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Setting the Agenda for Economic Recovery in the Third Republic

1. Introduction

Kenya's First Republic was largely a mixed economy. The main features included substantial government involvement in many sectors of the economy, proliferation of state enterprises, subsidies to ensure continuous operation of some of the inefficient state corporations, and general controls of prices of goods and services. The state was involved in the direct production and distribution of goods and services. The operative mechanism was one of state planning of the economy with five-year development planning periods. The yearly budgetary process was then used as the implementing tool of the development plans.

The Second Republic continued with much the same principles until the introduction of Structural Adjustment Programmes (SAPs) and other reforms in mid 1980s. There was significant paradigm shift to a more market-oriented economic regime. Aspects of free market initiatives and incentives were gradually incorporated in subsequent Development Plans. Since then, a major feature of the country's five year Development Plans has been a provision for facilitative guidelines and frameworks that encourage the operations of a market-based economy.

Despite these efforts, Kenya's economy performed poorly in the last 20 years as demonstrated by declining GDP, worsening poverty levels, huge public debt, painful unemployment, economic stagnation, etc. The poor performance can be blamed on poor governance, a bloated and inefficient public sector, uncoordinated planning and budgeting, and a huge domestic debt portfolio relative to GDP.

In anticipation of a new political dispensation in the Third Republic, the Institute of Policy Analysis and Research (IPAR) hosted an economic policy conference in November 2002, to inform the search for a forward-looking and adaptive development strategy. The conference explored opportunities of increasing productivity in various lead sectors, which would eventually spur economic growth and considerably reduce poverty levels.

The conference was meant to intimate the campaign agenda of political actors, provide building blocks for engineering national consensus on economic recovery targets and strategies, and form a basis for scrutinizing the delivery of political promises and commitments. Participants were drawn from Government Ministries and Parastatals, Civil Society, Private Sector, Media and our development partners.

Arising from the conference is the urgent need for the Third Republic to move away from conservative and reactive policy positions affecting critical economic sectors and focus on anticipatory medium and long-term strategizing. Kenya's situation requires a renewed commitment to spurring development based on a number of lead sectors. On the domestic front, this includes revitalizing agriculture and industry and maximizing the country's potential to become the regional services hub in banking, information and transportation. Addressing poverty and governance norms is also critical.

2. Banking and Finance

Nairobi has the greatest potential of becoming a regional financial centre in East Africa. Currently, Kenya has 46 commercial banks with a customer base estimated at 1.65 million. It has the best-developed financial markets in the region and a vibrant stock exchange. The country also has the largest and best-developed banking sector with a deposit base of KSh. 346 billion, compared to KSh. 100 billion and KSh. 80 billion in Tanzania and Uganda, respectively. The sector has a wide product range in a sophisticated market, supported by a good skills base. High borrowing costs and inaccessibility to credit by smallholders are the main problems in Kenya's banking and financial sector. The wide gap between lending and deposit rates, which has resulted in a large number of non-performing loans, is another major problem.

Recommendations

There is need to improve access to credit by entrepreneurs in both rural and urban areas, especially for small operators. Bank interest rates should be kept at economically sustainable levels. Closer linkages should also be established between the Treasury and the Central Bank, with the aim of formulating and implementing policies that can benefit the industry and the region. A super regulatory body should be established to oversee the sector. Legislation should be harmonised to ensure fair implementation.

3. Information & Communications Technology (ICT)

The sector has recorded phenomenal growth all over the world. In Kenya, these developments have had a notable impact on other sectors such as manufacturing, transport, and the public sector. The ICT sector offers services in outsourcing, ICT education and training, software development, and ICT systems design, development and integration.

Recommendations

The strengths and opportunities of the ICT sector lie in the skills and expertise available in the country. The main thrust of the sector should be to transform the country into a regional centre of excellence. This will require enabling interventions and investments in various areas including deregulation of the telecommunications sector and allowing for an Internet gateway and appropriate infrastructure. Standardization of ICT training and education is also necessary. Application of ICT in the form of e-services, e-commerce and e-government should also be encouraged. Efficient legal structures and dispute resolution mechanisms need to be put in place. Particular attention should be paid to anti-piracy laws.

More importantly, developments in ICT should be encouraged in all sectors to enable the economy to move together with the global economy. The review of the ICT policy should include stakeholder contributions. Participation in regional and international ICT fora is necessary in order to keep abreast with the changing technologies. It is also necessary to give recognition to such other media of communication and information transfer as broadcasting, postal and courier services.

4. The Transport Sector

Kenya's transport sector comprises water, road, air, rail and pipeline transport. The Port of Mombasa is located on a "maritime superhighway" mid-point between north and south, and east and west. The road network consists of 63,000km of classified network connecting the country to Uganda, Rwanda, Burundi and parts of northern Tanzania, Ethiopia and the Democratic Republic of Congo. Air transport comprises the Jomo Kenyatta, Moi and Eldoret International airports all of which are capable of handling over three million passengers and 200,000 tons of cargo. The flight time to most African, European or Middle Eastern destinations is not more than 8 hours. Kenya's airports are strategically located to become regional transit points. However, this is yet to be fully

exploited and can form a strategic basis of economic recovery. The rail transport has a 2050km long metric gauge single track with connections to Uganda and northern Tanzania. The pipeline transport, on the other hand, is currently moving nearly 3 million cubic metres of petroleum products to the land-locked countries of Uganda, Rwanda and Burundi.

About 70 percent of world trade is currently being carried out by sea. The Port of Mombasa is the gateway to eastern and central Africa, but its level of development is still very low, handling ships with an average capacity of 500-600 containers. Larger ships carrying up to 8,000-12,000 containers cannot dock at the port. In addition, cargo handling at Mombasa port is still very inefficient, thereby discouraging its use by the hinterland countries such as Uganda, Rwanda, Burundi and the Democratic Republic of Congo, as well as potential markets in Ethiopia and Sudan.

Recommendations

For Kenya to create an enabling environment and realize this phenomenal potential, several developments should be undertaken. A dual carriageway should be built between Mombasa and Malaba, and between Namanga and Moyale. The capacity at Kilindini harbour should be doubled. A Free Trade Zone should be created and a cruise terminal developed, preferably through public and private sector collaboration. A negotiated portion of the Fuel Levy should be allocated to the improvement of rail infrastructure and extension of the railhead between Kitale and Sudan, and between Nanyuki and Moyale. Streamlining of business and customs procedures will also be necessary.

Measures that should be undertaken include the expansion and modernization of the Port of Mombasa in order to improve efficiency in cargo handling. There is need to build a dual, electrified and re-gauged Mombasa-Malaba railway line. Modernization of the international airports

in Kenya, particularly Jomo Kenyatta International Airport, is necessary. It is also crucial to extend the pipeline to Uganda to ease pressure on the road network.

5. Reviving the Rural Economy

The absolute poor constitute about 56 percent of Kenya's population. Of these, 80 percent live below the poverty line, i.e. on less than a dollar a day. Indeed, statistics show that the incidence of poverty in Kenya increased between 1992 and 1997 from 46 to 52 percent for rural populations and 29 to 49 percent for urban populations.

Income inequalities are closely associated with problems relating to natural and market endowments, property rights, market entitlements (accessibility, infrastructure, etc), socio-economic opportunities (access to education and health facilities), increasing crime and a climate of fear. Law enforcement is lop-sided, especially with regard to security in rural areas as compared with the urban. The problems facing rural development are diverse and multi-sectoral in nature. The wide income disparity between the rich and the poor has led to the rising numbers of people falling below the poverty line. There are sharp regional and gender differences in income distribution that need thoughtful redress.

Recommendations

Policy remedies should clearly incorporate short, medium and long-term poverty reduction measures. These should address ownership and use of productive assets and technology, micro-finance credit, appropriate production and transport technology and investments in infrastructure (e.g. water, energy, communications). The remedies should also ensure free primary education and basic health cover insurance for all citizens. They should also address basic food security issues and property rights.

The poverty reduction efforts should incorporate broad-based participation by civil society and private sector acknowledging the multi-dimensional nature of poverty.

As such, roles of various actors in the rural economy should be redefined to enhance complementarity and minimize duplication of effort(s).

The government also needs to tactfully address issues of governance and income distribution. A review of land policy should be undertaken with the aim of reducing settlement on agricultural land. The possibility of re-settling the rural population in some designated settlement centers and leaving ample land purely for agricultural production should be explored. Economic utilization of idle land through property taxes needs to be encouraged. There is need to develop education services to both attract foreign students and reduce the need for local students to seek education in other countries. Ways of attracting foreign investment in rural development should also be devised.

6. Governance Issues

Kenya lags behind in development partly due to poor governance. The entrenchment of political patronage and the accompanying rewarding of mediocrity has led to employment of unqualified individuals in crucial positions within the public service. As such, it has been argued that poverty in the country is not due to lack of resources, but rather ineffective resource utilization and management. The situation has been further compounded by poor role modeling in governance and the promotion of systems that reward corruption, best exemplified by financial indiscipline and lack of accountability in public office.

Recommendations

For Kenya to develop as a regional services hub, there is great need for improving transparency and reducing costs of doing business. Insecurity should be addressed through a thorough restructuring and depoliticizing of the police/security machinery and providing it with adequate resources. Corruption could be reduced through enhanced

incentive structures and a well articulated code of ethics. Measures to restore investor confidence in the economy need to be instituted urgently. There is also need to initiate “moral rearmament” and a legal framework that increases the cost of corruption. Devolution of power to lower levels and popular participation at all levels should be facilitated. Improvement of civil service management, emphasizing transparent and meritorious recruitment practices is crucial.

For detailed discussion of the issues contained in this Brief, refer to the Report of the IPAR Annual Conference: **Setting the Agenda for Economic Recovery in the Third Republic** held on 26th November, 2002 at Norfolk Hotel, Nairobi. This Report will be available on our website (<http://www.ipar.or.ke>) from February, 2003.