

Policy Monitor

Supporting Sustainable Development through Research and Capacity Building

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**Development's in Kenya's
Public Debt:
2007-2017**

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To provide quality public policy advice to the Government of Kenya by conducting objective research and analysis and through capacity building in order to contribute to the achievement of national development goals

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Editorial

Welcome to the KIPPRA Policy Monitor edition for the first quarter of 2018/19. In the last quarter, the Institute engaged with stakeholders in various forums including policy seminars, dissemination workshops and the launch of the KIPPRA Mentorship Programme for University students (KMPUs).

Kenya's economic growth during the second quarter of 2018 remained impressive given the stable macroeconomic environment, adequate foreign exchange reserves, low interest rates and favourable weather conditions during the March-May long rains. However, imports of goods continued to rise during the quarter while introduction of 8% VAT on petroleum products exerted pressure on other related products.

Despite concerns about the sustainability of the country's public debt, expert analysis shows that the present value of Kenya's debt to GDP ratio of 49% is still below the 74% that is the global benchmark for lower middle-income countries and East African Community convergence criterion level of 50%. Nevertheless, the government needs to keep to the fiscal consolidation path and ensure prudent use of loans for strategic development programmes.

Since the introduction of interest rate capping through the Banking (Amendment) Act, 2016, commercial banks have increased their lending to the public sector as they shy from providing credit to the private sector. Major sub-sectors

including agriculture, manufacturing, building and construction, wholesale and retail, among others experienced decline in credit growth in 2017. There is need for the government and stakeholders to come up with a holistic strategy to ensure an interest regime that is favourable to the private sector and financial lending institutions.

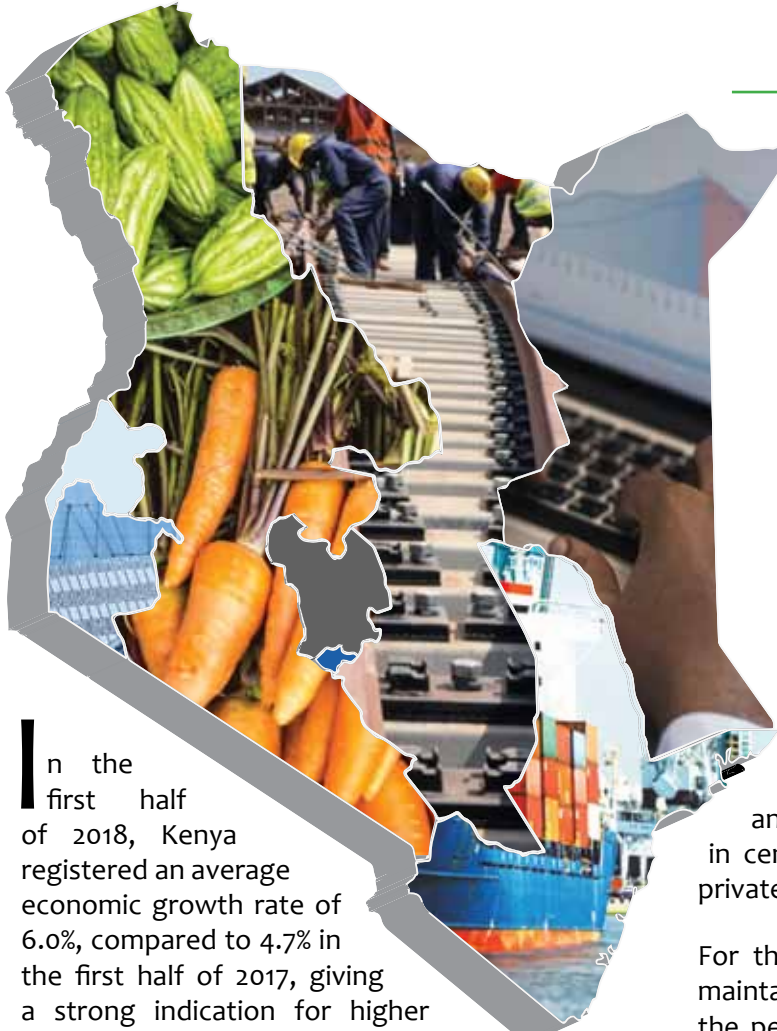
Exports from China to Kenya have increased exponentially in the last ten years due to enhanced bilateral cooperation, aggressive marketing strategy by China, involvement of the East Asian economic powerhouse in numerous infrastructure developments in Kenya and importation of low priced goods from China. This has created a significant trade imbalance. Kenya can creatively use its new trade policies and strategies to increase exports to China, protect its manufacturing sector, and tighten regulatory measures to combat contraband and counterfeit goods from China and elsewhere.

Finally, this edition looks at the emerging phenomena of violent unrests in public schools. The unrests have not only increased in frequency but have also become more violent with destruction of schools' and students' property, arson, and disruption of learning programmes. The government has often responded by forming taskforces to investigate the incidences, but measures taken to curb the unrests have not yielded much. There is a need to explore more holistic and multidimensional approaches to find a lasting solution to unrest in schools.

Recent Developments in

Kenya's Economy

By Benson Kiriga and Daniel Omanyo



In the first half of 2018, Kenya registered an average economic growth rate of 6.0%, compared to 4.7% in the first half of 2017, giving a strong indication for higher growth in the year. The economy expanded by 6.3% in the second quarter of 2018 compared to 4.7% in the second quarter 2017. This is attributed to stable macroeconomic conditions accompanied by favourable weather. The sectors that saw highest growth rates in the quarter were accommodation and restaurant (15.7%), information and communication (12.6%), electricity and water supply (8.6%), transport and storage (7.8%), wholesale and retail trade (7.7%), real estate (6.6%), construction (6.1%) and agriculture (5.6%). Manufacturing recorded an upswing from -0.2% in the second quarter of 2017 to 3.1% expansion in the second quarter of 2018. This was bolstered by improvements in agro-processing activities owing to increased agricultural production, and improved processing of liquid milk and production of butter.

Kenya's fiscal revenue for the 2017/18 climbed 6.2% (Ksh 86.6 billion) compared to the previous fiscal year at Ksh 1.66 trillion (16.8 % of GDP). This was, however, a 10.4% shortfall to the set target of 1.7 trillion (19.1% of GDP) for that year.

The sectors with notable deceleration in the second quarter compared to the first quarter were construction and mining, and quarrying. This is evidenced by the decline in cement consumption (6.8%) and slowdown in private sector credit to mining and quarrying.

For the period January to August 2018, inflation maintained a single digit level, averaging 4.2% for the period. This is attributable to a net decline in prices of food and non-alcoholic beverage because of the long rains in the months of April and May that saw inflation levels below 4.0%. However, September 2018 had an inflation rate of 5.7% mainly due to increase in prices of some foodstuffs, which outweighed decreases in few other food stuffs. Other contributing factors include increase in transport and housing, water, electricity, gas and other fuels indices reflecting the first-round effects of introduction of 8% VAT on fuel.

The current account deficit narrowed to Ksh 85.8 billion in the second quarter of 2018 mainly due to net surpluses in the services and secondary income accounts. However, there were larger increases in merchandise imports compared to exports during

the period. Imports grew by 8.8% while exports grew by 6.2%, resulting in widening of the balance of trade to 10.2%. Imports growth was attributed to increased expenditures on petroleum products, industrial machinery, medicinal and pharmaceutical products, wire products and aircraft associated equipment and parts. Growth in exports was driven by increase in exports of horticulture (11.7%), coffee (4.6%), and articles of apparel and clothing accessories (13.3%). Financial account net flows narrowed to Ksh 18.8 billion because of decreased inflows, coupled with increased debt securities outflows. Overall balance of payments position recorded a deficit of Ksh 33.6 billion. As a result, gross official reserves stood at Ksh 904.8 billion compared to Ksh 889.7 billion in the same period last year. Kenya's holdings of foreign exchange reserves remain high and continue to provide an adequate buffer to the economy, against short-term external shocks. According to the Central Bank of Kenya, foreign exchange reserves stood at approximately Ksh 851.2 billion as at end of September 2018 (5.6 months imports cover).

Interest rates remained low and stable as at end of June 2018, due to the interest rate capping. The Central Bank Rate (CBR) was revised to 9.5% in the second quarter of 2018 from 10.0% during the second quarter of 2017. Consequently, interest rates for commercial bank loans and advances dropped marginally to 13.21% in June 2018 from 13.66% in June 2017 while the savings rate increased from 5.66% in June 2017 to 6.60% in June 2018. The 91 days Treasury bill rates declined from 8.42% in June 2017 to 7.87% in June 2018. Interbank rates increased to 5.03%

in June 2018 from 3.99% in June 2017. The decline in lending rates is expected to improve spending and investments in the medium term and set the economy to its potential growth trajectory.

Kenya's fiscal revenue for the 2017/18 climbed 6.2% (Ksh 86.6 billion) compared to the previous fiscal year at Ksh 1.66 trillion (16.8 % of GDP). This was, however, a 10.4% shortfall to the set target of 1.7 trillion (19.1% of GDP) for that year. This shortfall resulted from under-performance in ministerial appropriation-in-aid due to delays in reporting by ministries, departments and agencies; and under-performance in ordinary revenues particularly excise tax which was 9.4% below the target, largely because of proliferation of illicit goods. Fiscal expenditure increased by about Ksh 1.48 billion (0.1%) compared to the previous fiscal year, reaching Ksh 2.1 trillion of which about Ksh 1.32 trillion and Ksh 485.7 billion was recurrent and development expenditure, respectively. Fiscal expenditure performed poorly against the Ksh 2.3 trillion target, recording a shortfall of Ksh 218.5 billion attributed largely to lower absorption of both recurrent and development expenditures by the National Government.

Fiscal deficit decelerated to approximately Ksh 624.2 billion by end of June 2018 and the deficit to-GDP ratio declined to 7.1%, from 9.2% by end of June 2017. The deficit was lower than the projected deficit of Ksh 670.4 billion (7.7% of GDP). The fiscal deficit in 2018/19 is expected to fall to 5.7% of GDP by end of June 2018. Following governments renewed



efforts on fiscal consolidation, revenue collection in the 2018/19 is expected to rebound, lifted by the improving operating economic environment, tax policy measures, and revenue administrative measures put in place by the National Treasury.

The implementation of the third Medium-Term Plan that includes the “Big Four” agenda is expected to spur growth in economic activity. The current stable macroeconomic conditions are expected to continue in the medium term with implementation of prudent fiscal policy that includes containing the public debt at sustainable levels. It is notable that demand on fiscal space is still high while exports are not growing at the desired rates against the steadily increasing import bills.

the slowdown in credit to the private sector persists, growth prospects could be depressed owing to derailment in aggregate domestic demand and slowed expansion in the micro, small and medium-sized enterprises. Extreme weather conditions are also potential headwinds to the growth outlook.

Externally, sudden unexpected increase in global oil prices presents a threat to Kenya’s balance of trade position. Essentially, a sharp rise in oil prices would exert pressure on the country’s terms of trade, pushing energy prices and overall inflation to the rooftop and dampening domestic demand. The upcoming bullet payment of the Eurobond and other syndicated loans could increase Kenya’s vulnerabilities particularly following any

Economic growth prospects, 2019-2021

	2015	2016	2017	2018	2019	2020	2021
GDP Growth	5.7	5.9	4.9	6.0	6.5	6.9	7.3
Inflation	6.6	6.3	8.0	4.9	5.0	5.0	5.0
Private Consumption	2.9	6.8	6.6	6.8	7.2	7.5	7.7
Government Consumption	11.5	8.5	8.4	7.9	8.6	8.4	7.9
Private Investment	5.9	-8.1	15.1	8.6	8.4	8.6	8.8
Government Investment	2.0	-15.6	-2.7	5.2	5.7	6.3	7.5
Exports of Goods and Services	6.2	-2.6	-6.2	3.4	4.6	4.8	5.7
Imports of Goods and Services	1.2	-6.3	8.4	6.8	7.1	7.5	7.6
Current Account Balance	-6.7	-5.2	-6.7	-6.4	-5.7	-5.3	-5.0
Fiscal Deficit	-6.0	-5.4	-6.2	-7.1	-7.0	-6.1	-5.8
Public Expenditure	26.1	25.2	26.2	25.4	26.0	26.1	26.3
Interest Rate	10.8	8.5	8.1	7.8	8.0	8.1	8.1
Ksh per Dollar	98.2	101.5	103.4	101.1	100.0	100.1	100.2

Source: KIPPRA Treasury Macroeconomic Model (KTMM)

With a stable macroeconomic environment and full implementation of the “Big Four” agenda, it is expected that growth in the medium term will reach above 6.0%. The growth momentum is expected to continue, reaching 7.3% by 2021. Continued growth in public investments particularly in infrastructure projects will complement private investment, thus providing the required impetus for economic growth.

Notwithstanding, there are downside risks that could threaten growth prospects. Domestically, if

unanticipated tightening of financial condition in the international financial markets.

Going forward, Kenya is set on a path of economic growth rebound in the medium term. It is important therefore that the government maintains momentum with the ongoing structural reforms to achieve the “Big Four” agenda. Furthermore, enhanced efforts to create an enabling environment for private sector development and full adherence to the fiscal consolidation strategy set out in the Budget Policy statement (2018) will bolster stronger recovery of the economy.

Developments in Kenya's Public Debt: 2007-2017

By Hellen Chemnyongoi and James Ochieng'

Overview

In the last decade, Kenya's nominal public debt has increased from 43.6% of GDP in 2007 to 57.2% of GDP as at December 2017. The upward trend is mainly attributed to increased government spending on infrastructure projects from Ksh 60.6 billion in 2007 to Ksh 285 billion in 2017, which was largely financed through borrowing. This growth in debt has generated a lot of debate on its sustainability.

There are various indicators of public debt sustainability, such as the present value (PV) of debt to GDP ratio, the PV of public sector to revenue ratio and the debt service to revenue ratio. For Kenya, the PV of debt to GDP ratio as at June 2018 stood at 49%, well below the 74% global benchmark for lower middle-income countries (LMICs) and 50% for East African Community (EAC) convergence criterion. Similarly, the PV of public sector to revenue ratio was at 227%, below the 300% LMICs threshold. The debt service to revenue ratio indicator in 2018 stood at 31%, slightly above the 30% LMICs threshold. The medium-term projection shows that this ratio will

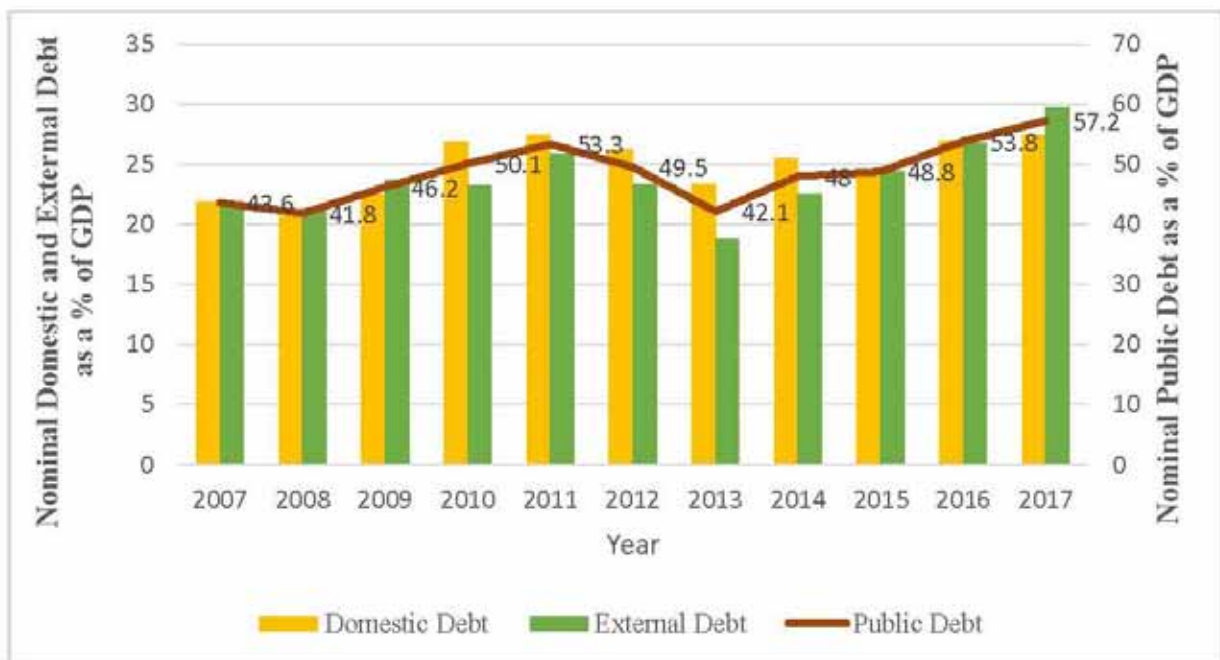
remain below the sustainability threshold. The debt sustainability indicators show that Kenya faces a low risk of external debt distress due to the high level of concessionality of current external debt and the positive outlook in other macroeconomic indicators.

Domestic Debt

Domestic debt as a percentage of GDP rose from 21.9% in 2007 to 27.4% in 2017. This is mainly attributed to increased borrowing by the government to finance widening fiscal deficit over the years. The treasury bonds as a share of domestic debt decreased from 67.1% in 2007 to 63.1% in 2017 while treasury bills increased from 23.3% to 35.2% during the same period under review. The share of Treasury bills has increased, with commercial banks investing more in Treasury bills as they are perceived to be riskless compared to lending to the private sector. The holders of Kenya's domestic debt are mainly commercial banks, non-banks such as pension funds and insurance companies, non-residents, and the Central Bank of Kenya. Among these, commercial banks hold the largest share; in 2007, they held 46.2% while in 2017 they held 55.9%.



Public debt as percentage age of GDP in Kenya



Source: Central Bank of Kenya (2017), Annual Report

External Debt

External debt for Kenya has shown an upward trend, increasing from 21.7% of GDP in 2007 to 29.8% in 2017. In comparison to domestic debt, the share of external debt in total public debt has surpassed that of domestic debt which stands at 27.4%. The shift towards external debt may be attributed to favourable borrowing terms in line with the government's external debt strategy of contracting loans on highly concessional terms. These features have a strong influence on overall cost and risk exposure of Kenya's existing external debt portfolio.

The bilateral debt category increased from Ksh 141 billion (35.3% of total external debt) in 2007 to Ksh 670 billion (38.9% of total external debt) in 2017. The lending countries with the leading outstanding national debt as at 30th June 2017 were China, Japan and France with Ksh 478.6 billion, Ksh 91.5 billion and Ksh 63.3 billion, respectively. This translates to 66.2%, 12.7% and 8.8% of total bilateral debt, respectively. Therefore, China, Japan and France account for 88% of Kenya's bilateral debt. In 2007, however, the top three bilateral creditors were Japan at Ksh 66.2 billion (46.7% of total bilateral debt), followed by France at Ksh 18.9 billion (13.3% of total bilateral debt) and then Germany at Ksh 13.5 billion (9.5% of total bilateral debt). Kenya owed

China Ksh 3.1 billion (2.2% of total bilateral debt) in 2007. The stock of debt from China started rising steadily in 2011 and has grown over time due to continued bilateral engagements in infrastructural developments with Kenya. This implies that China has overtaken Japan, France and Germany to be the leading bilateral donor.

The share of commercial loans in external debt has risen from Ksh 574 million in 2007, representing 0.1% of total external debt stock to Ksh 634 billion in 2017, representing 29.4% of total external debt. In 2014, Kenya issued her first Euro bond in London Stock Exchange and raised Ksh 202 billion (US\$ 2 billion). The second Euro bond was issued in February 2018 and raised Ksh 203 billion. Borrowing through syndicated loans and issuance of Eurobonds has increased the share of commercial loans in Kenya's external debt mix.

Multilateral debt increased from Ksh 240 billion in 2007 to Ksh 840 billion in 2017. In 2007, multilateral debt accounted for 61% of total external debt; this reduced to 31% in 2017, implying that the share of multilateral debt in total external debt has reduced by 30% over the last ten years.

Country Comparison

Over the last ten years, public debt for the EAC partner states, just like Kenya, has been rising. In 2007, Burundi had the highest public debt in the

EAC in nominal terms, standing at 129.6% of GDP. However, this reduced to 56.7% in 2017 due to debt relief initiatives such as Heavily Indebted Poor Countries and Multilateral Debt Relief Initiatives that the country has benefited from. Rwanda, Tanzania and Uganda have had their public debts rise from 26.7%, 28.4% and 22.0% of GDP, respectively, in 2007 to 40.6%, 38.2% and 39.0%, respectively, in 2017. South Sudan's public debt rose from 0% of GDP in 2011 to 66.3% in 2017. Therefore, as of 2017 in the EAC, South Sudan had the highest public debt at 66.3% of GDP followed by Kenya, Burundi, Rwanda, Uganda and Tanzania at 57.2%, 56.7%, 40.6%, 39.0% and 38.2%, respectively.

Source: Medium Term Debt Management Strategy 2018/19-2020/21

Conclusion

Due to high government spending and limited revenue, public debt is still expected to rise in the medium-term since the government will still need to borrow to finance the ongoing development projects, and Ksh 460.2 billion budgeted for the "Big Four" agenda. However, according to BPS 2018, it is projected that the nominal public debt, and net of deposits, will reduce to 43.7% of GDP in 2021/22 financial year, of which 22.8% will be from external sources. Nevertheless, with the

Public debt as a percentage of GDP in EAC

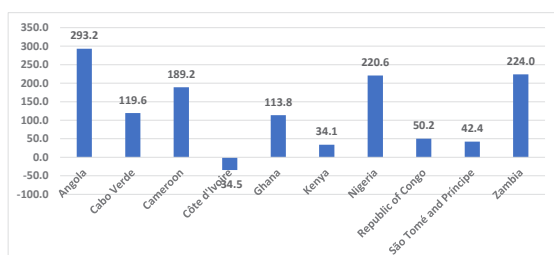
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Average
Burundi	129.6	102.5	25.7	46.9	39.8	39.9	36.6	33.9	42.4	47.2	56.7	54.7
Kenya	43.6	41.8	46.2	50.1	53.3	49.5	42.1	48.6	48.8	53.8	57.2	48.6
Rwanda	26.7	20.9	22.4	22.6	23.1	21.5	26.7	29.1	33.4	37.3	40.6	27.7
S. Sudan	-	-	-	-	0	8.9	17.6	38.3	69.3	86.5	66.3	41.0
Tanzania	28.4	21.5	24.4	27.3	27.8	29.2	30.9	33.8	37.2	38.0	38.2	30.6
Uganda	22.0	20.3	19.2	22.9	23.6	24.2	27.7	30.8	33.5	37.2	39.0	27.3

Source: IFS (2018) Data Base, IMF

In comparison to the ten LMICs in Sub-Saharan Africa (SSA), Kenya in 2017 was positioned seventh in terms of the size of public debt as a percentage of GDP. Cape Verde was ranked first followed by the Republic of Congo with 126% and 119.1%, respectively. This implies that Kenya's public debt at 57.2% is relatively lower compared to other LMICs and is still below the 74% threshold of low middle-income countries. Moreover, Kenya's rate of debt accumulation as a percentage of GDP has been relatively low compared to other LMICs in SSA. Between 2007 and 2017, Kenya's debt to GDP ratio increased by 34.1% while most of her peers' debt increased relatively by higher proportions.

prevailing macroeconomic conditions and increased infrastructure investments that are likely to spur growth, Kenya's debt will still be sustainable.

Debt accumulation as a percentage of GDP in LMIC



Nevertheless, with the prevailing macroeconomic conditions and increased infrastructure investments that are likely to spur growth, Kenya's debt will still be sustainable.

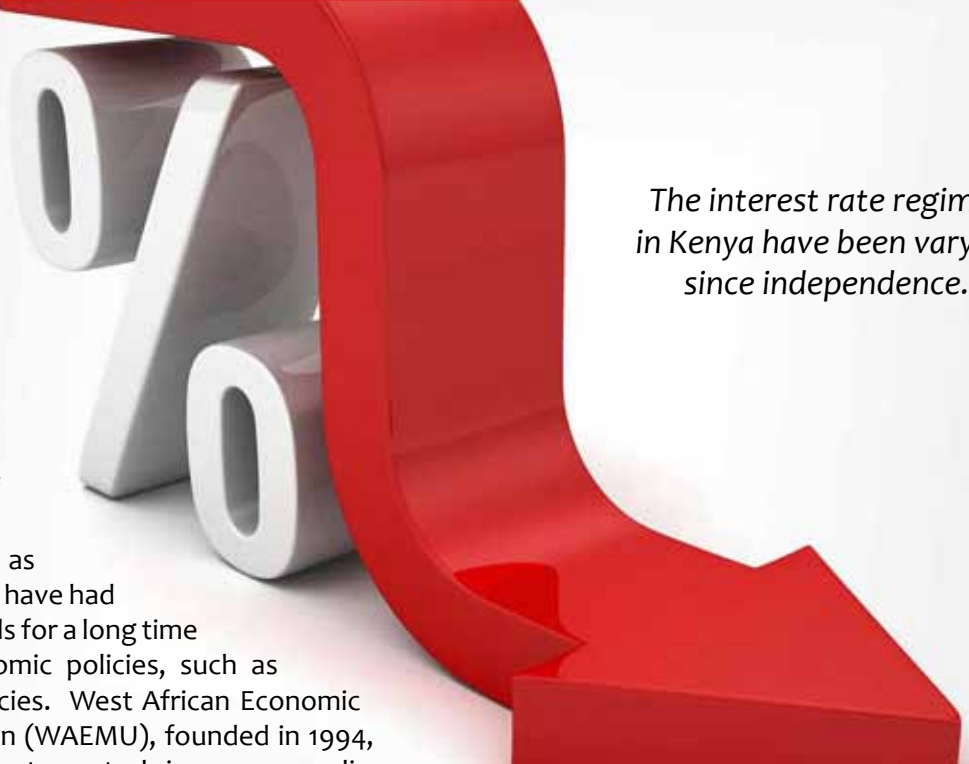
Interest Rate Capping: Implication to the Private Sector

By Protus Shigoli

Kenya is among 24 countries in Sub-Saharan Africa that either have or had capped interest rates in their economies in recent times. Interest rate controls in different economies depend on the structures of financial markets. Countries such as Ethiopia and Eritrea have had interest rate controls for a long time due to their economic policies, such as nationalization policies. West African Economic and Monetary Union (WAEMU), founded in 1994, introduced interest rate controls in 1997 as a policy while in recent times, Kenya (2016), Zambia (2013) and South Africa (2007) have seen interest rate capping regulations.

Interest rates capping is a strategy adopted by governments for varied reasons to address market failure. In some jurisdictions, it is aimed at increasing credit to a sector of the economy, taming usury behaviour of the commercial banks or ensuring credit flow to credit-constrained marginalized parts of the economy and enhancing financial inclusion. For example, Zambia established interest capping in 2013 to spur credit to Small and Medium-sized Enterprises (SMEs). In the West African Economic and Monetary Union, an interest rate ceiling was intended to spur affordable credit to the underprivileged households. The Kenyan case was motivated by a need for accessible and affordable credit to the private sector. Also, there were calls to reign on high bank profitability. Commercial banks provide financial intermediation to businesses and private households, making banking a critical sub-sector to the economy.

The controls on interest rates can either be fixed or



The interest rate regimes in Kenya have been varying since independence.

varied on a benchmark rate that is regarded as the policy rate. A varied or flexible cap is experienced in the case of Zambia where the interest rate is based on a fixed margin on the policy rate. WAEMU, on the other hand, has fixed its interest rate at 15% for banks and 24% for microfinance institutions. The capping also differs in different countries on what is capped. In South Africa and Zambia, the fees and commissions are included in the basket of what is capped. South Africa's regulation based on the National Credit Act (2005) regulates short-term credit as it deems it important in its economy.

Different countries have different institutions with regulatory responsibility in matters interest rates and credit. South Africa's interest rate controls were spearheaded by a credit regulatory body, while in Zambia the Bank of Zambia was responsible for the interest rate caps. Kenya's scenario differs from other countries in that it was the National Assembly that passed a legislation to cap the interest rates. Although, the legislation was based on a banking law, it did not address fees and commissions charged

and subsequently the non-bank financial institutions which also operate in the credit market. Kenya's case is also a flexible capping since the prevailing interest rate is dependent on the policy rate set by the Monetary Policy Committee.

The interest rate regimes in Kenya have been varying since independence. The Central Bank of Kenya (CBK) is mandated with managing the interest rates, with a purpose of ensuring affordable and accessible credit and maintaining macroeconomic stability. The interest rate regime remained unchanged for a long period after independence, with interest spread (difference between the lending rates and deposit rates) at 1% till early 1970s. The external economic shock of 1970s precipitated by the steep increase in prices of oil in 1973 and 1979/1980 that caused macroeconomic instability forced the CBK to review the interest rate regime among other monetary policy interventions to manage bank stability. The CBK raised interest rates on both loans and deposits but, due to inflation, there was negative real rate, thus challenges in mobilization of savings that fund commercial bank lending.

The country moved to liberalize the interest rates in 1991. Shortly after, there was upward pressure on lending rate, peaking at 38.6% in 1993 from 19% in 1990 mainly due to inflationary pressures, expanded government activities in the domestic financial market for deficit financing, therefore increasing the lending rates competitively to the government securities rates. Consequently, the savings rate went down to 11.3% in 1993 from 13.5% in 1990, marking an increase in the interest rate spread to above 20% post-liberalization. The interest rate spread in Kenya's commercial banks has continued to be high at an average of 10% to 12% through the turn of 2000 to 2016 before the capping law, higher compared to the Sub-Sahara Africa's average of 6.8%.

Interventions to Manage High Interest Rates

Kenya has had proposals geared towards intervening on the interest rates by both the legislature and the Central Bank of Kenya. In 2000, there was a parliamentary-led initiative to introduce pegging of the interest rate for both deposit and lending on the 91-day Treasury bill and an introduction of the Monetary Policy Committee responsible for monetary policy matters. Parliament through the Central Bank of Kenya (amendment) bill commonly known as 'Donde Bill' passed in late 2000 proposed to have the lending rate capped at 4% points above the prevailing 91-day treasury bill rate, while the deposit rate be at 70% of the bill

rate. The bill also sought to bar commercial banks from charging any other charges apart from interest rates, legal and valuation fees. Another condition was that the interest charged must not surpass the principal amount. The bill became controversial on technicality issues around the presidential ascent and its commencement date, ending in a court case that the court of appeal issued an advisory for commercial banks to disregard the law.

In 2014, CBK introduced the Kenya Banks Reference Rate (KBRR) as a monetary policy instrument to base the interest rates. The KBRR framework required commercial banks to disclose to the customers the effective base rate of their loans and any additional premium charged above it. KBRR was an average of the 2-month moving 91-day Treasury bill and CBR. KBRR was to mitigate issues around transparency of loans pricing and improve transmission mechanism of monetary policy into banks' lending rate. Other efforts by CBK and the Kenya Bankers Association – the banking industry umbrella body – include the launch of the cost of credit website in 2015 aimed at addressing the issue of price transparency to protect consumers from information asymmetry. These efforts had little impact, since the interest rate spread in 2014, 2015 and 2016 were above 9%, and higher than Sub-Saharan Africa's and world's average of 6.8% and 6.6%, respectively.

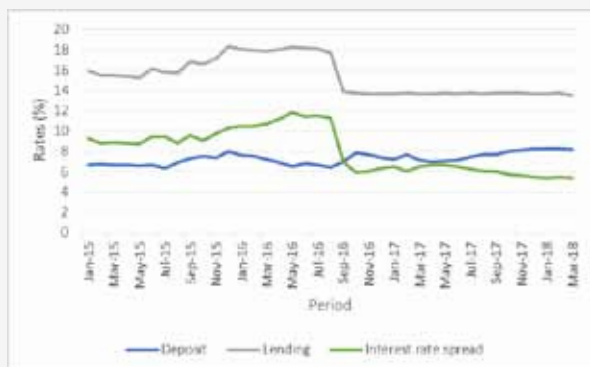
Acting on the criticism of continued profitability of the Kenyan banks by the public, the National Assembly amended the Banking Act in August 2016 to introduce interest rate controls. A cap of 4 percentage points above CBR for lending rates and a minimum of 70% of the CBR on deposits was introduced basically to manage the interest rate



spread by banks. The restrictions brought down the high interest rate spreads the commercial banks were experiencing before due to a capped regime that put a ceiling on the lending rate at 4% above the CBR. Consequently, the amendments were meant to boost savings in the economy through relatively higher returns on deposits at 70% of the CBR rate.

Prior to the interest rate controls, commercial banks had higher spreads averaging above 9% from January 2015 to September 2016. The average spread dropped from the last quarter of 2016 after the interest rate capping law became operational to 6% in weighted terms. Commercial banks weighted average lending and deposit rate were also affected by the rate. The lending rate declined by 2% to 14%, since the prevailing CBR rate was 10% while the deposit rate improved slightly in September 2016 to above a weighted average of 7%.

Implications on interest rates and spreads

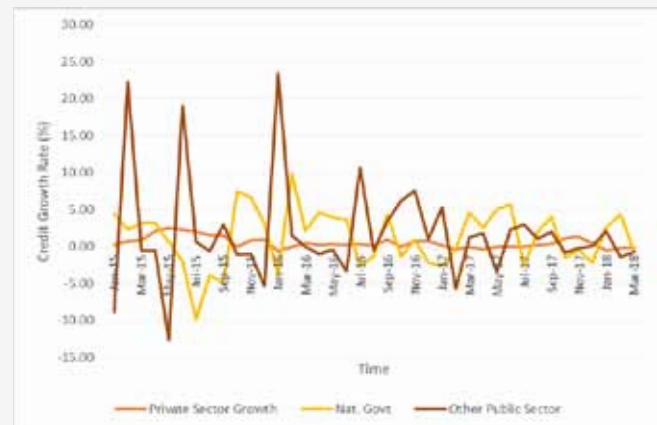


Data Source: CBK Commercial Banks Average Weighted Interest Rate

Implications to Private Sector Credit

Commercial banks' lending rates are informed by, among other things, the cost of funds, risk premiums placed on the borrower and market competition with the bottom line being the objective. Therefore, with declining interest rate spread, the room to price the above components of the interest rate shrinks, therefore making the banks to seek ways of boosting earnings despite the new conditions, including starving the perceived risky private sector consumers.

Credit growth rate by commercial banks to public and private sector



Data Source: Central Bank of Kenya Statistical Bulletins

Credit growth to the private sector was trending upwards from January 2015 by an average of 1% per month to September 2015. The last quarter of 2015 saw increased national government participation in the domestic credit market, with returns on Treasury bills of up to 21.61% in October 2015. During this period, the Treasury bill rates were between 14.61%, 21.65%, 12.34% for the 91-day for September, October and December. Similar figures were reflected in the 182-day and 364-day Treasury bills. 1-year Treasury bonds rates issued on September and October 2015 had rates of 19.06 and 23.514% compared to prevailing lending rates 16.82 and 16.58%.

The private sector subsequently experienced a relatively stagnant growth rate of an average 0.5% in 2016. Commercial banks' lending to private sector dipped in that period as the national government competed with the private sector for credit. The capping law came into effect in mid-September 2016. October 2016 shows the reaction in the credit market, with a slump in credit to private sector and national government while other public sector had above 5% growth after the operationalization of the interest rate law. From September 2016, commercial banks have been skewing their credit to the public sector, notably to other public sectors such as parastatals which enjoyed high credit growth rates from August to November 2016, thereafter dipping in December 2016 and rising in January 2017, then slumping in February 2017.

The national government domestic credit growth rate rebounded from March 2017 to a peak of 5.74 in June 2017 where the Treasury bill rate was at average 10% compared to an average lending rate of 13.61%. Commercial banks preferred investing in national government securities to private sector even with high lending rates in favor of the private

sector, thus causing disintermediation. The national government credit growth has only slowed twice from March 2017; that is during the two election periods of July and the last quarter of 2017 but came back up from January 2018. This shows increasing preference for the commercial banks to lend to the national government and other public-sector enterprises compared to private sector ones.

The private sector experienced mixed fortunes although most of the sub-sectors had a decline of credit advanced to them in the fourth quarter of 2016 when interest rate law was implemented. Agriculture, manufacturing, transport and communication, trade and private households all saw a decline in credit growth to the sub-sectors in the fourth quarter of 2016. In the selected sub-sectors, real estate was the only sub-sector that recorded a slight increase of 0.2% between quarter 3 and 4 of 2016.

Average quarterly credit growth rate for select sub-sectors

Sub-Sector	Average Credit Growth Rate (%)					
	Q3-2016	Q4-2016	Q1-2017	Q2-2017	Q3-2017	Q4-2017
Agriculture	-2.49	-0.23	-1.43	-0.54	1.26	-2.29
Manufacturing	-3.13	-0.44	0.43	0.48	1.46	1.64
Trade	2.84	-0.19	0.10	0.53	1.67	0.50
Transport and Communication	2.18	1.53	-0.75	-1.32	-0.58	0.08
Real Estate	0.65	0.77	1.31	0.44	0.29	0.70
Private Households	0.29	-1.29	1.86	0.02	2.55	1.38

Despite its blanket nature, the rate caps did not affect the banking sector in uniform; rather, there was segmented effects felt by different commercial banks. The large banks (Tier 1) attracted large concentration of deposit accounts in 2016 and 2017. The large banks' share of total deposits in December 2016 was 88.02% and 88.82% in 2017. The number of deposit accounts in medium tier banks shrunk by 0.73% to 9.09% in 2017 from 9.82% in 2016. The same happened to the small banks where number of deposit accounts went down from 2.15% in 2016 to 2.08% in 2017. There was capital movement towards the big banks necessitated by various factors, among them, perceived stability of the large banks coupled with the new deposit rate occasioned by the interest rate cap.

The quality of the deployed assets by banks has also been changing upwards. Small banks have been recording a continuous increase in their non-performing loans (NPLs) portfolio from 12.62% in

2015 as a share of the total gross loans and advances in the peer to 15.94% post-capping rate era in 2017. Both medium and large banks have gone through similar challenges, with medium banks' NPLs portfolio recording a 6.82% rise between 2015 and 2017 while the large banks had an increase from 5.33% in 2015 to 8.45% in 2017. This can be attributed to both increasing supervision especially in terms of loans provision, and poor quality of the assets deployed to the private sector. Notably, the big banks had a loans and advances market share of 94.9% as at 2017 while the medium and small share 3.18% and 1.93%, respectively.

Commercial banks' income structure was also impacted as indicated by data from the audited financial records. For tier one, interest income has been declining at least from 2016 level of 69.77% to 67.18% in 2017 earnings. Medium tier banks experienced the same result post-capping, as interest income dipped from 74.66% in 2016 to 72.46% in 2017. The same trend was observed with

the small banks where the decline was by 5.77% to 67.98% in 2017. Non-interest income continued to spur as large, medium and small banks experienced an upward trend in non-interest income of 32.82%,



29.50% and 34.83% in 2017 from 30.23%, 27.43%, 28.62% in 2016, respectively, which is an indication of adaptation of commercial banks to new income models to maintain profitability.

The performance of microfinance banks after interest capping law has been declining. This segment of the non-bank financial institutions is regulated by the CBK but was not affected by the interest capping law. Commercial banks were competing with MFBs for deposits due to the floor on deposit rate placed by the interest rates law which made commercial banks deposit rates competitive. To this end, MFBs shed off 3.2% of their deposits, a main source of funding, between 2016 and 2017. Consequently, their loan portfolio shrunk by 8.9% in 2017. MFBs did not offer alternative credit considering contracting credit to private sector by the commercial banks.

Conclusion

Commercial banks play a critical role in the economy through financial intermediation. Indeed, Kenya vision 2030, which aspires to create a vibrant and globally competitive financial services sector, recognizes the role played by financial services in promoting savings and investments. However, the capping of interest rates seems to have contracted credit to the private sector. Further, some critical sectors of the economy have had reduced credit from commercial banks. To mitigate risk, commercial banks have increased their lending to the public sector, which is considered less risky, thus crowding out the private sector.

The Banking Act (Amendment) 2016 intended to increase intermediation to sectors of the economy that were marginalized, such as the private sector in terms of affordable credit provision. The interest rate restrictions have, however, had opposite results evidenced by decreasing growth rate of credit to the private sector. Notably, the Banking Act (Amendment) 2016 is silent on the non-banking financial institutions such as the savings and credit cooperative societies (SACCOs) and microfinance banks. The law did not address issues such as fees and commissions which also bring up the cost of credit. It unilaterally focused on interest rates while commercial banks have opted to raise fees on loans to boost their income and mitigate against reduced spreads from the interest rate capping.

Way forward

The continued approach by economies to put controls on interest rates points to an existing problem that must be addressed. Capping interest rates might have unintended consequences, and taming specific failures in the financial markets is a starting point. A holistic approach to addressing the architecture of the financial sector should be done to incorporate all financial service providers in finding a working solution to provision of accessible and affordable credit.

First, maintaining fiscal discipline is important to reduce competition for credit with the private sector in the domestic credit market. Secondly, CBK should be allowed to exercise its mandate in regulating the banking sector. This will entail encouraging competitive behaviour and seeking input from stakeholders such as the Kenya Bankers Association (KBA) in the interest rate capping review debate to reach a common ground that will enable achievement of accessible and affordable credit supply to the private sector. Third, borrower risk is an important composition of the interest rate. Therefore, a review of risk profiling framework should be conducted and should also be based on the sector-wide risk profiles. This involves improving the working structure of the commercial banks and credit reference bureaus to be able to accurately determine dependable lending risk assessments and reports.

Lastly, there is need to fast-track the creation of the financial sector ombudsman through the proposed Financial Markets Conduct Bill 2018 that seeks to harmonize the financial markets functioning. The bill is concerned with supervision of the conduct of providers of financial products in relation to financial sector customers. This will help in addressing consumer protection issues and taming commercial banks' predatory nature through the ombudsman. The bill further incorporates conditions of the unsuccessful Central Bank of Kenya (Amendment) Act 2000 – that the interest charged must not surpass the principal amount to ease indebtedness – and the onus for compliance is on the commercial banks to do due diligence before lending.

Trade Imbalance between Kenya and China

By Paul Odhiambo and Kenneth Malot

China has been Africa's biggest trading partner in the last decade. China-Africa trade grew from US\$ 765 million in 1978 to US\$ 170 billion in 2017. However, trade imbalance between China and several African countries is increasingly dominating policy debates as China's commercial presence in the continent has raised concerns whether China is committed to its external engagement principles of shared prosperity, mutual development, sincere friendship and win-win relationship. Nonetheless, China underscored the need to address the trade imbalance between Africa and China during this year's Forum on China-Africa Cooperation (FOCAC) summit held from 2-4 September in China.

The theme of the summit was: "China and Africa: Toward an Even Stronger Community with a Shared Future through Win-Win Cooperation." Since its launch in October 2000, the FOCAC has become a tri-annual dialogue platform for collective consultation and strengthening of comprehensive cooperation and strategic partnership between China and African countries. During September's summit, eight major initiatives were launched for the next three years (2018-2021). The initiatives include industrial promotion,

infrastructure connectivity, trade facilitation, green development, capacity development, health care, people-to-people exchanges, and peace and security. His Excellency, President Uhuru Kenyatta who attended the summit observed that the eight priority initiatives identified in the next FOCAC cycle (2018-2021) are aligned with Kenya's "Big Four"

slightly declined to Ksh 9.9 billion in 2017. High Chinese import bill to Kenya can also be attributed to aggressive marketing of Chinese goods and services, low prices of Chinese goods and engagement of China's construction companies in mega projects such as the Standard Gauge Railway which involves

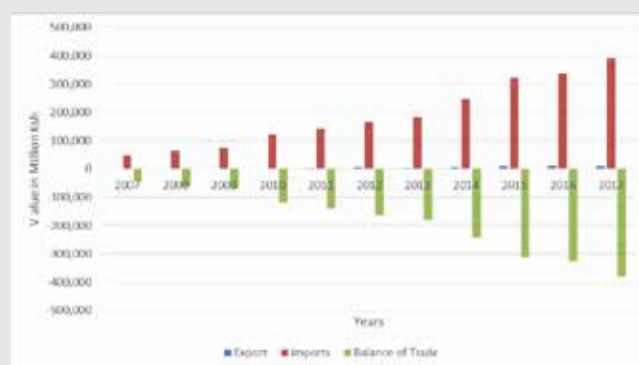


agenda.

China has become a major trading partner of Kenya due to enhanced bilateral cooperation between the two countries in the past fifteen years. China became the leading source of imports for Kenya in 2015. Chinese imports have more than doubled over the last five years, growing from Ksh 167.2 billion in 2012 to Ksh 390 billion in 2017. As a result, Chinese goods accounted for 22.6% of all Kenya's imports in 2017. However, Kenya's export to China have been low during the same period. The exports to China grew from Ksh 5.3 billion in 2012 to Ksh 10 billion in 2016 but

importation of heavy machinery and construction materials from the East Asian economic powerhouse. Other factors that have contributed to this trade imbalance include importation of goods including onions, clothes, toilet paper, cement and fish that can be manufactured and produced locally. Importation of such products is seen as in direct competition with local industries.

Kenya-China trade flows (2007-2017)



Source: Customs Department, Kenya Revenue Authority

The trade balance is heavily in favour of China, whose exports to Kenya are largely capital goods including: telecommunication equipment, railway vehicles and associated equipment, automatic data processing machines, rails and railway track construction materials, among others, while Kenya's exports to China are mainly primary products comprising titanium ores and concentrates, petroleum oils, vegetable textile fibres, leather, hides and skins, tea, coffee, gemstones, manufactures of base materials, crude vegetable materials and the like.

Out of the 2018 FOCAC eight initiatives, industrial promotion, trade facilitation and capacity development could play a considerable role in tackling the problem of trade imbalance between Kenya and China if the former strategically works towards increasing its exports to the latter and negotiates for favourable trade terms. In addition, it is critical that Kenya prioritizes the implementation of the 2018 Beijing Plan of Action especially the promotion of industrial partnering and production, production capacity cooperation, building industrial parks and economic and trade cooperation zones, improvement of Africa's investment environment and promoting of vocational training for African workforce.

Trade facilitation is critical in improving a country's competitiveness and effectiveness of border agencies, and therefore reducing trade costs. In addition, trade facilitation can also help in strengthening governance and formalization of informal sector. In the Beijing Action Plan, China and Africa appreciate the need

to implement China-Africa trade and investment facilitation to promote trade connectivity in the continent. Some of the key issues that the two sides agreed to address so that trade facilitation is enhanced include strengthening African countries' customs and taxation law enforcement capabilities. Africa and China have also agreed to cooperate on issues such as market access, personnel training on customs, boosting African countries' exports to China with focus on non-resource products, value added agricultural produce and industrial products.

The Chinese leadership made various commitments during the September summit to promote African products to China, including creation of a China-Africa Economic and Trade Expo; encouragement of African states to participate in the China International Import Expo in November 2018; enhancement of Africa's capacity in the secondary and tertiary industries and improvement of Africa's internally-driven growth that reduces reliance on export of raw materials. China also offered 50 trade facilitation programmes for Africa to deepen cooperation on market regulation and customs procedures. In addition, the Chinese government offered to create a new US\$ 5 billion Fund for financing imports from Africa. China is also committed to continue holding free trade negotiations with interested African countries to expand the duty-free access to Chinese markets.

The Beijing Action Plan (2019-2021) which was adopted in September 2018 is expected to solidify and promote trade between African countries that have diplomatic relations with

China, Kenya included. Chinas pledge of zero-tariff treatment for 97% of tax items from developing African countries will make it easier for Kenya to benefit from this policy through enhanced market access. Further, increased collaboration between China and African countries is expected to improve customs management and modernization, expand cooperation with Africa on customs clearance facilitation, law enforcement and capacity-building, jointly fight the smuggling of endangered species and their products, counterfeit products, commercial fraud and other crimes.

In conclusion, Kenya needs to be tactful in its strategy and engagement towards taking advantage of the market available in China and make it a win-win situation. The recent development of the National Trade Policy, the National Export Development and Promotion Strategy and the three initiatives (industrial promotion, trade facilitation and capacity development) in the Beijing Action Plan provide a framework for the country to expand its export base and promote value addition so as to obtain the maximum value. The government has also established an export insurance scheme to help Kenyan exports venture into new international markets. Moreover, a Cabinet sub-committee on export has been established to bring on board key ministries to push for the development of exports. It is critical that both national and county governments come up with concrete action plans that will lead to export diversification and transformation of primary export products.

Curbing School Unrests in Kenya: The Way Forward

By Mary Mwami and Mercy Matwere



Education for all is fundamental in attaining a knowledge-based society that can drive innovation and entrepreneurship required to steer Kenya in achieving the goals articulated in the Kenya Vision 2030. It is thus undesirable for the education sector to witness school unrests as this disrupts the learning process. School unrests refer to any form of disruption or disturbance, including students' riots, protests, attempted arson, and walkouts.

School unrest is not a new phenomenon in Kenya. In the 1960s through the 1970s, students especially in higher learning institutions held demonstrations as a way of airing their views but reported student unrests were few and far between. The unrests were also less violent – as the episodes were mainly in form of boycott of classes and peaceful protests. The unrests not only increased in frequency but also evolved into more violent episodes in the 1980s through 2000s. The unrests have now come to be associated with destruction of school property, arson, rape and loss of student lives.

Besides the increased frequency and intensity, another notable pattern is that most unrests occur during the second term; that is, between May and July, every year. This has led many of the taskforces

formed to advise the government to link the unrests to the mock exams (which were banned) and the increased pressure on students due to concentration of the extracurricular activities in the second term. But the exam link does not seem to explain the larger proportion of arson attacks restricted to public and not private schools. Also, it does not explain the continuing unrests even after the mock exams were scrapped. Thus, curbing school unrests is important as the trends impose social and economic costs on society, including disruption of learning activities, absenteeism from school, destruction of property, serious injury and the associated increase in medical costs and loss of life.

In responding to the unrests, the Ministry in charge of education has frequently set up committees or taskforces to investigate the episodes at their peak points and provide remedial actions. But this approach has been beset by some weaknesses. The first is that the taskforces have a limited time to examine and submit their reports which does not provide ample time for analysis of root causes. As a result, the reported findings are usually not rooted on a clear analytical framework such as root cause analysis but on views or perceptions of respondents. Some of the identified causes may need further examination as there is no clear

reason why identified causes such as abdication of parental responsibilities and fear of exams should be restricted to public and not private secondary schools.

Secondly, the measures that the government has taken to curb school unrests tend to be more reactive interventions rather than proactive approaches. Some of the measures implemented include: ban on sub-county and county mock examinations, ban on ranking of schools based on national examination results, and establishment of student councils and elections of their leaders. In addition, the government has established competitive recruitment of school principals, outlawed corporal punishment in schools, introduced counselling and guidance, and more recently began the implementation of the delocalization of school headship.

The taskforces have also provided proposals which have been subsequently adopted as part of regulations. These include measures to counteract cases of fires and introduction of counselling and mentorship in schools. Even so, there is a challenge of effective implementation of proposals emanating from taskforces. As an example, not all schools have a functional counselling and mentorship programme and not all adhere to the fire and safety measures as required by regulations. These challenges are worsened by the under-resourced inspection units.

An additional weakness in the current and past scenarios of school unrest is the conflicting or dissenting views of various key stakeholders on the cause of the school unrests. Even if the government was keen on implementing the proposals, there would be confusion. A classic recent example is the attempted implementation of delocalization policy. The policy was informed by previous views that lack of its implementation was one of the causes of the unrest. An observable trend among stakeholders is that there is a tendency to hold strong views on the causes of the unrests, which do not seem to be rooted in any research study or findings.

Other causes of school unrests include the views that the unrests, and specifically the recent arson attacks, could have resulted from: weak management of schools; and disconnect between administrators and learners.

A gap exists in establishment of policies on ways of dealing with the perpetrators of school unrest. There is weak profiling of indiscipline cases as the Basic Education Regulations 2015 provides for suspension or expulsion of the offenders and creates room for admission in other schools. This paves way for spreading the negative influence on other schools. The Children Act and the juvenile justice system in Kenya reinforce child rights and emphasize on upholding “the best interest of the child”, with the court proceedings having to consider the physical, emotional and educational needs of a child. Many of the secondary school students are aged below 18 years and enjoy the rights of children, which complicates the disciplinary processes. Some of the recent proposed punishment include prosecution of offenders, blacklisting the offenders and their names being included in the Directorate of Criminal Investigations (DCI) records, and ring leaders being denied admission to Kenyan universities. Implementation of some of these penalties will need to be included in the Children’s Act.

It is therefore important to address the phenomenon of school unrests in a more holistic manner. It would be important to consider psychomotor development of children, their temperament, social behaviour, communication skills, self-esteem, family and school influences. The government, in collaboration with all education stakeholders, should seek a new approach to establish the root cause of the unrests without resorting to quick fix solutions. For this to happen, the unrests should be examined through a multidimensional preventive approach, including rational decision-making among students and examining the cognitive, emotional, psychological, cultural and social factors that drive their choices



A. Acts of Parliament

The Tax Laws (Amendment) Act No. 9 of 2018

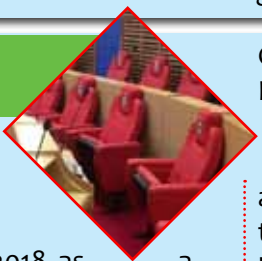


This Act makes amendments to the Income Tax Act Cap 470, the Stamp Duty Act Cap 480 and the Value Added Tax Act 2013. There are several dates for each of the Acts to be amended as follows:

- Amendments relating to the Income Tax Act came into effect on 1st of July 2018. The Tax Laws (Amendment) Act amends the Income Tax Act by introducing a new definition of “winnings” to mean the “positive difference between payouts made and stakes placed in a given month, for each player, payable to punters by bookmakers licenced under the Betting, Lotteries and Gaming Act. The Income Tax Act previously defined “winnings” under the Betting, Lotteries and Gaming Act as “winnings of any kind and a reference to the amount or to the payment of winnings shall be construed accordingly”. The Income Tax Act, however, has a proviso that the definition shall only apply in the case of winnings payable to punters (players) by bookmakers. The tax on winnings is applicable to both resident and non-resident persons with or without a permanent establishment in Kenya. The Tax Laws Act introduces a 20% withholding tax on winnings as a final tax. The Income Tax Act has also been amended by providing that compensating tax does not apply to a power producer under a power purchase agreement.
- Amendments relating to the Stamp Duty Act will come into force on 1st of October 2018. The Tax Amendment Act has amended the Stamp Duty Act by exempting first-time home owners from stamp duty, specifically for houses purchased under the affordable housing scheme. Stamp duty is ordinarily charged at a rate of 4% in urban areas and 2% in rural areas on the value of the house, as approved by a Government valuer; and
- The Value Added Tax 2013 which came into effect on 1st of July 2018 was amended by providing that some zero-rated items will now have VAT exempt status. The main difference between zero rate and exempt supplies is that the suppliers of zero-rated goods and/or services can still claim all their input VAT, but suppliers of exempt goods are either not registered for VAT or if they are, they cannot claim their input VAT. Because of the amendment, suppliers of these goods and services will no longer be in a position to claim input VAT against their output VAT and are therefore likely to pass on this input VAT to consumers, potentially increasing prices. Some of the notable goods and services which are now VAT exempt include transfer of a business as a going concern by a registered person to another registered person, Supply of maize (corn) flour, cassava flour, wheat or meslin flour and maize flour containing cassava flour by more than ten % in weight, Taxable goods supplied to marine fisheries and fish processors, goods imported by passengers arriving from places outside Kenya, and Taxable goods for emergency relief purposes for use in specific areas supplied to or imported by the government, NGOs or relief agencies.

B. Senate Bills (Those concerning county governments)

Prevention of Terrorism (Amendment) Bill 2018



This Bill was gazetted on 19th July 2018 as a Senate Bill and its main objective is to amend the Prevention of Terrorism Act 2012 to provide for the duty of institution administrators to counter radicalization. Part II of the Fourth Schedule to the Constitution assigns the function of pre-primary education to county governments and is therefore a Bill concerning

County Governments. The Bill in amending the Prevention of Terrorism Act 2012 seeks to ensure that all institution administrators are mandated and charged with the duty of ensuring measures are put in place in their respective institutions to prevent radicalization and violent extremism. Under the Bill, the schools’ administrators will be required to keep and update records of all their students, ensure teachers are sensitized to detect extremism behaviour in students and collaborate with key stakeholders in countering radicalization.

Petition to County Assemblies (Procedure) Bill 2018

This Bill was published on 10th August 2018 as a Senate Bill and it seeks to provide for the procedure for petitioning a County Assembly. Article 37 of the Constitution provides that every person has a right to present petitions to public authorities. Section 15 of the County Governments Act 2012 (No. 17 of 2012) specifically provides for the right to petition a County Assembly. On the procedure for the exercise of the right, section 15(2) of the County

Governments Act 2012 requires each County Assembly to provide for the procedure to be applied in the respective County Assembly. This may result in the enactment of different procedures for petitioning county assemblies across the 47 counties. This Bill therefore seeks to provide a uniform and harmonized procedure that would apply in all county assemblies. The procedure is similar to that applicable to the National Parliament as set out in the Petition to Parliament (Procedure) Act 2012.

Preservation of Human Dignity and Enforcement of Economic and Social Rights Bill, 2018

This Bill was published on 4th September 2018 as a Senate Bill and it imposes obligations on the national and county governments to put in place mechanisms for the realization of the economic and social rights set out under Article 43 of the Constitution. This Bill also imposes an obligation on county governments to prepare county strategic plans to be integrated within the County Integrated Development Plan which would provide county governments with a framework for implementation of the economic and social rights. The county governments are also required to conduct a baseline survey for purposes of developing the county strategic plan. The national and county governments are also required

to submit a report to the KNCHR and the Senate on progress made on the realization of economic and social rights and action taken in giving effect to Article 43 of the Constitution. Further, each County Executive Committee member responsible for finance is required to include in the budget statement measures aimed at fulfilling Article 43 rights and activities for that year and any progress achieved at availing these to the residents of the county. The Bill proposes that the Kenya National Commission on Human Rights (KNCHR) is required to prepare an economic and social rights index which includes the extent to which a county government has realized the economic and social rights of residents and the extent to which a county government has adhered to its county strategic plan.

Treaty Making and Ratification (Amendment) Bill 2018

This Bill was published on 10th August 2018 as a Senate Bill and its purpose is to amend the Treaty Making and Ratification Act 2012 (No. 45 of 2012) to set out the role of the Senate in treaty making and ratification process. The function of considering and approving the ratification of treaties resides in both Houses of Parliament in exercise of their shared legislative authority under Article 94 of the Constitution. The proposed amendments to the Treaty Making and Ratification Act are therefore intended to bring the provisions of the Act into conformity with the letter and spirit of the Constitution.

Finance Act 2018 Enacted

On 21st September 2018, the President assented into law the 2018 Finance Bill which introduced some tax changes earlier presented in the 2018/2019 Budget Statement. Among them is the introduction a Presumptive Tax which applies for micro enterprises, those with annual turnover less than Ksh 5 million. The tax rate is 15% of the value of business permit (trade license). Other changes included increase of excise duty on telephone and internet data services (from 10% to 15%); on mobile money transfer services (from 10% to 12%) and introduced an excise duty of 20% on bank money transfer services. The Act also introduces 8% VAT on petroleum products.

Envisaged Public Investment Management Guidelines

In the Financial Year 2018/2019 budget speech, the Cabinet Secretary for National Treasury and Planning announced that a Public Investment Management unit would be set up as part of efforts to reform public finance management. The newly established Public Investment Management Unit has proposed guidelines on public investment meant to enhance efficiency. The guidelines outline that all projects will undergo screening to check for consistency with the strategic goals of the government and an appraisal of their economic viability will be done. Only public investment projects that meet the set criteria will qualify for budget funding. The projects subjected to these guidelines will include those wholly or partially funded by public finances



and those under Public Private Partnership (PPP) as long as the guidelines are not contradicting the PPP Act 2013.

Country Policy and Institutions Index Assessment Report

The World Bank released the Country Policy and Institutions Index Assessment (CPIA) report in July 2018 and launched it in September 2018 at the World Bank office in Nairobi. The report ranks 38 African countries according to progress made in improving the quality of their policies and institutions. Countries are ranked on a scale of one to six, with one being the worst and six the best. The ranking covers 16 dimensions, classified in four broad areas: economic management, structural policies, social inclusion policies and equity, and public sector management and institutions.

The key findings from the report were that the average CPIA score for Sub-Saharan Africa (SSA) International Development Association (IDA) eligible countries in Africa was unchanged at 3.1 compared with 2016. More than 20 of the IDA eligible countries in the regions posted a weak score of 3.2 or below. Rwanda led in the region with a score of 4.0. Senegal followed closely with a score of 3.8, while Cape Verde, Kenya, and Tanzania had a score of 3.7. About 30%



of the countries in the region strengthened their policies and quality of institutions in 2017 compared with 2016, while 40% of the countries registered a decline. Kenya's score dropped from 3.8 to 3.7. The decline was a result of poor economic management and weak capacity of the Debt Management Office of the National Treasury. Nevertheless, the country was ranked among the top five in the region. Kenya's highest performing cluster was Economic Cluster with a score of 4.0 while the lowest performing one was Public Sector Management and Institutions with a score of 3.4. However, this was better compared to the SSA IDA eligible countries of 3.0. Sub-Saharan Africa also performed worst in this category.

Cable Car to Ease Transport in Mombasa

The Kenyan Cabinet has approved the construction of a Ksh 4.1 billion (US\$ 40 million) cable car project to ease movement of passengers between Mombasa Island and the mainland. The project, which will be funded by an Austrian company, will be expected to charge commuters a fee before ceding the investment

to the government after 25 years. The cable cars will reduce the existing journey the ferry makes across the 500-metre Likoni Channel from 10 minutes to two minutes and will be able to carry up to 11,000 passengers an hour. The only cable cars in Sub-Saharan Africa are in Nigeria and South Africa.

Cybercrime is an Emerging Security Threat in Kenya

Kenya lost Ksh 21.1 billion to cybercrime in 2017, which was a 40% increase from Ksh 15.1 billion in 2015, according to the 2017 Kenya Cyber Security Report. Kenya ranks third in Africa and 45 globally in the 2017 World Cyber Security Index. The index which is compiled by the International Telecommunications Union covers 134 countries globally. The main factors affecting cyber security in Kenya include overconfidence by users and lack of smart cyber security strategies. The report notes that three-quarters of employees in formal sector in Kenya have experienced cybercrime in their organizations. The study also reveals that most organizations fail to provide sufficient resources for cybersecurity, thus making them prone to attacks. Kenya, through the Ministry of Information and Communication Technology, seeks to enhance cyber security in collaboration with other African countries as the country moves towards digitalization of most government services. The Ministry in collaboration with Naseba and Africa Cyberspace Network (ACN) held

an African Cyber Defense Summit at KICC on 9-10 July 2018. The summit was held with the support of Kenya Airways, Kenya Revenue Authority, Communication Authority and Kenya Institute for Public Policy Research and Analysis (KIPPR). The Ministry further published the proposed Privacy and Data Protection Bill 2018 in August to elicit public comments. The essence of a data privacy and protection regime is to ensure that the rights of the data subjects are secured and guaranteed.



Export Development and Promotion Strategy to Promote Manufacturing

Kenya aims to transform the manufacturing sector from the 8.4% share of the country's wealth to 15% in the medium term. Illicit goods and services remain the biggest impediment for Kenya's realization of a healthy nation. The 2018 Trade Week and Exposition saw the launch of an aggressive *Integrated National Export Development and Promotion Strategy* that seeks to grow exports by 25% annually to achieve a trade surplus. One of the most ambitious policy frameworks since independence, it will see mobilization of more than Ksh 800 billion from trade, industry, agriculture, fish, livestock, mining, petroleum, handicrafts and services economic sectors.



Prospects of Banking Sector Charter to Financial Institutions

The coming into effect of the Kenya Banking Sector Charter 2018 introduces a number of measures aimed at enhancing fairness, transparency and accountability, financial literacy, and financial access whereby financial institutions should, among other measures, promote micro, small and medium enterprise (MSME) development through increased business loans towards this segment of enterprises financing by at least 20% by 2020. The National Assembly had a proposal to enhance lending to MSMEs. During the reading of the Finance Bill, Hon. Jude Njomo proposed a new clause 58A into the Finance Bill 2018 to introduce in Section 33C in the Banking Act requiring all banks or financial institutions to reserve at least 10% of loan portfolio for lending to small and medium scale enterprises. Hon. Njomo, however, later withdrew this proposal after consultations.



Coffee Faces Competition from Macadamia

Despite the government making attempts to turn around the returns of coffee farmers in central Kenya, the number of those replacing the bushes with macadamia trees is on the rise. This is spurred on by seemingly insatiable demands of a thriving nut export market, where farmers are benefiting from prompt payments and lucrative returns uncommon in the coffee sector. Macadamia nuts are also less labour-intensive compared to coffee.

Government efforts to revive the coffee sub-sector include: formation of a taskforce to look into the plight of farmers with a view to improving their earnings; a recommendation of a Ksh 478 million debt waiver for coffee farmers and their cooperatives; setting up of a Ksh 1.7 billion Stabex fund; and upgrading the Nairobi Coffee Exchange.



Securing a Sustainable Future for the Fisheries Sector

Globally, Seafood, including fish, is one of the most traded food commodities where 35% to 38% of the world production enters international trade channels, generating a value of US\$ 152 billion in 2017. Over 54% of this trade originates in developing countries. Additionally, the fishing sector is a source of livelihood for about 660 to 880 million people. However, there are concerns on sustainability due to the increasing pressure on wild stocks, mainly due to over-fishing, harmful fish subsidies, pollution, and the effects of climate change. All this results in an estimated economic loss of US\$ 83 billion per year for fisheries and over US\$ 6 billion per year from diseases in aquaculture. The main challenges of fish and seafood exports and imports are harmful subsidies and non-tariff measures. There are efforts by UNCTAD, UN Environment and FAO to support countries in intervention efforts at the multilateral level, and by way of national-level policy design and implementation.

Plans to end Human-Wildlife Conflicts in Taita Taveta County

Wildlife-human conflicts have become a norm in the Tsavo East and Tsavo West National Parks which occupy more than 63% of Taita Taveta County land. There has been loss of lives, crops mostly for smallholder farmers and livestock from wildlife attacks. There have been attempts by the national government to help address the issue, although the county government feels more needs to be done. Taita Taveta County government has started going around the county carrying out civic education aimed at giving the county residents an opportunity to petition the Senate and the National Government. The

petition will see the County demand that the two national parks be transformed into game reserves. The county is also seeking a substantial share of the billions collected from the parks, which should be channeled into the county for development.



Kenya's Bilateral Engagements

Kenya has strengthened its bilateral ties with friendly countries across the globe in the last three months. High profile leaders who visited Kenya in between July and September include South Korea's Prime Minister Lee Nak Yeon, Switzerland's President Alain Berset and Britain's Prime Minister Theresa May. Prime Minister Lee and President Kenyatta agreed to strengthen the partnership between Nairobi and Seoul especially in technology and the blue economy. The Korean Premier also said that his country was committed to Kenya's "Big Four" plan by enhancing manufacturing through transfer of skills. During the visit of the British Premier, the two countries signed agreements to ensure that duty-free quota for Kenyan goods continues even after Britain leaves the European Union in March 2019. President Kenyatta also signed an agreement with Britain's Prime Minister Theresa May to repatriate proceeds of corruption and crime hidden in Switzerland and Britain. It was the second agreement signed with a foreign jurisdiction to return proceeds of corruption and crime after Kenya signed another deal with Switzerland in June 2018, when the President of Switzerland, Alain Berset, was in the country.

President Kenyatta held bilateral talks with President Donald Trump during his official trip to Washington



Britain's Prime Minister Theresa May and Kenya's President Uhuru Kenyatta arrive to address a joint news conference at the State House in Nairobi, Kenya

in the last week of August. During the visit, the two leaders focused on the fight against terrorism, trade and investment. President Kenyatta also attended the Forum on China-Africa Cooperation (FOCAC) summit held on 3th and 4th September. At the sidelines of the summit, President Kenyatta and China's President Xi Jinping held bilateral talks in which they discussed the construction of the Phase 2B of the Standard Gauge Railway from Naivasha to Kisumu. The two leaders also witnessed the signing of an agreement on Economic and Investment Cooperation. They also witnessed the signing of the agreement within the Framework of the Belt and the Road initiative, which is being viewed as the major foreign policy signature of President Jinping.

Kenya Launches Campaign for UN Security Council Seat

Kenya has developed a plan and a strategy to campaign for non-permanent membership of the United Nations Security Council for the term 2021-2022. Elections will be held during the 74th session of the United Nations General Assembly in 2020. While approving the campaign for the Security Council seat, the Cabinet noted that the position will enhance Kenya's influence in international decision making particularly on peace and security matters across the globe, which will in turn benefit the country, Eastern African sub-region, Africa and the world at large. The UN Security Council is one of the most powerful organs of the UN and is mandated with the maintenance of international peace and security in accordance with chapters VI, VII, VIII and XII of the UN Charter. The membership of the UN Security Council includes five permanent members

(Britain, China, France, Russia and USA) and ten non-permanent members, of whom five are elected yearly. Previously, Kenya has been a non-permanent member of the UN Security Council twice in the years 1973-1974 and 1997-1998.



UN Security Council Session

Kenya Plans to Open More Diplomatic Missions

Kenya is set to expand its diplomatic representation in Africa to consolidate the country's Pan-Africanist foreign policy agenda. New resident missions will be opened in Maputo (Mozambique), Accra (Ghana), Abidjan (Ivory Coast), Dakar (Senegal), Rabat (Morocco) and Djibouti. Consulates will be established in Arusha (Tanzania), Goma (DRC), Cape Town (South Africa) and Lagos (Nigeria). Further, two liaison offices will be established in Kismayu (Somalia) and Hargeisa (Somaliland). The new

diplomatic missions in the continent will enable the country to expand its influence and realize its trade diplomacy objectives in Francophone and Lusophone Africa. The consulates will be critical for expanding trade diplomacy objectives in strategic cities outside capitals where full missions are situated. The consular missions will also serve Kenyans residing in those cities. Due to emerging importance of Asia in global trade and investment, a resident mission will be opened in Jakarta, Indonesia, consulate in Mumbai (India) and two other consulates in Guangzhou and Shanghai, China.

Current KIPPRA Research Projects

Corruption Perception Survey on Water Sector Trust Fund

KIPPRA undertook a survey on corruption perceptions, practices and mitigation measures for the Water Sector Trust Fund (WSTF) in nineteen (19) counties between September 23rd and October 20th. Respondents were drawn from WSTF management, staff and stakeholders. The findings of the survey will inform policy making in the fight against graft at the WSTF and provide a framework for improving governance in water resources management and service delivery.



KIPPRA-Wide Research Survey 2018/2019: Gender and Development

There is growing global attention to analyze key development issues with a focus on gender dimensions of interventions. This is driven by the knowledge that development decisions and practices do affect men, women, boys and girls differently. The KIPPRA-wide research survey on gender and development aims at evaluating the economic, social, political and institutional constraints that maintain gender disparities in Kenya. The survey seeks to establish the linkages between gender programmes and Kenya's overall development agenda, including the "Big Four" agenda, the sustainable development goals (SDGs), and Agenda 2063. The output from this research is intended to inform policy and will also be disseminated in a conference in June 2019.

Sustaining Momentum in Achieving the Kenya Vision 2030

KIPPRA has embarked on a study that reviews the implementation of Kenya's Vision 2030 to identify emerging issues, gaps and challenges. Other objectives of the study are to: review the development and growth paradigm adopted and structures put in place to support the Vision's implementation; assess the coordination mechanisms and frameworks across the governance mechanisms; and propose a growth path to getting the per capita income growth required to attain an upper middle-income country status by the year 2030. The study approach is consultative, and its results will be disseminated in 2019.

Study on Economic Inclusion of Young People through Inclusive Entrepreneurship

Three think tanks, namely, KIPPRA, the Economic Policy Analysis Unit or CIRES (CAPEC) of Cote d'Ivoire, and the Laboratory of Quantitative Analysis Applied to Development – SAHEL (LAQAD-S) in Burkina Faso are collaborating in the realization of a three-year project funded by IDRC and managed

by CAPEC. The project's overall objective is to analyze the contribution of inclusive entrepreneurship to young people and women's well-being. The findings are expected to provide useful insights that will guide implementation and support mechanisms of inclusive entrepreneurship while maximizing its impact on vulnerable groups, including women and youth.

An Assessment of Inclusive Business Practices in Kenya

On 12th September 2018, KIPPRA held the second stakeholders' workshop to disseminate and discuss preliminary findings of a pre-assessment survey on inclusive business practices in Kenya. The aim was to get feedback from firms that have integrated inclusive business practices in their operations. The concept of Inclusive Business (IB) entails the practice by firms to integrate economically-excluded segments of the population into their business strategies/models. It not only seeks to improve access to quality and affordable products and services, generate income and livelihood opportunities for the bottom of the pyramid (BoP) population, but also boost firm's productivity. Inclusive growth has increasingly become an important policy issue, as emphasized in development agenda such as Sustainable Development Goal (SDG) 8, AU Agenda 2063, Kenya Vision 2030 and the "Big Four" agenda. Some of the feedback from the participants included

suggestions of firms to be included in the next phase of assessment such as those in the textile sector. A number of participants also emphasized the need for the government to give incentives to encourage firms to adopt inclusive business practices.



KIPPRA Policy Analyst Anne Gitonga speaks at the forum

KIPPRA researcher Juliana Mbithi makes a presentation

KIPPRA researcher, Hannah Wang'ombe, makes a contribution to the discussion



Participants at the workshop

Successful Launch of KIPPRA Mentorship Programme for Universities

On 30th August 2018, KIPPRA launched the Mentorship Programme for Universities (KMPUs) at Strathmore University. KMPUs is one of KIPPRA's capacity development programmes aimed at revamping intellectual exchanges on public



KIPPRA Board Chair Dr. Linda Musumba addresses the forum



Treasury and Planning PS Dr. Julius Muia was the chief guest at the launch



Vision 2030 Delivery Secretariat Chair Dr. James Mwangi speaks during the launch



Official launch of the programme

policy among policy makers and the university community. The KMPUs will also play a pivotal role in sensitizing university students and lecturers on government agenda and public policy process. The role of public participation in the public policy process and in the achievement of Kenya's development goals and particularly the "Big Four" agenda was emphasized. The youth and academia were particularly challenged to come up with innovations that can address current policy challenges facing the country and aid in the achievement of the "Big Four" agenda. The launch marks the beginning of a series of KMPUs forums to be held in other counties. The programme will also be rolled out to universities outside Nairobi.



Participants during the launch

Leather and Leather Products Roundtable

On 5th July 2018, KIPPRA hosted a roundtable on *Revitalizing Leather and Leather Products in Kenya*. The aim of the roundtable was to share the preliminary results of a leather and leather products study conducted in 14 counties between 7th and 18th May this year. The forum was, therefore, meant to trigger discussion among stakeholders on how the potential of the sub-sector could be exploited to realize the objectives of the manufacturing sector as stipulated in Vision 2030, Medium Term Plan III, Special Economic Zone Act and the "Big Four" agenda. The preliminary findings indicate that leather contributes 2 per cent to the country's Gross Domestic Product (GDP).

Key issues brought out at the workshop include competitiveness, value addition, incentives along the value chains, investment opportunities and constraints and challenges in the sub-sector. It was noted that there is need to train farmers and butchers on proper handling of animals as well as the hides and skins to ensure maintenance of quality. Some participants also pointed out the importance of developing and enforcing standards to ensure and maintain high quality of Kenyan leather and leather products.



Discussions at the workshop



Head of Trade & Foreign Policy Department Dr Christopher Onyango addresses the forum



Plenary discussions at the workshop



KIPPRA Executive Director Dr Rose Ngugi during the workshop

ABOUT KIPPRA

The Kenya Institute for Public Policy Research and Analysis (KIPPRA) is an autonomous institute whose primary mission is to conduct public policy research leading to policy advice. KIPPRA's mission is to produce consistently high-quality analysis of key issues of public policy and to contribute to the achievement of national long-term development objectives by positively influencing the decision making process. These goals are met through effective dissemination of recommendations resulting from analysis and by training policy analysts in the public and private sectors. KIPPRA therefore produces a body of well-researched and documented information on public policy, and in the process assists in formulating long-term strategic perspectives. KIPPRA serves as a centralized source from which the Government and the private sector may obtain information and advice on public policy issues.

KIPPRA acknowledges generous support from the Government of Kenya and the Think Tank Initiative (TTI) of IDRC. The TTI is a collaborative initiative of Hewlett Foundation, International Development Research Centre (IDRC) and other partners. Other organizations are welcome to contribute to KIPPRA research either as core support, or support to specific projects, by contacting the Executive Director, KIPPRA.

Send to us your comments on the articles published in this newsletter and any other aspects that may help to make the *KIPPRA Policy Monitor* useful to you. This may include policy issues you would like KIPPRA to prioritize.



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