8.3 Performance Indicators of Selected Economic Activities

Fluctuations were recorded in the economy's performance in selected sectors. For example, wholesale and retail trade contribution to GDP grew marginally from 10.2 per cent in 2010 to 10.6 per cent in 2011. Transport and communication, real estate and rental and manufacturing sectors registered a decline, while hotels and restaurants stagnated (Table 8.1).

Table 8.1: Gross domestic product by activity, 2006-2011

	2006	2007	2008	2009	2010	2011
Wholesale and Retail	9.3	9.7	10.1	9.8	10.2	10.6
Hotels and Restaurants	1.5	1.6	1.1	1.7	1.7	1.7
Transport and Communication	10.6	10.6	10.2	9.8	10.0	9.7
Financial Intermediation	4.0	4.8	4.6	5.5	5.6	6.4
Real Estate and Rental	5.4	5.3	5.1	4.9	4.8	4.5
Agriculture	23.4	21.7	22.3	23.5	21.4	24.0
Manufacturing	10.3	10.4	10.8	9.9	9.9	9.4

Source: Kenya National Bureau of Statistics (2011; 2012)

Table 8.2 shows that finance, insurance, real estate and business services and wholesale, retail, restaurants and hotels registered the highest rate of growth in terms of employment creation at 6.3 per cent and 5.5 per cent, respectively.

Table 8.2: Wage employment by industry in the private sector, '000' people

	2006	2007	2008	2009	2010	2011	% change	% Share 2011
Private Sector								
Agriculture and Forestry	280.3	289	289.7	288	291.8	293.0	0.4	20.25
Manufacturing	228.5	237.9	237.2	238.6	238.6	247.6	2.1	17.10
Wholesale, Retail, Restaurants and Hotels	179.6	189.8	196.4	209.2	220.6	232.3	5.3	16.05
Transport and Communications	90.9	117.8	120.3	124.7	132.2	138.0	4.4	9.53
Finance, Insurance, Real Estate and Business Services	75.5	79	81.9	84.3	87.1	94.7	6.3	6.55
Others	352.9	368.2	380.4	401.7	426.7	441.7	3.5	30.53
Total Private	1207.7	1,281.70	1,305.90	1346.5	1,397.00	1446.6		100.00

Source: Kenya National Bureau of Statistics (2011; 2012)

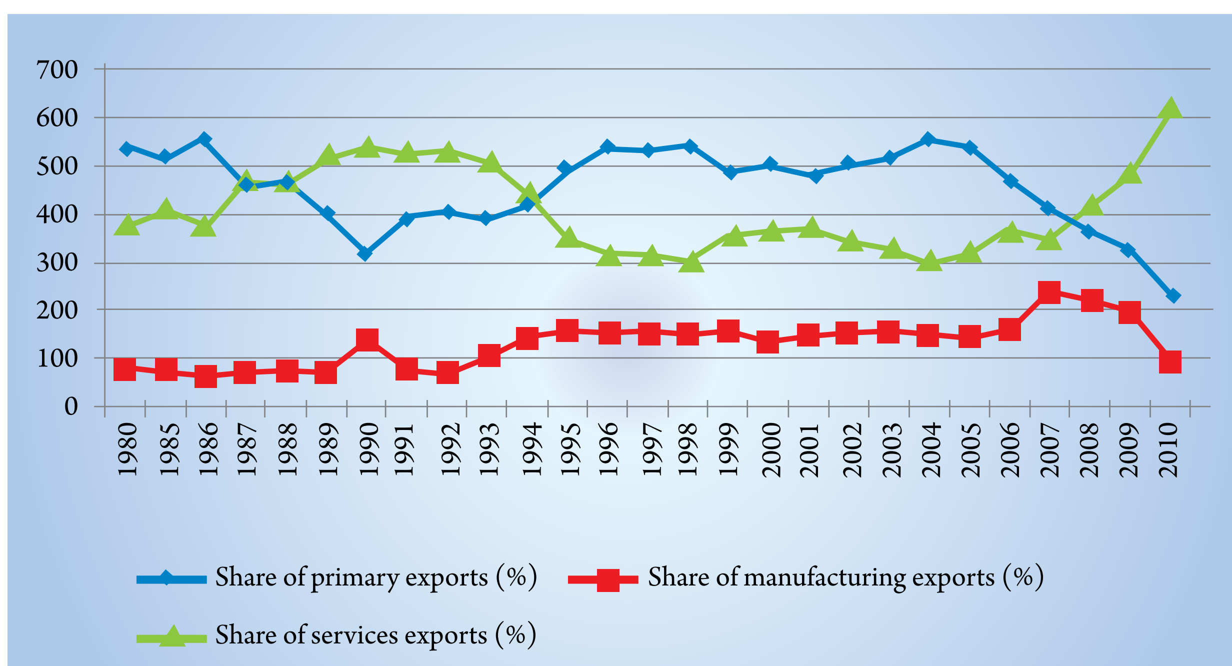
Table 8.3: Employment in the informal sector by industry, '000'

	2006	2007	2008	2009	2010	2011	% change	% Share 2011
Manufacturing	1492.7	1567.1	1644.2	1711.2	1801.1	1829.3	1.6	19.7
Building and Construction	194.7	202.8	211.4	217.5	228.9	243.3	6.3	2.6
Wholesale, Retail, Restaurants and Hotels	4177.3	4446.2	4719	5003.7	5266.8	5593.0	6.2	60.3
Transport and Communications	214.2	228.8	243.5	259.4	273	287.6	5.3	3.1
Community, Social and Personal Services	668.2	715.4	763	815.3	858.1	900.8	5.0	9.7
Others	321.5	341.3	361.4	381.9	401.9	418.1	4.0	4.5
Total Public	7,068.6	7,501.6	7,942.5	8,389	8,829.8	9272.1		

Source: Kenya National Bureau of Statistics (2012)

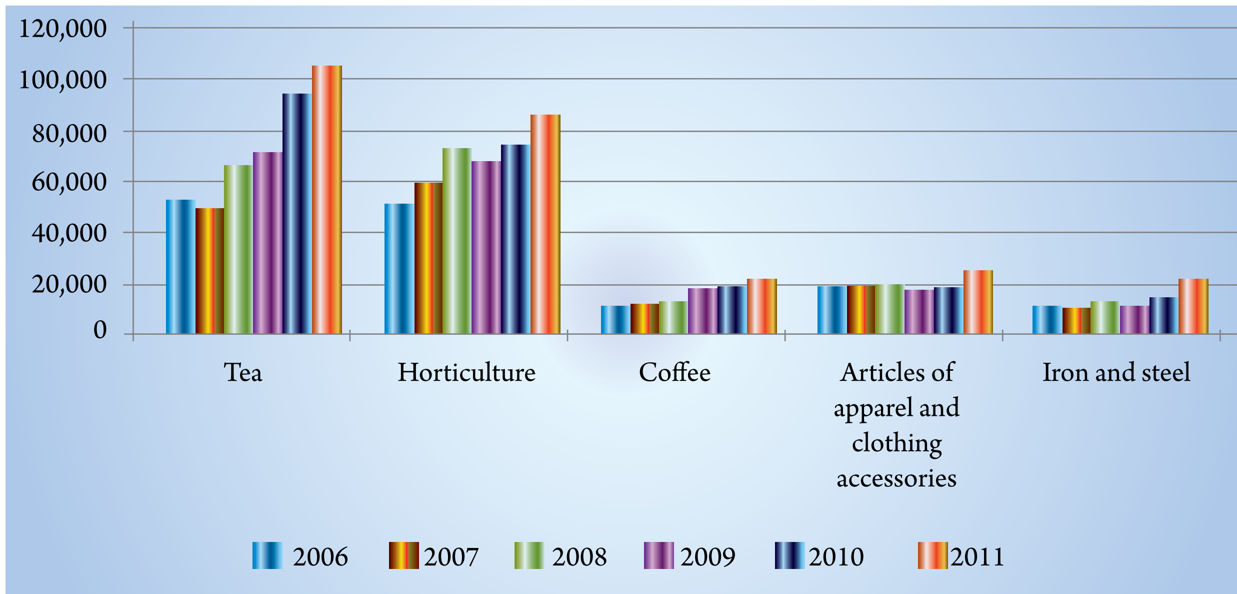
The wholesale and retail sub-sector generated the most jobs in the informal sector. This was about 60.3 per cent of all employment in 2011 (Table 8.3). Manufacturing accounted for 19.7 per cent of all jobs, while transport and communication accounted for less than 5 per cent. Given that wholesale and retail trade is distributed evenly across the country, it has the potential to create employment in rural areas. It can, therefore, play an important role in mitigating the high cost of living in Kenya.

Figure 8.1: Sector composition of exports (% share) in Kenya



Source: Kenya National Bureau of Statistics (various); World Bank (various)

Figure 8.2: Structure of Kenyan exports (top five exports) in Ksh million



Source: Kenya National Bureau of Statistics (2011)

8.3.1 External Trade

Structure of Kenya's external trade

The main tradables are from the agricultural, manufacturing and services sectors. In 2010, trade as a share of GDP was 63.7 per cent while exports accounted for 28.6 per cent and imports contributed 35.1 per cent. Between 1980 and 2010, the export composition changed slightly, with primary commodities constituting the largest share (47.5%) of the value of export products. The services sector accounted for 39.9 per cent and the manufacturing sector about 12.5 per cent. The share of primary exports, which had dominated the export basket for most of this period, began declining in 2004 (Figure 8.1). The share of the services exports grew significantly, with the sub-sector dominating the other sub-sectors during 2008-2010 period.

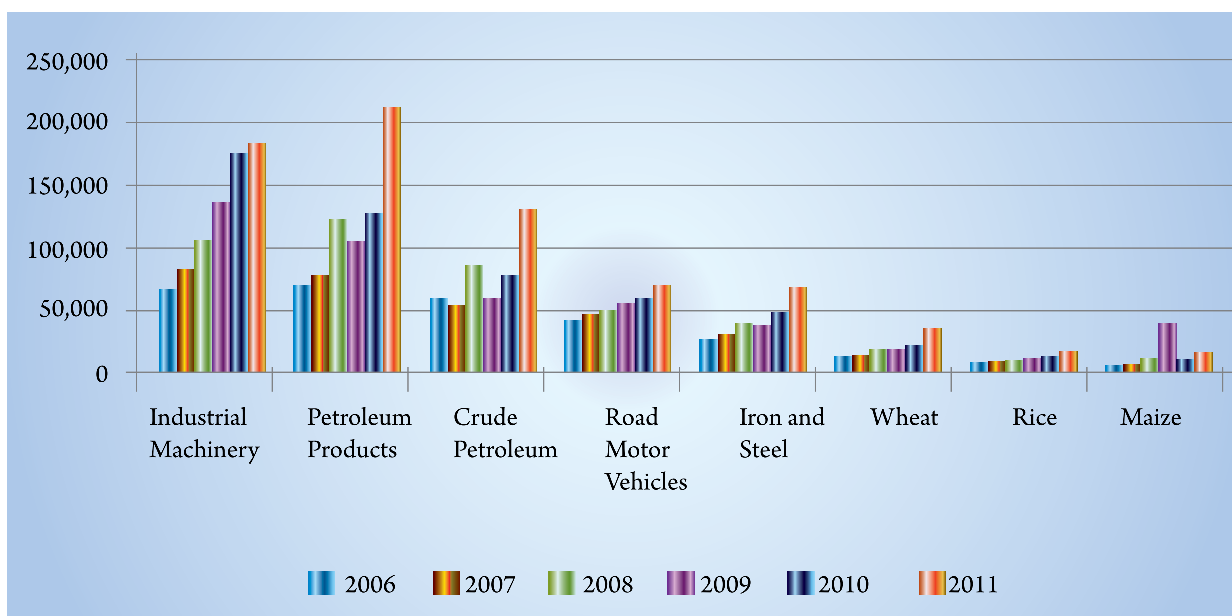
Agricultural commodity exports still dominate Kenya's exports, with the five exports (Figure 8.2) being tea, horticulture, and coffee, articles of apparel and clothing accessories and iron and steel. Reliance on primary commodity exports exposes a country to external shocks because these products are prone to price fluctuations. Kenya is the leading exporter of both tea and horticultural products in Africa and fourth in the world. Kenya accounts for about 60 per cent of total world's rose flower exports. Coffee is the third leading export commodity for Kenya.

Kenya's top imports (food and non-food) include industrial machinery, petroleum products, crude petroleum, motor vehicles, iron and steel, wheat, rice and maize (Figure 8.3). Fuel imports account for about a third of Kenya's imports, and this exposes the economy to fuel-related external shocks. Despite the high potential for wheat, rice and maize production in Kenya, the country imports significant amounts of these food products.

8.3.2 Regional trade performance

Regional Trade Arrangements (RTAs) are instrumental in promoting global trade and foreign direct investments (FDI). Currently, between 50 per cent and 60 per cent of global trade benefits from regional preferences (WTO, 2007). Kenya actively participates in two regional trade agreements: the East African Community (EAC) and the Common Market for Eastern and Southern Africa (COMESA). EAC is the most advanced regional economic grouping in Africa, although the

Figure 8.3: Structure of Kenya's main imports in Ksh million



Source: Kenya National Bureau of Statistics (2011)

process of establishing an EAC monetary union, which began in 2011, is still going on. The last stage of economic integration will be the formation of a political federation slated for 2015.

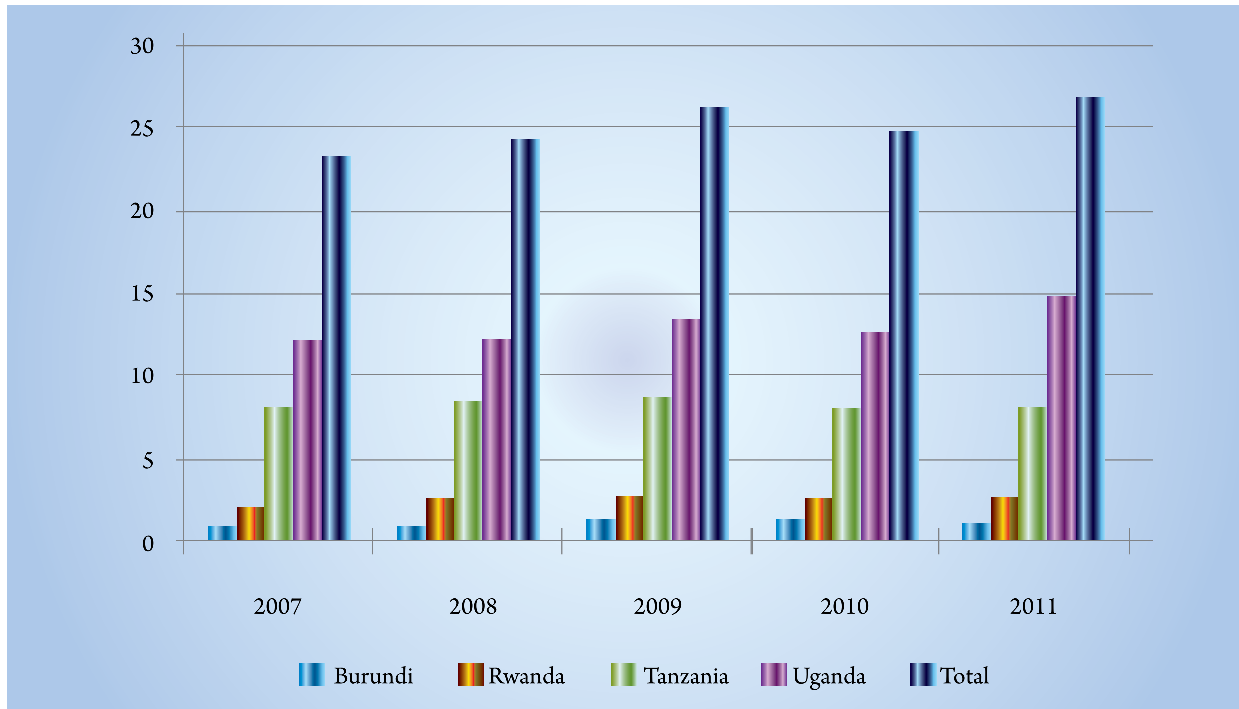
Plans are at an advanced stage to merge the three RTAs in Southern Africa; that is COMESA, EAC, and the Southern African Development Cooperation (SADC) to form a tripartite Free Trade Area (FTA). The main benefits of the envisioned tripartite FTA include an enlarged market, and elimination of overlapping membership that has constrained trade in the region especially through conflicting and differing rules of origin (RoO).

East African Community

The EAC, which was revived in 1999, consists of Burundi, Kenya, Rwanda, Tanzania and Uganda. Burundi and Rwanda acceded to the EAC in 2007. The EAC covers an area of approximately 1.82 million square kilometres, a population of about 133.5 million (2010) and a GDP of US$ 74.5 billion (2010 estimates). In an attempt to enhance economic integration, the EAC countries established a Custom Union on 1st January 2005 and became operational on 1st January 2010. The EAC Common Market Protocol was signed in November 2009 and ratified in 2010. This paved way for free movement of capital and persons. The EAC is now working towards establishing a monetary union by the end of 2012.

Trade among the five EAC partner states grew from US$ 1.81 billion in 2004 to US$ 4.06 billion by 2010, an increase of 124 per cent. The establishment of the Customs Union in 2005, among other factors, may have contributed to this growth. Despite this growth, the share of intra-EAC trade to total EAC trade has declined from 13 per cent in 2004 to about 11 per cent in 2010. Agricultural and manufactured commodities characterize intra-EAC trade to some extent. Food, live animals, beverages, tobacco and inedible crude materials are still dominant. Kenya's exports to the region are, however, more diversified to include chemicals, fuels and lubricants, machinery and transport equipment (East African Community, 2011).

Figure 8.4: Percentage share of Kenya's total exports to EAC

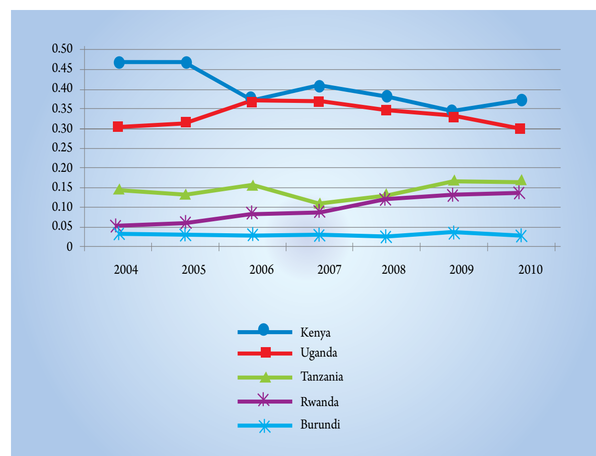


Source: Kenya National Bureau of Statistics (2012)

The EAC countries are major export destinations for Kenyan goods. For example, in 2011, Uganda was Kenya's leading export destination (absorbing 14.8% of the country's total exports). Tanzania was fourth (8%) and Rwanda tenth (2%) (Figure 8.4). Kenya's total exports to EAC increased by 35 per cent from US$ 1.61 billion to US$ 1.19 billion between 2010 and 2011.

Figure 8.4 indicates that Kenya's exports to Tanzania over the five-year period have almost stagnated. However, exports to Uganda have increased from 12.7 per cent to 14.8 per cent, while exports to Rwanda increased by 0.08 per cent. Kenya's exports to the EAC in 2011 accounted for 55.3 per cent of the country's total exports to Africa and 26.8 per cent of total exports to the world. Between 2010 and 2011, Kenya's imports from EAC increased by 31 per cent from US$ 232 million to US$ 305.9 million. This is because of increased importation of milk and cream, maize and dried leguminous vegetables from Uganda, and rice and sugar from Tanzania (Kenya National Bureau of Statistics, 2011). Overall, Kenya's exports to EAC grew from US$ 1.2 billion in 2008 to US$ 1.92 billion in 2010, an increase of 58 per cent (Kenya National Bureau of Statistics, 2012).

Figure 8.5: Kenya's share in total EAC trade

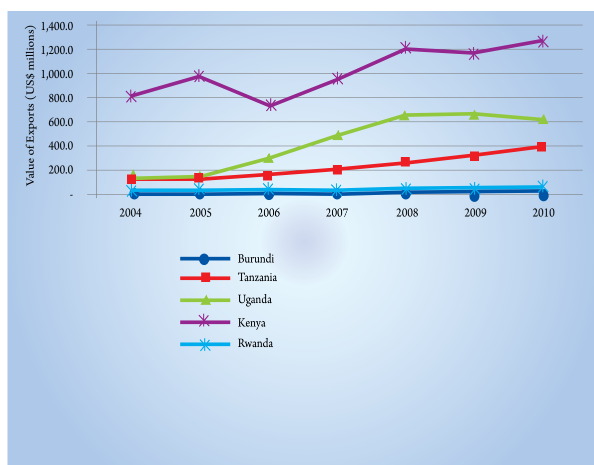


Source: EAC Secretariat (2011)

Kenya accounted for about 40 per cent of intra-EAC trade, with Uganda and Tanzania accounting for 33 per cent and 14 per cent, respectively (East African Community Secretariat, 2011). It is, however, important to note that Kenya's share has decreased

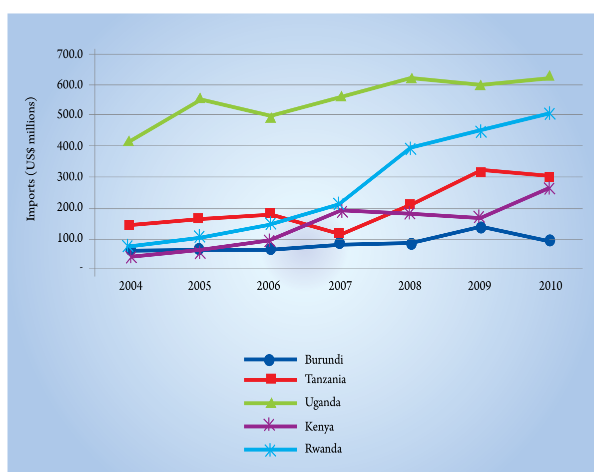
from a high of 47 per cent in 2004 to a low of 34 per cent in 2009 (Figure 8.6). This implies that although Kenya dominates exports and imports in the EAC (Figure 8.6 and 8.7), the trade share of her partner states has increased in the recent years.

Figure 8.6: Intra-EAC exports: 2005-2010 (US$ millions)



Source: EAC Secretariat (2011)

Figure 8.7: Intra-EAC imports: 2005-2010 (US$ millions)



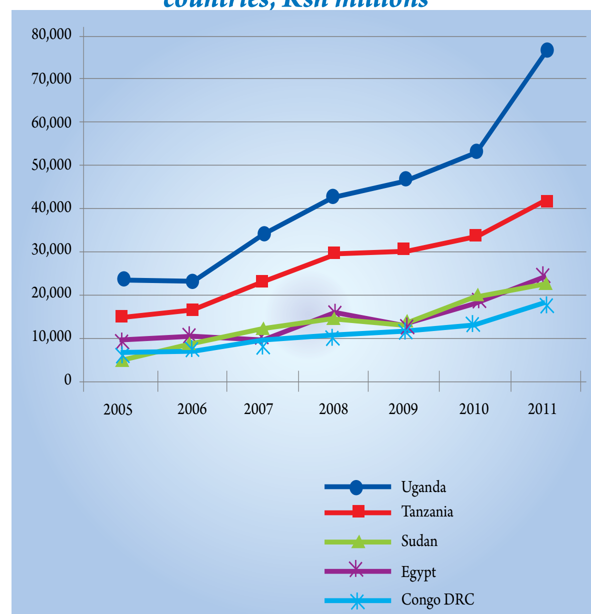
Source: EAC Secretariat (2011)

Common Market for Eastern and Southern Africa

The Treaty establishing COMESA was signed on 5th November 1993 in Kampala, Uganda. COMESA comprises 19 member countries: Burundi, Comoros, DRC Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Seychelles, Madagascar, Malawi, Mauritius, Rwanda, Sudan, Swaziland, Uganda, Zambia and Zimbabwe. The population within the COMESA is more than 406 million. The annual import and export bill is US$ 32 billion and US$ 82 billion, respectively (2010 estimates). The COMESA FTA was launched in 2000 while the Customs Union was launched in June 2009 in Zimbabwe. It was expected to be implemented fully in 2012. The COMESA members span a large portion of the African continent, meaning that access to some markets within the region is a challenge to some countries because of physical and geographical challenges.

Since the launch of the COMESA FTA in 2000, Kenya's trade in the region has increased from US$ 670 million to US$ 2.2 billion by 2010. The COMESA is Kenya's leading export destination, accounting for approximately 35.5 per cent of total export products by 2011. Kenya's exports to COMESA increased by 33 per cent from US$ 1.6 billion in 2010 to US$ 2.1 billion in 2011. Imports from COMESA increased by 34.8 per cent from US$ 482 million in 2010 to US$ 650 million in 2011.

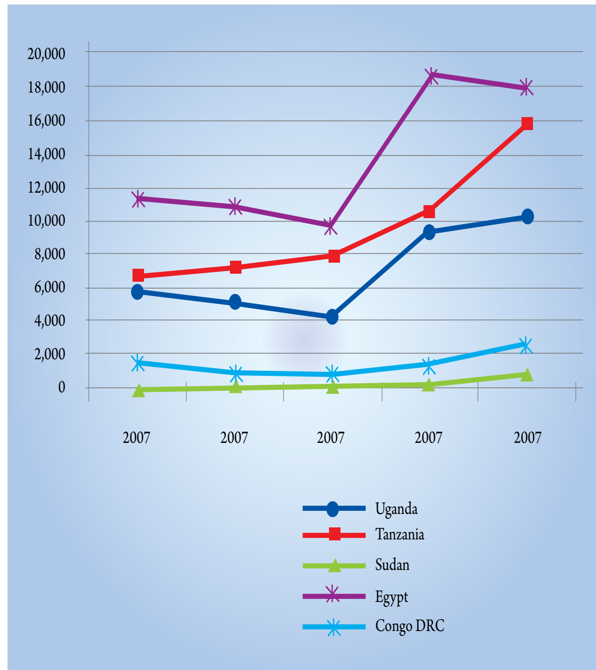
Figure 8.8: Exports to leading COMESA countries, Ksh millions



Source: Kenya National Bureau of Statistics (2012)
Note: Tanzania is not a member of COMESA

It is important to note that Kenya's exports to the COMESA region are dominated by commodities destined for the EAC region, except Egypt and Sudan (Figure 8.8). Most of the imports to Kenya from the region are from Egypt, Uganda and Mauritius in that order (Figure 8.9).

Figure 8.9: Imports from the COMESA region (Ksh millions)

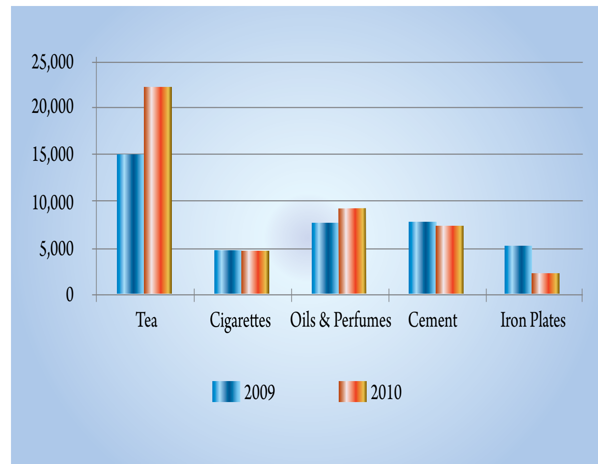


Source: Kenya National Bureau of Statistics (2012)
Note: Tanzania is not a member of COMESA but is a member of EAC

8.4 Composition of Kenyan Trade in the Regional Market (EAC and COMESA)

The leading exports from Kenya to the COMESA and EAC markets include tea, with most of the tea going to Egypt and Sudan. Oils and perfumes mainly go to Uganda and Tanzania, while Kenya exports most of its cement to Sudan, Uganda and Tanzania. Other exports in terms of volumes include natural sodium carbonate, iron and steel bars and cigarettes (Figure 8.10). Most of Kenya's exports to the region are manufactured goods. This is crucial in increasing the country's competitiveness in the region.

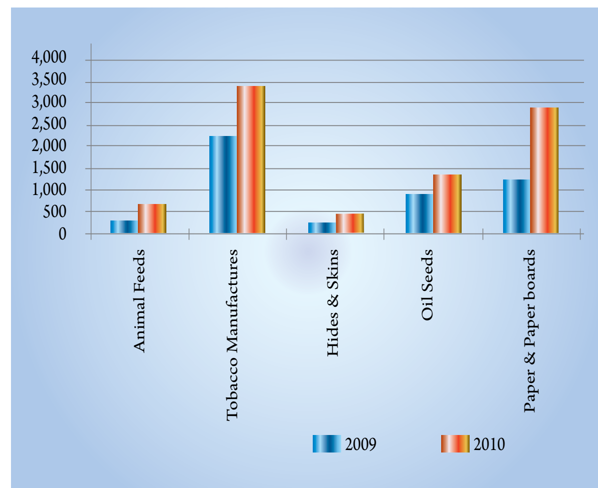
Figure 8.10: Leading Kenyan exports to COMESA and EAC (Ksh millions)



Source: Kenya National Bureau of Statistics (2011)

Kenya also imports agricultural products such as raw tobacco and oil seeds from the region. Other imports include animal feeds mainly from Uganda, and paper and paper boards from Tanzania (Figure 8.11).

Figure 8.11: Leading imports to Kenya from EAC and COMESA (Ksh million)



Source: Kenya National Bureau of Statistics (2011)

8.5 Challenges and Policy Recommendations

The expansion of the EAC has increased trade opportunities for Kenya's businesses over the last decade. However, Kenya is yet to fully exploit the

opportunities offered by the EAC integrated market. Increasingly, member countries are realizing that tariffs, non-tariff barriers (NTBs), quotas and other trade policies are an element of the overall cost of trade, and that institutional and regulatory barriers are often more costly and generate no offsetting revenue.

Overlapping membership persists despite efforts to harmonize the three economic groupings in Southern Africa. Further, these RECs are at different stages of development. Even though Kenya is the leading exporting country in the EAC and among the leading exporters in COMESA, alongside countries such as Egypt, the country's full export potential is far from being exploited because of low levels of diversification, lack of complementarities, and supply-side constrains such as poor roads, railways, ports and information and communication technology (ICT).

Kenya, alongside other countries in the region, should work towards the removal of NTBs through constant engagement among the member states. Given the huge capital outlays involved in constructing and implementing infrastructural projects, member states should cooperate in areas such as roads, railways, ports, ICT, among others. Individual member states should design policy strategies to increase supply-side flexibility, and diversify their exports from agricultural and primary related exports.

Chapter 9

Foreign Policy

9.1 Foreign Policy and National Interest

Kenya's foreign policy aims at articulating key national interests, including national security, economic growth and development, and preservation of its sovereignty. Kenya's international relations policy acknowledges that peace, stability and security are a prerequisite to social and economic development. Kenya endeavours to enhance its national security and peaceful coexistence through the policy of good neighbourliness and amicable means of solving disputes.

To guarantee its economic interests, Kenya has focused more on economic diplomacy in recent times by strengthening strategic ties with regional economic blocs such as the European Union, ECOWAS and SADC. She has also deepened bilateral ties with emerging economic powers such as China, India and Brazil. Currently, Kenya is exploring potential markets in the Middle East, Eastern Europe, Southeast Asia and Latin America. Her foreign policy rests upon five interlinked pillars, namely: economic diplomacy, peace diplomacy, environmental diplomacy, Diaspora diplomacy, and cultural diplomacy (Government of Kenya, 2009).

Because of global food price volatility and food crisis in several parts of the developing world, agriculture has become an imperative variable in international relations, as states explore means of sharing agro-technology to boost their agricultural productivity. At a time when most African states focusing on economic growth and development in their foreign relations, efforts are being made to ensure that agricultural production is integrated in economic diplomacy so that African countries enhance their shared ecological experiences and agricultural trade interests (Juma, 2011).

9.2 Integration of Agriculture into Economic Diplomacy

Food insecurity is increasingly becoming a key concern in Sub-Saharan Africa because of its adverse effect on people. An under-developed agricultural sector is a major challenge to food security in Africa (Mwaniki, 2008). Attempts to address food insecurity through international co-operation have contributed to the development of agricultural diplomacy.

One of the specific objectives of Kenya's economic diplomacy is to "enhance technological advancement by exploring new sources of affordable and appropriate technology." In its quest to address

food insecurity, Kenya needs to enhance its agro-technology and technical training from countries with advanced agro-technologies. Broadening the scope of economic diplomacy to include agricultural diplomacy objectives is crucial in realizing food production through acquisition of agro-technology. Kenya's bilateral ties with Israel, South Korea and Brazil could be critical in realizing its agricultural diplomacy objectives.

9.2.1 Kenya-Israel relations

Due to Kenya-Israeli cordial relations, many Kenyans have acquired agricultural training in Israel. The Kibwezi Agricultural Demonstration Farm was a joint project by MASHAV (Israel's Agency for International Development Cooperation), Kenya's Ministry of Agriculture and other stakeholders. The project was established in 1991 as a demonstration farm employing pressurized irrigation in 40 hectares of semi-arid land in Makueni County. The Kibwezi project became a training centre with the aim of transferring expertise to farm households in the area.

Persistent food insecurity and climate change have prompted the government of Kenya to explore adoption of Israeli agro-technology to enhance agricultural productivity. This is because Israel has rich experience in desert agriculture. Israel's irrigation farming techniques could benefit farming in Kenya's arid and semi-arid areas. Despite unfavourable climatic conditions for agricultural activities in Israel, the country has one of the most advanced agro-technologies in the world. Agricultural production mainly relies on irrigation. It is highly sophisticated, capital intensive and based on high-level technology.

9.2.2 Kenya-South Korea relations

Kenya and South Korea have signed several agreements and memoranda of understanding to enhance political, social and economic relations. The success of Korea's Saemaul Movement and the Green Revolution has inspired developing countries to strengthen their cooperation with South Korea for agricultural development.

South Korea's agricultural technologies include biotechnology, breeding, soil and nutrition management, agricultural mechanization and post-harvest management (Cho, 2011). The key features of the Green Revolution and Saemaul Movement that developing countries could adopt from South Korea include political leadership, community participation, institutional building, technology development, strong support from international societies, agricultural infrastructure development and parallel development of other industries.

Since 2009, South Korea, through the Korea Project on International Agriculture (KOPIA) has initiated projects to boost food production in Kenya by introducing new rice growing techniques. KOPIA closely works with the Kenya Agricultural Research Institute (KARI) in boosting food production by demonstrating new rice planting methods. Korea also established a KOPIA Centre in Kenya that teaches farmers about artificial insemination for their livestock. Furthermore, farmers learn greenhouse and poultry farming techniques.

9.2.3 Kenya-Brazil relations

Kenya and Brazil cooperate on bio-diesel technology and agriculture research and development. The two countries have also signed memorandum of understanding on cooperation between Foreign Service Institute of Kenya's Ministry of Foreign Affairs and Brazil's Rio Branco Institute of Ministry of External Affairs.

Due its vast agricultural resources, Brazil is relatively self-sufficient in food production. Agriculture accounts for 8 per cent of Brazil's GDP and about 25 per cent of the labour force is employed in the agriculture sector. Due to its success in agriculture and bio-fuel technology, Brazil assists African

countries to increase their food and energy resources through financial and technical assistance.

The Government of Brazil established Empresa Brasileira de Pesquisa Agropecuria (Embrapa) or the Brazilian Agricultural Research Corporation in 1973 to be responsible for providing feasible solutions for sustainable development of Brazilian agribusiness through knowledge and technology generation and transfer. It has been instrumental in agricultural innovation and technology. Embrapa's programmes cover other regions apart from Latin America, including North America, Europe, Africa and Asia. Because Kenya and Brazil are both on the tropics, Kenya's agricultural research institutions could work closely with Embrapa to acquire relevant agro-technology to boost food production.

9.3 Policy Recommendations

Agricultural diplomacy is a key pillar in Kenya's foreign policy and the government should, therefore, integrate it into economic diplomacy. Linking food security with economic growth and sustainable development as espoused in economic diplomacy is critical to ensuring that food security becomes vital in Kenya's foreign economic policy objectives.

Kenya should give agriculture development a special place in its diplomatic relations with Israel, South Korea, Brazil and other countries with advanced agro-technologies. Kenya's bilateral ties with countries with advanced agro-technology should be agriculture development-centred, meaning that agricultural development should be a top priority for Kenya's envoys in Israel, Korea, Brazil and other countries with advanced agro-technology.

The government should establish a national agricultural institution to coordinate various research institutions in the agricultural sector. Such national agriculture research institutions could work closely with Embrapa (Brazil), KOPIA (South Korea) and MASHAV (Israel) to enhance international cooperation on agricultural innovation and sharing of technology that will be critical for the development of Kenya's agriculture.

Chapter 10

Financial Services

10.1 Introduction

The financial sector plays a key role in mobilizing savings and investments required to achieve the Kenya Vision 2030 objectives. The sector includes the banking, capital markets, insurance, pension schemes, Savings and Credit Cooperative Organizations (SACCOs) societies and informal financial services such as Rotating Savings and Credit Associations (ROSCAs) and Accumulating Savings and Credit Associations (ASCAs). The sector recorded a decelerated growth rate of 7.8 per cent in 2011 compared to 9.0 per cent in 2010. However, the sector's contribution to GDP expanded to 6.4 per cent from 5.6 per cent in the same period (Kenya National Bureau of Statistics, 2012).

10.2 Structure of the Sector

As at 2011, the financial services sector comprised of 43 commercial banks, 1 mortgage finance company, 6 deposit taking microfinance institutions, 4 representative offices of foreign banks, 118 foreign exchange bureaus and 2 credit reference bureaus (Central Bank of Kenya, 2012). In the same period, there were 45 licensed insurance companies and 2 reinsurance companies. There were also 141 licensed insurance brokers, 14 medical insurance providers (MIPs) and 3,668 insurance agents. Other insurance players included 105 investigators, 75 motor assessors, 21 loss adjusters, 2 claims settling agents, 8 risk managers and 23 insurance surveyors (Association of Kenya Insurers, 2012). Nairobi Securities Exchange (NSE) was the only securities exchange in Kenya. As at 2011, there were 6,570 registered SACCOs; 2,168 were active and 216 operated Front Office Savings Activities (Sacco Societies Regulatory Authority, 2012).

10.3 Policy Changes

Despite the decelerated growth, there were several transformational policy changes in 2011, including the launching and commencement of the cheque truncation process. Physical cheques presented for payment would be converted into images that were transmitted electronically to the Clearing House for processing and eventual payment. This milestone demonstrated the focus in promoting the establishment of efficient and effective payment, clearing and settlement systems. Some of the benefits that would accrue include reduced costs associated with the handling of physical cheques, shorter clearing cycle, reduction of risks associated with manual and longer cheque clearing cycle, and

thus faster and safer access to funds. To regulate and supervise the payment systems and payment service providers in Kenya, the National Payments System Act 2011 was enacted to enable Kenya's payment system to comply with International Settlement core principles and give Central Bank of Kenya (CBK) enhanced legal and regulatory powers over the payment systems. An Anti-Money Laundering Advisory Board was appointed to implement the Proceeds of Crime and Anti-Money Laundering Act 2009.

The capital markets achieved several milestones. To complement the supervisory role of the Capital Markets Authority (CMA), the Capital Markets Act was amended to legally recognize the self-regulatory organizations. This move was crucial to stemming out vices of poor governance in the capital markets. Further, the CMA Act was amended to facilitate the establishment of a Futures market. Therefore, in readiness to evolve into a full service securities exchange supporting trading, clearing and settlement of equities, debt and derivatives, the Nairobi Stock Exchange changed its name to Nairobi Securities Exchange (NSE).

NSE in partnership with FTSE International launched FTSE NSE Kenya Index Series. The index series consists of FTSE NSE Kenya 25 Index (to reflect the performance of the 25 most liquid stocks) and FTSE NSE Kenya 15 Index (to reflect the performance of the largest 15 stocks, ranked by full market capitalization).

These new index series will act as a gauge by which investors could measure the performance of their portfolios and as a foundation for the development of index related products such as Exchange Traded Funds (ETFs). These would run concurrently with the NSE 20 Share and NSE All Share Indices. To further improve efficiency in the market, the equity Settlement Cycle was reduced from the previous T+4 to T+3. Investors could get their money three (3) days from the sale of their shares, and those who purchase shares would have their accounts credited in the same time. Finally, NSE reclassifiied listed companies to provide a more accurate reflection of the diversity of the companies listed to enable investors compare company and sector performance easily.

10.4 Banking Sector Performance Indicators

10.4.1 Assets and profitability

The banking sector registered enhanced performance. Assets expanded by 20.4 per cent from Ksh 1.68 trillion in 2010 to Ksh 2.02 trillion in 2011 (Central Bank of Kenya, 2012). Customer deposits grew by 20.2 per cent from Ksh 1.24 trillion in 2010 to Ksh 1.49 trillion in 2011. The sector attributed this growth to increased deposit mobilization by banks as they expanded their outreach and opened new branches to tap new customers. The use of agents by banks also contributed to increased mobilization of deposits. In 2011, the sector's pre-tax profit increased by 20.5 per cent to Ksh 89.5 billion from Ksh 74.3 billion in 2010. Increased loans, advances and fees from innovative products introduced by banks generated income that contributed to this growth.

10.4.2 Access to banking services

Bank branches increased by 9.2 per cent from 1,063 in 2010 to 1,161 in 2011. The highest number of branches was in Nairobi County. About 40 per cent of all the branches in 2011 were in Nairobi. As at 2011, ten Kenyan banks had subsidiaries, with 223 branches operating in the East African Community (EAC) partner states and South Sudan. Of these, 113 branches were in Uganda (Central Bank of Kenya, 2012).

To support commercial banks in providing financial services in the country efficiently, the CBK in conjunction with the Kenya Bankers Association established a third currency centre in Meru. Other currency centres opened in the last two years are

in Nyeri and Nakuru. Currency centres reduce the distance over which cash is moved between one Central Bank of Kenya office and the upcountry branches of commercial banks.

Agency banking model, which was rolled out in 2010, attracted more customers. Ten (10) banks were granted approval to roll out Agent Banking Network as at 2011. Eight (8) banks contracted 9,748 active agents to facilitate over 8 million transactions valued at Ksh 43.6 billion (Central Bank of Kenya, 2012). This represents 3 per cent of the total deposit base in the banking industry. The introduction of agent banking was intended to enable cost effective provision of banking services to customers, particularly the unbanked or under-banked.

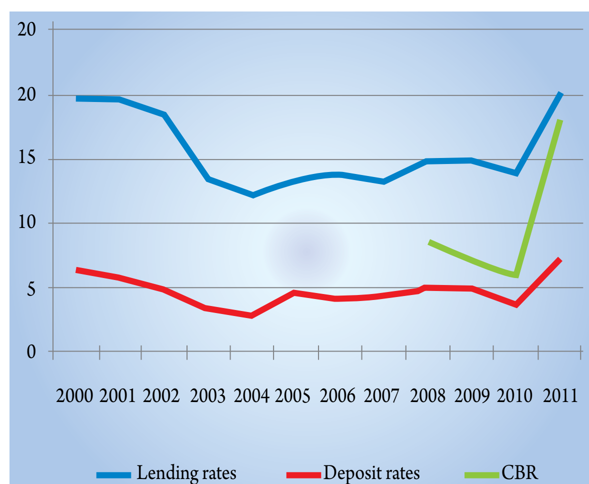
Use of mobile phone money transfer services also increased. Over 18 million Kenyans used mobile phone platforms to make payments and send remittances. More than 40,000 agents facilitated transactions of up to US$ 41 million per day as at 2011 (Central Bank of Kenya, 2012). Two new mobile money transfer services were launched in 2011, that is MobiKash by Mobikash Afrika Limited and Tangaza by Tangaza Limited. Other players in the competitive money transfer market were Safaricom (M-Pesa), Airtel (Zap), Yu cash and Orange Money (Telkom). Thirteen (13) banks have signed up partnerships with mobile phone providers to enhance connectivity and facilitate money transfer services for their customers.

In 2011, commercial banks also improved the use of the Internet as a remote delivery channel for banking services. Twenty-three (23) banks had internet products on offer. Other factors that enhanced access to financial services included enhanced provision of Sharia compliant financial products and installation of more ATMs. The ATMs increased by 11.4 per cent to 2,205. Consequently, bank customer deposit accounts increased to 14.3 million in 2011 compared to 11.9 million in 2010 (Central Bank of Kenya, 2012).

10.4.3 Cost of credit

The average lending rates increased from 13.87 per cent in 2010 to 20.04 per cent in 2011. In the same period, average deposit rates also increased from 3.59 per cent in 2010 to 6.99 per cent in 2011 (Figure 10.1). The high increases were a result of the monetary policy tightening that increased the Central Bank Rate (CBR) from 6 per cent in 2010 to 18 per cent in 2011. The aim was to rein in on inflationary pressure and stabilize the exchange rate. Commercial banks, however, capped any increments in monthly loan repayments at 20 percentage points above the applicable rates. They also extended the period for servicing loans, which helped to cushion borrowers from high interest rates and difficult economic conditions.

Figure 10.1: Lending, deposit rates and CBR in Kenya (%)

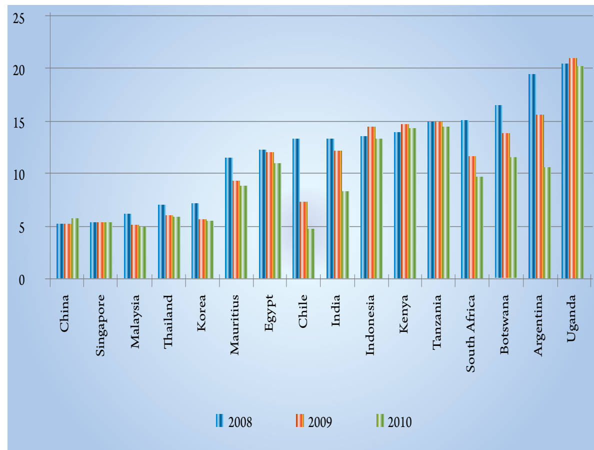


Source: Central Bank of Kenya (2012)

Lending rates in Kenya remained high compared to the rates in middle-income countries (Figure 10.2). Consequently, the interest rate spread has also remained high at about 10 per cent as shown in Figure 10.3. This is attributed to the positive relationship between lending and deposits rates, as commercial banks continue to reap from the high interest rate spreads. For example, interest income from loans and advances as a total of banks' income increased from 49.0 per cent in 2010 to 55.4 per

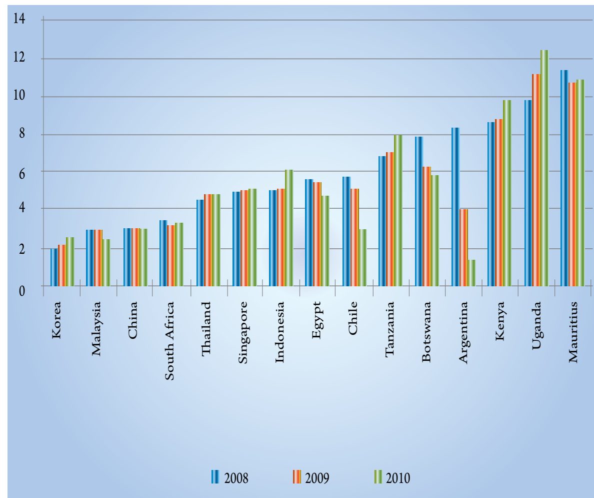
cent in 2011. The high interest rate spread indicates inefficiency in the sector.

Figure 10.2: Lending rates (%) for selected countries



Source: World Bank (2012)

Figure 10.3: Interest rate spread (%) across selected countries

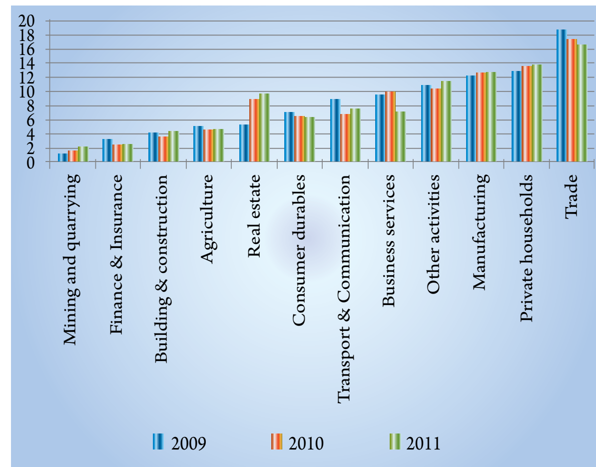


Source: World Bank (2012)

10.4.4 Credit to the private sector

Domestic credit grew by 30.2 per cent from Ksh 914.9 billion in 2010 to Ksh 1,191 billion in 2011. Increased lending to mining and quarrying, building and construction, real estate, transport and communications, and households sectors contributed to this growth (Figure 10.4). The banks' capacity to extend credit was a result of increased deposits.

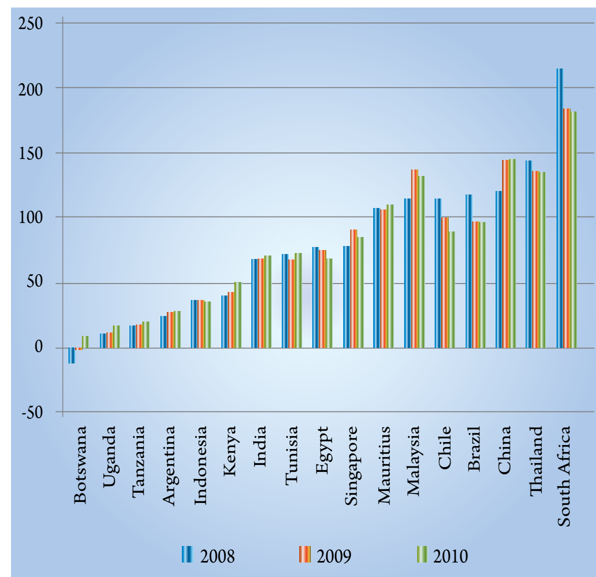
Figure 10.4: Private sector credit distribution (%)



Source: Central Bank of Kenya (2012)

Although commercial banks' credit to the private sector in Kenya has increased, the credit average is still below 50 per cent of GDP. This compares unfavourably with countries such as South Africa, China, Thailand and Malaysia. The credit level in these countries is above 100 per cent of GDP (Figure 10.5).

Figure 10.5: Domestic credit to the private sector (% of GDP) for selected countries



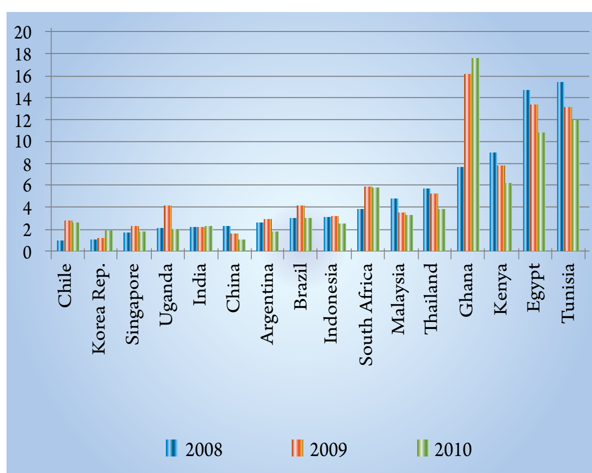
Source: World Bank (2012)

10.4.5 Non-performing loans

The stock of gross non-performing loans (NPLs) declined by 8 per cent from Ksh 57.6 billion in 2010 to Ksh 53.0 billion in 2011. Consequently, the ratio of gross NPLs to gross loans improved from 6.3 per cent to 4.4 per cent over the same period. The reduction in NPLs is attributed to continued deployment of enhanced appraisal standards by the banks (Central Bank of Kenya, 2012). However, when compared to other countries, the ratio of NPLs to gross loans is still relatively high at 8 per cent (Figure 10.6).

The sharing of credit information launched in 2010 picked gradually. Metropol Ltd was licensed as the second credit reference bureau after Credit Reference Bureau (CRB) Africa. As at 2011, there were over 1.3 million credit reports accessed by banks, and over 6,000 credit reports accessed by individuals. Credit reports totalling 1,306,439 were requested by banks from the CRBs as at 2011. These increased from 284,722 reports requested in 2010 (Central Bank of Kenya, 2012).

Figure 10.6: Non-performing loans for selected countries (%)



Source: World Bank (2012)

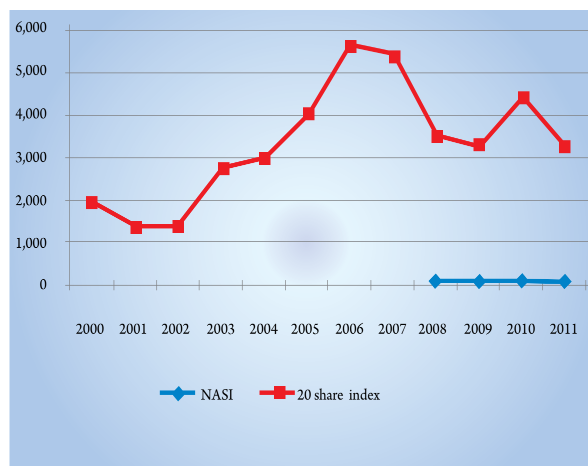
10.5 Capital Market Indicators

Although the stock market performance indicators deteriorated in 2011, three new companies were listed, raising the number of listed companies at the NSE to 58 from 55 in 2010. British American Investment Company Ltd made an Initial Public Offer (IPO), while CFC Insurance Holdings and Trans Century Limited were listed through an introduction. In an introduction, only existing shares are listed (no new shares are issued) and no additional funds are raised (Capital Markets Authority, 2011a). One company, CMC Holdings Limited, was however suspended from trading for three months to facilitate investigations into allegations relating to the company's conduct in its affairs (Capital Markets Authority, 2011b). Demutualization of NSE that was expected to be complete in 2011 is still pending. Therefore, issues of own transparency and corporate governance at the securities exchange are unresolved.

10.5.1 Stock indices

In 2011, the NSE 20 share index decreased by 27.7 per cent to close at 3,205 points from 4,432.6 points in 2010 (Figure 10.7). This indicated a slump in the market after a recovery in 2010. Similarly, the Nairobi All Share Index (NASI) launched in 2008 decreased by 30.4 per cent to close at 68 points from 97.8 points in 2010. As at 2011, the newly launched FTSE index series stood at 90.31 points and 92.64 points for the FTSE NSE Kenya 15 Index and FTSE NSE Kenya 25 Index, respectively.

Figure 10.7: NSE 20 share index and NASI

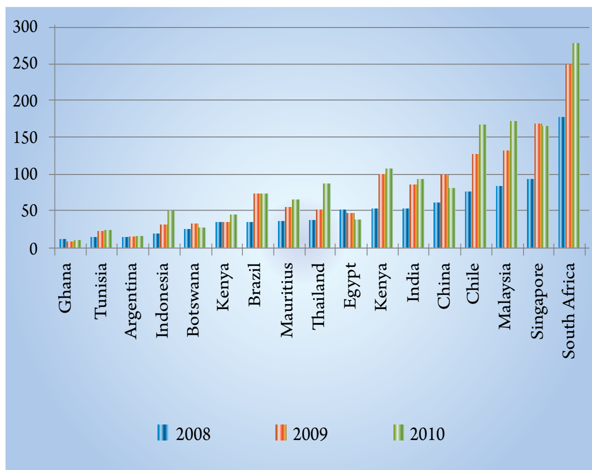


Source: Kenya National Bureau of Statistics (2012)

10.5.2 Stock market capitalization

The market capitalization also recorded a decline to Ksh 868.2 billion in 2011 from Ksh 1,166.992 billion in 2010. This is a decrease of 25.6 per cent. Kenya's market capitalization remains small when compared to other countries, that is below 50 per cent of GDP (Figure 10.8).

Figure 10.8: Stock market capitalization (%) of selected countries



Source: World Bank (2012)

10.5.3 Bonds market

The bonds market achieved a milestone when the government issued its first 30-year savings and deposits bond worth Ksh 10 billion. This is the longest dated security ever issued in the capital markets. The government also issued a 12-year infrastructure bond worth Ksh 11.6 billion. In the corporate sector, although mortgage financier Shelter Afrique issued a bond of Ksh 2.5 billion, bond issues in the sector are still low (Capital Markets Authority, 2011a).

10.6 Other Financial Institutions

Microfinance institutions (MFIs) targeting low-income population complemented the efforts of financial inclusions. In 2011, the Central Bank of Kenya licensed Rafiki DTM Ltd to commence nation-wide deposit-taking microfinance business, making it the sixth DTM to be licensed. Faulu Kenya, Kenya Women Finance Trust, Uwezo, SMEP and Remu Limited are other licensed deposit taking MFIs. There was notable growth in deposit taking MFIs. The total assets increased by 6 per cent from Ksh 23.4 billion in 2010 to Ksh 24.8 billion in 2011. Customer deposits grew by 25 per cent from Ksh 8.0 billion in 2010 to Ksh 10.0 billion in 2011. The growth in customer deposits was partly due to growth in branches, which grew from 34 in 2010 to 60 in 2011. However, profit before tax dropped by 19 per cent from Ksh 304 million in 2010 to Ksh 245 million in 2011. The reduction in profits was due to formation costs for newly licensed DTMs, and increased provisions for non-performing loans (Central Bank of Kenya, 2012).

In the co-operative sector, the total assets of Saccos offering FOSA increased by 15 per cent from Ksh 216.0 billion in 2010 to Ksh 248.8 billion in 2011. In the same period, deposits increased by 14 per cent to Ksh 180.0 billion, while credit to members increased by 18 per cent to Ksh 186.1 billion. The Sacco Societies Regulatory Authority (SASRA) licensed more deposit taking Saccos. As at 2011, the SASRA had licensed 110 deposit-taking Saccos (SASRA, 2012). The deposit taking Sacco business refers to the taking of demand deposit from members, which occur in Sacco societies operating FOSA. SASRA's move is expected to improve governance in the Sacco sub-sector and position it for competition with the other players in the financial sector. Governance of cooperatives was further enhanced with the formation of the Ethics Commission for Co-operatives Societies (ECCOS) to handle all cooperative ethical and integrity issues in the cooperative movement (Ministry of Co-operative Development and Marketing, 2012).

In the insurance sector, there were 45 licensed insurance companies as at the end of 2011. While the industry profit after taxation decreased slightly from Ksh 7.80 billion in 2010 to Ksh 7.78 billion, gross premium rose by 15.9 per cent to Ksh 91.6 billion in the same period. Similarly, assets grew by 10.2 per cent to Ksh 230.76 billion compared to Ksh 209.48

billion in 2010. Net claims increased marginally from Ksh 39.50 billion in 2010 to Ksh 39.58 billion in 2011 (Association of Kenya Insurers, 2012). The poor governance continued to affect the industry. One company, Blue Shield Insurance Company, was placed under statutory management because of various challenges, including inability to meet its obligations. To rein in on fraud in the industry, the Insurance Regulatory Authority (IRA) partnered with the police to establish the Insurance Fraud Investigation Unit to investigate and prosecute cases of fraud in the sector. Further, IRA licensed the first Sharia compliant insurance company (Taful), targeting customers of Islamic faith as an initiative of increasing the penetration rate. This rate remained at around 3 per cent (Insurance Regulatory Authority, 2012).

Assets of the pension industry grew by 4.5 per cent in the first six months to Ksh 471 billion as at June 2011. The National Social Security Fund (NSSF) share was Ksh 113.5 billion, fund managers held Ksh 327 billion, while schemes that were not under the control of fund managers held Ksh 30 billion of the assets. The Retirement Benefits Authority (RBA), which is the industry's regulator, put in place various initiatives aimed at widening the pension services coverage and improving pension scheme governance. That is, BLUE SME Jua Kali Individual Retirement benefits scheme (Mbao Pension Plan), the Trustee Trainee programme and risk-based supervision. Because of these efforts, the total membership of Individual Retirement Benefit Schemes grew by 60 per cent from 25,289 members in June 2010 to 40,574 members in June 2011 (Retirement Benefits Authority, 2012).

10.7 Emerging Policy Issues and Recommendations

Technological advances, while necessary, have made banks' businesses more vulnerable. As systems become more complex, the opportunities for fraud increase. As a starting point, the Central Bank of Kenya should adopt and enforce international credit card security standards.

Governance issues facing the Cooper Motor Corporation (CMC) exposed the weak corporate governance rules in Kenya again. Poor corporate governance in listed companies threatens to further erode investor confidence at the NSE. Capital markets are crucial in enhancing long-term resource mobilization for investment, hence corporate governance should be excellent.

Chapter 11

Infrastructure and Economic Services

11.1 Introduction

Infrastructure is an important element in determining and shaping the factors that affect the cost of living. Lalnunmawia (2010) notes that developed infrastructure contributes to development through backward and forward linkages, and facilitates growth. Social infrastructure such as water supply, sanitation, sewage disposal, education and health affect the quality of life directly. Therefore, not only does under-developed infrastructure make life difficult, but it also raises the cost of living, which affects the poor and the middle-class the most. The high cost of living also encourages corruption in leadership because people in these positions feel their salaries and assets are not enough to maintain their living standards in the future. Lack of or poor infrastructure also discourages investors, and affects even the tourism industry for which Kenya heavily depends on. Moreover, poor maintenance of the available infrastructure is also a matter of big concern in the country.

11.2 Infrastructure Expenditure Analysis

Table 11.1 shows Kenya's expenditure pattern on physical infrastructure. Total expenditure in 2009/10 was Ksh 168 billion, representing an increase of 52.4 per cent between 2007/08 and 2009/10. Development and donor-funded expenditure on transport decreased during the same period.

11.2.1 Analysis of resource allocation and utilization in infrastructure sub-sectors

Inadequate resource allocation is a major setback in the infrastructure sub-sectors. The shortfall in resource requirements in this sector is pronounced under the development vote of government budget estimates. In 2011/12, it was a huge Ksh 63.4 billion compared to the Ksh 10.2 billion under the recurrent vote (Tables 11.2 and 11.3).

Table 11.1: Expenditure on physical infrastructure (Ksh millions)

	Sub-sector	2007/08	2008/09	2009/10	2007/08–2009/10 Change %
Analysis of Actual Recurrent Expenditure	Roads	16,567	21,159	21,435	29.4
	Transport	1,968	3,214	3,363	70.9
	Public Works	709	3,443.59	3384	377.3
	Housing	1,294	1,716	1,857	43.5
	Energy	290	366	372	28.3
	Local Government	973	10,547	11,308	1062.2
	Nairobi Metropolitan	37	268	339	816.2
	Total	21,838	38,261	40,049	83.4
Analysis of Development Expenditure	Roads	24,596	42,353	46,437	88.8
	Transport	3,244	4,231	2,481	-23.5
	Public Works	1454	2597	2267	55.9
	Housing	1284	2,330	2,066	60.9
	Energy	17,704	30,386	31,260	76.6
	Local Government	2,796	3,517	3,462	23.8
	Nairobi Metropolitan	-	2,050	1,690	-
	Total	51,078	88,328	90,449	77.1
Analysis of Donor-funded Programmes in Physical Infrastructure	Roads	25,543	25,558	26,000	1.8
	Transport	4,789	2,739	1,943	-59.4
	Public Works	115	80	-	-
	Housing	68	179	176	158.8
	Energy	6,775	7,816	8,042	18.7
	Local Government	101	1,263	1,500	1385.1
	Nairobi Metropolitan	-	50	-	-
	Total	37,391	37,685	37,661	0.7
	Total	110,307	164,274	168,159	52.4

Source: Ministry of Finance (2011)

The low absorption rate of financial resources allocated to the sector works against resource use efficiency and any arguments for increased budgetary allocations to the sector. Between 2007/08 and 2009/10, for example, the average under-utilization of development expenditure was a significant 20 per cent, which is double the average under-utilization rate recorded for recurrent expenditure over the same period (Tables 11.4 and 11.5). However, the approved and actual development expenditure budget on the physical infrastructure sector has increased steadily since 2007/08.

11.3 Infrastructure Sector Performance

The performance of infrastructure and related economic services over the last three years and the medium-term future projections show the strong influence of the sector on the cost of living. The scope of this performance review covers services

Table 11.2: Recurrent resource requirements vs allocation (Ksh millions)

		Requirements vs Allocation		
Sub-sector	**Estimates 2010/11**	**Requirement 2011/12**	**Allocation 2011/12**	**Variance**
Roads	25,548	31,040	25,646	-5,394.0
Transport	4,430	6,357	3,816	-2,541.0
Public Works	1,470.72	1,827	1,519.04	-308.0
Housing	977.8	2,170	1,702	-468.0
Energy	2,283.29	2,682.87	2,381	-301.9
Local Government	13,201	15,135	14,243	-892.0
Nairobi Metro	319	580	334	-246.0
Total	48,229.81	59,791.87	49,641.04	-10,150.83

Source: Government of Kenya (2011b)

Table 11.3: Development resource requirements vs allocation (Ksh millions)

		Requirements Vs Allocation		
Sub-sector	**Estimates 2010/11**	**Requirement - 2011/12**	**Allocation -2011/12**	**Variance**
Roads	79,194	87,276	81,299	-5,977
Transport	7,213	13,378	9,255	-4,123
Public Works	5,051.9	9,561	6,052	-3,509
Housing	2,982	11,045	2,782	-8,263
Energy	34,072.85	65,448.38	44,880	-20,568
Local Government	5,799	17,865	4,486	-13,379
Nairobi Metro	1,158	9,132	1,558	-7,574
Total	135,470.75	213,705.38	150,312	-63,393

Source: Government of Kenya (2011b)

Table 11.4: Development expenditure (Ksh millions)

Sub Sectors	Approved Estimates			Actual Expenditures			Absorption Rate: Actual/ Approved (%)		
	2007/08	2008/09	2009/10	2007/08	2008/09	2009/10	2007/08	2008/09	2009/10
Roads	33,682	46,437	58,491	24,597	36,279	36,577	73	78	63
Trans-port	4,789	2,482	5,792	3,324	2,013	3,548	69	81	61
Public Works	1,705	2,287	3,971	1,454	2,137	3,007	85	93	76
Housing	1,364	2,066	2,074	1,284	1,900	2063	94	92	99

Sub Sectors	Approved Estimates			Actual Expenditures			Absorption Rate: Actual/ Approved (%)		
	2007/08	2008/09	2009/10	2007/08	2008/09	2009/10	2007/08	2008/09	2009/10
Energy	21,075	31,260	33,118	17,704	30,560	32,513	84	98	98
Local Govern-ment	2,973	2,375	4,556	2,796	2,057	1,988	94	87	44
Nairobi Metro-politan Devel-opment	0	1,650	1,420	0	1,150	1,144	...	70	81
Total	65,588	88,557	109,422	51,159	76,096	80,840	78	86	74

Source: Government of Kenya (2011b)

Table 11.5: Recurrent expenditure (Ksh millions)

Sub-Sectors	Approved Estimates			Actual Expenditures			Absorption Rate: Actual/ Approved (%)		
	2007/08	2008/09	2009/10	2007/08	2008/09	2009/10	2007/08	2008/09	2009/10
Roads	24,400	21,159	21,852	17,277	20,647	20,969	71	98	96
Trans-port	4,021	3,214	3,389	3,937	3,191	3,286	98	99	97
Public Works	792	991	1,671	709	929	1232	90	94	74
Housing	1,766	1,715	1,836.50	1,293	1,433	1,515.30	73	84	83
Energy	322	365	409.3	290	348	362	90	95	88
Local Govern-ment	1,005	1,296	11,348	963	1,078	11,330	96	83	100
Nairobi Metro-politan Devel-opment	42	268	338	39	266	299	93	99	88
Total	32,348	29,008	40,843.80	24,508	27,892	38,993.30	76	96	95

Source: Government of Kenya (2011b)

in energy, housing and transport. These three sub-sectors have recently received increased and significant financial resource allocations as shown by the expenditure analysis above. Their contribution to Kenya's GDP is substantial (Table 11.6) and they are also the infrastructure sub-sectors under which Kenyans have felt the most severe changes in the consumer price index.

Table 11.6: Infrastructure contribution to GDP (%)

	2007	2008	2009	2010	2011*
National GDP Growth	7.0	1.5	2.7	5.8	4.4
Infrastructure					
Electricity and Water	1.5	2.1	1.9	1.4	0.9
Electricity	0.8	1.5	1.2	0.7	0.2
Water Supply	0.6	0.6	0.6	0.7	0.7
Construction	3.8	3.8	4.1	4.3	4.1
Transport and Communication	10.6	10.3	9.9	10.0	9.7
Transport and Storage	7.6	7.6	7.3	7.4	7.5
Post and Telecommunications	3.0	2.7	2.6	2.5	2.2
Real Estate-renting and Business Services	5.3	5.1	4.9	4.8	4.5
Real Estate Dwellings, Owner-occupied and Rented	2.7	2.5	2.5	2.4	2.2
Real Estate-renting and Business Services	2.6	2.6	2.5	2.4	2.3
Total Infrastructure	38.5	38.8	37.5	36.6	34.3

*Provisional figures
Source: Kenya National Bureau of Statistics (2011)

Table 11.6 shows that electricity, transport and real estate lead in contribution to the national GDP in Kenya's infrastructure services portfolio. The following is the performance review for energy, transport and housing sub-sectors. Where data allows, projected trends for up to the year 2020 are presented.

11.4 Energy Sector Performance and Prospects

According to Rural Electrification Authority (REA), only 28 per cent of households in Kenya were connected to electricity by 2011. This included 15 per cent of rural households and half of urban households. The cost of electricity by 2011 was 13 US cents per kWh, which means that Kenya is still far from meeting the anticipated demand for adequate and affordable power supply. Geothermal generation is the preferred core generation strategy in the country, as reflected in resolutions of a series of national energy conferences Kenya has held. The unit cost of electricity from geothermal generation is much cheaper, estimated at 7 US cents per kWh.

Total electricity generation

Despite realizing 11 per cent increase in total electricity generation from 6.3 TWh in 2007 to 7.0 TWh in 2010, Kenya is still behind countries such as Egypt and Nigeria on this performance indicator.

Table 11.7: Power generation (TWh)

Year	Kenya	Egypt	Nigeria	South Africa	UAE
2007	6.32				
2008	6.46				
2009	6.50	125.07	22.04	231.69	80.94
2010	6.96	137.59	23.50	240.53	80.82
2011*	7.67	144.52	25.32	255.20	81.24
2012*	8.23	151.72	27.30	271.90	82.97
2013*	8.79	159.73	29.49	284.53	86.81
2014*	9.94	168.10	31.80	298.73	90.90
2015*	10.65	176.94	34.38	310.64	94.65

Source: Business Monitor International (BMI); Kenya National Bureau of Statistics (2011)
*Forecasted by Business Monitor International (BMI)

Table 11.8: Total generation capacity (MW) with forecasts, 2011-2015

Year	Kenya	Egypt	Nigeria	South Africa	UAE
2007	1,196.60				
2008	1,267.90				
2009	1,311.50	24,216.14	6,752.65	43,756.51	17,710.80
2010	1,412.20	25,094.23	7,099.67	44,395.52	18,525.39
2011	1,484.12	25,603.88	7,471.61	45,405.30	19,303.97
2012	1,589.71	26,227.26	8,069.34	46,108.43	20,121.40
2013	2,186.87	27,127.66	8,742.66	48,609.31	21,200.66
2014	2,560.21	28,092.64	9,502.32	50,533.23	22,443.09
2015	2,697.04	29,093.68	10,360.91	52,786.46	23,493.11

Source: Business Monitor International (BMI, 2011); Kenya National Bureau of Statistics (2011)

Power generation in 2010 went up by 2.4 per cent from 2009, and is projected to reach 10.6 Terrawatt hours (TWh) by 2015, assuming an 8.5 per cent mean annual increase. Thermal generation accounts for a third of total electricity generation in Kenya. The Business Monitor International (BMI) projects a substantial rise in thermal generation from coal, gas and oil at 6.4 per cent per annum up to the year 2015. Daewoo's US$ 1.3 billion plan to build and operate a coal-fired plant with two turbines each of 300 MW is a major contributor to the expected increase in thermal generation. This is expected to be approximately 3.3 TWh or 31 per cent of total generation by 2015 (BMI, 2011). Geothermal generation will get a major boost once the planned US$ 1.4 billion projects for additional 280 MW of installed capacity by 2015 (Olkaria I and IV) becomes operational.

Installed electricity capacity

Generation capacity is advancing towards 1,500 MW, although capacity in Kenya is relatively low compared to Nigeria, Egypt and South Africa. Kenya shows no signs of catching up with the production levels of these countries soon, meaning that the cost of electricity and related services may remain relatively high in Kenya because of supply constraints in the face of a rising population and economic growth.

Hydropower forms the largest proportion of Kenya's total installed capacity (50% by 2012). Vagaries of weather and effects of climate change limit the sustainability of hydropower generation, such that actual power generation and other forms of generation, including oil-based thermal generation, claim higher share in total generation. Kenya should find other commercially viable alternative sources of energy to reduce dependence on hydropower and thermal energy.

Electricity consumption

Power consumption in Kenya is projected to rise from 6.4 TWh in 2010 to 11.6 TWh by the end of 2015, representing a 6.2 per cent mean annual growth in consumption, according to Business Monitor International (BMI), Kenya Power Report for Quarter III of 2011. The average consumption for Middle East and Africa was 837 TWh in 2010 and is projected to reach 1,090 TWh by 2015 (BMI, 2011).

Table 11.9: Electricity consumption (TWh)

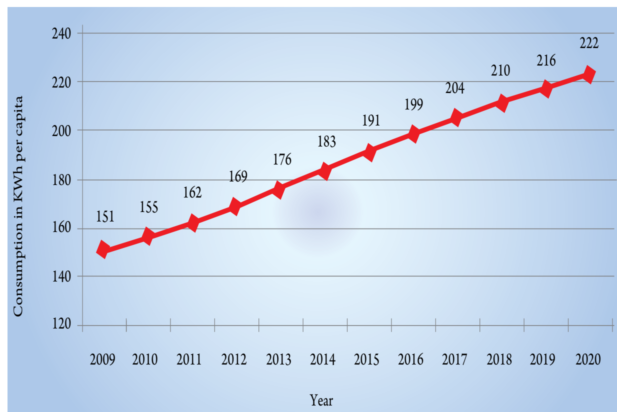
Year	Kenya	Egypt	Nigeria	South Africa	UAE
2009	6.00	114.00	19.68	208.21	66.60
2010	6.35	121.75	21.31	215.42	68.95
2011*	6.79	126.84	23.04	221.45	71.19

Year	Kenya	Egypt	Nigeria	South Africa	UAE
2012*	7.27	132.98	24.88	229.65	74.25
2013*	7.78	141.42	26.92	238.37	77.66
2014*	8.32	150.29	29.01	247.19	81.39
2015*	8.88	159.72	31.40	256.59	85.46

Source: BMI (2011)
*Forecasts

Reflecting increasing demand for energy services in Kenya, it was projected that per capita consumption of energy would grow from a low average of 150 kWh in 2009 to 169 kWh in 2012; 190 kWh in 2015; and further to above 220 kWh by 2020 as shown in Figure 11.1.

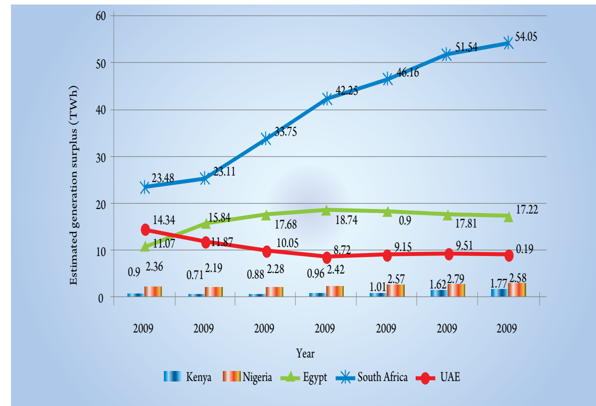
Figure 11.1: Electricity consumption and forecasts to the year 2020



Source: BMI (2011)

Analysis of electricity generation and consumption patterns reveals a slim generation surplus, which is expected to remain at less than 2 TWh in the medium term. Egypt and South Africa are expected to have a higher surplus over the years as shown in Figure 11.2. The low surplus in Kenya compares unfavourably with other comparator countries. In addition, Kenya may be unable to accommodate sudden surges in demand.

Figure 11.2: Estimated electricity generation surplus



Source: BMI (2011)

The total local energy production increased from 357.4 ToE in 2010 to 400.7 ToE in 2011. As shown in Table 11.10, the total local production as a percentage of the total energy in the country increased from 8.4 per cent in 2010 to 9.4 per cent in 2011, while per capita consumption stood at 107.8 kilogrammes of oil equivalent in 2011.

Government policies in the energy sector need to promote affordability, supply availability, and distribution through infrastructure development and increased uptake through awareness creation. For instance, zero-rating of Liquefied Petroleum Gas (LPG) cylinders has not led to any significant increase in uptake in both Kenya and Tanzania due to constraints in supply availability and transport and logistics infrastructure for distribution.

Experience across countries justifies emphasis on several interventions towards improved energy sector efficiency, mainly:

- Liberalization of the energy market;
- Deliberate interventions in the energy market through fiscal incentives (taxes, duties, levies) and non-fiscal incentives (subsidies, fees, guarantees, credits);
- Conservation and efficiency measures;

Table 11.10: Production, trade and consumption of energy expressed in terms of primary source of energy, TOE

	2007	2008	2009	2010*	2011*
Imports of crude oil	1,598.7	1,773.3	1,627.9	1,551.5	1,772.1
Net exports of petroleum	1,836	1902.8	2,565.6	2,662.8	2,813.0
Stock change and balancing	-312.9	-543.0	-582.7	-492.2	-960.6
Total consumption of liquid fuels	3,121.8	3,133.1	3,610.8	3,722.1	3,624.5
Hydro and geothermal energy					
Local production of hydropower	308.8	280.9	182.4	269.9	276.6
Local production of geothermal	85.0	89.3	111.2	90.9	124.1
Imports of hydropower	1.9	2.1	3.3	2.6	2.9
Total consumption of hydro and geothermal	395.7	372.3	296.9	363.4	403.6
Total local energy production	393.8	370.2	293.6	357.4	400.7
Total net imports	-125.9	-18.6	-839.8	-943.5	-803.8
Total energy consumption	3,627.1	3,614.2	4,002.3	4250.7	4,262.3
Local production as percentage of total	10.9	10.2	7.3	8.4	9.4
Per capita consumption in terms of kilogrammes of oil equivalent	97.5	97.5	94.4	107.3	107.8

*Provisional figures. NB: Modern sector only; fuel wood and charcoal are excluded
Source: Government of Kenya (2011a)

- Gender mainstreaming in the energy sector;
- Technology transfer and training in energy technologies;
- Expansion of decentralized, renewable off-grid energy systems, especially solar power, with consideration for input subsidies to offset the high installation costs;
- Reducing reliance on foreign multinationals; and
- Favourable tax reforms and import regulations that encourage private sector investments

To citizens, government interventions must promise affordability, safety and security, and poverty reduction as key targets in the energy sector. Kenya should develop solar energy given the high potential from the favourable sun hours and solar intensity. This can be harnessed as a renewable and environmentally friendly source for local solutions, including remote areas, and does not need expensive centralized distribution networks. The government should also spearhead technology transfer arrangements with leading countries in solar energy, such as Germany and Spain.

Kenya is building capacity for nuclear energy generation. However, how effectively this option addresses concerns about affordability, safety and security, and poverty reduction needs to guide the debate and priority setting in this sub-sector. The percentage of nuclear energy generation is high in France. South Africa, as a regional example and Germany as an example of policy aversion to nuclear risks, all represent practical cases that can rationalize the nuclear energy debate in Kenya. Germany is notable in this case because her nuclear-reversal policy announced in 2011 will phase out all nuclear plants in the country by 2022.

Table 11.11: Value of outputs in the transport sector, 2007-2010, in Ksh millions

Transport Mode	2007	2008	2009	2010	2011
Road	233,224	273,047	285,250	326,318	388,013
Rail	4,550	4,449	4,356	5,591	2,992
Marine	23,233	21,868	21,039	21,483	22, 117
Air	80,254	83,010	80,519	84,257	99,176
Services incidental to transport	33,971	38,823	40,016	47,977	59,161
Pipeline	8,736	9,222	11,837	13,906	14,174
Total	383,968	430,419	442,661	550,390	585, 633
Total outputs as per cent of GDP	29	32	32	37	38

Source: Kenya National Bureau of Statistics (2011)

11.5 Transport Sector

The total value of outputs transported grew from Ksh 383 billion to Ksh 585 billion in 2011 (Table 11.12). In 2011, the road transport sector had the highest value of outputs of Ksh 388 billion, followed by air transport at Ksh 99 billion, then marine transport at Ksh 22 billion. The least was rail transport at Ksh 2 billion. Services incidental to transport stood at Ksh 59 billion in 2011. The total value of outputs in the transport sub-sector expressed as a per cent of GDP increased from 29 per cent in 2007 to 38 per cent in 2011.

11.5.1 Road transport

Based on the Road Inventory and Condition Survey (RICS), Kenya's road network is established to reach 160,886 km in length, comprising 11,189 km of paved roads and 149,689 km of unpaved roads. Table 11.20 shows the road conditions in Kenya. The findings of the RICS project reveal that 17 per cent of all classified roads are in good condition, 51 per cent are in fair condition, and 31 per cent are in poor condition. Majority (71%) of unclassified roads are in poor condition, while only 5 per cent are in good condition. In aggregate, most of the roads in Kenya (56%) are in poor condition, with only 10 per cent in good condition as shown in Table 11.12.

Table 11.12: Summary of road conditions in Kenya

	Good	Fair	Poor	Grand Total
Classified	10,651	31,847	19,438	61,936
Unclassified	5,440	22,165	71,345	98,950
Total	16,091	54,012	90,78	160,886
Condition classified (%)	17	51	31	100
Condition unclassified (%)	5	22	72	100
Condition all (%)	10	34	56	100

Source: Kenya Roads Board (2011)

The Kenya Roads Board released Ksh 15.5 billion for maintenance of various roads in the country. These funds were derived from the fuel levy, transit tolls and coffee cess collections for 7 months from July 2011 to January 2012 (Table 11.13). Majority of the funding was allocated to major trunk roads (Kenya National Highways Authority - KeNHA) Ksh 8 billion and Rural Roads (Kenya Rural Roads Authority - KeRRA) Ksh 5.6 billion.

Table 11.13: Kenya Roads Board allocation of funds for road maintenance by agency and road class

Road Authority/Agency Road	Class	Amount Released (Ksh)
Kenya National Highways Authority (KeNHA)	A, B, C (Major trunk roads)	8,144,285,587
Kenya Rural Roads Authority	D, E and others (rural roads)	5,492,917,334
Kenya Rural Roads Authority	Coffee roads / coffee cess	171,326,752
Kenya Urban Roads Authority	Urban Roads	1,599,795,535
Kenya Wildlife Service	National Parks	118,350,000
Total releases		15,526,675,208
Constituency roads - each constituency		20,000,000

Source: Kenya Roads Board (2011)

The Road Sector Investment Programme (RSIP) estimated that Ksh 648 billion was required for development, rehabilitation and reconstruction of roads between 2010 and 2014. Maintenance intervention was estimated to cost Ksh 23 billion. The Kenya Roads Board (KRB) projected that during 2011/2012, the Kenya Roads Board Fund (KRBF) would collect Ksh 24.1 billion. This would comprise proceeds from the Road Maintenance Levy Fund (RMLF) amounting to Ksh 23.7 billion, transit tolls amounting to Ksh 350 million, and agricultural cess of Ksh 80 million. The government has allocated about Ksh 72 billion from the Exchequer to the KRBF collections for road works. However, these funds still fall short of the total requirement to improve the road network condition to satisfactory levels.

Road transport is still the main mode of transport in Kenya and the region. Its safety is, however, in question given the high traffic accident rates in the country and the related cost. A paradox that worries road users and decision makers alike is that the remarkable improvement in road network quality has only worsened Kenya's road crash and fatality records. The proportion of Kenya's paved road network was approximately 12 per cent by the year 2011, which is still far below such countries as Egypt (87%).

The road safety challenges associated with traffic accidents are a major issue of public policy and welfare. As shown in Table 11.15, reported traffic accidents fluctuated between the period 2007 and 2010. The highest recorded figures were in 2009, with 12,369 accidents. This figure dropped to 9,771 in 2010, perhaps because of road safety campaigns by the government and other agencies. Fatalities from traffic accidents have increased, rising from 2,530 in 2007 to 3,055 in 2010. Cases of serious injuries and slight injuries decreased from 10,658 and 10,327 in 2007 to 9,327 and 9,739 in 2010, respectively. An analysis of 2010 reveals that approximately 8 people out of 100,000 died because of road accidents.

Kenya could emulate public transport systems in countries where public transportation is a public service provided by the Local Authority at a subsidized rate. In the past, the Nyayo Bus Service and Kenya Bus Services (KBS) demonstrated such possibilities in Nairobi. Powers were in place to authorize councils in Kenya to establish and maintain omnibus services under Article 153 (1) Cap 265 on Local Government. Such and similar legal provisions can be considered under the new Urban Areas and Cities Act of 2011 to effect affordable public transport services and to arrange suitable partnerships with the private sector for effective and efficient public transport within counties.

Local governance needs to facilitate private sector participation in public transport through a

conducive operation environment, with favourable public transport infrastructure and tax incentives, and effective regulation to ensure fairness. Strong and well-organized corporate entities that can sue and be sued, as opposed to loose bodies such as the current Saccos, are essential in mainstreaming the public transport sector.

Table 11.14: Road safety indicators: Traffic accidents, 2007-2010

	Year			
Indicator	2007	2008	2009	2010
Total reported traffic accidents	10,225	9,093	12,369	9,771
Persons killed (fatalities)	2,530	2,463	4,072	3,055
Seriously injured	10,658	9,481	10,644	9,327
Slightly injured	10,327	9,476	11,906	9,739
Fatalities per 100,000 population	7	6	11	8

Source: Kenya National Bureau of Statistics (2011)

11.5.2 Maritime and inland waterways transport

The port of Mombasa is Kenya's main seaport. It handles the bulk of the country's and the East African region's imports and exports. Currently, it is the only port that is fully developed with modern equipment to handle dry bulks (such as grain and fertilizer), liquid bulks (such as crude oil and oil products), bagged products (such as coffee and tea), break bulk (such as iron and steel), motor vehicles, machinery and containerized cargo. Other ports include Lamu, Malindi, Kilifi, Mtwapa, Kiunga, Shimoni, Funzi and Vanga.

Maritime transport is critical to Kenya's export-led growth strategy because it links the region to the rest of the world. The challenges affecting this mode of transport, however, are many and include high cost of transporting containers within the East African region, congestion at the ports, inadequate container capacity against the high proportion of containerized cargo, and under-performing trans-shipment functions. For example, the cost of importing a 20-foot container in the EAC countries is three to five times higher than in Malaysia, Singapore and Mauritius. The import cost of a 20-foot container excluding tariffs and trade taxes in Kenya and Tanzania in 2009 was US$ 2,190 and US$ 1,475, respectively. This situation is compounded by under-utilization of inland waterways.

Over the years, the port of Mombasa has recorded impressive performance. For example, in August 2010, the port registered 1,339 moves[1] within 24 hours, setting a new record performance at the container terminal. This performance exceeded the agreement between the Kenya Ports Authority (KPA) and the East African Conference Lines (EACL) to deliver 200 moves per 24 hours. The port's performance contract with the government targeted 408 moves per 24 hours. The improved performance is attributed to improved vessel planning and dedicated staff. Table 11.15 shows the performance of the port of Mombasa. In terms of traffic, the port recorded a total throughput of 19,952.

Challenges and opportunities at the Port

- The implementation of the Kilindini Waterfront Operating System (KWATOS), which has been interfaced with Kenya Revenue Authority's Simba System, seeks to improve efficiency of the port.

- The port's ICT strategy involving the implementation of the Port Community Based System is envisaged to transform Mombasa into an e-port. It will provide a common platform for sharing shipping information and result in faster cargo clearance and improved overall port efficiency.

Table 11.15: Traffic handled at the port of Mombasa

	Unit	2008	2009	2010	2011
Containers traffic	TEU's [2]	615,733	618,816	695,600	770,804
Ships docking	No.	1,686	1,748	1,579	1,684
Total imports	000'DWT[3]	13,311	16,508	16,244	16,937
Of which transit in	"	4,471	4,612	5,004	5,166
total exports	"	2,685	2,449	2,575	2,788
Of which transit out	"	404	368	377	430
Total imports and exports	"	15,996	18,957	18,819	19,725
Transhipment	"	419	105	158	227
Grand total (port throughput)	"	16,415	19,062	18,977	19,952

Source: Kenya National Bureau of Statistics (2011)

- The introduction delivery of cargo on a 24/7 basis in 2008 has improved cargo deliveries, reduced congestion, enhanced ship turnaround and overall port performance. However, the private sector operators do not work on a 24/7 basis, and this causes congestion.

- The port's security has improved through the construction of the control tower, which is fitted with modern maritime communication equipment, including a Vessel Traffic Management System (VTMS) that monitors movement of vessels within the harbour, Global Maritime Distress Signalling System (GMDSS), and Closed Circuit Television that monitors goings on in the port and its surroundings.

- The Kenya Ports Authority (KPA) has worked with the private sector to improve cargo handling efficiency by appointing some Container Freight Stations (CFSs) to receive cargo directly from the ship. This has reduced cargo dwell time in the port, mitigated congestion, and enhanced yard planning.

- The Port Master Plan is under review to facilitate the development of the port in line with Kenya's Vision 2030.

- Expensive fuel could increase the cost of commodities shipped through the port. Further, congestion at the port is a problem that is partly blamed for the increasing cost of goods. For instance, the drop in tea auction prices is attributed to congestion at the Mombasa port. This delays the shipping of tea for the weekly auctions.

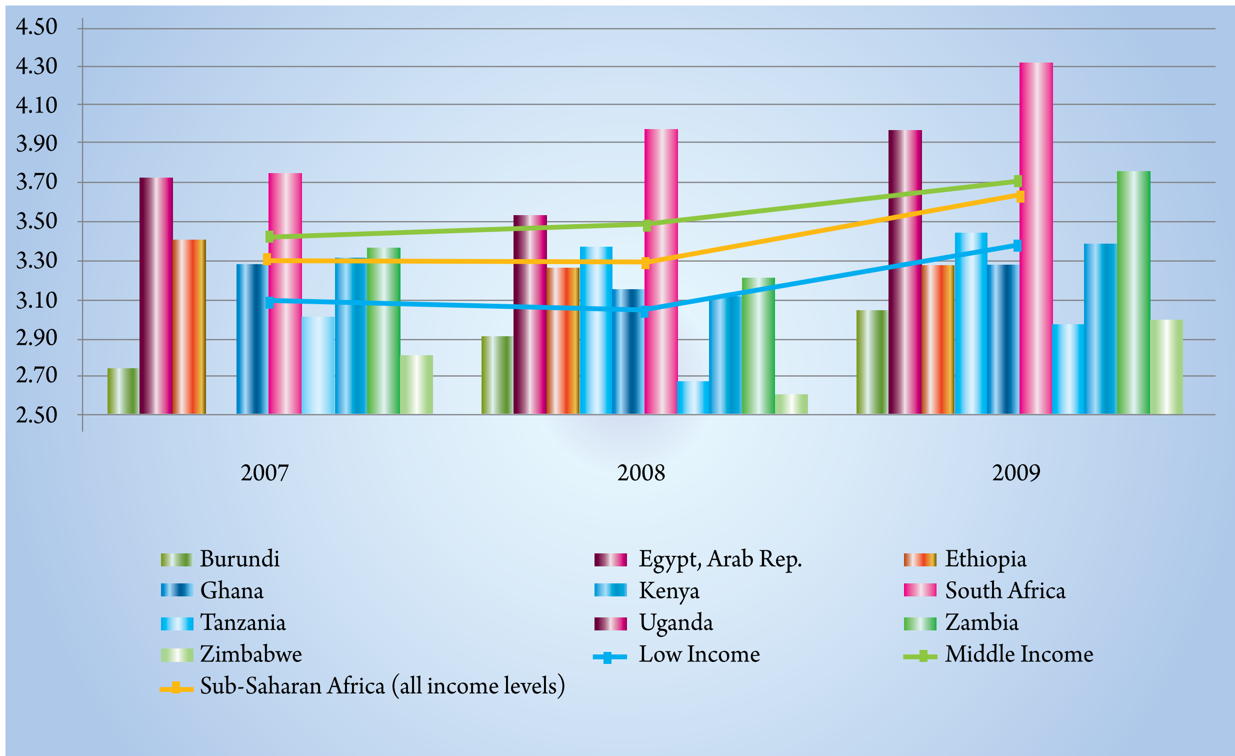
- Higher commodity prices and uncertainty in key global markets triggered by the US and Europe's financial crises could suppress global trade volumes and slow Mombasa port's performance.

Burden of Customs procedures

For the period 2007 to 2009, Kenya and Uganda performed relatively well among the EAC countries in customs procedures. Burundi and Tanzania trailed (Figure 11.3).

The Liner Shipping Connectivity Index captures how well countries are connected to global shipping networks (Figure 11.4). The index generates a value of 100 for the country. The highest average index was in 2004. Kenya and Tanzania performed poorly on this indicator, way below South Africa and Egypt. This calls for enhancement of trans-shipment,

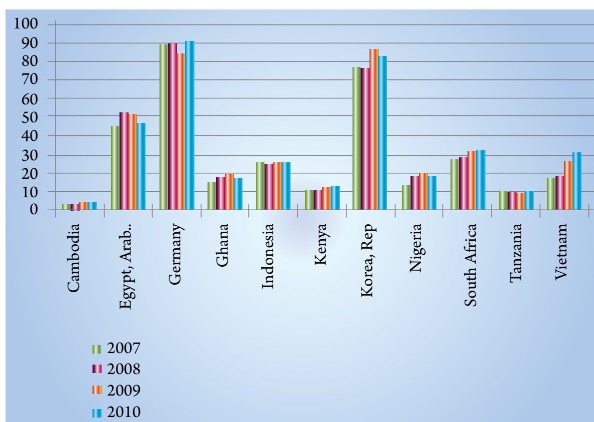
Figure 11.3: Burden of customs procedures in the EAC and other African Countries



The Liner Shipping Connectivity Index

container carrying capacity, vessel size and number, and the number of shipping companies that are efficient in their scheduled services and coverage.

Figure 11.4: The Liner Shipping Connectivity Index



Source: World Bank (2011)

In the medium term, improving maritime transport in the region requires keen attention. The port of Mombasa is set to become the EAC's trans-shipment hub after dredging is complete. Reducing and streamlining customs clearance procedures and other non-tariff barriers is therefore critical, as well as reducing waiting time at the berths and dwell time of containers by at least 50 per cent. A united maritime transport charter for Africa is an opportunity for the growth of this sub-sector. The plan by shipping lines such as Maersk to introduce congestion surcharges is, however, a threat to the sub-sector.

11.6 Construction and Housing

11.6.1 Overview

Shelter is a basic human need. As an economic good, housing has both consumption (demand for housing services) and investment (demand for housing stock) purposes. Generally, housing is an important asset in every aspect. It is a personal, social, public, economic and financial asset.

Analysis of the performance of the construction and housing sector reveals a rise in the index of

completed buildings. In the private sector, the index of completed building works increased by 88 per cent between 2007 and 2009. The index increased by 68 per cent in the public sector in the same period. The government expenditure on roads also increased, with an index of 219.4 in 2007 and 394.8 in 2010.

Table 11.16: Construction and housing indicators

	Year			
Indicator	2007	2008	2009	2010
Index of completed buildings in main towns (private sector)	108.2	142.2	203.0	
Index of completed buildings in main towns (public sector)	4.5	5.1	7.6	
Index of government expenditure on roads	219.4	223.8	312.9	394.8
Cement consumption ('000 tonnes)	2,061.4	2,205.8	2,671.2	3,104.8
Employment ('000)	81.3	84.8	93.4	101.3
Building materials cost index		7.60	3.10	3.20
Labour cost index		6.1	8.8	6.9

	Year			
Indicator	2007	2008	2009	2010
Value of building plans approved: Nairobi (Ksh million)	59,765.1	52,073.0	78,303.7	93,574.8
Value of building plans approved: Other towns (Ksh millions)	7,322.7	17,248.7	15,888.4	17,992.9
Total value of building plans approved: % of GDP	3.6	3.3	4.0	4.4

Source: Government of Kenya (2011)

Table 11.17: Share of housing: Rural and urban population

	Rural	Urban	Total
Population	26,122,722	12,487,375	38,610,097
No. of houses (1999 census)	8,476,000	1,924,000	10,400,000
Ratio (People to Houses)	3.08	6.49	3.71

Source: Government of Kenya (2011)

Inadequate housing in Kenya is a challenge that has persisted from pre-colonial times. It necessitated the creation of a Central Housing Board in 1953 as a principal medium through which the colonial government could promote the development of houses for Africans.

Through the amendment of the Housing Ordinance of 1953, the National Housing Corporation was created in 1965 as the government's main agency

through which public funds for low cost housing could be channelled to local authorities. It also provides technical assistance to authorities in designing and implementing their housing schemes.

Alongside NHC, the Housing Finance Company of Kenya (HFCK), which was later rebranded to Housing Finance (HF) in 2002, was also created to cater for the needs of the mid and high-income consumers. Its main objective was to carry out the government's policy of "promoting thrift and home ownership" by providing savings and mortgage facilities to the Kenyan public.

In the Economic Recovery Strategy for Wealth and Employment Creation (2003), the government recognized shelter and housing as basic needs for human survival, thus underscoring the importance of housing for well-being. The high cost of decent housing, which the majority of the population could not afford, is thus a fundamental issue.

In addition to other international conventions and declarations for which Kenya is a signatory, the Constitution confers the right to "accessible and adequate housing and reasonable standards of sanitation to all citizens" (Government of Kenya, 2010). In light of this, housing should be visualized beyond a mere dwelling unit, because it encompasses far more than living space and shelter. The nature and value of housing is determined by the services it offers, which include neighbourhood amenities, access to education, health facility and security in addition to shelter (Grimes, 1976).

In the Economic Recovery Strategy (ERS), the government through the National Housing Development Programme targeted provision of 450,000 housing units annually. Of these, 150,000 units would be constructed in urban areas and 300,000 units in rural areas within five years. The government also committed to enacting appropriate land and housing legislation to facilitate private sector development of affordable houses and to explore the possibility of working with development partners to develop a framework for upgrading slums and informal settlements in urban areas. In spite of the above initiatives, about 38 per cent of Kenyans still lack decent housing (Nabutola, 2004). Seventy-one (71) per cent of the urban population lives in informal settlements. Unless serious and concerted action by all stakeholders is undertaken, this percentage is likely to rise.

11.6.2 Housing and human welfare

Housing is a basic human need with implications on human welfare. Housing conditions influence individual's outcome on health, education, socio-political participation, labour participation, among other aspects of life (WHO, 1989).

The Constitution of Kenya confers the right to "accessible and adequate housing, and to reasonable standards of sanitation" to the citizens (Constitution of Kenya, 2010). This is in addition to other international conventions and declarations for which Kenya is a signatory, such as MDGs and International Covenant on Economic, Social, and Cultural Rights' (ICESCR).

According to ICESCR, the social economic, cultural, climatic, ecological and other factors, in part, determine adequacy of housing. The essential components of adequacy include legal security of tenure, availability of services, materials, facilities and infrastructure, affordability, habitability, accessibility, location, and cultural adequacy.

Countries must monitor to ascertain the full extent of homelessness and inadequate housing within their jurisdiction to guarantee the right to adequate housing.

State obligations vis-à-vis the right to adequate housing do not mean that the state is required to develop housing for the entire population, or that housing should be provided free of charge to the populace. It also does not mean that this right will manifest itself in the same manner in all places

at all times. Rather, recognition of the right to housing by a state means that the state undertakes to ensure that everyone has access to affordable and acceptable housing. The state will undertake a series of measures, which indicate policy and legislative recognition of each of the constituent aspects of the right to housing. The state will protect and improve houses and neighbourhoods rather than damage or destroy them. The overall goal of Kenya's housing policy is to facilitate the provision of adequate shelter and a healthy living environment at an affordable cost to all socio-economic groups to foster sustainable human settlements.

The housing policy developed in 1966/67 directed the government to provide the maximum number of people with adequate shelter and a healthy environment at the lowest possible cost. However, Kenya has not yet achieved this; instead urban housing is characterized by acute shortage in the number of habitable dwellings, inadequate infrastructure, and extensive substandard human settlement. Informal settlements, which cater to over 60 per cent of urban dwellers in Kenya, do not conform to the requirements of either shelter or housing, and therefore the national and county governments have a collective responsibility of ensuring the attainment of the right to adequate housing.

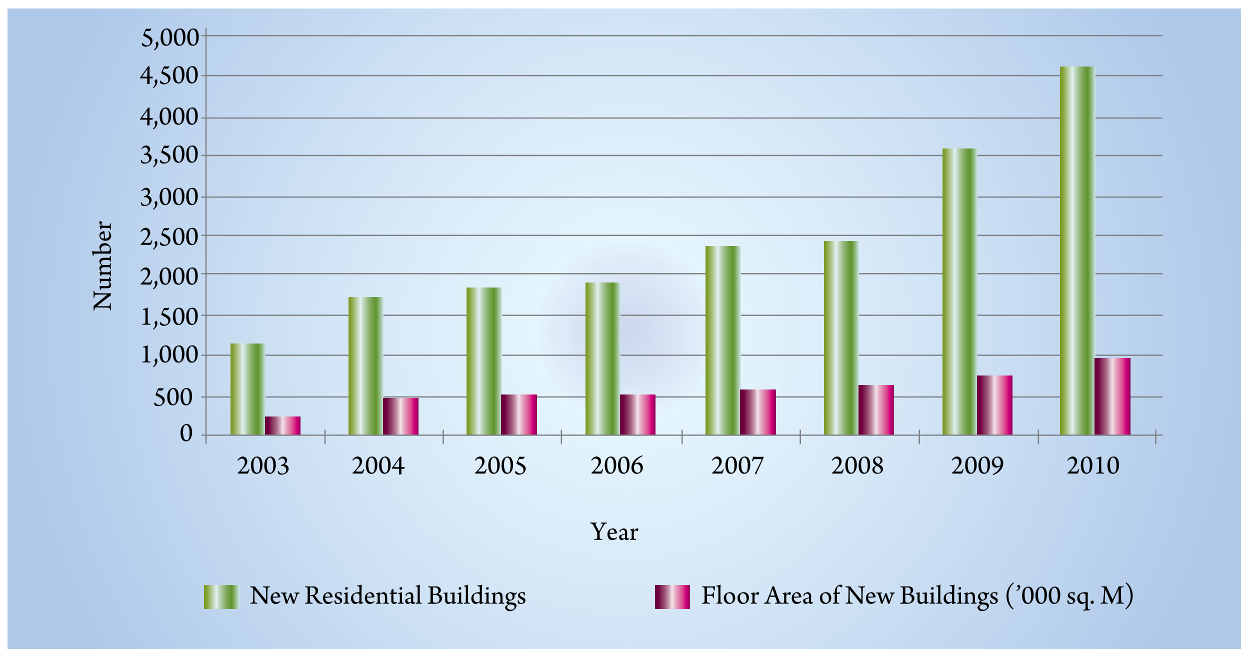
According to estimates from the Ministry of Housing, 150,000 housing units are required annually to meet urban housing demand. However, formal housing supply is only about 30,000 units per annum, with less than 20 per cent of this catering for low-income groups. Households address the gap independently, thus contributing to poor quality housing and the growth of slum dwellings.

11.6.3 Trends and performance in the housing sector

Performance in the housing sector has generally improved in the last seven years. According to Figure 11.5, the number of new residential buildings has increased steadily between 2003 and 2010.

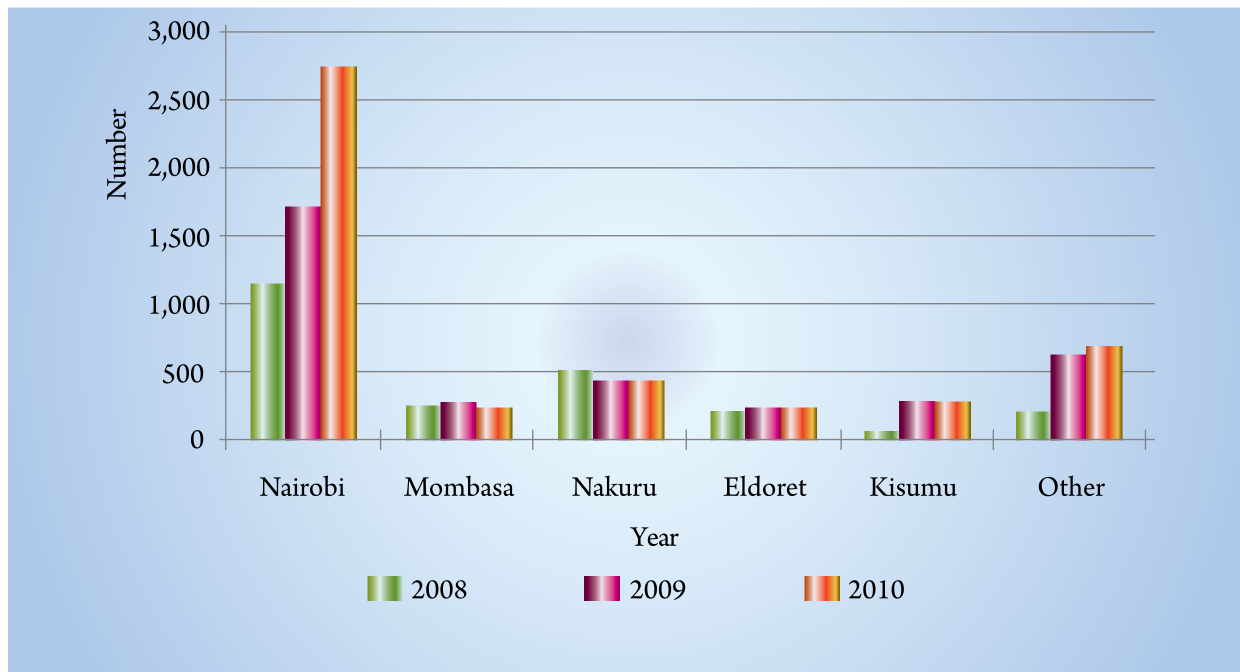
The number of completed private ownership buildings increased mainly in Nairobi. Figure 11.6

Figure 11.5: Reported completion of buildings for residential purposes



Source: Kenya National Bureau of Statistics (2011)

Figure 11.6: Reported completion of buildings for private ownership



Source: Kenya National Bureau of Statistics (2011)

reveals that other areas such as Mombasa, Nakuru, Eldoret and Kisumu recorded no significant increase in completed buildings for private ownership.

Residential building costs related to materials and labour increased between 2007 and 2010 as illustrated in Figure 11.7.

Figure 11.7: Residential building cost index

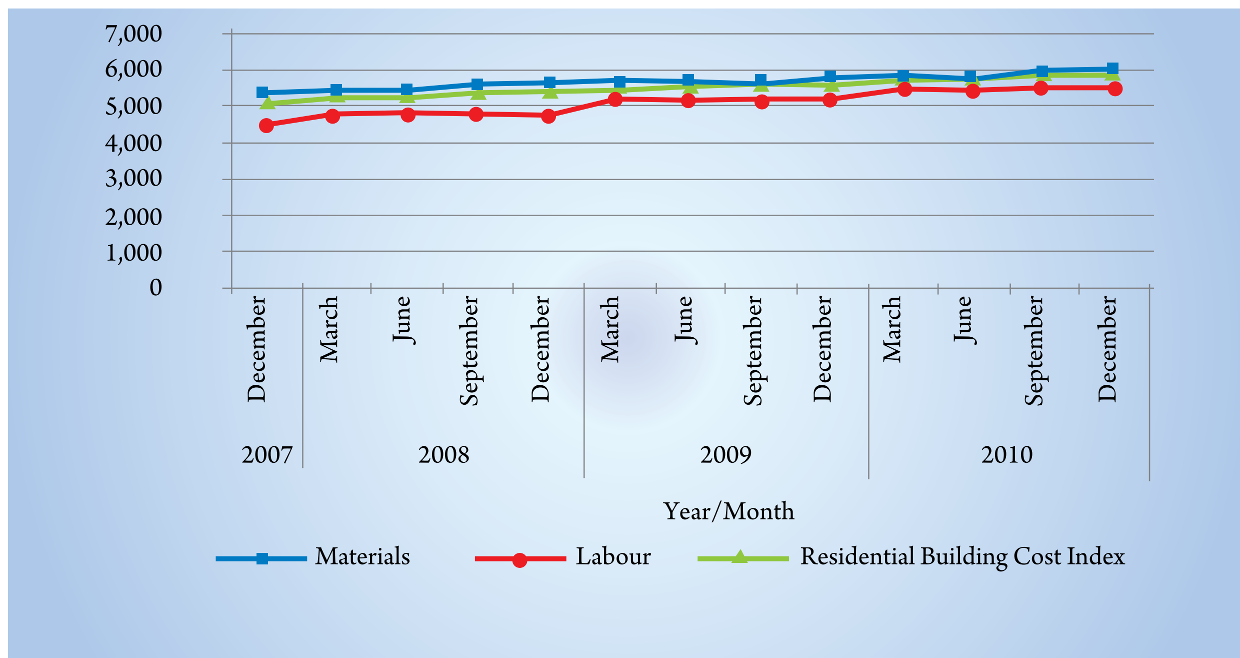
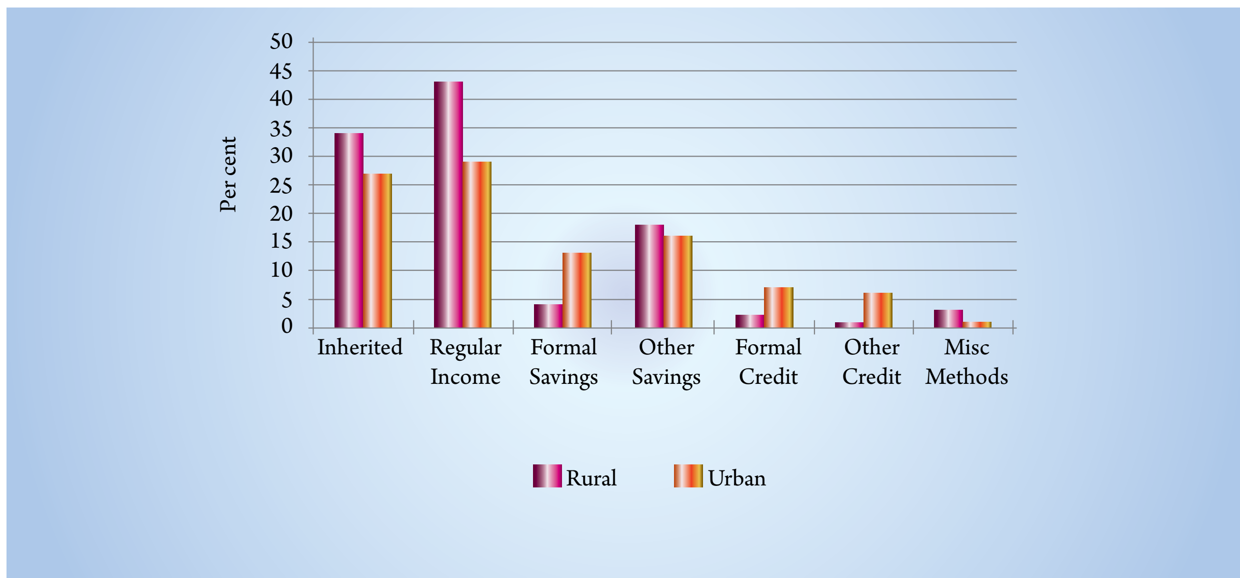


Figure 11.8: Home acquisition by residence



Source: FSD Kenya (2009)

11.6.4 Affordability of housing

Affordable housing is described as reasonably adequate in standard and location for lower or middle-income households. Its cost does not deter a household from meeting other basic needs on a sustainable basis.

The commonly used indicator of housing affordability is the housing-expenditure-to-income-ratio. The accepted housing cost threshold should not exceed 30 per cent of a household's gross income. Affordability of housing is mainly a problem in Kenya's urban areas, where majority (73%) are tenants. Table 11.18 presents the housing cost comparison in selected countries. It reveals that Nairobi has a relatively lower buying price per square metre of US$ 900 and high rental yield of 7.18 per cent. Figure 11.8 illustrates home acquisition by residence. It shows that the mortgage market is prominent in urban areas compared to rural areas.

Table 11.18: Housing cost comparison: BRICS[4] economies and other selected African countries

Country, City	Buying Price US$ per square metre	Price/Rent Ratio (x)	Rent per Month ($)	Gross Rental Yield (%)	Date of Last Update
Kenya, Nairobi	900	14x	1,616	7.18	Sep. 8, 2011
Brazil, Sao Paolo	2,616	14x	1,896	7.25	Nov. 30, 2010
Russia, Moscow	13,910	24x	5,823	4.19	Jun. 22, 2010
India, Mumbai	12,913	36x	3,562	2.76	Apr. 20, 2011
China, Shanghai	6,932	38x	1,841	2.66	Feb. 28, 2011
South Africa, Cape Town	4,272	17x	2,466	5.77	Oct. 31, 2010
Tanzania, Dar es Salaam	700	12x	500	8.57	Dec. 20, 2005
Egypt, Cairo	1,025	15x	860	6.71	Aug. 22, 2009

Source: Global Property Guide (2011) available from www.globalpropertyguide.com

The above comparison is based on the assumptions that:

- The buying price per square metre, the rent per month, and the gross rental yield are based on yields research. All figures are based on the average for a 120 square metre apartment in a prime inner city area, except in the Caribbean or Pacific.
- The price/rent ratio indicates the years of rent, which would be required to buy a 120 square metre of apartment.

The high cost of housing is attributed to various factors. On the demand side, it has been attributed to the ever-growing population, urbanization, income constraints, distortion of the housing market (land speculation), and the demographic transitioning in which people are living longer and in smaller families. On the supply perspective, the limited supply of serviced land, high cost of infrastructure, and existence of old and dilapidated buildings in low-income housing estates contribute to the high cost. These houses sit on prime land, which is not optimally utilized.

11.6.5 Housing supply

The Ministry of Housing in 2007 estimated annual housing supply at 35,000 units against the required 150,000 units. Out of the annual production, only 6,000 units catered for the low income urban households. The National Housing Corporation (NHC) and Housing Finance (HF) have assisted Kenyans and Local Authorities in building decent and affordable houses through various schemes such as Tenant Purchase, Outright Sale, Rental Housing, Rural and Peri-Urban Housing Loans and mortgage loans advanced to prospective homeowners and property developers. However, data on actual stock of housing is not up to date. The NHC, for instance, has only developed 43,000 housing units since it was established 50 years ago. This shows that the private sector supplies most of the housing stock.

Mortgage loans in Kenya grew from Ksh 16 billion in 2006 to Ksh 61 billion in 2010. The average mortgage loan was estimated at Ksh 4 million. This reflects an expensive housing market or a predominance of high-income mortgage borrowers (Central Bank of Kenya and World Bank, 2010).

Kevin (2011) maintains that only 8 per cent of Kenyans, an equivalent of 320,000 households can afford a mortgage facility. To buy a house worth Ksh 2 million, for example, one must have a net salary of Ksh 100,000 to service the loan at Ksh 42,000 a month for 15 years at an interest rate of 14.5 per cent. Those earning less, therefore, cannot afford a mortgage facility. As a result, the supply of informal rental housing built without complying with planning procedures or local authority by-laws is growing much faster than formal housing.

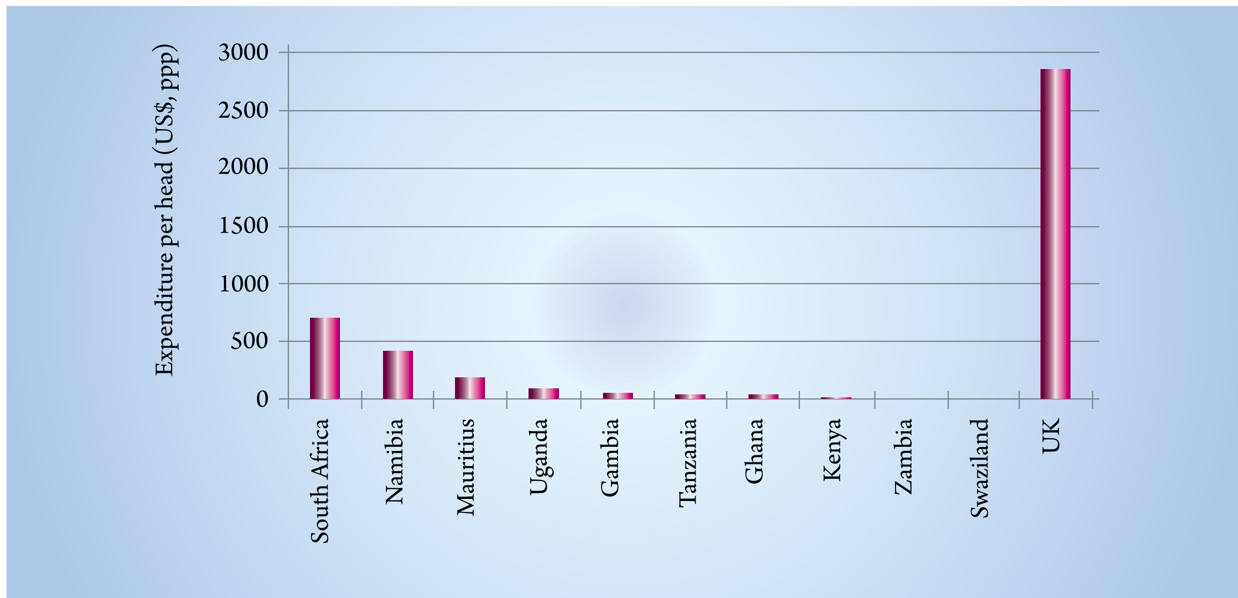
Due to financial constraints, the government shifted focus to provide an enabling environment for housing development by the private sectors, NGOs and CBOs, among others. The urban housing programme derived actors in housing provision from relevant Ministries and other organizations such as the NHC, NACHU, KUSCO, NGOs, the private sector and private individuals. In this endeavour, the housing supply projections were as captured in Table 11.19.

Table 11.19: Housing supply projections

Supply scheme	No. Of Units (annually)
Civil Servants Housing Scheme (Ministry of Lands and Housing)	150, 000
Kenya Slum Upgrading	45,000
Urban Renewal/Redevelopment	25,000
Site and Service Schemes	45, 000
Rental Housing Scheme	45, 000
Mortgage Housing	15, 000

Despite the projected housing supply, progress on the above initiatives remains bleak, with only 600 units developed at Langata decanting site in Nairobi.

Figure 11.9: Local authority spending in selected African countries



Source: Reconstructed from UN-Habitat (2010) and State of African Cities 2010
http://www.trcollege.net/articles/77-infrastructure

The fact that most local authorities' spending on infrastructure upgrading is limited can further explain this. Consequently, the shortage services such housing develops. Figure 11.7 illustrates local authority spending on housing in selected African countries compared with the UK. South Africa ranks as the best among African countries. However, it is still far below the United Kingdom.

END NOTES

1. Moves relate to the discharge and loading of containers at berths
2. TEU's - Twenty-Foot Equivalent Units.
3. DWT- Deadweight Tonnes (a measure of how much weight a ship should carry).
4. BRICS is an international political organization of leading emerging economies, distinguished by their large economies and significant influence on regional and global affairs.

INTERNATIONAL EDITION

MACROECONOMICS

PART III

MEDIUM TERM PROSPECTS

OLIVIER BLANCHARD

Chapter 12

Medium Term Prospects

12.1 Macroeconomic Prospects

Kenya's economy is on a recovery path and elatively higher growth is expected in the medium term. The growth rate for 2010 was impressive at 5.8 per cent compared to 2.6 per cent in 2009. Much as economic recovery is expected to continue in the medium term, year 2011 registered a growth rate of 4.4 per cent, which was lower than expected. The decline was due to economic shocks in terms of high oil prices, depreciation of the Kenya shilling and drought related problems. However, the implementation of the Constitution of Kenya 2010, political reforms that include the general elections in March 2013, and effective implementation of the medium term prospects (MTP) of the Vision 2030 are important domestic factors. The delay of the long rains in 2012 may adversely affect the medium term growth rate. The ongoing institutional reforms are also important to the domestic market for sustainability purposes. External factors, on the other hand, include the global economic crisis, volatile crude oil prices and political instability in the neighbouring countries.

Smooth implementation of the Constitution of Kenya is essential to the medium term prospects. The objectives of the Kenya Vision 2030, the MTP 2008-2012, and other institutional reforms are also being implemented. The objective of the MTP and the Vision 2030 is a 10 per cent real GDP growth by 2012-2013. The implementation of flagship projects is expected to continue. Economic recovery is expected to continue, although projections show that it may slow down slightly in 2012. Despite the positive projections, the 10 per cent growth expected in 2012/2013 may not be achievable, and the economy is, in the medium term, projected to grow at 4.5 per cent in 2012, 5.1 per cent in 2013, and 6.0 per cent in 2014. The recovery is pegged on a favourable international environment, effective implementation of the medium term policy agenda, and favourable weather conditions. The projections assume that international oil prices will remain stable in the medium term. Table 12.1 summarizes the key macroeconomic variables for the years 2009, 2010, 2011 and three-year forecasts.

Table 12.1: Optimistic scenario - Macroeconomic projections (%) for 2012-2014

	2009	2010	2011	2012	2013	2014
GDP growth	2.7	5.8	4.4	4.5	5.1	6.0
Inflation overall	9.0	4.0	14.0	9.6	8.0	6.0
Treasury bill interest rate	7.4	3.6	8.7	13.6	7.9	8.0

	2009	2010	2011	2012	2013	2014
Private consumption growth	5.0	7.2	2.8	7.0	7.0	7.0
Private investments growth	4.0	5.0	12.0	7.0	7.0	11.0
Government consumption growth	3.8	9.2	10.6	8.0	6.0	7.0
Government investments growth	8.2	5.0	9.0	9.0	9.0	11.0
Export of goods and services	-9.3	17.7	6.7	5.0	6.0	7.0
Import of goods and services	2.8	6.1	15.6	11.0	10.0	11.0
Financial deficit as a % GDP	-5.4	-5.6	-4.7	-3.8	-3.2	-3.1
Public expenditure % GDP	31.0	33.4	33.0	31.8	30.4	30.0

Source: KIPPRA Treasury Macro Model (KTMM)

The average overall inflation for 2011 was 14.0 per cent compared to 4.1 per cent in 2010. However, 2012 average inflation eased slightly to 9.6 per cent. Stable international oil prices and prudent fiscal and monetary policies were expected to yield single digit inflation level of about 7.0 per cent in the medium term. Improved food production and favourable weather conditions are crucial to future overall price stability, because food commodities account for a large share of the consumer basket.

The assumptions underlying the fiscal framework in the medium term projections are consistent with the Budget Policy Statement, and adjustments were made to reflect actual budget implementation. Public expenditure as a percentage of GDP was still quite high at 31.8 per cent in 2012. In terms of real growth in government expenditure, average consumption and investment in 2012 was about 8 per cent and 9 per cent, respectively. Similarly, investment was expected to be high because of increased infrastructure development and implementation of the planned development programmes in line with the medium term expenditure. In 2012, 2013 and 2014, high levels of both consumption and investments are expected to stabilize to enable Kenya achieve the projected economic growth rates.

The tourism sector is expected to stabilize and maintain the growth trend at about 12 per cent annually. Vigorous marketing of Kenya as one of the best tourist destinations, and both political and economic stability, are expected to support this growth. This will boost exports in the medium term and support economic growth outcomes. Imports are expected to expand with economic growth. The projected growth in Sub-Saharan Africa at 5.7 per cent in 2013 and 5.8 per cent in 2015 will provide an impetus to private investment for the recovery process.

As the economy expands in the medium term, imports will grow further to 10 per cent in 2013 and 11 per cent in 2014. This growth will be driven by the need to complement domestic production through purchase of intermediate and capital goods and purchase of oil and oil related products from international markets.

Some of the prerequisites for steady growth trajectory include maintaining macroeconomic stability, deepening structural reforms, and strengthening institutions. In addition to stabilizing economic growth, it is expected to create employment and reduce inequality.

However, some challenges and uncertainties may dampen the medium term prospects, the main challenges being poor weather conditions, slow implementation of the Constitution, and an uncertain international economic environment. Table 12.2 presents a pessimistic scenario that shows

projected GDP growth of 4.7 per cent and 5.0 per cent in 2013 and 2014, respectively. The forecasts are based on the assumption that inflation rate will remain high in 2013 due to supply constraints, weak Kenya shilling against the US dollar that will push commodity prices even higher, and a slow global economy. The general elections and other political shocks are also likely to discourage potential investors from taking advantage of the existing investment opportunities in the country.

Table 12.2: Economic projections for 2012-2014 (pessimistic scenario)

Variable	2009	2010	2011	2012	2013	2014
GDP growth	2.7	5.8	4.4	4.5	4.7	5.0
Inflation overall	9.0	4.0	14.0	9.6	11.0	10.0
Private consumption growth	5.0	7.2	2.8	7.0	5.0	6.0
Private investments growth	4.0	5.0	12.0	7.0	5.0	11.0
Government consumption growth	3.8	9.2	10.6	8.0	6.0	7.0
Government investments growth	8.2	5.0	9.0	9.0	12.0	14.0
Exports of goods and services	-9.3	17.7	6.7	5.0	11.0	7.0
Imports of goods and services	2.8	6.1	15.6	11.0	10.0	11.0
Financial deficit as % of GDP	-5.4	-5.6	-4.7	-3.8	-3.2	-3.2
Public expenditure as % of GDP	31.0	33.4	33.0	31.8	30.3	29.6

Source: KIPPRA Estimates

Slow uptake of the Public-Private Partnership (PPP) initiative in the implementation of the MTP may lead to a slower rate of economic expansion than envisaged in the Vision 2030. In addition, weak implementation of the budget can adversely affect growth in the medium term.

12.2 Poverty

Poverty identification and measurement requires data on household and individual economic conditions. Such data is collected through household surveys. However, the major shortcoming with household surveys is that they require considerable expenditure and expertise to conduct and analyze. For this reason, household surveys are conducted occasionally and cannot be used to construct frequent poverty indices and profiles, yet such poverty indices and profiles are necessary for effective evaluation of poverty reduction strategies.

In view of the above, KIPPRA formulated a methodology for predicting medium term poverty rates. Information on poverty status at some reference period is key to poverty evaluation exercise. In this case, the reference time is 2005/06. The details of the methodology for determining poverty rates as a reference and the subsequent periods are available in Mwabu *et al* (2001).

The method for predicting medium term poverty rates was developed on the idea that changes in poverty over time and space are determined mainly by changes in economic growth and in the distribution of income. Other factors being constant, poverty increases with growth and worsens with inequality. The medium term poverty prospects assume that the Constitution of Kenya

2010 will be implemented smoothly and in a timely manner, together with the objectives of the Medium Term Plan (MTP) 2008-2012. The Gini coefficient is assumed to be 0.41 in the ensuing poverty projections. To check if the predicted poverty rates are reasonable, we have included the poverty projections for 2005/06 and the actual poverty estimates for the same year (computed by the Kenya National Bureau of Statistics using the same survey data).

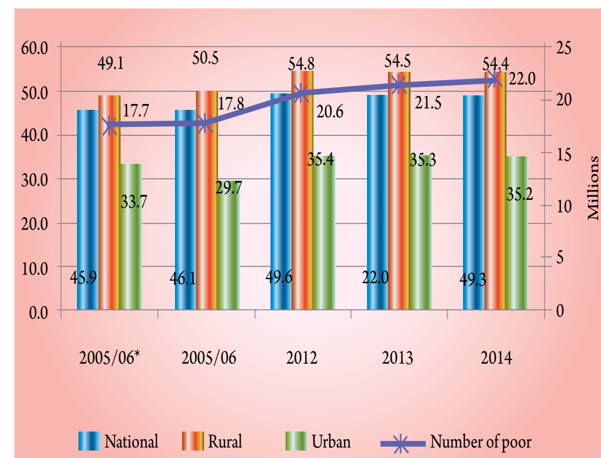
Poverty headcount ratio

The headcount ratio is the most popular of poverty measures. It is the ratio of the poor to the total population. Poverty is projected to continue affecting over 50 per cent of the rural population in the next three years (Figure 12.1). Further, it will affect nearly 35 per cent of the total urban population. For instance, the projections show that national poverty was projected at 49.6 per cent by the end of 2012, and this failed to meet the poverty target of 30-35 per cent by 2012 as outlined in Vision 2030. The poverty headcount in the rural areas is expected to be higher than the national level throughout the review period.

According to the Vision 2030, six growth sectors, notably tourism, agriculture, wholesale and retail trade, manufacturing, business process outsourcing–BPO and financial services help attain poverty reduction goals. Moreover, it is expected that increased spending on infrastructure (roads, water, sewerage, communications, electricity and lighting) would create an enabling environment for poor communities to participate in wealth creation for themselves and the country, meaning that poverty eradication efforts should be geared towards assisting the majority of the population in rural areas to be in a position to afford the basic minimum requirements. Further, the rate of poverty should decline faster than the population growth rate if the number of the poor is to decline.

According to the household survey conducted in 2005/06, the poverty line was about Ksh 1,562 for rural areas and Ksh 2,913 for urban areas. Currently, poverty is expected to be higher because of the recent rise in the cost of living. Although there is a declining trend in national poverty, the number of poor people in subsequent years will increase. These projections assume that inequality remains constant.

Figure 12.1: Poverty headcount ratio and number of poor population



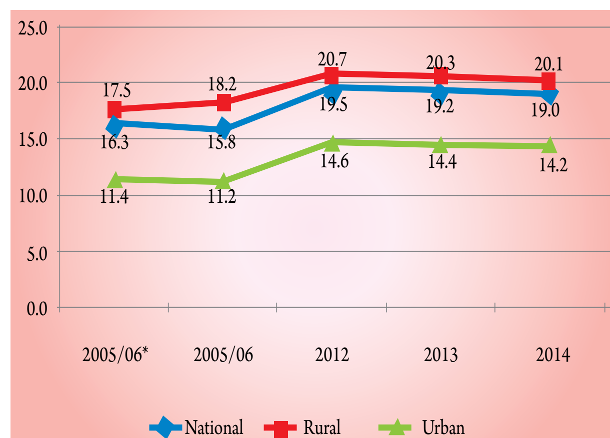
Source: KIPPRA projections based on KIHBS 2005/2006
Note: *Actual figures using survey data.

The poverty headcount ratio, however, has several shortcomings. First, it does not show how far the poor are below the poverty line; that is, it ignores the inequality among the poor. Second, it forces the overall poverty index to remain the same even when the welfare of the poor has improved or worsened. Third, an income transfer from a poor person to a person just below the poverty line (enabling him/her to cross the poverty line) would lead to a reduction in poverty despite the decline in the income of the poor. The poverty headcount declines because, for the same population, there are fewer people below the poverty line even though the poverty gap for the same population has widened. It is projected that during the period 2012 and 2014, *ceteris paribus*, more people will become poor (Figure 12.1).

Poverty gap

This measure is also referred to as the poverty depth. It is a measure of the shortfall of the average income of the poor from the poverty line, and can be used to estimate, under the assumption of perfect targeting, the amount of resources that would bring the expenditure of every poor person up to the poverty line, thereby eliminating absolute poverty. The national trend for the poverty gap follows very closely the trend for rural areas. The actual poverty gap for 2005/06 and the projected poverty gap for the same year are shown in Figure 12.2. The projection is based on the Welfare Monitoring Survey II (1994). A comparison between the actual poverty gap and projected poverty gap for 2005/06 shows that the model is precise. The actual poverty gaps are 16.3 per cent, 17.5 per cent and 11.4 per cent for national, rural and urban areas, respectively. The projected poverty gap for the same year is 15.8 per cent, 18.2 per cent and 11.2 per cent for national, rural and urban areas, respectively. Based on the above, the national poverty gap is projected to decline from 19.5 per cent in 2012 to 19.0 per cent by 2014, which means that, at the national level, the average income of a poor person will fall below the poverty line by 19.2 per cent in 2013 before recording slight improvement in 2014 (19%).

Figure 12.2: Poverty gap



Source: KIPPRA projections based on KIHBS 2005/2006
Note: *Actual figures using survey data

A poor person living in a rural area will be worse off than one living in an urban area. Rural incomes will fall below the poverty line by 20.3 per cent (14.4% for urban) and 20.1 per cent (14.2% in urban) in 2013 and 2014, respectively. Although poverty will affect both the rural and urban population, the average income of the poor living in the rural areas will fall far below the rural poverty line, meaning that poverty in Kenya is a rural phenomenon.

Owing to the huge population in the rural areas (79% of the total population) and the depth in poverty, the government would need to spend much more resources to uplift an average poor person living in the rural areas above the poverty line, compared to an average poor person living in the urban areas. Moreover, while more people will fall into poverty over the review period, the average income shortfall will decline for both rural and urban areas, over the projected years.

The main limitation of the indicator is that it is insensitive to the distribution of income among the poor. Poverty severity, however, overcomes this limitation.

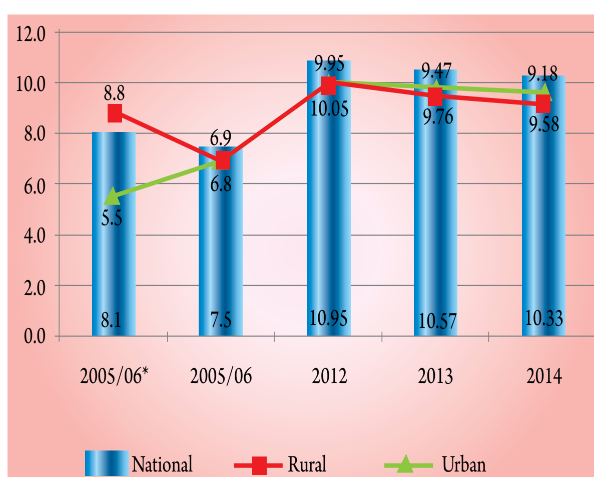
Poverty severity

The severity of poverty is measured by the square of the poverty gap, which increases more than proportionately with the poverty gap. In doing so, it attributes more weight among the poorest of the poor. Consistent with high poverty incidence in rural areas (Figure 12.1), the degree of inequality (poverty gap) among the poor is higher in rural than in urban areas (Figure 12.2).

The poverty projections show that the rural poverty severity index is 1.6 times higher than the urban index (Figure 12.3). However, the projected poverty severity for urban areas for 2013 and 2014 is higher than the rural severity index because poverty gaps in rural and urban areas respond differently to changes in growth and inequality. The poverty severity profiles indicate that, over the projection period,

the decline in urban poverty gap is less responsive to increases in growth and to reductions in inequality than rural poverty, the main reason being the differences in the income earning opportunities for the urban poor, who are mainly wage earners. Poverty severity will be worse in urban than in rural areas over the projected years (Figure 12.3). This has direct implications on the design of policies that govern determination of wages of urban workers, whose labour incomes are dependent on their relative market power vis-à-vis that of employers.

Figure 12.3: Poverty severity 2005/06-2014



Source: KIPPRA projections based on KIHBS 2005/2006
Note: *Actual figures using survey data

The larger the poverty severity index, the greater the poverty gap. This indicates that poverty is severest among the very poor. The poverty reduction policies in urban areas should be geared towards reducing the degree of inequality amongst the poor. Social protection measures can be used to mitigate severity of poverty in both rural and urban areas.

12.3 Education

Prospects in the education sector will depend on interventions towards increasing access to schooling, and reducing and, or eliminating inequalities. Other initiatives include focusing on the quality of the actual teaching and learning process in the classroom, and institutionalizing the link between education and training with the labour market. The government should also integrate ECDE into primary education as provided for in the Sessional Paper No. 1 of 2005.

Table 12.3 presents the targets for the education sector policy in the medium term. The target for secondary to university transition rate is over 10 per cent by 2015 against the 6.5 per cent attained in 2010. Tertiary gross enrolment rate (GER) was 4.1 per cent in 2010, which was relatively low compared to countries such as Korea with a GER rate of over 52 per cent.

Table 12.3: Education indicators and targets for Kenya, 2015

Education Indicators	Measure (2010)	Target (2015)
Primary		
Net Enrolment Rate (NER)	91.4	100
NER male	90.6	-
NER female	92.3	-
Primary completion rate	76.8	100
Transition rate (Std. 8 to Form 1)	66.8	75
Secondary		
Net Enrolment Rate (NER)	32	65
NER male	34.0	-
NER female	30.9	-
Secondary to University transition rate	6.5	Over 10%
Tertiary education GER (2007-2010)	4.1	0ver 50

Source: Government of Kenya (2010)

Table 12.4 presents the projected demand for education in the next three years. The pre-primary school age population aged 4-5 years is expected to increase from 2.68 million in 2010 to about 3.12 million by 2015, primary school age population from 8.6 million children to 10.7 million children by 2015, and secondary school age population (14-17

years) from 3.2 million in 2010 to about 3.6 million by 2015.

Taking the policy targets and the expected school age population growth into account, ECDE enrolment is projected to increase from 2.19 million in 2010 to 2.56 million in 2015. On the other hand, primary enrolment is projected to increase from 9.38 million in 2010 to 11.47 million students in 2015 and secondary school enrolment from 1.7 million in 2010 to 2.42 million by 2015 (Table 12.4).

Table 12.4: Early childhood development and education, primary and secondary enrolment projections, 2010-2015 (millions)

Population	2010 (Actual)	2011	2012	2013	2014	2015
ECDE (4-5 years)	2.68	2.75	2.82	2.88	2.95	3.12
Primary (6-13 years)	8.6	8.78	9.26	9.74	10.22	10.70
Secondary (14-17 years)	3.2	3.24	3.33	3.43	3.53	3.63
ECDE						
Public	1.50	1.42	1.47	1.52	1.57	1.84
Private	0.69	0.65	0.67	0.70	0.71	.72
Total	2.19	2.07	2.14	2.22	2.29	2.56
GER (%)	61	75	76	77	78	85
Primary Education						
Public	8.52	8.85	9.21	9.61	10.05	10.51
Private	0.86	0.88	0.90	0.92	0.94	.97
Total	9.38	9.73	10.11	10.53	10.99	11.47
GER (%)	109.8	111	109	108	108	107
Secondary Education						
Public	1.54	1.82	2.01	2.11	2.17	2.23
Private	0.16	0.17	0.17	0.17	0.178	0.18
Total	1.70	1.99	2.18	2.28	2.34	2.42
GER (%)	47.8	61	65	66	66	67

Source: KIPPRA Estimates (2010)

The gross enrolment rates are projected at 85 per cent at ECDE, 107 per cent in primary school, and 67 per cent at secondary school levels by 2015. This assumes that there will be no supply and demand constraints that hinder access to education. However, there is need to address regional disparities and low transition levels across education levels. The government also needs to improve the quality and internal efficiency across all education levels by enhancing the quality of learning outcomes and their linkages with the labour market.

Overall, the government in collaboration with various actors in the education and training sector will need to design and make pro-growth strategies and policies for sustained skills development and competitiveness over the medium and longer term. Some of these strategies include investing in areas of balancing between education quality and quantity across all levels, and development of infrastructure in areas of low demand. Strengthening of public private partnerships, especially at tertiary education level, is a potential intervention for enabling Kenya to expand access to higher education in line with the Vision 2030 objectives. Skills development and on-the-job training will also be required to ensure constant upgrading of workers' skills.

Kenya needs to adopt existing technologies to enhance the productivity of its industries, with specific emphasis on human capacity to leverage ICT in education, daily activities and production processes fully. Innovation is particularly important for the economy in areas of cutting-edge products and processes to maintain a competitive edge. Although individuals, some higher learning and research institutions have made attempts in these areas, there is need to enhance financing of research and development, both in the medium term and long-term. There is also need to create an environment that is conducive to creativity to support innovation. The public and private sector, high-quality scientific research institutions, extensive collaboration in research between tertiary education institutions and industry and by laws

that protect intellectual property rights should also support innovation.

12.4 Health

Despite some strides made in reducing mortality rates, Kenya is still far from achieving the MDGs related to health. Guided by NHSSP II and the MTP, the government has a framework to accelerate improvement of indicators for achievement of MDG 4 on reduction of child mortality. These indicators include under-five mortality rate, infant mortality rate and the proportion of 1-year-old children immunized against measles (Government of Kenya, 2010).

Together with partners, the ministries of health through NHSSPII and the Division of Malaria Control (DOMC) are also spearheading the National Malaria Strategy (2009-2017) with the aim of controlling malaria (Government of Kenya, 2001 and 2009). Given that malaria is the chief cause of morbidity and mortality across all ages, its control will have a significant effect on health indicators across the range, particularly on pregnant women and children aged under-five. More importantly, maternal education can reduce neonatal morbidity and mortality significantly.

Implementation of the proposed social health insurance scheme will promote equity and provide access to basic health services to the poorest quintiles of the population. Moreover, with the help of donors, the government's e-Learning programme is expected to play a positive role in skill development especially among registered nurses. These health workers are essential to effective health service delivery throughout the country. The programme is helping in achievement of MDG 4, 5, and 6, while elevating the professional standards of nurses. It is equipping them to deal effectively with diverse and complex health challenges. However, if the recent labour unrest in the sector is not resolved fully, it will have adverse effects on the medium term health of the population.

12.5 Agriculture

The agriculture sector is expected to record growth as experienced in 2010, despite poor weather conditions in the last quarter of 2010. The underlying assumptions are that the investment made between 2009 and 2011 to revive the irrigation schemes under the Economic Stimulus Programme, and programmes such as the National Accelerated Agriculture Input Access Programme (NAAIAP), will continue to bear positive results.

Kenya's economy is agricultural-based. Therefore, based on KTMM estimates, GDP projected growth for 2012 is 5.2 per cent, 5.8 per cent for 2013, and 6.3 per cent for 2014. As the country transitions to the devolved government structure, this growth will be reflected in the agricultural sector. It is expected that investment in the sector will increase, specifically in irrigation, value addition and access to physical markets and market infrastructure.

12.6 Tourism

This section discusses the medium term prospects for the tourism sector in terms of tourist arrivals, earnings, value added in hotels and restaurants, and major source markets. The assumption is that the macroeconomic environment will remain stable during the period 2012-2015, and that the general election in 2013 will not negatively affect performance in the tourism sector because of the recent constitutional, institutional and legislative reforms in the judiciary, police and political parties, among other areas.

Tourist arrivals: In the baseline scenario, Kenya will achieve the average growth rate in arrivals of 11 per cent, same as experienced during the pre-crisis period 2005-2007. The growth will be maintained through 2012-2015 (Table 12.5). If the exchange rate remains stable and close to the current levels,

Table 12.5: Projected tourist arrivals, earnings and value added in hotel and restaurants

	Actual Performance						Projected Performance			
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Number ('000)	1,600.5	1,816.9	1,203.2	1,490.0	1,609.1	1,900.0	2,109.0	2,341.0	2,598.5	2,884.3
Growth (%)	8.2	13.5	-33.8	23.8	7.9	18.1	11.0	11.0	11.0	11.0
Ksh billion	56.2	65.4	52.71	62.5	73.7	98.0	116.3	138.1	163.9	194.6
Growth (%)	14.9	16.4	-19.4	18.6	17.9	33.0	18.7	18.7	18.7	18.7
2001 Constant prices (Ksh billion)	17.894	20.814	13.298	18.993	19.796	22.726	26.089	29.950	34.383	39.472
Growth (%)	14.9	16.3	-36.1	42.8	4.2	14.8	14.8	14.8	14.8	14.8

Source: Calculated from Kenya National Bureau of Statistics, Statistical Abstracts (2007-2011)

this might also accelerate arrivals and earnings in the forecast period. All factors remaining the same, tourism arrivals are predicted to reach the 2 million mark, respectively, in 2012/2013.

Tourism earnings: Throughout the pre-crisis period of 2005-2007, tourism earnings grew at about 18.7 per cent, on average, per year. In 2011, the tourism sector earnings exceeded the record set in 2010 by 33 per cent. Using the pre-crisis average growth rate, the forecast earnings for the medium term are predicted to reach Ksh 100 billion in 2012.

Value added in hotels and restaurants: Using the year 2001 constant prices, in the baseline scenario, the value added for hotels and restaurants for the period 2012-2015 is projected using the average annual growth rate in value added for the period 2005 to 2007 of 14.8 per cent.

The forecasted arrivals and earnings for year 2012 were much lower than the Ministry of Tourism's target of 3 million arrivals and Ksh 200 billion in revenue (Ministry of Tourism, 2009). The sector may achieve this in 2015/16. However, this will depend on increased funding to the sector, implementation of flagship projects, improved quality of tourism facilities, tourism promotion and marketing to emerging source markets, transformation of various institutions in the sector, stability of the exchange rate and peaceful elections in 2013.

Major source markets

Even though 2012/2013 is an election period for Kenya, tourism growth is expected to continue, sustained by arrival of new chartered and scheduled airlines especially from emerging markets. Anticipated airlines include Novair (Sweden) and Pegas Touristik (Russia), which have already started operating regular flights to Mombasa, and Air Korea, Southern China Airlines, Jordanian Airlines and Etihad (Ministry of Tourism, 2012).

The prospects for inbound tourists are derived using departures by country of residence. Tourism sector performance indicators for the last four years show that the tourism market has recovered gradually from the 2007-2008 crisis. Therefore, the mean growth rates in departures for various key markets in 2008-2011 are used to forecast for the 2012-2015 period (Table 12.6). The highest growth rates in arrivals over the forecast period are expected from Tanzania, Uganda, Japan, Canada, and the US.

The economic crisis in the Euro zone may have an impact on Kenya's tourism industry in the short-term because the country's major source markets are European. In November 2011, the European Central Bank (ECB) projected a decline in Euro zone economic growth. It forecasted a 1.5 per cent economic growth for the EU member states in 2012. Despite this, Kenya anticipates growth in arrivals from Russia, China, UAE and the Scandinavian countries. Other traditional markets expected to

Table 12.6: Projected departures by country of residence (selected key markets)

	Actual Departures ('000)						Mean	Projected Departures ('000)			
	2006	2007	2008	2009	2010	2011	Growth 2008-11 (%)	2012	2013	2014	2015
UK	272.0	313.6	216.7	245.9	247.1	246.5	4.6	257.8	269.6	281.9	294.8
Germany	248.9	263.2	137.3	149.7	154.8	157.2	4.7	164.5	172.2	180.2	188.6
Italy	129.9	146.6	80.2	112.1	112.6	113.6	13.7	129.2	146.9	167.0	189.9
France	76.2	84.7	43.1	51.3	52.0	53.1	7.5	57.1	61.4	66.0	70.9
USA	91.9	116.8	89.4	127.2	131.5	132.6	15.5	153.2	176.9	204.3	236.0
Switzerland	60.3	60.5	37.7	43.1	44.1	45.8	6.8	48.9	52.3	55.8	59.7
Scandinavia	39.5	43.3	30.9	41.5	43.1	44.3	13.6	50.3	57.2	65.0	73.9
India	35.7	37.1	35.3	38.2	41.2	41.6	5.7	44.0	46.5	49.1	51.9
Canada	22.1	27.4	18.9	28.1	28.9	29.7	18.1	35.1	41.4	48.9	57.8
Japan	21.5	22.0	14.2	18.8	20.1	24.3	20.1	29.2	35.0	42.1	50.5
Tanzania	25.8	27.6	23.2	46.1	46.6	46.2	33.0	61.4	81.7	108.6	144.5
Uganda	19.8	20.9	22.8	42.7	43.4	43.9	30.0	57.1	74.2	96.5	125.5
Oceania**	24.0	28.7	19.2	22.8	24.0	27.3	12.6	30.7	34.6	39.0	43.9

Source: Kenya National Bureau of Statistics (2007-2012) and authors' calculations
Note: Oceania** = Australia and New Zealand

maintain arrivals include Canada, Tanzania, Oceania (Australia and New Zealand), USA and India.

Prospects for intra-EAC tourism

Currently, citizens of the East African Community (EAC) countries wishing to travel within the EAC require an EAC travel passport, available from immigration offices of each country, and also the individual country's travel passport or a temporary passport (issued within one day). Temporary passports are also available from either immigration offices in each of the EAC countries or at border posts. Immigration procedures at points of entry/exit within the EAC are now harmonized. In all EAC airports, there is an express clearance counter for EAC citizens.

However, several non-tariff barriers (NTB) still exist. Unlike other members of the EAC, Tanzania requires citizens of the other member countries to take yellow fever vaccination before travelling into the country. In addition, tour company vans travelling into Tanzania from other EAC countries are required to either pay a levy or alternatively, offload tourists at the border and transfer them into Tanzania-registered vans. This is unique to Tanzania only, and may inconvenience tourists coming into the region.

The EAC member countries apply a similar common external tariff to all goods imported from outside the EAC. At the border/ports of exit, travellers in possession of goods not exceeding US$ 500 purchased in another EAC country are exempted from paying value-added tax (VAT), charged at 16 per cent. In essence, this can promote intra-EAC shopping expeditions, especially for household goods and stocks for micro-enterprises not exceeding US$ 500 per trip.

The EAC plans to formalize a monetary union within 2012-2015. Once this is realized, it will enhance regional tourism in that, with a common currency in place, pricing of tourism commodities will be made easier.

12.7 Energy

Thermal electricity generation is still entirely oil-based. It forms a large and growing share of total electricity generation, which is about 40 per cent over the period 2009-2011. Following success in coal exploits in eastern Kenya, there are prospects to start coal-based thermal generation from 2014. Coal is expected to dominate thermal electricity generation from 2014, and the BMI forecasts a contribution of 67 per cent to thermal electricity in 2014 and rising to over 90 per cent of thermal generation in 2020. If backed by proper governance and management, the discovery of oil in Turkana County can be a timely game changer in favour of cheaper oil-based thermal generation from the next decade.

Hydropower generation is expected to decline in share from about 40 per cent in 2009 to slightly below 30 per cent by 2020. Wind is expected to gain a larger share in electricity generation from a low of 0.05 per cent in 2012 to 2 per cent in 2015 and steadily to 8 per cent by 2020 (1.29 Terawatt hours).

Geothermal generation will claim increasing share from an estimated 19 per cent in 2012 (1.5 TWh) to slightly over 20 per cent by 2020 (3.2 TWh). With ambitious development plans, there can be a decline in generation from biomass and waste from about 5 per cent (0.4 TWh) in 2012 to slightly below 4 per cent by 2020 (0.6 TWh). There will still be the key challenge of distribution losses, which are estimated to remain at 15 per cent up to the year 2020, still below the 10 per cent target in best-practice scenarios. Renewable energy developments are expected to gain under the government's Feed-in-Tariffs (FiTs) scheme. According to the Ministry of Energy's first revision of FiTs in 2010, solar projects receive assured tariffs per kWh of up to US$ 0.20, small hydropower projects up to US$ 0.12, wind power projects up to US$ 0.12, geothermal projects up to US$ 0.085, biomass and biogas projects up to US$ 0.08.

National energy development plans

Kenya's energy sub-sector is beaming with ambitious development plans could be a great boost to the country's infrastructure sector and progress towards becoming a middle-level economy. New geothermal and wind power plants are in schedule for development in the medium term. Upgrading and construction of hydropower plants targets the stations in Tana, Sangoro (in Nyanza) and Kindaruma under the New Planned Power Generation Capacity Programme. Other key projects planned in the energy sub-sector include a power importation deal between Kenya and the Democratic Republic of Congo (from Inga Dam), a coal plant to be built by Daewoo, and feasibility studies on nuclear and sea wave power plants.

Building of new transmission lines and integration of power grids in the wider EAC will be implemented to expand the regional electricity market. A joint project between Kenya and Tanzania for a natural gas processing plant in Mombasa is in the pipeline. Tanzania will offer the gas deposits to be processed. Kenya can thus benefit from piped gas supply. Table 12.7 provides a summary of the main energy projects that are planned to the year 2015 and their estimated costs.

An overview of the budgets required by Kenya's energy sector plans reveals that close to US$ 800 million will be needed to expand exploration for geothermal resources (known potential of 7 GW), US$ 1.5 billion for generation, US$ 1.1 billion for rural electrification and US$ 465 million for distribution.

12.8 Port Facilities in Kenya

Dredging of Mombasa port

BMI (2011) projects a throughput in excess of the existing port capacity of 20 million tonnes. In terms of TEUs, it is expected that there will be 852,461 TEUs by 2014. The turnaround time at

Table 12.7: National energy development plans

Project	Description	Timeline	Estimated cost (Million US$)
Transmission line from Zambia to Kenya	Building 1,447km transmission line from Serenje in Zambia via Mbeya and Arusha in Tanzania to Nairobi	To have started in 2011 and to take 4 years to complete	780
Import deal for access to 40GW of hydropower from the Inga Dam in the DRC	Integration of power grids in the DRC, Kenya, Uganda, Rwanda and Burundi in order to create a regional electricity market comprising Nile Basin Development Programme and the East African Energy Pool. Upgrading of 769km of 220kV and 110kV power lines and 17 transformer stations	Import deal sealed in 2010	
New Planned Power Generation Capacity Programme	Adding 421MW capacity: 5MW Ngong wind power project; 10MW Tana hydropower; 21MW Sangoro hydropower; 25MW Kindaruma plant upgrade; 80MW Early Geothermal power project; and 280MW Olkaria I & IV.	Plan approved in August 2010 and to take 3 - 4 years to realize. Olkaria IV to be complete by end of 2012	1,400 for Olkaria I and IV alone; 52 for Kindaruma upgrade
Coal-fired plant by Daewoo	Daewoo to build and operate a coal plant with 2 turbines each of 300MW		1,300
Joint natural gas processing plant	Tanzania to offer gas deposits and Kenya to process the same in Mombasa. A gas pipeline to be built from Dar es Salaam through Tanga to Mombasa. Financing by AfDB		
Nuclear plant	To build 1GW nuclear plant along the coast under PPP arrangements		3,500 using South Korean technology
Geothermal exploration	Sinking of 566 wells in the Great Rift Valley	10 years	2,600
Lake Turkana Wind Power (LTWP) Farm	A flagship project by a consortium of Dutch and African companies and individuals. It is approved as a CDM project that can earn carbon credits and reduce carbon emissions by over 700,000 tonnes per annum. Its design capacity is 310MW	2 years to complete (earliest 2013)	820
Feasibility study for sea wave power plant	Israeli's SDE Energy firm to conduct feasibility studies for 100MW sea wave power plant that will cost US$ 0.02 per kWh to install and sell electricity at US$ 0.08 per kWh		
Ngong II Wind Power Project	KenGen has floated a tender for constructing 10MW wind power project in Ngong		28.6 (loan from Spain)

Source: Author's compilation

the port needs to be reduced for greater regional competitiveness. Port expansion is expected to improve the port's performance especially in terms of handling capacity and cargo dwell time.

Dredging involved deepening of the channel up to 15 metres to enable larger post-"Panamax" vessels access the port. It covered the entrance and navigation channels, turning basins, the shallow area between berth 1-5, and new berths 20-23 at the new container terminal. Expanding the existing container handling facilities and construction of a second container terminal will cater for the present and expected traffic growth. The new terminal is supposed to handle 1.2 million TEUs per annum and should be completed in 2013.

Lamu Port and South Sudan and Ethiopia Transport (LAPSSET)

LAPSSET is one of the Kenya Vision 2030 flagship projects envisaged to form Kenya's second transport and economic development corridor spanning South Sudan, Ethiopia and eventually Doula in Cameroon. The Lamu Port will comprise 32 modern berths and will be three times the size of the current Mombasa port at the more sheltered Manda Bay that is also large and deep enough to accommodate post-"Panamax" vessels. The initial three berths to be constructed are designed to handle 30,000 Dead Weight Tonnage (DWT) and 100,000 DWT for general and bulk and container cargo, respectively.

Liquefied Petroleum Gas (LPG) import terminal

The facility, once complete, will accommodate tankers of up to 27,000 DWT and will handle about 600,000 metric tons of LPG per year. This facility will help streamline the supply of LPG in the country and hence reduce its overall cost.

PART IV

IMPERATIVES FOR REDUCING THE COST OF LIVING IN KENYA

Chapter 13

Imperatives for Reducing the Cost of Living in Kenya

Introduction

Recent events show increasing discontent with the cost of living in Kenya. In 2008 and 2011, the country experienced high inflation. In May 2008, inflation peaked at 31.5 per cent and in November 2011 at 19.7 per cent. Inflation rose from 3.8 per cent in November 2010 to 19.7 per cent in November 2011. Over the same period, the Kenya shilling also depreciated rapidly. The government responded by announcing a 20 per cent excise tax cut on fuel in the 2011/2012 budget, while in May 2012, minimum wages were increased by about 13.1 per cent.

In June 2010, Kenya's parliament passed the Price Control (Essential Goods) Bill with a clause allowing the Finance Minister to set maximum retail and wholesale prices of essential goods, including fuel, maize flour, wheat, wheat flour, rice, cooking oil, sugar, paraffin, diesel and petrol.

In 2011, consumer organizations and civil society groups across the country organized protests and demonstrations demanding reduction of the price of maize flour under the banner of "*unga* (maize meal) revolution". In April 2011, the Consumer Federation of Kenya (COFEK) sued the Attorney General, Energy and Finance ministers, the Energy Regulatory Commission, and the National Oil Corporation for their failure to cushion consumers from high food and fuel prices. On Labour Day 2011, the Secretary General of the Central Organization of Trade Unions (K), threatened industrial action if demands for a 60 per cent increase in the minimum wage were not met.

This part of the report analyses the cost of living in Kenya with the aim of providing a better understanding of the underlying factors as well as developing relevant policy options to address persistent increases in prices. Salary demand is one of the key fiscal challenges that the government faces (Ministry of Finance, 2012). The establishment of the Salaries and Remuneration Commission as part of the implementation of the Constitution of Kenya 2010 will provide an avenue for regular review of the salaries and remuneration of all state officers. Nonetheless, it is important to establish the underlying factors behind the rising cost of living, as this has significant implications on macroeconomic stability and Kenya's global competitiveness.

Measuring the Cost of Living

An ideal measure of the cost-of-living index would measure changes over time in the amount that consumers need to spend to reach a certain level of satisfaction or standard of living. The cost of living index would use prices of all goods and services in the universe (including non-consumption ones such as for business purposes and investment). Similarly, the basket from which the cost of living index is derived would not be fixed but vary regularly. However, in practice, the Consumer Price Index (CPI) is commonly used as a proxy for the cost of living. The CPI measures changes in prices of a household's 'basket' of goods and services from one period to another. The items included in the basket are weighed by their expenditure shares or importance in a household's budget. The basket is re-priced at regular intervals and the cost aggregates compared with those of the same basket in a selected base period. In computing CPI, household expenditure on such items as savings, insurance, pensions, loans, own production, and lotteries and gambling are excluded.

Inflation is the persistent increase in the level of general prices of goods and services, as measured by the CPI, over a given period. Achieving and maintaining price stability is a key macroeconomic policy goal. Its responsibility lies with the Central Bank of Kenya (CBK). In this case, the CPI and inflation is used to assess changes in the cost of living and the relevant policy implications. The monetary policy target for inflation is about 5 per cent. In the last two years, inflation has remained above this target.

Consumer Price Index and Inflation Trends in Kenya

Price data for constructing the indices are collected by the Kenya National Bureau of Statistics (KNBS) through a survey of retail prices for consumer goods and services. The overall annual inflation is therefore calculated as a percentage change in the consumer price index over two consecutive 12-month periods. Kenya adopted the geometric mean approach in computing CPI in October 2009. Prior to this, the country used the arithmetic mean approach. The latter had an upward bias and was too sensitive to price changes. The shift from the arithmetic mean towards the geometric mean was also rationalized by the need to conform to best practice.

CPI computation is based on 12 categories of goods and services based on the Classification of Individual Consumption by Purpose (COICOP), which is an international standard classification. Commodities in the basket were also increased to 234 from 216 in the previous basket. The new commodities in the basket include fresh milk (unprocessed), pork, arrow roots, *wimbi* (millet) flour, black beans *(njahi)* and capsicum *(pilipili hoho)*. There is also camel meat, mineral water, laboratory tests and optician services, parking charges, bicycle taxi *(boda boda)* fares, cell phone airtime, Internet costs, cellular handset, computer, primary and secondary school transport. The KNBS collects retail prices data in 25 towns across the country.

Table 13.1 shows the classification of items and their respective weights in the basket of goods and services. Notably, three items (food and non-alcoholic beverages; housing, water, electricity, gas and other fuels; and transport) represent about two-thirds of the total basket.

Commodities with the most weight in the "food and non-alcoholic beverages" items were beef with bones at 9.87 per cent and sugar at 5.99 per cent. In the category "alcoholic beverages, tobacco and narcotics", the largest share of household expenditure was on beer (46.7%) and cigarettes (28.17%). In the category "clothing and footwear", men's trousers took the largest share of expenditure at 8.4 per cent. "Other housing" took the largest share of household spending on "housing, water, electricity, gas and other fuels".

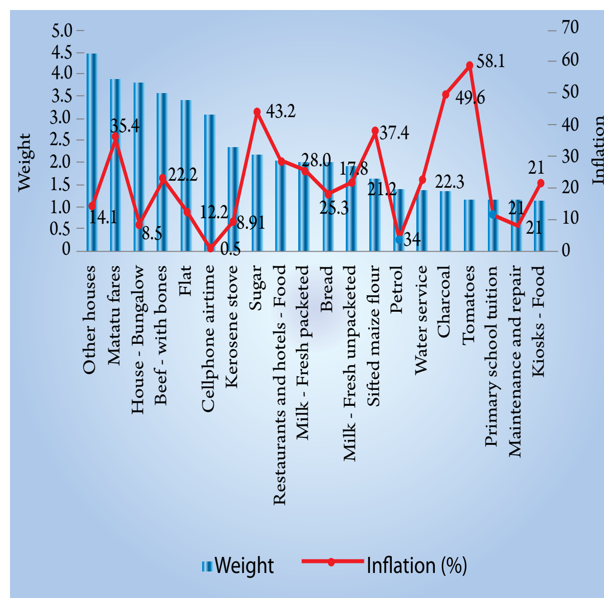
Table 13.1: Comparison of expenditure proportion weights

Description	Old Weights (%)	Description	New Weights (%)
Food and non-alcoholic drinks	50.50	Food and non-alcoholic beverages	36.0
Alcohol and tobacco	2.97	Alcoholic beverages, tobacco and narcotics	2.1
Clothing and footwear	9.00	Clothing and footwear	7.4
Housing	11.74	Housing, water, electricity, gas and other fuels	18.3
Fuel and power	4.18	Furnishings, household equipment and routine household maintenance	6.2
Household goods and services	5.82	Health	3.1
Medical goods and services	1.59	Transport	8.7
Transport and communications	5.75	Communications	3.8
Recreation, entertainment and education	6.02	Recreation and culture	2.3
Personal goods	2.45	Education	3.1
		Restaurants and hotels	4.5
		Miscellaneous goods and services	4.5
Total	100.00	Total	100.0

Source: Kenya National Bureau of Statistics (2010)

Note: The old weights are based on the 1993/94 Urban Household Budget Survey, whereas the new weights were computed from the 2005/2006 Kenya Integrated Household Budget Survey.

Figure 13.1: Top 20 commodities with the highest weights



Source: Kenya National Bureau of Statistics (2011)

Note: The reported inflation rates are for the period February 2009 (base year) to June 2011. The total number of products is 210.

Figure 13.1 shows the twenty commodities with the most weight in the food basket. These commodities comprise 44.8 per cent of the urban household expenditure. About 4.45 per cent of urban households' expenditure is on "other houses", while 3.9 per cent is on *matatu* (public transport) fares. The "other houses" category includes Swahili, shanty, *manyatta* and traditional structures, while *"matatu"* refers to the privately-owned demand-responsive public transport service vehicles, mainly of low capacity. The commodities that reported the highest price hikes include tomatoes (58.1%), charcoal (49.6%), sugar (43.2%), sifted maize flour (37.4%) and *matatu* fares (35.4%).

Table 13.2 presents the respective contributions of each expenditure item to inflation in 2011. The direct contribution of food and non-alcoholic beverages inflation to overall inflation fluctuated between 52 per cent and 73 per cent. The next largest share was housing, water, electricity, gas and other fuels, which fluctuated between 12 per cent and 14 per cent.

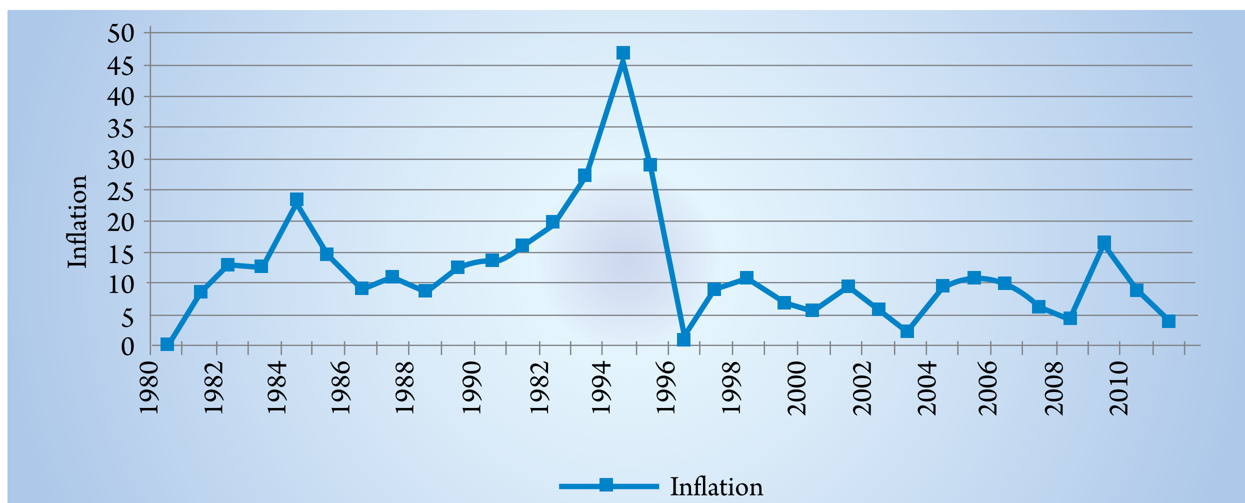
Table 13.2: Contribution to inflation, 2011 (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Food and non-alcoholic beverages	72.7	60.6	64.3	63.6	63.1	62.6	61.1	56.3	55.4	56.3	52.9
Alcoholic beverages, tobacco and narcotics	0.1	0.1	0.3	0.8	0.9	1.4	1.4	1.3	1.3	1.2	1.3
Clothing and footwear	5.1	3.8	2.4	2.1	1.9	2.2	2.0	1.9	2.3	2.1	3.0
Housing, water, electricity, gas and other fuels	13.9	12.8	12.3	13.1	13.4	13.5	14.5	13.0	13.1	13.0	14.9
Furnishings, household equipment and routine household maintenance	6.5	5.0	3.2	3.5	3.6	3.2	3.3	2.9	2.9	2.6	2.8
Health	3.7	2.8	1.9	1.2	1.2	1.1	1.1	1.1	1.0	0.9	1.0
Transport	5.7	22.0	18.5	16.6	16.5	15.2	14.8	13.7	13.3	12.7	12.9
Communication	-22.3	-17.7	-12.1	-9.5	-9.2	-8.1	-8.0	-0.3	0.0	0.8	0.8
Recreation and culture	2.2	1.7	1.4	1.2	1.2	1.0	0.9	0.8	0.9	0.9	1.3
Education	2.8	2.0	1.4	1.1	1.1	1.0	0.9	0.8	0.8	0.7	0.7
Restaurant and hotels	8.8	6.1	5.6	5.1	5.1	5.4	6.2	6.7	7.4	6.9	6.4
Miscellaneous goods and services	0.6	0.7	0.8	1.2	1.4	1.5	1.7	1.7	1.8	1.8	2.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Kenya National Bureau of Statistics (2011)

Kenya has experienced both high and low inflation, with inflation being high most of the time. Figure 13.2 gives the trend of inflation between 1980 and 2011. The highest level of inflation was recorded in 1993 at 46 per cent, whereas the lowest levels of inflation were recorded in 1995, 2002 and 2004, respectively.

Figure 13.2: Trends in inflation



Source: Kenya National Bureau of Statistics (Various)

The spike in inflation in 1993 was attributed mainly to a politically motivated domestic shock arising from excess liquidity. In 1992, money supply grew by 47 per cent. A large amount of money was released into circulation, which was borrowed from the Central Bank of Kenya. The easing of inflationary pressure in 1995 was attributed to tight monetary policy by the monetary authorities through measures to regulate money supply, reduce the budget deficit, and lower VAT from 18 per cent to 15 per cent in the 1995/1996 budget.

Consumer Prices by Income Groups

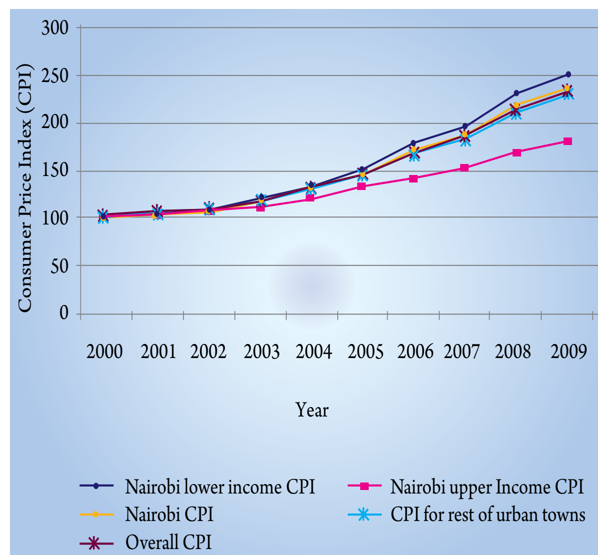
Between 2000 and 2009, the movement in the general price levels has been upward. However, price levels between 2000 and 2003 were stable, increasing by only 6 per cent per year. Between 2003 and 2009, consumer prices rose fast and increased by about 35 per cent per annum.

Several observations emerge from Figure 13.3, which illustrate CPI by income groups. Using 2000 as the base year, the figure shows that relative to higher income households, lower income households experienced steeper rises in prices especially between 2003 and 2009.

Between 2000 and 2009, prices of the basket of goods consumed by lower income households increased by 148 per cent, whereas the price for the basket of goods consumed by upper income households rose by 132 per cent.

Similarly, a comparison between the CPI in Nairobi and in other urban towns shows that households in Nairobi bear a heavier burden of steeper rises in prices than households in other urban areas. Therefore, during the period 2000-2009, prices in Nairobi remained above the overall prices, but the difference is small. The fact that Nairobi relies almost exclusively on food supply from rural areas and other urban areas explains this fact. The food becomes more expensive in Nairobi because of the extra costs from transportation, insurance, refrigeration, and storage.

Figure 13.3: CPI by income groups



Source: Kenya National Bureau of Statistics (Various)

Earnings and the Cost of Living

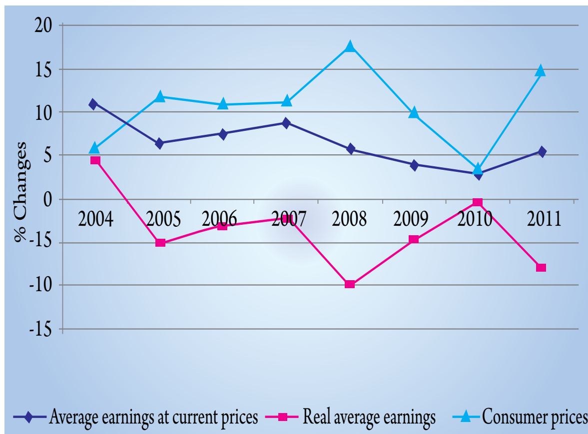
Between 2004 and 2011, real average earnings shrunk by 3.6 per cent annually, with the worst annual decline being in 2008 (Figure 13.4). The fact that actual earnings at current prices have remained constant and failed to keep pace with faster increases in consumer prices explains this fact. It may suggest reduced purchasing power, which may have implications for productivity and competitiveness of the economy.

For years, Kenya has used the minimum wage policy to cushion workers from high cost of living. The minimum wage was introduced in Kenya in 1932 to protect the welfare of single males who lived in urban areas without family responsibilities. This policy was sustained through 1963. The scope expanded to protecting low-skilled workers against exploitation from employers.

The Wages and Conditions of Employment Act (Cap 229) of the Laws of Kenya stipulates that the basic wage to be paid to any employee should not

be less favourable than that specified in relation to the category of the employee and to the area of employment. The elements of minimum/general wage determination criteria used in Kenya as set forth in the Wage Guidelines (2005) include cost of living compensation, realized productivity gains, and the ability of employers and the economy to sustain the increased labour costs.

Figure 13.4: Labour earnings and consumer prices in Kenya



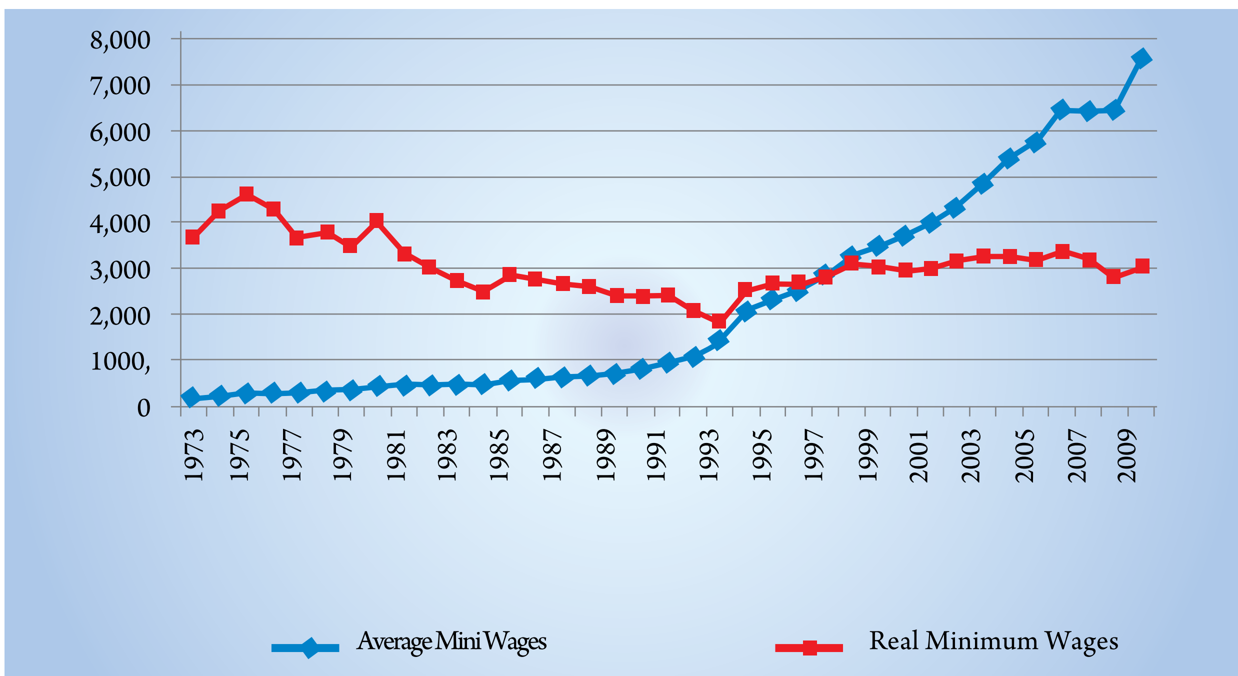
Source: Kenya National Bureau of Statistics (Various)

Minimum Wage Legislation

The widening income inequality in many countries, especially when stemming from some deterioration in wages at the lower end of the scale has led policy makers to consider minimum wages. In addition, concerns about accelerated inflation and the erosion of purchasing power of wages, especially of the lowest paid, has also played a role. Timely adjustment of minimum wages reflecting consumer price increases helps these workers to maintain their living standards.

Among developed countries, the United Kingdom, Ireland and Austria introduced a national minimum wage in 1999, 2000, and 2009, respectively. In the United Kingdom, minimum wages were motivated by the increase in child poverty, and as a way to attract more adults into the labour force by "making work pay." South Africa, for example, introduced new minimum wage floors in 2002 to support the wages of millions of low-paid workers in various economic sectors, including domestic workers. China issued new regulations on minimum wages in 2004 for similar reasons.

Figure 13.5: Real and average minimum wages (Ksh)



Source: Kenya National Bureau of Statistics (Various)

In Kenya, minimum wage legislation faces several implementation challenges. Enforcement of the statutory minimum wage is a problem due to lack of capacity in government, lack of cooperation from employers, and the general lack of awareness about minimum wages by workers. Due to this, enforcement is mainly in the formal sector.

Figure 13.5 shows that nominal minimum wages were relatively constant between the 1970s and early 1990s, but then rose significantly from the mid 1990s. Real minimum wages declined from the mid 1970s to the early 1990s when they started rising again. However, real minimum wages have not recovered to their 1970 levels. This suggests that the purchasing power of the minimum wage has been eroded by inflation over time, meaning that the welfare of workers earning this wage has worsened.

The costs and benefits of minimum wages depend on the level at which they are set, and enforcement of the regulation. The extent and type of involvement of social partners in minimum wage fixing plays an important role in this respect. The ILO Convention No. 131 leaves the determination of minimum wages that are necessary to protect "wage earners against unduly low wages" to the member states.

The Convention highlights the potential trade-offs by emphasizing that two key elements be taken into consideration. These are "the needs of workers and their families," which take into account the general level of wages in the economy, the cost of living, social security benefits, and the relative living standards of other social groups". The second element considers economic factors, which include the requirements of economic development, levels of productivity, and desirability of attaining and maintaining a high level of employment.

Key Drivers of Cost of Living

A vector auto regression analysis (VAR) was undertaken to assess the interrelationship between the overall CPI and the key sub-components, namely food and non-alcoholic items index, the price index for energy products and the price index for transport. The analysis was conducted using monthly data for the period between October 1997 and March 2012. The VAR representation used is:

$$A_0 X_t = B_0 + B_1 X_{t-1} + \ldots + B_p X_t\text{-}p + e_t$$

Meaning:

A_0 is a matrix containing contemporaneous effects with *1s* in the leading diagonal; X_t is a vector containing endogenous variables; B_0 is a column vector of intercepts; B_1 to B_p are matrices containing structural coefficients for variables lagged p times; P is the number of lags determined by different information criterion; and e_t is a column vector of pure innovations and is used to capture exogenous factors in the model:

$$CPI = 0.63 + 0.02\ FOOD_{t-1} + 0.87\ ENERGY_{t-2} + 0.64\ TRANSPORT_{t-3}$$

Where CPI is the overall price index, *FOOD* refers to food and non-alcoholic items price index, *ENERGY* is the energy price index and *TRANSPORT* is the transport price index. The results indicate that the energy price index has the highest contribution to the aggregate CPI, followed by transport price index and food and non-alcoholic items price index. However, the impact of increases in food prices affects CPI faster. When the food price index increases by 100 per cent, the aggregate CPI will increase by 2 per cent within one month. A 100 per cent increase in the energy price index takes two months to increase the aggregate CPI by 87 per cent. A 100 per cent increase in the transport price index takes three months to increase the aggregate CPI by 64 per cent.

It is evident that the effect of prices of food and non-alcoholic items drives the aggregate prices in the economy within a shorter time compared to energy and transport prices, which take slightly longer. There are also feedback effects. The analysis below, therefore, focuses on the underlying factors driving

the CPI due to changes in key components, namely food inflation, energy and transport.

Food Inflation and Cost of Living

The connection between rising food prices and poverty is that poor people spend a substantial proportion of their income on food, thus any factor that affects prices of food also affects the poor and people who are vulnerable to poverty. According to KIHBS 2005/06, the expenditure on food by rural households accounts for 62.3 per cent of total household expenditure. Urban households spend 39.6 per cent of their budget on food, with the main source of consumption being purchases, own-production, own stock, and gifts. The share of purchases in total consumption is high in both urban areas (79.9%) and rural areas (53.9%). While the share of own produce accounts for 26.8 per cent in rural areas, it accounts for only 4.3 per cent in the urban areas, meaning that urban dwellers are net consumers and are therefore likely to be hit hard by the rising cost of food.

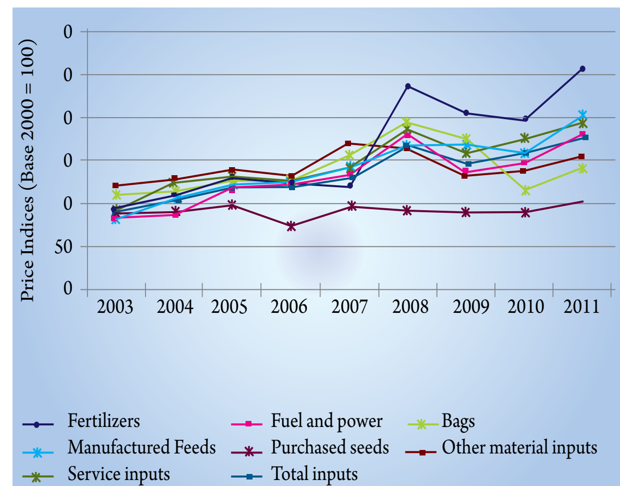
In 2005/06, about 46 per cent of the population lived below the poverty line. Moreover, about 45.8 per cent of the population could not afford their basic daily calorie requirements (2,250 kilo calories per adult equivalent per day). Consumption levels of nearly 19.1 per cent of the population was inadequate to meet their basic food needs alone, even if the individual spent all their income on food.

Table 13.3 shows that changes in the nominal prices of various food commodities have varied from year to year, with the highest increase being between 2007/08 and 2008/09 for most of the items. In 2007/08, the price of dry beans increased by 49 per cent, maize flour 45 per cent, rice grade II 45 per cent, cooking fat 40 per cent, maize grain 40 per cent, and kale 38 per cent. Between 2008 and 2009, the price of maize grain increased by 34.7 per cent, maize flour 25 per cent, refined sugar 22.7 per cent, green grams 22 per cent, and kales 18.9 per cent.

Commodity prices have remained unstable, while production has more or less stagnated. This affects both the producers who need to stay in production and the consumers who need to purchase food at favourable prices. There is high variability of price within the production season and between successive market years, making price stabilization critical.

Price indices for various agricultural inputs between 2003 and 2011 are presented in Figure 13.6. The price index for all inputs rose from 89.2 per cent in 2003 to 177 per cent in 2011, indicating that prices increased by 98 per cent. However, the highest price increases were recorded for fertilizer (173%), manufactured feeds (144%), fuel and power (121%) and service inputs (76%). The prices of purchased seeds and other material inputs were almost constant, though there were year-to-year variations.

Figure 13.6: Agricultural input price indices



Source: Kenya National Bureau of Statistics (Various)

Figure 13.6 shows that input price fluctuations were higher in the period 2007-2011 than in 2003-2007. The period 2008-2011 also coincides with the period when inflation was high in the country. Therefore, high input prices during this period would partly explain the high food prices, which contributed significantly to the high inflation levels then.

Energy Prices and Cost of Living

Electricity is the most popular source of energy for all enterprises. About 80 per cent of households in Kenya use kerosene, 60 per cent use charcoal, 55 per cent use wood fuel, 37 per cent use electricity, and 21 per cent use LPG. Only 1.8 per cent of households use petrol and diesel. The demand for kerosene and LPG is higher in urban areas than in rural areas. Across income groups, the use of kerosene, wood and material residue, which are largely regarded as 'unclean' fuels, decline as income increases. The use of electricity, LPG, charcoal and biogas increases with higher income. In particular, demand for kerosene decreases as household income increases for both the urban and rural population. This supports the widely held notion that kerosene is an important fuel for the poor in Kenya.

Between 2009 and 2011, prices of almost all fuels increased, with some fuel prices recording higher rises. Table 13.4 shows price increases for the main fuels used in Kenya.

Table 13.3: Annual commodity price changes 1999-2010

ITEM	Unit	Percent change										
		1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010
Proteins												
Beef - with bones	1 Kg	3.7	4.0	-3.8	0.5	1.4	7.6	7.2	5.5	19.1	13.4	8.1
Milk - Tetrapack	1/2 litre	14.5	-1.1	-2.2	0.2	4.4	4.9	8.7	-2.0	14.9	10.5	-4.2
Carbohydrates												
Maize Flour	1 Kg	5.0	-21.8	10.6	18.7	13.4	0.7	0.1	-11.0	45.6	25.0	-12.7
Maize Grain	1 Kg	3.8	-24.1	-1.0	16.3	14.2	-0.3	2.3	-8.9	38.9	34.7	-29.7
Rice, Grade II	1 Kg	-2.8	-23.3	6.5	2.6	10.7	15.5	-1.9	3.7	45.3	8.4	0.8
Wheat Flour	2 kg	-0.1	-6.4	-1.0	3.3	25.0	-4.4	-3.9	24.9	24.8	-2.0	-1.2
Sugar - Refined	1 Kg	29.0	-10.4	-16.5	8.7	9.9	24.3	2.0	12.1	-3.8	22.7	10.6
English Potatoes	1 Kg	-9.1	1.8	21.8	0.6	-6.2	5.5	20.5	1.0	29.5	14.0	4.0
Vegetables												
Kales - *Sukuma wiki*	1 Kg	7.8	-11.6	42.1	12.8	10.0	-1.1	11.7	-15.5	31.1	18.9	-15.0
Tomatoes	1 Kg	-1.6	11.7	-5.5	3.5	9.4	5.5	-0.4	19.3	10.1	7.3	-10.4
Pulses												
Dry beans	1 Kg	-9.3	-9.8	-17.8	9.8	4.5	11.6	5.9	-2.3	49.3	11.5	0.3
Green Grams	1 Kg	-6.0	-13.7	-11.0	4.6	2.7	3.5	43.9	-15.0	14.7	22.0	12.8
Fats and Oils												
Cooking Fat	500 gms	-10.4	-18.8	11.8	0.8	13.3	7.7	-2.3	16.1	40.5	-9.8	-9.9
Margarine	500 gms	3.1	-1.6	-0.8	2.1	5.2	-7.7	7.3	7.9	22.2	3.0	-12.8

Source: Kenya National Bureau of Statistics (2012)

Table 13.4: Net average rise in CPI (February 2009 – November 2011)

Fuel type	% growth in fuel index- CPI (2009=100)
Petrol	1.06
Electricity	19.6
LPG	13.4
Kerosene	19.3
Diesel	14.3
Charcoal	25
Candles	7.19
Firewood	10.3

Source: Kenya National Bureau of Statistics (2011)

Household expenditure on fuel responds differently to price and income changes. The demand for petrol and diesel at household level is highly responsive to price changes. When price of petrol increases by one unit, demand falls by 4 units, whereas a one unit increase in the price of diesel leads to fall in demand by 6 units (KIPPRA, 2010). This implies that households could have coping mechanisms, such as reducing consumption of these fuels upon price increase.

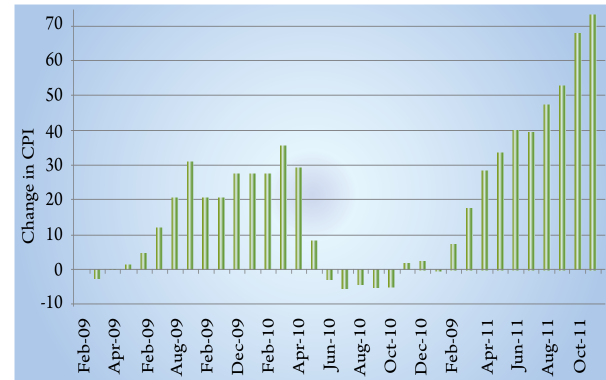
Demand for charcoal, kerosene, LPG, electricity and wood fuel are inelastic, implying that consumers have no alternative but to continue using these products even when prices increase.

There is also evidence of substitution of fuels in households in Kenya between petrol and diesel, kerosene and LPG, kerosene and electricity, kerosene and fuel wood, fuel wood and charcoal, charcoal and LPG (KIPPRA, 2010). However, substitution of fuels may not cushion the households if prices of all energy sources trends upwards.

Causes of rising electricity prices

Among commercial fuels in Kenya, the price of electricity rose by the highest percentage at 73 per cent, with kerosene, diesel and LPG following in that order. The price of petrol increased by the least margin (7.6%). The monthly movement in the consumer price index for electricity is shown in Figure 13.7.

Figure 13.7: Changes in electricity prices (February 2009=base–November 2011)



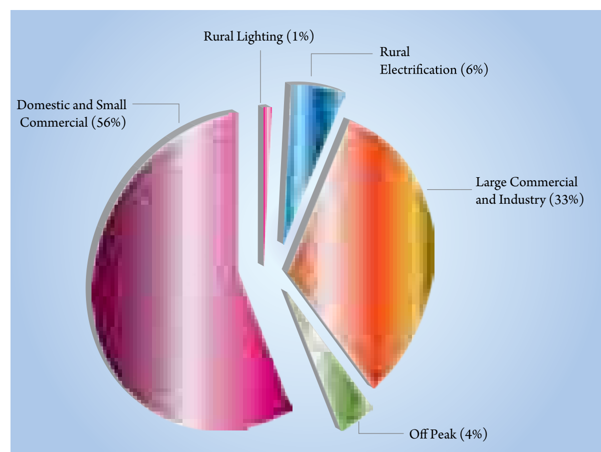
Source: Kenya National Bureau of Statistics (2011)

The sharp increase in electricity prices in the period 2009-2011 is explained by several developments in the demand and supply of electricity. First, total demand for power in 2011 increased by 9 per cent, compared to an average rise of 6 per cent per year between 2006 and 2011. Figure 13.8 shows that increased demand for electricity by domestic and small commercial consumers accounted for most of the growth in demand, and this phenomenon could be attributed to increasing urbanization and micro enterprise activity in the economy. Although rural electrification and off-peak account for small proportions of aggregate power demand, these consumer categories grew rapidly at 29 per cent and 23 per cent, respectively, during the same period.

Second, the country has invested heavily in hydropower generation. Frequent shortages of water in the main reservoirs often adversely affect the effective capacity factor of hydropower. The effective capacity factor of installed hydropower plants recorded a low of 51 per cent in 2010. A slightly lower factor of 50 per cent followed in 2011. However, increased oil-based thermal generation

compensated for the drop in the capacity factor of hydropower plants in 2011. The installed capacity of geothermal plants increased slightly to 190.6 MW in 2011 from 189 MW in 2009. Similarly, power generated from geothermal sources increased slightly to 1443.7 GWh in 2011 from 1144.2 GWh in 2010, while the effective capacity factor increased from 65 per cent in 2010 to 87 per cent in 2011. One shortcoming of these renewable energy technologies (hydro and geothermal) is the fluctuation in the effective capacity factor due to inconsistency in the flow of the respective renewable resources.

Figure 13.8: Contribution to power demand growth

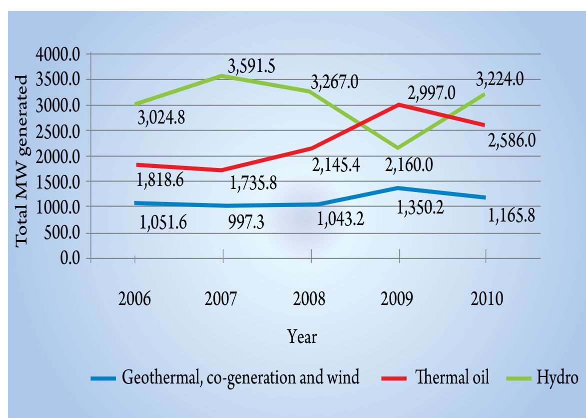


Source: Kenya National Bureau of Statistics (2012)

The price of electricity in Kenya includes the following components: A fixed charge; Consumption charge; Fuel cost adjustment; Foreign exchange adjustment; VAT at 16 per cent (on consumption, fixed charge, fuel cost adjustment and foreign exchange adjustment); and Energy Regulatory Commission (ERC) levy and rural electrification levy. In addition, the price is adjusted to factor in inflation. This is done after every six months to cover the utility company from inflationary pressure. Electricity tariff is largely regulated with review of the same scheduled for every three years upon application and approval by the ERC. The last review was in July 2008, and the next review was due in May 2011. However, upon consultation with the ERC and other stakeholders, it was put on hold to allow the country's socio-economic conditions to stabilize (Kenya Power and Lighting Company, 2011).

In the pricing of power, fuel cost adjustment shows high fluctuation. This cost is derived from the increased use of thermal oil (petroleum) for power generation, and factors in the price of fuel, which is affected by international crude prices and exchange rate fluctuations. Foreign exchange adjustment element covers the cost of capital, and increases with depreciation of the domestic currency. Another important observation in the power sector is that while fossil fuel power generators can use petroleum, natural gas or coal, fuel generators in Kenya mostly use petroleum (automotive gas oil).

Figure 13.9: Power generation mix for the period 2006-2011



Source: Kenya National Bureau of Statistics (2012)

Between July 2009 and April 2010, the price of electricity increased by an average of 25 per cent with respect to the base year. The increase is attributed to declining water reservoir levels for hydropower generation, and the subsequent use of thermal oil generation.

Figure 13.9 presents the power generation mix. It shows a relatively larger share of thermal generation in the period compared to past years, and that thermal generation and non-hydro renewable sources (geothermal, cogeneration and wind power) have been on an upward trend since 2006. However, hydropower generation has fluctuated significantly.

In the pricing of electricity, the fuel cost adjustment component, which is collected by Kenya Power and Lighting Company on behalf of the Independent and Emergency Power Producers (IPPs and EPPs), rises with increase in use of the more expensive thermal (oil) generation. This is one of the causes of the sharp increases in power prices for most of 2011. There was a marked increase in the proportion of thermal generation from 32 per cent in 2010 to 37 per cent in 2011. Unfortunately, the proportion of power generated from renewable sources also decreased to 20 per cent from 22 per cent in the same period. Ideally, increased proportion of power generated from renewable sources should have rescued the situation because of the cheap nature of this resource.

As at February 2011, the end user tariff was Ksh 11.3 per kWh (US cents 14/kWh), with Ksh 7.52 (32%) being the fuel cost adjustment (Kenya Power and Lighting Company, 2011). Closely related to the power generation mix is the international and domestic crude oil prices, which peaked between 2009 and 2011, implying an increase in the local diesel (automotive gas oil) price. This cost is usually passed on to the final consumers as fuel cost charge.

International crude oil prices increased erratically in the entire period. The largest increase was in May 2009 (31%) and the largest decline was in May 2010 (8.3%). Further, rapid depreciation of the Kenya shilling for most of 2011 (up to Ksh 101 per dollar in October 2011) also contributed to the price volatility. The CPI for power increased by 72 per cent in November 2011.

In summary, heavy dependence on hydro electricity generation, adverse weather conditions with prolonged dry periods, use of oil for thermal generation against a backdrop of increasing international crude prices, and volatile exchange rates are responsible for the increase in the price of electricity.

Implications of Rising Electricity Prices for Cost of Living

Power costs affect the cost of living through direct and indirect channels. The first channel includes the rise in the power bill (expenditure) for households, institutions and enterprises, especially among those with limited fuel substitution possibilities. Demand for electricity in Kenya is price inelastic, implying that power demand does not respond to power price changes because of the importance this energy category carries to both households and enterprises. Given non-increasing income, consumers will forego other expenditure to meet the need for fuel, thus reducing their welfare. The indirect channel involves increased production and operation costs to firms, which in turn pass the excess charges to the final consumer through increased prices of goods and services.

At the household level, substitution of electricity with other fuels, especially for the power-consuming activities such as heating and cooking is expected as households attempt to cushion themselves against increased prices. According to KIPPRA (2010), the cross price elasticity of demand for power with respect to other fuel prices is less than zero, implying that electricity is a complement (and not a substitute) to other fuels at the household level. In general, households do not replace electricity with other fuels and have to bear the full impact of increased prices.

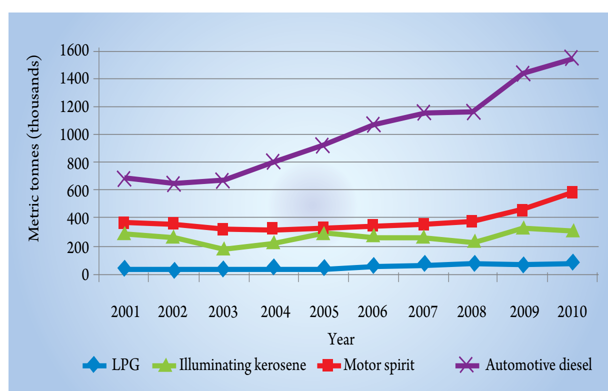
At the firm level, increased cost of electricity forces firms to adjust the prices of their products and services upwards in order to recover their production costs. This reduces the demand for these products in the domestic and international markets because cheaper alternatives in the form of more competitive imports act as substitutes. Implications that are more serious involve the loss of international markets to products from countries where electricity prices are more competitive, and relocation by investors to regions where the operating environment is more favourable.

Causes of Rising Petroleum Prices

According to Dees *et al* (2008), global demand for oil is high especially in the Organization for Economic Cooperation and Development (OECD) and emerging economies such as China, Brazil and India. Some Oil Producing and Exporting Countries (OPEC) influence the prices of oil through supply quotas, thus interfering with the market pricing mechanisms for crude oil. Besides demand and supply forces, however, other factors such as refinery capacity utilization, expectations of shortages in the long run and related supply rigidities, and the role of financial players and financial investors (speculative activities) influence the price of crude oil significantly.

Notably, Kenya is not in the OECD and OPEC categories and neither is it an emerging global economy. Kenya, therefore, has no control of international crude prices from which the prices of all other petroleum products are derived. However, demand for petroleum products in Kenya has been rising over the last decade, and this trend will continue because of the demands of the Vision 2030 projects and the demand created by the new devolved governments. Figure 13.10 shows the domestic trends of selected petroleum products in Kenya.

Figure 13.10: Domestic demand of selected petroleum products



Source: Kenya National Bureau of Statistics (2011)

Kenya is a small net importer of oil. Petroleum is purchased through the Open Tender System (OTS) coordinated by the Ministry of Energy. This includes imports of crude and refined products, which fulfil 50 per cent and 35 per cent of the petroleum requirements, respectively. Oil Marketing Companies (OMCs) outside the official tender system meet the rest of Kenya's requirement (15%) through importation of refined petroleum products.

The major petroleum products imported in refined form include diesel (automotive gas oil), LPG, petrol and kerosene. Crude oil is refined into several products at the Kenya Petroleum Refineries facility, and the products are transported through pipeline to depots owned and operated by the Kenya Pipeline Company.

Pricing of petroleum products in Kenya was deregulated in October 1994. However, concerns that fluctuations in domestic prices remained above those in international crude oil prices led to re-introduction of regulation in December 2010. To ensure that domestic prices reflect movements in international petroleum prices, the ERC effected capping of maximum retail prices of petroleum products based on the petroleum pricing formula. The use of a predetermined formula by the ERC to fix prices of petroleum products is a short-term measure to stabilize the movement of the prices of local petroleum products in a predictable pattern.

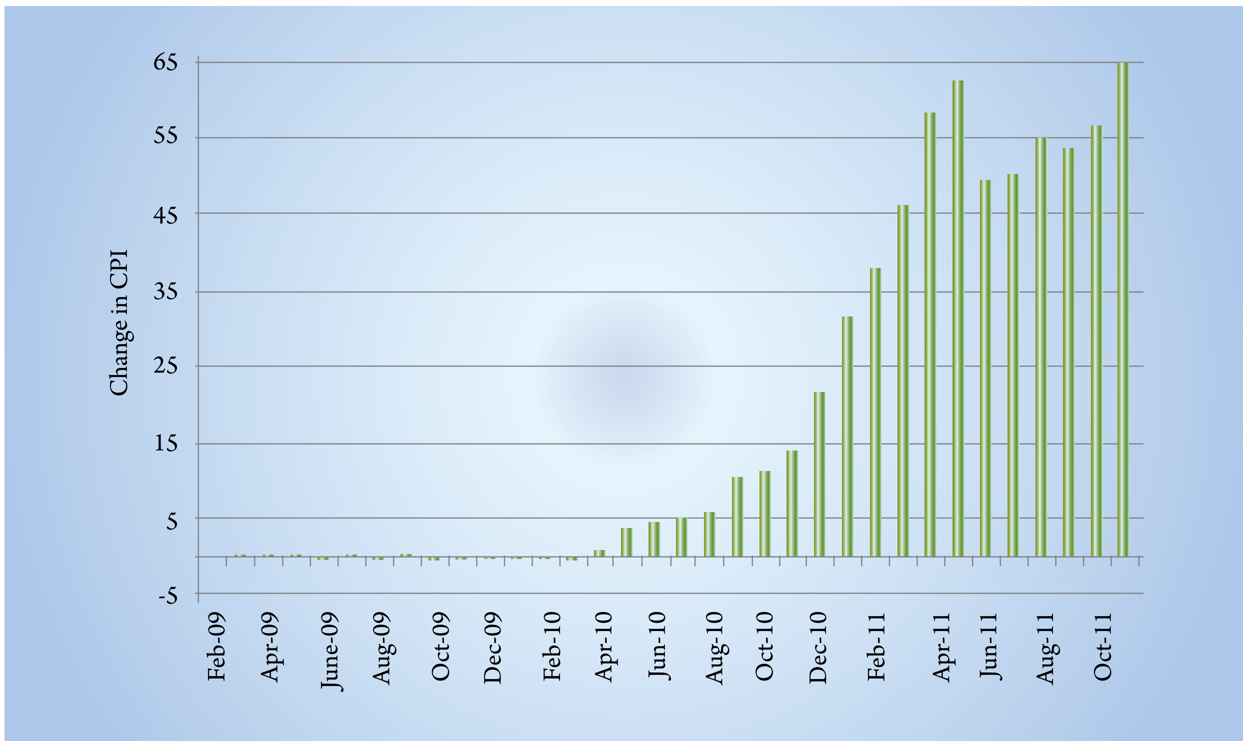
However, the major petroleum firms are also the same players in importation of crude oil and refined products. This affects petroleum distribution in the country. Since the pricing formula incorporates the importation and distribution costs, and thus gets inputs from the major oil companies, possibilities arise of the fixed price being the 'official price' predetermined by these companies. Movement in prices of fuel is presented in Figures 13.9, 13.10, 13.11 and 13.12.

Although prices of all petroleum products increased, prices of kerosene and LPG rose by the highest margin of 65 per cent and 50 per cent, respectively. Notably, the price increases persisted even after the

Figure 13.11: Changes in diesel (automotive gas oil) prices (February 2009=base – November 2011)

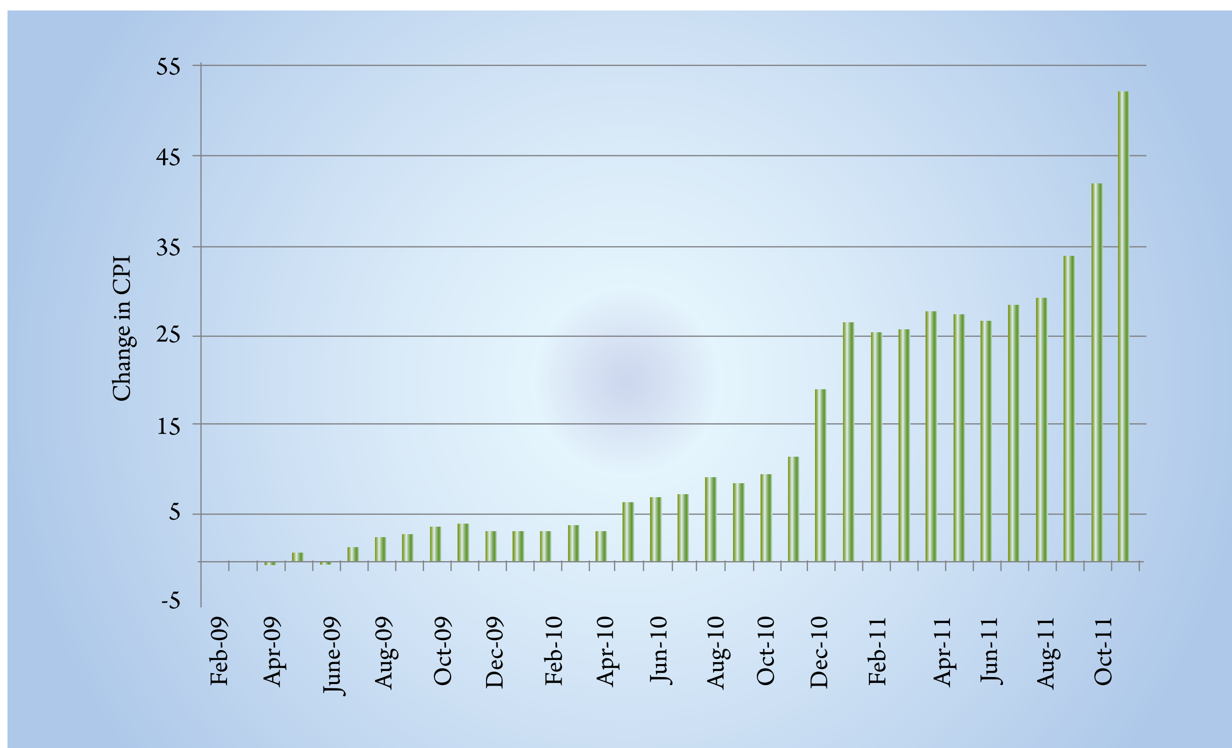
Source: Kenya National Bureau of Statistics (2011)

Figure 13.12: Changes in kerosene prices (February 2009=base – November 2011



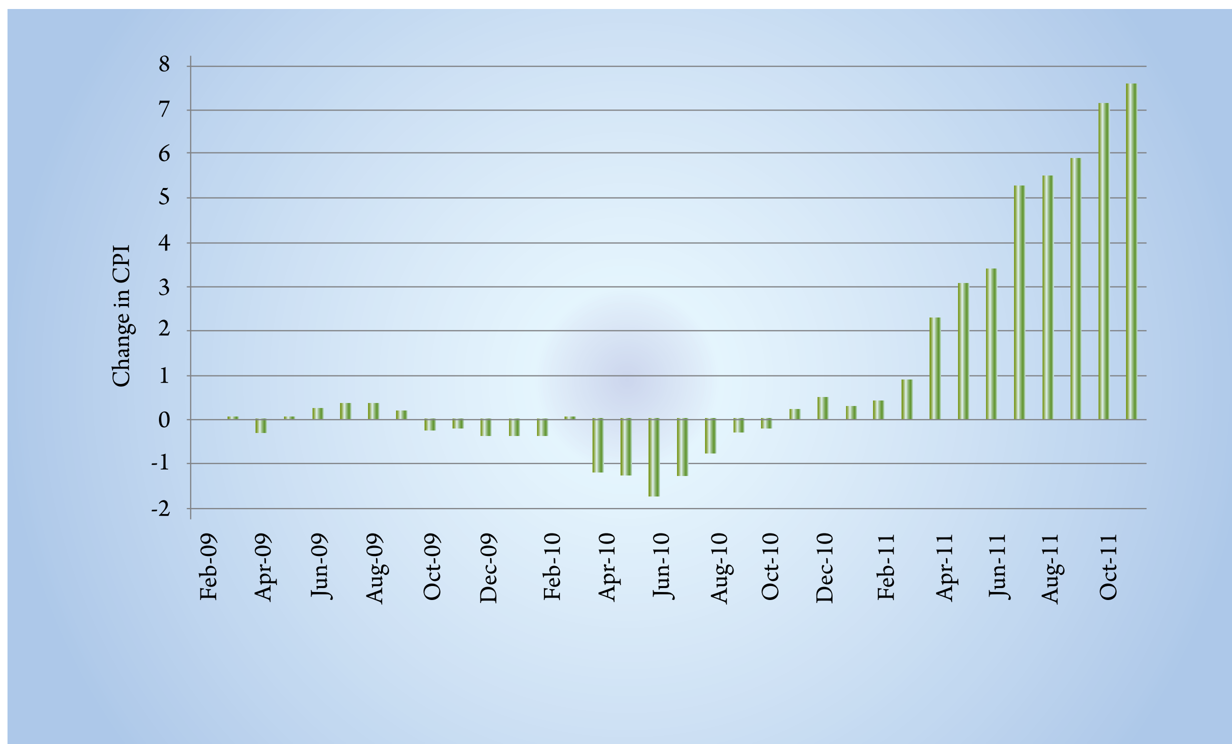
Source: Kenya National Bureau of Statistics (2011)

Figure 13.13: Changes in LPG prices (February 2009 – November 2011)



Source: Kenya National Bureau of Statistics (2011)

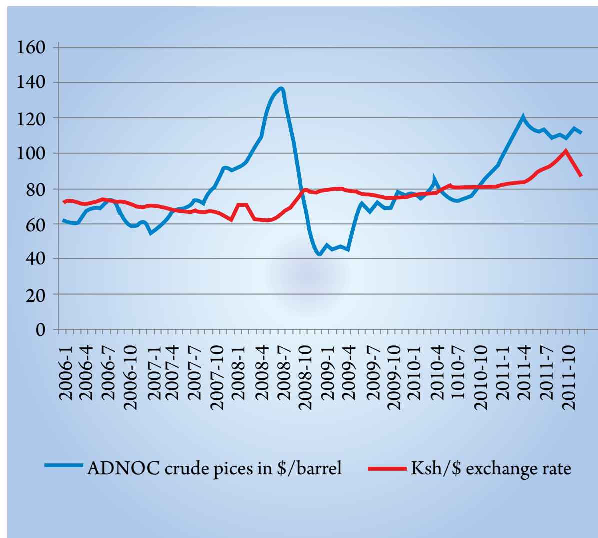
Figure 13.14: Changes in petrol prices (February 2009 – November 2011)



Source: Kenya National Bureau of Statistics (2011)

start of regulation in December 2010, implying that the pressure from international crude prices and dollar exchange rate kept the prices high. Figure 13.15 illustrates the movement in international oil prices and exchange rates, which are two major determinants of petroleum fuel prices.

Figure 13.15: Movement of the ADNOC[1] Murban crude prices and the shilling-dollar exchange rates



Sources: www.adnoc.ae and www.centralbank.go.ke

Between 2006 and 2011, international crude oil price fluctuations reached the lowest price of US$ 44.95 in February 2010 and the highest in July 2011 (US$ 113.95). The Kenya shilling also depreciated to the lowest rate of Ksh 101.26 per US$ in October 2011, causing an increase in the price of already expensive petroleum products.

The petroleum sub-sector in Kenya is vulnerable to external shocks of international crude price increases and foreign exchange rate. In addition, existing issues of petroleum handling in Kenya contribute to the rising cost of products. Because of the economy's heavy dependence on petroleum fuel, these shocks easily affect the rest of the economy.

The Kenya Petroleum Refineries Limited processes crude oil to meet 50 per cent of national petroleum requirements. It is the only facility of its kind in East and Central Africa. The refinery has been associated with inefficiencies that translate into higher cost of petroleum products in the market. The inefficiencies include low product yields, delays caused by system interruption, and lack of a cracking facility.

The Kenya refinery is undergoing transformation into a merchant refinery that will import crude oil and sell the refined products to marketers. This is expected to reduce the internally induced losses and costs of petroleum products because the refinery will have the incentive of maximizing profits. The new mode of operation was expected to take effect in July 2012 after publication of the associated regulations by the Ministry of Energy.

The facility refines approximately 1.6 million metric tonnes of crude oil per year. These are delivered in 20 batches of 80,000 metric tonnes. The Port of Mombasa cannot handle larger shipments due to lack of equivalent berthing facilities, and this has implications on the economies of scale and cost of products. Kenya is addressing this challenge through government investment in offshore petroleum offloading jetty, which is being constructed by the National Oil Corporation in Mombasa.

The two main means of transporting petroleum products within Kenya are pipeline and road. According to the ERC pricing formula, the average tariffs for the two means of transport to petroleum depots in major towns are Ksh 3.3 and Ksh 7.5 per 1,000 litres per kilometre (exclusive of VAT), respectively. The pipeline delivers petroleum products to few depots located in major towns, from where other oil marketers transport the product to their businesses by road. The absence of wide coverage of pipeline and accompanying facilities interrupts supply and increases the price of petroleum products, in addition to the public health risks associated with road transportation of petroleum.

The port of Mombasa lacks a bulk handling facility for LPG, and this causes supply disruptions in the

market, leading to high prices and frequent stock-outs. Further, prices of LPG are not regulated in Kenya, making it difficult to have uniform prices for products throughout specific areas. The initial cost of LPG is also high for the low-income households, especially in urban areas, thus hindering the group from adopting LPG. The ongoing investment and innovations could reduce the price of LPG in the Kenyan market. The construction of a bulk LPG handling facility at Kipevu Jetty in Mombasa is expected to ease LPG shortages and associated costs. while the introduction to the market of smaller cylinders of one kilogramme refillable in non-standard amounts will provide the low-income group access to cleaner fuels.

Kerosene and Diesel Prices and Cost of Living

Petroleum products are mainly consumed at the household and firm level. Households and firms, therefore, bear the greatest burden when prices of petroleum products increase. There are concurrent effects from the increased energy expenditure on petroleum products by both households and enterprises, and from the increased prices of commodities, inputs and services, whose value addition and distribution chains utilize petroleum products (mostly diesel). Increased fuel cost leads to increased passenger and product transportation cost for locally produced and imported goods, all of which are passed on along the consumption chain.

Kerosene prices rose substantially between 2009 and 2011, with the largest monthly increase of 65 per cent recorded in November 2011. This has serious implications on fuel expenditure in rural and urban households, which mostly use kerosene for lighting and cooking, respectively (KIPPRA, 2010). An interesting observation is the high increase of the prices of charcoal during the same period. Charcoal attained a net average increase of 26 per cent. The findings of KIPPRA (2010) reveal that low-income urban households use kerosene and charcoal as main fuels for cooking. It is therefore correct to infer that increasing prices of kerosene led many urban households to turn to charcoal as an alternative cooking fuel, given that the price of LPG rose higher than that of kerosene. The increased demand led to higher charcoal prices, leaving the low-income households worse off. This is in addition to the negative environmental effects of charcoal production. The higher price of LPG hinders the shift to cleaner fuels, especially by the urban poor.

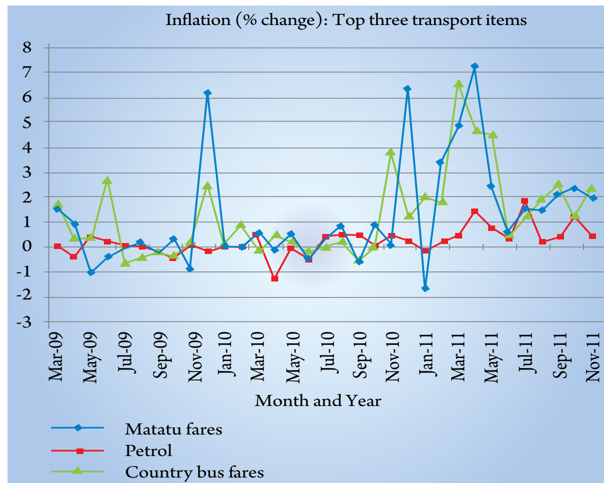
Diesel is the main fuel used for distribution of goods, farming and transportation of passengers through public and private means. The increasing price of this product leads to increased cost of living through increased cost of manufactured products, intermediate goods, farm produce and both personal and public transport. These items constitute relatively high weight in the consumption basket, implying that both the upper and lower income segments experience increased household and enterprise expenditures. However, the lower income households, which are the majority in Kenya, are likely to bear the greatest burden of increased fuel costs, because incomes largely remained stagnant and there were little efforts to cushion the poor.

Transport and the Cost of Living

Transport is a predominant need for households, and is associated with two main types of direct costs, namely financial cost and travel time cost. Indirect costs include environmental costs (pollution from emissions) and social costs (exclusion due to high fares and road accidents).

The most important transport items in the CPI are *matatu* fares, petrol and country bus fares, respectively. Inflation has affected the three components in varying degrees (Figure 13.14). *Matatu* fares experienced the sharpest rise in inflation between November 2009 and January 2010 (6%) and between March and April 2011 (7%). Inflation on country bus fares was erratic, and recorded a high of 6.58 per cent between February and March 2011. Inflation on petrol was less erratic. Its highest point was 1.83 per cent between June and July 2011.

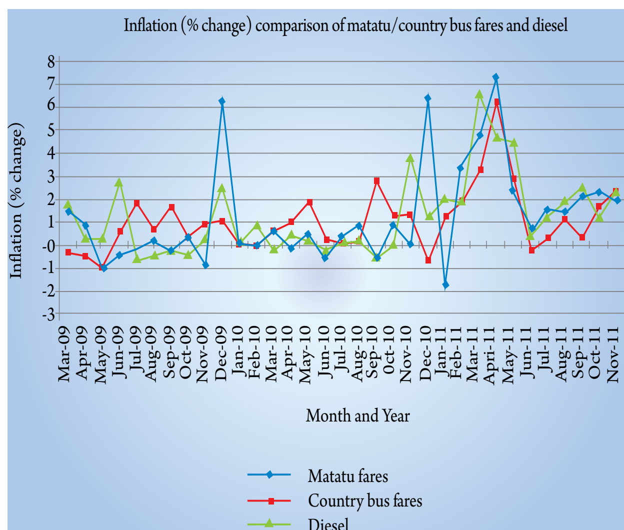
Figure 13.16: Inflation of top three transport items



Source: Kenya National Bureau of Statistics (2011)

A comparison between *matatu* fares and the price of diesel reveals that between January 2011 and November 2011, increases in *matatu* fares corresponded with increases in diesel prices. Although this behaviour was not sustained through the entire analysis period, it could be argued that since majority (67%) of *matatus* use diesel fuel, a rise in the price of diesel would lead to an increase in the fares charged by *matatu* operators to cover this extra cost. The same pattern and explanation can be used in the case of country bus fares as presented in Figure 13.15.

Figure 13.17: Comparison of inflation in fares and price of diesel

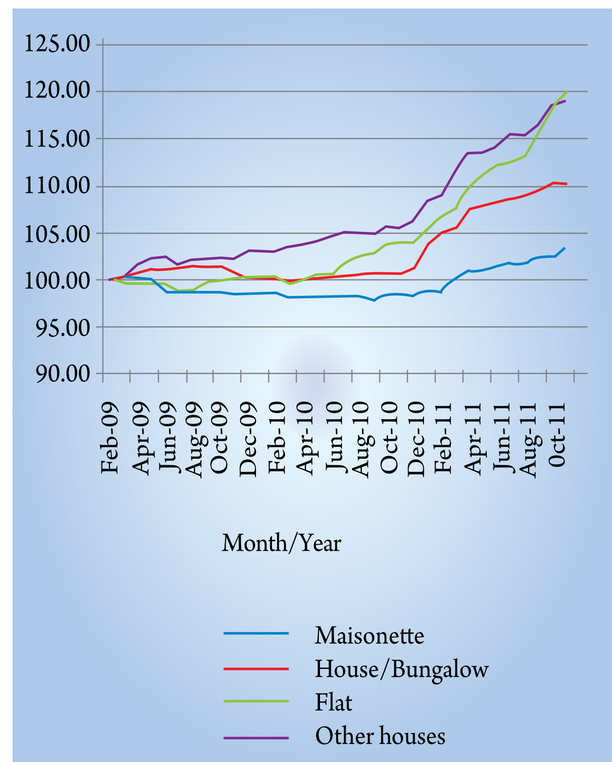


Source: Kenya National Bureau of Statistics (2009)

Housing and the Cost of Living

Household expenditure on housing, water, electricity, gas and other fuels has a CPI weight of 18.30 per cent, which is second to expenditure on "food and non-alcoholic beverages whose weight is 36.04 per cent. Therefore, housing ranks high among top commodities that drive up the cost of living in Kenya. Housing, water, electricity, gas and other fuels' index went up by 1.55 per cent from October 2011 to November 2011, and increased by 16.95 per cent from November 2010 to November 2011.

Figure 13.18: Housing price index from February 2009 to October 2011

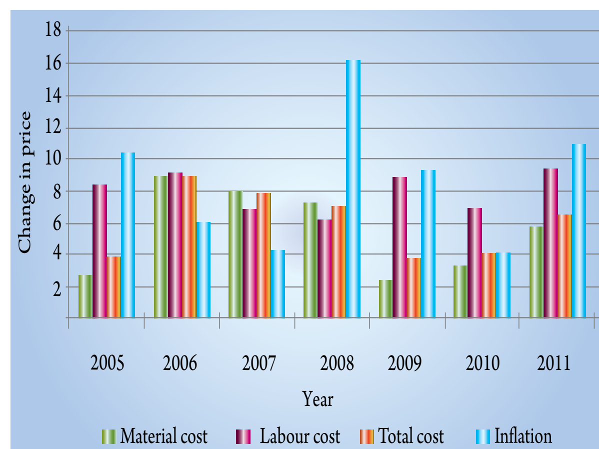


Source: Kenya National Bureau of Statistics (2011)

The price of other houses and flats, which are usually inhabited by middle and low-income households, rose rapidly from October 2010 (Figure 13.16). The prices of maisonettes and bungalows also increased but by lower margins. This difference in rental prices suggests that consumers are moving down the ladder from larger to smaller rental property, thus exerting pressure at the bottom of the housing market. Figure

13.17 shows the building and construction cost indices for residential buildings in Kenya.

Figure 13.19: Annual percentage change in building and construction costs for residential buildings in Kenya



Source: Kenya National Bureau of Statistics (Various)

Before 2008, the escalation of building and construction costs was either closer to the inflation rate or above it. However, after 2008, inflation rose faster than the rise in building and housing costs. Overall, labour cost rose faster than material costs over the 2005-2011 period. Therefore, efforts to manage escalating housing costs have to address the escalation in labour costs.

The housing market in Kenya is liberalized. The escalation of housing prices gives credence to the observation that the supply of housing units does not meet demand in terms of quality and quantity. Because of this mismatch, abuse of tenancy rights is prevalent. This includes arbitrary rent increases and evictions, especially in informal settlements.

The Rent Restriction Act (Cap 296) gives the Rent Tribunal the mandate of restricting, possessing, extracting premiums and fixing standard rent in residential houses in urban settlements. The department of Rent Tribunal of the Ministry of Housing is responsible for resolving disputes between property owners and tenants of controlled tenancy, that is residential premises whose standard rent is up to Ksh 2,500. Unfortunately, the ceiling of Ksh 2,500 stipulated in the Act has been rendered obsolete. Property owners in the informal housing sector and many in the formal sector who own few rental units generally manage them informally and even secretly without tenancy agreements.

On the supply-side, there are many challenges that affect housing. First, housing policies in Kenya still favour the home ownership model. However, the reality suggests that many urban households are unable or unwilling to own a home. The extent of the informal housing witnessed in major urban areas and inadequate supply of formal housing stock would reduce, if housing policies promoted the rental housing option.

While Kenya's mortgage market is growing, the industry is dominated by the large banks, which control 90 per cent of the outstanding loan assets portfolio. This indicates that there exists either many barriers to entry or high risks for medium and smaller banks. The market is further concentrated by having the top five lenders representing over 80 per cent of the total mortgage portfolio. The top two banks hold over 50 per cent of the mortgage market share, and only 9 banks (6 large, 2 medium and 1 small bank) have a mortgage portfolio exceeding Ksh 1 billion annually.

Kenya's mortgage market has not targeted the medium-to-low income mortgage segment. The average mortgage loan is approximately Ksh 4 million, which reflects the dominance of high-income mortgage borrowers. Since 2006, the average size of a mortgage loan has grown steadily. It is, however, still concentrated around the high-end clientele of Kenya's mortgage market, based primarily in Nairobi.

END NOTES

1. Abu Dhabi National Oil Company

PART V

Conclusions and Policy Recommendations

Chapter 14

Conclusions and Policy Recommendations

14.1 Introduction

Despite several interventions over the years, the cost of living in Kenya is still high. Inflation is above the desired target of 5 per cent. The high inflation experienced in 2008 and 2009 sparked citizen protests, which was a sign that interventions were ineffective. This called for the need to put in place short, medium and long term interventions. Based on the above analysis, various policy issues emerge, which lead to the following policy recommendations.

14.2 Labour Market

The real wage has been falling in Kenya. To address this problem, the country needs to develop and institutionalize an integrated wage policy. The policy should link workers welfare concerns to macroeconomic policy (especially inflation policy), social justice, and democratic participation. This way, wages would be adjusted to reflect both productivity increases and cost of living, while considering the consequences of wage increases on global competitiveness.

Kenya's employment is predominantly in the informal economy. Policy should target to improve productivity and working conditions in the sector. Statistics on the sector are limited to the number of persons engaged in the sector by county and activity. Data on entitlements, benefits, and conditions of work and social protection of employees in this sector is not available.

To enhance the capacity to design effective policies and programmes, the country needs to invest in a national survey that will map out the magnitude of the informal sector, its causes, conditions and constraints of operation and linkages with the formal sector. This will help to establish programmes and policy packages that aim to raise the quantity, earnings and quality of employment and also simplify business regulations and registration, procedures, and improve physical infrastructure.

Education and vocational training are important determinants of formal sector employment and higher earnings. Consequently, an effective policy to raise earnings, reduce inequalities in inter-sector earnings, and reduce poverty should focus on enhancing skills. This will enable the youth to take advantage of emerging employment opportunities. There is also need to improve access and attainment at post-primary education because, currently,

only about 15.5 per cent of adults have secondary education and above. Other human capital interventions are necessary, including improving health outcomes.

Unemployment in Kenya is high especially among the youth. This can be addressed in various ways:

a) Establishing programmes that quicken the transition from school to work, including job counselling bureaus, industrial mentorship programmes and employers-employee consortia

b) Introducing a two-shift working system (7 a.m-4 p.m. and 4 p.m.-12 a.m.)

c) Providing incentives for employment-intensive sub-sectors in agriculture, manufacturing (furniture, textiles, leather products, beverages, food products, etc), construction, retail trade, tourism and information and communication technologies (ICT)

d) Developing labour export programmes through foreign missions abroad

e) Introducing a wage subsidy to target groups that are most vulnerable to unemployment, including young college and university graduates

f) Developing employment protection legislation, which may provide fairness and basic security to employees

g) Promoting youth entrepreneurship by supporting internship programmes for young graduates.

14.3 Crop Markets

To address high variability of crop prices within the production season and across successive years, the government should establish commodity markets (international futures and options) where hedging and "synthetic storage" approaches can be applied.

Similarly, the country should adopt warehouse receipt systems run by private warehouse operators. In this case, public sector agencies can reduce the cost for both warehouse construction and operational costs (staff, chemicals, etc). This will ensure that food prices are within bounds that allow surplus production to continue. Secondly, it will address consumers' food security concerns.

Post-harvest losses are incurred because of factors such as poor storage. Lack of proper storage at the farm level necessitates selling of produce to avoid losses, which tends to accelerate intra-seasonal price instability. These can be reduced by encouraging farmers to adopt on-farm storage.

14.4 Livestock Markets

Institutional impediments in the livestock sector call for updating and harmonizing the legal framework that governs the sector to facilitate and promote trade. Stakeholders should mobilize resources and develop livestock market centres that offer minimum infrastructure, especially in livestock production areas. There is also need to promote and empower livestock traders' cooperatives to facilitate the development of processing plants and slaughter/abattoirs in livestock production areas.

14.5 Energy Sector

Kenya is vulnerable to international crude oil price shocks. Investment to reduce the economy's dependence on petroleum must be fast-tracked to shield the economy from such shocks. Demographic changes and economic growth trends will increase demand for energy.

Energy projects are costly and any delays in funding and cooperation must be addressed to avoid failures. Environmental concerns from coal-based energy generation are expected to gain ground and dominate thermal generation by 2015. Similar concerns over the safety of nuclear energy sources further the case for increased investment in renewable energy sources, with a record of safety

and environmental friendliness such as wind, solar and hydro sources.

Kenya should fast-track importation of cheaper power from neighbouring countries that use alternatives to diesel generation. This includes the Kenya-Tanzania 400kV and the Kenya-Ethiopia interconnection. In addition, the government should increase funding to geothermal and wind power projects to reduce reliance on weather-dependent hydropower generation. LPG cylinders should be zero-rated to make them affordable to the poor. Currently, the initial cost of the apparatus is prohibitive to low income households that mostly use kerosene for lighting and cooking.

Implementation of petroleum handling projects should be fast-tracked. These projects include the conversion of the refinery into merchant refining, construction of an offshore jetty, construction of bulk LPG handling facilities, and extension of the pipeline and related infrastructure to more regions.

Similarly, there is need to firm up innovative open-ended funding for green energy projects, such as through public infrastructure bonds, attracting investors in a (Build, Operate, Own and Transfer (BOOT) concession, and encouraging ongoing incentives such as Feed-in-Tariffs (FiTs). The opportunities availed by the recently launched African Carbon Asset Development Facility to attract more funding for renewable energy developments need to be pursued more aggressively, especially through private sector proposals.

14.6 Transport Sector

The use of non-motorized (NMT) modes of transport, namely, walking and cycling should be mainstreamed into the infrastructure development agenda in the country. This is justified by the fact that NMT facilitates 49 per cent of all trips in urban areas. The proportion is larger in rural areas. Promotion of this mode of transport would cater for trips covering about 20 km (cycling) and 2-5 km (walking).

Although the Integrated National Transport Policy (Government of Kenya, 2009) rightly provides for the development of NMT, the development of NMT infrastructure and services has not been taken up in road construction projects. In addition, the attitude and behaviour of road users towards NMT users is largely unfriendly. Enhanced use of NMT will help reduce the cost of living in majority of households.

Public policy should actively promote a mass rapid transport system. Efforts to this end include the feasibility study for mass transit in Nairobi metropolitan region by the Ministry of Transport, the development of commuter train services, and development of a bus rapid transit system. However, a detailed plan on ways to integrate the current public transport system into a new system offering world-class services is lacking. An efficient mass rapid transit system will help households to reduce their cost of living.

Kenya should adopt the concept of mixed-use high-density development by adopting a national land use policy that designs human settlements in ways that reduce the need to commute.

14.7 Housing Sector

Public policy should address the problem of informal settlements by easing market-related constraints that make it difficult for urban residents to access affordable and decent housing. To this end, Kenya should hasten the process of reviewing the regulatory framework, including rent dispute resolution, building code and land titling. In addition, policy should create land banks to ease speculation on land and promote micro financing in the housing sector in order to boost housing supply, especially in the low-end market.

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Annex

Annex 1: International comparison of sector's performance, 2010

Country	Sector's growth	% contribution to GDP	% contribution to exports
Brazil	9.7	15.8	37.1
China	9.0	29.6	93.6
Egypt	5.5	15.8	43.4
India	8.3	14.2	63.8
Kenya	5.0	7.7	34.7
Korea (S)	14.8	30.6	89.0
Malaysia	11.4	26.1	67.2
Singapore	29.6	22.2	73.1
Thailand	13.9	35.6	75.3

Annex 2: Sub-sectors percentage contributions to manufacturing value added and employment

Subsector	2006		2007		2008		2009		2010	
	EM	GDP	EM	GDP	EM	GDP	EM	GDP	EM	GDP
Total food manufacturing	30.68	20.37	30.36	20.93	30.62	19.34	30.62	22.57	30.62	21.81
Tobacco and beverages	3.55	9.04	3.44	9.45	3.26	9.19	3.26	9.68	3.26	10.06
Textiles and clothing	23.48	3.25	23.32	3.1	23.43	2.73	23.43	2.18	23.14	2.16
Leather and footwear	0.94	1.75	1.10	1.83	0.99	1.67	0.99	1.55	0.99	1.88
Wood and furniture	5.46	1.39	5.36	1.39	5.39	1.43	5.38	1.57	5.39	1.77
Paper and printing	6.66	6.51	6.63	6.5	6.60	6.4	6.60	5.15	6.60	4.75

Subsector	2006		2007		2008		2009		2010	
	EM	GDP	EM	GDP	EM	GDP	EM	GDP	EM	GDP
Industrial chemicals, paint and soap	5.80	1.42	5.77	1.40	5.72	1.38	5.72	1.50	5.72	1.59
Petroleum refineries: oils, vaseline	0.09	15.38	0.08	15.32	0.09	17.40	0.09	10.61	0.09	10.62
Rubber products	1.26	1.34	1.41	1.24	1.41	1.00	1.41	1.12	1.41	1.05
Plastic products	3.15	1.93	3.35	1.78	3.27	1.39	3.27	1.61	3.27	1.52
Clay and glass products	2.58	1.46	2.73	1.51	2.75	1.76	2.75	2.07	2.73	2.04
Metal products	9.46	4.58	9.42	4.60	9.52	4.07	9.52	4.20	9.52	4.15
Non-metallic mineral products	0.90	11.08	1.17	11.41	1.19	13.37	1.19	15.67	1.19	15.46
Transport equipment	3.57	1.76	3.09	1.61	3.09	1.53	3.09	1.61	3.09	2.02

*EM-employment
Source: Authors' calculations from Kenya National Bureau of Statistics (2011), Statistical Abstract

Annex 3: Kenya CPI; New Groups, base period February 2009=100 (annual average)

CPI Group	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Food and non-alcoholic beverages	40.9	42.9	43.6	50.3	58.1	64.9	69.8	72.7	89.5	103.3	109.3	131.8
Alcoholic beverages, tobacco and narcotics	56.9	61.1	65.0	67.4	69.0	73.8	79.0	83.5	94.8	103.7	111.5	122.0
Transport	52.1	55.3	55.5	59.2	72.6	76.8	82.1	86.0	98.0	102.5	107.9	131.0
Communication	43.2	53.9	57.9	59.8	76.2	93.5	98.7	99.5	100.0	99.6	89.3	75.2
Recreation and culture	90.0	93.7	94.8	95.6	94.7	93.6	93.1	94.7	97.9	100.6	101.9	110.0
Hotels and restaurants	59.9	57.9	53.2	55.8	67.5	76.5	78.0	81.8	94.4	102.5	106.7	122.3
All tourism goods (average)	57.2	60.8	61.7	64.7	73.0	79.9	83.4	86.4	95.8	102.0	104.4	115.4
Clothing and footwear	80.2	80.8	81.3	82.1	84.8	89.0	90.9	93.0	97.4	101.5	105.0	112.4
Housing, water, electricity, gas and other fuels	54.2	60.0	61.8	64.4	68.9	76.2	81.3	86.9	97.5	101.8	105.1	117.1
Furnishings, household equipment and routine household maintenance	68.3	70.6	71.3	72.9	75.5	80.7	83.1	87.1	94.7	100.8	104.1	113.0
Health	58.7	67.7	70.9	75.8	78.4	82.7	84.3	86.8	92.9	101.7	106.2	113.9
Education	81.3	84.9	88.1	93.3	96.0	97.9	98.4	99.5	99.9	100.0	101.4	105.8

CPI Group	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Miscellaneous goods and services	73.4	76.5	77.8	79.4	81.3	84.5	86.1	88.4	94.6	101.4	103.7	111.2
All other goods (average)	69.4	73.4	75.2	78.0	80.8	85.2	87.4	90.3	96.2	101.2	104.2	112.2
Overall Kenya	49.9	52.8	53.8	59.1	66.0	72.6	76.9	80.2	93.2	102.1	106.3	121.2

Source: Kenya National Bureau of Statistics, Statistical Abstracts; and Economic Surveys, 2000-2012

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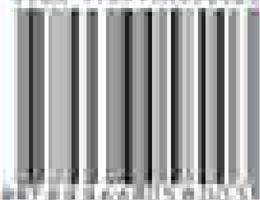
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