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KENYA'S AGENDA FOR ACTION

Commercial Legal and Institutional Reform
Diagnostic of Kenya's Business Environment

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June 2009

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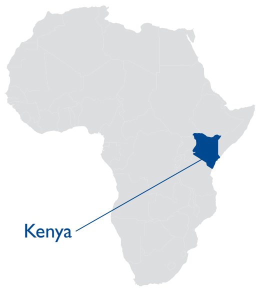


INTRODUCTION

This report addresses the legal and institutional conditions underlying economic development in Kenya, as well as opportunities for supporting stronger, more broad-based economic growth. Through examination of relevant laws, institutions, and social dynamics, it aims to inform decisions of the United States Agency for International Development (USAID) and other donors that relate to legal and institutional reforms affecting Kenyan businesses. This report also provides insight and guidance concerning economic development for government officials, private sector representatives, and others. Detailed recommendations are included at the end of each chapter.

KENYA'S CRISIS IN LEADERSHIP: THE NEED FOR PRIVATE ENGAGEMENT

For more than a year following its troubled 2007 presidential election and its February 2008 formation of a coalition government, political stresses in Kenya have persisted, placing its economy in unenviable circumstances. The country is constrained by outdated laws and chaotic, dysfunctional courts, hampered by deficient infrastructure and bureaucratic systems that undermine small business and the agriculture sector disproportionately, and beholden to virtually unchecked corruption. Kenya's endowment of geography, beauty, bounty, and a capable populace has been neglected by those who, in relatively short order, could transform it into abundant opportunities for all Kenyans, including the 21 million who live on less than $2 per day.[1] In the immediate future, the strongest hope for meaningful reform lies with Kenya's private and nongovernmental actors. Without the continued persistence of individual businesses and business associations, NGOs, lawyers, academics, the media, and others, the way forward will continue to be obstructed by politics.

As of spring 2009, the private sector faces a unique opportunity to lead, one that builds on its post-election role in driving the country away from the precipice of civil war. At least in part, the private sector has the capacity to help fill gaps left by lawmakers in a variety of ways. The private sector could help new businesses navigate tangled regulatory conditions, access finance, and get training in much-needed skills. It could insist on continued law and court reform. And it could mount a collective, committed resistance to corruption. For those courageous politicians and government officials who are willing to step away from the country's festering system of spoils, there are also manifold opportunities to lead. As the table on this page illustrates, East African countries need not be victims of the global recession if, like Tanzania, they persist in their pro-growth economic reform efforts and attacks on official corruption.[2] Even where, as in Kenya, government "corruption and mismanagement is rife,"[3] enormous opportunities await those who responsibly and creatively grasp for them.

OPPORTUNITIES LOST: A COMPARISON OF REAL GDP GROWTH RATES IN KENYA AND TANZANIA

Year	Kenya	Tanzania
2004	1.5	5.2
2005	2.2	5.8
2006	5.8	6.8
2007	4.1	5.8
2008	2.2	7.1

Fortunately, Kenya has not fallen entirely behind in its goal to become a middle-income country over the next generation, a target set forth in its

1 Unless identified otherwise, statistics cited in this report are drawn from a number of sources, including the Economist Intelligence Unit (EIU) Country Profile (2008), the CIA's online World Factbook (2008), the OECD's Africa Economic Outlook (2007), and other publications external to Kenya, which themselves draw most of their data from international sources or the Kenyan government's own surveys. Given limitations in domestic information gathering, most figures cannot be said to be exact, but they do represent best estimates as accepted by the international community.

2 For a similar report addressing business climate legal and institutional reform issues in Tanzania, see the USAID/BizCLIR website, www.bizclir.com.

3 The Economist, "Next machetes, then machineguns?" March 12, 2009.

2007 blueprint for development, entitled *Vision 2030.* In recent years, some reforms that support future economic development have taken place. These include a strengthened system of tax collection, a number of administrative fixes in international trade, considerably improved access to finance, and some streamlining of business licensing and regulation. It is also widely agreed that the city of Nairobi is a cleaner, safer, and more attractive destination—both for tourists and investors—than it was just a few years ago. Moreover, a public-private initiative to bring an undersea system of fiber-optic cables to East Africa promises to enable the creation of many technology-oriented jobs and businesses, if not in 2009, then likely next year.[4]

Kenya's commitment to education has deepened. Efforts to improve access to education have greatly taxed the public schools in recent years. However, the removal of all primary school fees in 2003 and the more recent reduction in secondary school fees represent an important commitment to Kenya's regional advantages in literacy, educational attainment, and workforce capacity. Higher education in Kenya, though challenged by rising costs and distracted politicians, is also one of the country's key strengths relative to other countries in the region. Continued commitment to building a highly skilled professional class is important for implementation of sophisticated economic reforms.[5]

Drawn from a diagnostic process described later in this Introduction, this report examines the environment for growing the private sector in Kenya. It also identifies opportunities that can stimulate the country's reform efforts so that, ultimately, Kenya's vast poverty can be reduced. Many of these opportunities require government reforms, but, as noted, where the government fails to act, there remains room for private initiative. Generally tracking the major areas covered by the World Bank's annual *Doing Business* initiative,[6] this report reviews the legal frameworks, numerous public and private institutions, and social dynamics underlying conditions for reform. Based on its findings, a variety of recommendations are made.

SUMMARY OF DIAGNOSTIC FINDINGS

The combined quantitative and qualitative aspects of this diagnostic found that Taxation is, overall, the strongest of the areas studied, while Enforcing Contracts is the weakest. Moreover, the diagnostic identified the legal frameworks underlying the areas studied as better off than the other aspects considered, with the public implementing institutions found to be in the poorest shape.

STARTING A BUSINESS

The mechanics of joining the formal economy through registration with the central government of Kenya have been streamlined recently, and will be further adjusted with the enactment of the Companies Bill. However, the only place formal registration may take place is in Nairobi, presenting a particular disadvantage to micro, small and medium-sized enterprises (MSMEs) located outside of the capital. Moreover, notwithstanding the Company Registry's clearly posted and straightforward formal procedures, businesses typically find that bribes to registry officials make the process move faster. One significant disincentive to registration is the application of the Value Added Tax, which, at 16%, is prohibitively high. Registration with the national Company Registry is not the only formal aspect of business-start up; all businesses are also required to obtain, on an annual basis, a Single Business Permit from their local authorities. Although in some regions that process runs smoothly, in others it becomes mired in bureaucracy, corruption, and delay.

DEALING WITH LICENSES

In recent years, Kenya has taken steps toward streamlining systems for business licensing and regulation, eliminating or simplifying more than 600 license requirements in 2007. However, the consensus of businesses interviewed for this diagnostic is that licensing reform has lost its momentum. Although efforts to enact a Business

4 *See* McKinsey & Co., *BPO&O in Kenya: Updating the Value Proposition and Developing a Marketing Plan* (Pre-Read document, February 23, 2009).

5 As noted in a recent report that underscores the vital relationship between higher education and economic development, university education supplies "the human capital that in turn builds the very institutions that are regarded as an indispensable factor of development—the accountants, doctors, engineers, lawyers, teachers—that comprise the middle class." Devesh Capur and Megan Crowley, *Beyond the ABCs: Higher Education and Developing Countries,* Center for Global Development Working Paper 139 (February 2008), at 4–5.

6 *See generally,* World Bank, *Doing Business 2009* (2008), and accompanying literature at www.DoingBusiness.org.

Regulation Bill and create an "e-registry" of licenses continue, progress is slow and public awareness is low. Moreover, businesses strongly assert that national regulatory reform has not impacted the opaque and poorly administered requirements put upon them by local authorities. MSMEs are particularly disadvantaged by dysfunction and impunity in local government regimes. Against this backdrop of stagnant government reform is a vital opportunity for nongovernmental actors to do more to support their own interests. Business organizations, NGOs, and the media can expose fraud and abuse in government institutions by promoting awareness of the licensing environment.

COMPETITION AND CONSUMER PROTECTION

Kenya lacks well-conceived competition and consumer protection policies, laws, and practices. First, it is unclear whether the purpose of Kenya's competition law is to protect the competitive process, protect individual competitors, or promote other social goals. Second, the law's provisions are often confusing or inconsistent with international best practice, thereby creating legal uncertainty for businesses and making enforcement difficult. Third, there is no competition advocacy mandate in the law to provide a check on, among other things, overly restrictive governmental regulations. Finally, Kenya lacks an overarching consumer protection law, thus leaving its consumers unnecessarily exposed to false and misleading information. Consequently, Kenya's competition and consumer protection laws and policies need serious review and revision.

EMPLOYING WORKERS

Kenya's significantly revised regime of labor laws, hastily enacted in 2007, has been slow to take effect due to employer objections over new restrictions that will likely drive up the cost of doing business. Definitively resolving these issues before the end of 2009 should be a major priority of the government. If the issues are not resolved, domestic and foreign investment will be undermined. In addition, economic development initiatives should do more to anticipate and incorporate critical workforce issues, including the readiness of Kenyan workers to meet the priorities of *Vision 2030*. This includes, in particular, a readiness to meet growing needs in technology and services. Finally, issues of social security have long been neglected in Kenya, with enforcement of existing laws tied up in government ambivalence over formalization of enterprises, formalization of work, and legislative reform. This, too, adds to the uncertainty of the business environment for potential entrepreneurs and investors.

REGISTERING PROPERTY

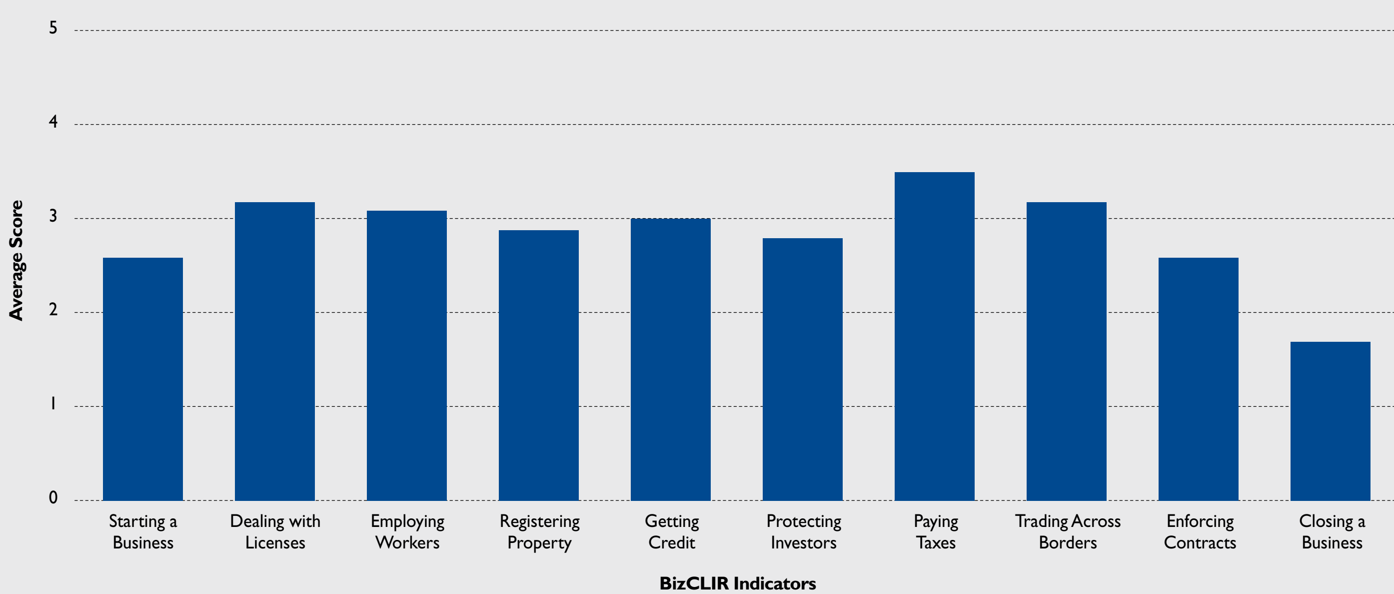
Real property. Kenya's National Land Policy has been under development since 2004, with the draft only recently submitted to the Council of Ministers for official review. The speed of deliberation has been appropriate and exemplary, as the process has incorporated a high level of participation across a representative cross-section of stakeholders, thus providing a basis for consensus-building on a range of controversial issues. Once the policy—which covers public, community, and private land—is settled, it will be possible and necessary to replace the existing tangle of separate laws with a coherent, overarching land law to reflect the policy. Much of the groundwork of legislative drafting can be done in parallel with policy development and finalization, so a new law can be proposed shortly after the policy is adopted. This work should begin now. Likewise, the final policy and accompanying legal changes will require extensive public education and awareness campaigns. Production of materials and messages can begin now. Although the land policy can provide the basis for new land laws, separate work is needed to establish a policy on land *use*. Land use policy is needed as part of the national development agenda. Such a policy is vitally important to the resolution of ownership issues because use restrictions have direct impact on the development of land for residential, commercial and agricultural purposes. Consequently, it is appropriate to begin a land use policy development program as soon as capacity and resources are available.

Intellectual property. There is far too little awareness in Kenya of the damaging impact of Intellectual Property Rights (IPR) violations. Local pharmaceuticals experts report that counterfeit anti-malaria medications are reducing the effectiveness of legitimate drugs by accelerating resistance to treatment: medicines that should be effective for five years are becoming ineffective after only two years. Moreover, lack of public awareness about the benefits of IPR protections causes many Kenyan entrepreneurs and inventors to forego those benefits, including both local and international sales and revenues that can come from new products, works, and designs. Industry leaders feel that there is a poor understanding of IPR among government officials who should be pursuing more effective enforcement and protection regimes. Although the new Anti-Counterfeit Law suggests an improved level of government support for IPR issues, widespread ignorance regarding the importance of this and other IPR legislation, unless addressed, will undermine implementation and enforcement of the new law.

GETTING CREDIT

In many ways, the recent history of access to finance represents a "good news story" for Kenya. Private financial institutions are growing, competing, innovating, and expanding into areas previously viewed as "unbankable." Though access to financial services, especially in rural areas, remains a key issue in Kenya, the recent expansion is encouraging. Notwithstanding these advances, success in the financial sector appears to have taken place *in spite* of the business enabling environment, rather than as a *result* of it. First, credit information remains weak. Second, though laws support collateralized lending, the registries for security interests in property (land, chattel, motor vehicle, or securities) are paper-based systems which are time-consuming to use. The cumbersome registries add time and costs to the lending process. Finally, the commercial courts are not an efficient and transparent

INDICATOR SCORE COMPARISONS



arbiter of disputes relating to finance. A great number of steps can be taken to improve the environment for accessing finance in Kenya.

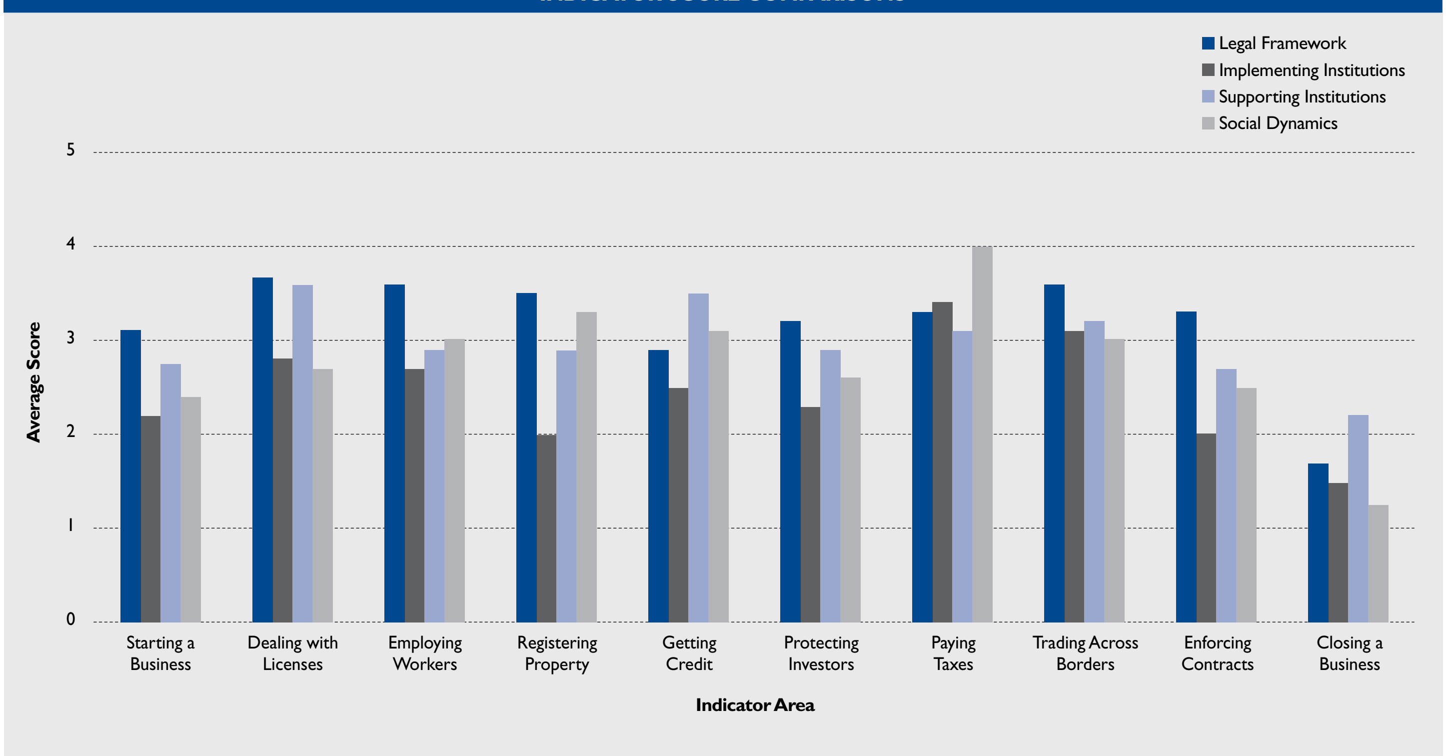
PROTECTING INVESTORS

Kenya has benefited in recent years from growing investor interest in Africa because of the country's strategic location, stability, and level of advancement. Violence following the 2007 election, however, sparked investors' fears and uncertainty, and the global financial crisis and food crisis have further caused investors to hedge their bets. Corruption within the business community and the government have had an impact as well, and the country's weak corporate governance culture has contributed to recent scandals. Kenya has also suffered from the trend of consolidation in multinational companies. In recent years, several major companies have shut down processing operations or reduced production lines in Kenya as they rely on fewer production locations. If Kenya continues to have uncompetitive business costs, this trend will continue. Kenya now faces a crossroads. It can take advantage of its regional appeal and strategic position by taking real steps toward improving the business environment. Or, it can squander its opportunities and watch as increased security risks and corruption cause investors to consider neighboring countries that have taken more effective steps lately to improve their investment appeal.

PAYING TAXES

The perceptions of Kenyan taxpayers toward their system of tax collection have been improving in recent years, as the Kenya Revenue Authority (KRA) has embarked upon a program designed to increase the fairness of the system and improve the efficiency of its operations. Although the KRA can indeed be considered progressive, committed, professional, and technically advanced, it still falls short of meeting international best practice in many areas. Implementation of a number of specific reforms identified in this report can instill greater confidence in the system of taxation, thereby resulting in greater taxpayer participation, and, ultimately, increased revenue collection.

INDICATOR SCORE COMPARISONS



TRADING ACROSS BORDERS

Trade facilitation. Road, rail, and port improvements alone will not increase the competitive position of Kenya or its EAC neighbors. Border processes—a critical complement to such reforms—must be harmonized, simplified, and automated. Estimates are that 40 percent of transport costs are attributable to these "soft" infrastructure issues. Kenya's border processes are generally predictable and transparent, and various administrative improvements have been made. But the pace of reform has been slow, and modern border processes are not yet institutionalized. Perhaps most importantly, Kenya lacks a comprehensive trade facilitation strategy that is properly sequenced, provides measurable goals and accountability, and includes all public border institutions.

Trade policy. In recent years, Kenya has enhanced its trade potential by incorporating international and regional agreements into its legal and regulatory frameworks and by creating or strengthening a variety of institutions charged with implementing these agreements. The country is a founding member of the World Trade Organization (WTO), a charter member of the East African Community (EAC), and an active member of Common Market for Eastern and Southern Africa (COMESA). In 2005, Kenya took the significant step of establishing an EAC Customs Union along with Uganda and Tanzania. Rwanda and Burundi joined in June 2007. Kenya adopted the EAC Common External Tariff (CET), replacing a four-band tariff structure with a simplified three-band tariff structure of 0, 10, and 25 percent. Recently, Kenya has joined the effort to integrate the EAC with COMESA with a goal to eliminate the agreements' redundancies, an initiative that will take considerable dedication, coordination, and follow-through.

ENFORCING CONTRACTS

Judicial proceedings in Kenya are notoriously slow. This poses a significant impediment to Kenyan economic development because it operates as a barrier to investment in the country and prevents the prompt resolution of commercial disputes for litigants, leaving them unable to deploy their assets in an efficient manner. There are four principal reasons for this situation: an inadequate number of judges and magistrates; low compensation for magistrates and court staff; adherence to internal operating systems which have gradually become dysfunctional; and a legal culture that tolerates delay.

CROSS-CUTTING THEMES

MICRO, SMALL AND MEDIUM-SIZED ENTERPRISES: VULNERABLE AND LEFT BEHIND

Kenya has many natural advantages that allow larger businesses and industries, notwithstanding the challenges of the business environment, to endure. As long as there is peace, there will be tourists at national parks, trade out of the port of Mombasa, and large companies engaged in facilitating both sectors. Larger businesses also have the advantage of influence: companies that are perceived as individually important to the economy—those that have multinational ties, employ many people, or otherwise bring growth or new opportunity to the country—can attract the attention of Kenya's leaders, even without engaging the country's notorious systems of graft. Thus, much room exists for improvement in the business environment to support larger enterprise, the advantage of size and power is always on the side of the larger companies.

The vast majority of Kenya's businesses do not have those advantages. MSMEs—those with 1 to 200 employees—are far less able to individually influence political reform and do not have luxury of overriding the petty demands of small government actors. This diagnostic found that their concerns are often ignored or obscured by an inattentive government. Examples identified in this report include:

- As noted above, the only place to formally register a company is at the Company Registry in Nairobi. Smaller businesses located outside the capital are disadvantaged by the costs of travel, including working time lost. The costs of registering are among the many incentives to remain informal.

- MSMEs are vastly over-burdened by the country's regulatory environment, particularly by the numerous licenses and permits that are required at the local level. The absence of a customer-service orientation within most local authorities means that MSMEs do not get the assistance for complying that they often need.
- Various ministries are charged with supporting MSMEs at the national level, but no lead agency exists, and little coordination occurs among them.
- The VAT, at 16 percent, is prohibitively high for MSMEs. Moreover, taxpayers and tax professionals agree that corruption especially affects small and medium taxpayers as they are less able than the larger companies to escape the call for informal "facilitation" money.
- The high transaction costs in registering collateral mean that banks are less inclined to loan money to MSMEs, which typically seek smaller loans than those sought by larger customers.

There are many dimensions to the challenge of strengthening conditions for Kenya's MSMEs. The organizations that represent their interests—including the Kenya Private Sector Alliance, Kenya Association of Manufacturers, and Federation of Kenyan Employers—are relatively strong, but they face the added demands to address needs that the government is neglecting.

OBSTACLES TO IMPLEMENTATION OF REFORMS

A pervasive perception exists in Kenya, especially since the formation in 2008 of the coalition government, that talk of reform is just idle rhetoric. Throughout this diagnostic, interviewees explained how reforms currently underway in Kenya are falling short due to a variety of obstacles, including:

- Legislative change is the cornerstone of many necessary reforms in trade, social security, competition, consumer protection, broad-based licensing reform, and various other topics addressed in this report. Although it is true that legislative reform takes time—laws proposed and enacted without meaningful stakeholder input have little chance of success—the clock has not even begun ticking on certain critical reforms because they lack parliamentary champions who have the will to move forward.
- Existing reform initiatives on several fronts incorporate few quantifiable objectives and thus would allow little accountability during implementation. A welcome initiative, the Prime Minister's Roundtable, gave hope in 2008 of commitment at the highest levels to listening to and addressing private sector concerns. Lately, however, many business participants see the effort as "more talk." Similarly, important trade facilitation objectives carry with them good intentions, but have an absence of quantifiable benchmarks that would allow accountability during implementation.
- Existing initiatives are also poorly communicated to the business community and public at large. For example, the government's commitment to licensing reform does not yet fully engage the private sector, so businesses remain generally unaware of plans to streamline the licensing environment. Also, while KenInvest, Kenya's semiautonomous investment promotion agency, offers useful services and information to prospective new businesses, its resources are largely unknown in the investment community.
- Existing reform initiatives are too slow. Regulations to accompany Kenya's new credit reference bureaus took 10 years to be formally issued.
- Implementation of certain reforms—in particular, those entailed in *Vision 2030*—is not yet adequately centered on preparing the workforce for changes to come. For example, curricula at professional schools and vocational institutions do not anticipate changes on the employment horizon, such as the need for a more sophisticated understanding of intellectual property or

- workers who are ready to service business process outsourcing facilities.
- Without whole-scale reform of Kenya's courts, various improvements in access to finance, real property rights and intellectual property, among other areas, will be severely limited.

Opportunities for reform are widely understood in Kenya, and many have been underway for some time. However, removing obstacles to their implementation should be a key priority.

CORRUPTION IN THE NEIGHBORHOOD: HOW KENYA FARES RELATIVE TO ITS NEIGHBORS IN THE CORRUPTION PERCEPTION INDEX (180 COUNTRIES SURVEYED)

Country	World Bank Ranking	Score
Burundi	159	1.9
Kenya	**147**	**2.1**
Rwanda	102	3
Tanzania	102	3
Uganda	126	2.6
Ghana	*67*	*3.9*
Nigeria	*121*	*2.7*
South Africa	*54*	*4.9*

Source: Transparency International, *Corruption Perception Index (2008).* Scored on a scale of 1 to 10, with 10 being best (perceived as the least corrupt).

A CRISIS IN GOVERNANCE

Perceptions of corruption in Kenya are remarkably high: the country ranks 147th out of 180 countries surveyed in the most recent Corruption Perceptions Index issued by Transparency International.[7] Within the EAC, only Burundi ranks worse. Deep within so many of Kenya's institutions—ministries, city and municipal councils, registries, procurement offices, banks, and others—petty transaction fees persist and, as a result, so does a pervasive lack of trust in government. This has bred deep cynicism and a resigned complicity on behalf of the users of public services. For the most part, the average citizen or businessperson cannot even think of launching an enterprise or trade-related activity without paying a series of informal fees.

Kenya's failure to fight corruption is illustrated by the following examples:

- A recent survey of the East African Business Council found that Kenya is the EAC country where new businesses are *most* likely to have to pay a bribe in the business start-up process. Bribes are paid nearly 34 percent of the time.[8]
- Public officials are not required to file annual, verifiable statements of their wealth. Thus, Kenya lacks key information about the possible use of government funds for personal enrichment.
- Corruption among loan officers is a widely reported problem. Loan officers, for example, are known to delay applications until a speed payment is made by the borrower.
- Corruption is a particularly serious issue in the preparation of government tenders, especially in the construction industry.
- Due to extreme backlogs in the court system and the reliance of the Kenya Anti-Corruption Commission on the Attorney General to prosecute corruption cases, the ability of the Commission to impact corruption through investigation is severely curtailed.
- Professional responsibility and ethics courses are not required within the law school curriculum.

As detailed by Transparency International, Kenya's recent National Corruption Perceptions Survey,[9] over three quarters of Kenyans believe that the government has "the power and the ability" to fight corruption but lacks the will to do so. Moreover, at the roundtable discussion held at the conclusion of this diagnostic—attended by nearly 100 people—participants identified these governance issues as the *most* important cross-cutting theme of the team's work. The challenge before Kenya is to rise to the rigorous expectations of transparent and accountable conduct that their potential trading and investment partners will demand. Thus elimination of the country's culture of corruption in the business environment is a necessity.

7 Transparency International, *Corruption Perceptions Index* (2007).
8 East African Business Council, *The Business Climate Index—Survey 2008* (October 2008) at 28.
9 Transparency International Kenya, *National Corruption Perceptions Survey* (March 2009).

USAID/BizCLIR DIAGNOSTIC TEAM	
Elizabeth Shackelford, Booz Allen Hamilton	Team Lead, Protecting Investors
Farah Sheriff, Booz Allen Hamilton	Co-Deputy Team Lead, Starting a Business
Anna Capetenakis, Booz Allen Hamilton	Co-Deputy Team Lead, Starting a Business
Wade Channell, USAID (Washington, D.C.)	Registering Property
Van Carlton, Independent Consultant	Paying Taxes
Joanne Cornelison, Independent Consultant	Trading Across Borders (trade facilitation)
Danielle Dukowicz, USAID (Washington, D.C.)	Trading Across Borders (trade policy)
Nick Francyk, Federal Trade Commission	Competition and Consumer Protection
Michael Ingram, Booz Allen Hamilton	Getting Credit
Judge John Olsen, U.S. Bankruptcy Court, Middle District of Florida	Enforcing Contracts, Closing a Business
Louise Williams, Independent Consultant	Dealing with Licenses, Employing Workers

THE ABUNDANCE OF REGIONAL OPPORTUNITY

As evidenced by its membership in the EAC and its participation in a regional customs union, Kenya recognizes that its economic growth will require greater integration with its neighbors.

Cross-border finance is one critical area of interest. With the EAC's goal of a regional market where goods and labor flow across borders, it is imperative that the financial sector operate just as efficiently, if not more so. Central banks already collaborate on supervision exercises across borders, stimulating learning and best practice dissemination. Core institutions, such as credit bureaus and collateral registries, should not be redesigned for each country. Instead, once in place in one country, such institutions should be replicated across the EAC, thus reducing the overall cost of reform and increasing the ability of these systems to work together. Harmonization of regulatory frameworks for finance is already on the EAC agenda. These efforts should be supported and accelerated.

In addition, Kenya's place in East Africa presents enormous opportunities for trade in services—professional services, franchised businesses, and trade facilitation services. The imminent arrival of undersea fiber optic cables to East Africa should make regional understanding of opportunities a priority for both the public and private sectors. Although country- and region-level harmonization is beyond the scope of this report, they should be important themes in Kenya's economic development plans.

THE BIZCLIR DIAGNOSTIC AND INDICATORS

This diagnostic took place from March 1–17, 2009. An 11-member team of U.S.-based government representatives and consultants traveled to Kenya and conducted interviews across the public and private sectors, including with national and local officials, business owners, business associations, chambers of commerce, nongovernmental organizations, the banking and lending community, university representatives, labor unions, and many others. Interviews and observations took place in and near Nairobi, Mombasa, Nakuru, Nyeri and Kisumu. The diagnostic culminated in a roundtable presentation and discussion on March 16, 2009 in Nairobi, attended by nearly 100 local stakeholders and donors. At the roundtable, team members introduced their preliminary observations, which were then subject to feedback and elaboration from participants.

This input helped shape the final conclusions of the team, which are now found in this report.

The diagnostic process and this report are grounded in a methodology, established through USAID's Economic Growth Office, which has been used in over 35 countries since 1998. In 2007, incorporating lessons learned from its first-generation legal, institutional, and trade diagnostic tool, USAID sponsored the development of an updated and redesigned set of indicators through its Business Climate Legal and Institutional Reform (BizCLIR) project.[10] The indicators now substantially align with the structure of the World Bank's enormously influential *Doing Business* country reports, although this report represents a new effort to more clearly distinguish the two methodologies. In addition, this report includes a new emphasis on detailing recommendations and explaining how lessons learned from previous development efforts might specifically apply in Kenya.

WORLD BANK *DOING BUSINESS* CATEGORIES—KENYA

	2009	2008	Change in Rank
Doing Business Overall (*181 economies surveyed)*	82	78	-4
Starting a Business	109	115	+6
Dealing with Licenses[11]	9	9	0
Employing Workers	68	71	+3
Registering Property	119	116	-3
Getting Credit	5	5	0
Protecting Investors	88	84	-4
Paying Taxes	158	158	0
Trading Across Borders	148	152	+4
Enforcing Contracts	107	106	-1
Closing a Business	76	79	+3

Since 2002, *Doing Business* has assisted countries in targeting where their regulatory environments may favor or interfere with economic growth. For each of the topics it examines, the World Bank considers a few key indicia of whether and how the environment for doing business is "working," measured by such means as the number of procedures involved in achieving a goal, the number of days it takes, and the costs of the procedures in relation to per-capita income. The World Bank now gathers data from 181 economies and ranks each, thereby demonstrating how their respective regulatory environments compare to others throughout the world.

USAID's BizCLIR indicators take the topics covered by *Doing Business* and delve deeper into their related legal frameworks, implementing and supporting institutions, and social dynamics to better understand *why* a country has a particular ranking. In short, BizCLIR regards the *Doing Business* findings as "the tip of the iceberg" and aims to assist countries in improving their *Doing Business* areas by addressing the *whole* iceberg. The BizCLIR indicators consider key business issues from a variety of perspectives, illuminating, for example, how certain business processes apply to rural communities, micro-enterprises, and SMEs. The BizCLIR approach was chosen in light of recent demand for better understanding of the issues highlighted in the *Doing Business* initiative and the need to help donors and countries understand, with greater particularity, how to reform.

Each chapter of this report is structured the same way. Following an introduction, each has four sections followed by recommendations.

LEGAL FRAMEWORK

The chapters first examine the laws and regulations that serve as the structural basis for Kenya's ability to achieve and sustain market-based development. They discuss the following questions: How accessible is the law, not only to elite, well-informed groups, but also to less-sophisticated actors, rural constituencies, or foreign investors? How clear are the laws, and how closely do existing laws reflect emerging global standards? How well do the laws respond to commercial realities that end-users face? What inconsistencies or gaps are present in the legal framework?

IMPLEMENTING INSTITUTIONS

Next, the chapters examine those institutions that hold primary responsibility for implementation and enforcement of the legal framework.

10 Detailed information about BizCLIR, including an on-line library of BizCLIR reports, can be found at www.bizclir.com.

11 In its most recent survey, the World Bank changed the designation of the category "Dealing with Licenses" to "Dealing with Construction Permits," a title that more accurately reflects the scope of its survey.

These institutions include government ministries, authorities, and registries, and, in certain cases, private institutions such as banks and credit bureaus. In addition, courts are examined with respect to their effectiveness in addressing disputes that arise in the commercial arena.

SUPPORTING INSTITUTIONS

The chapters then look closely at those organizations, individuals, or activities without which the legal framework or policy agenda in Kenya cannot be fully developed, implemented, or enforced. Examples include lawyers, banks, business support organizations and private services, professional associations, universities, and the media.

SOCIAL DYNAMICS

Finally, the chapters discuss key social issues. Roadblocks to reform, in particular, are considered. These indicators also seek to identify significant opportunities for bolstering the business environment—such as supporting champions of reform and regional initiatives, as well as facilitating access to formal institutions. Social dynamics also concern such important issues as gender, human capacity, and public health, each of which may have a significant bearing on how the business environment functions. Indeed, a full understanding of legal and institutional issues cannot be achieved without a nuanced consideration of a country's social dynamics.

RECOMMENDATIONS

Following this four-part analysis, each chapter sets forth a set of recommendations. These recommendations are drawn from the key findings in each chapter and reflect current reform capacities, opportunities, and political will to reform. Some of the suggestions within the respective sets of recommendations may overlap—that is, some may be consolidated into a single reform initiative—and all turn on the priorities and preferences enunciated by the government itself. The recommendations in this report are intended to serve among other functions as a threshold list for donor coordination of immediate initiatives and preparation of scopes of work. Compared to previous reports, the recommendations here are presented in greater detail, in response to specific requests for better understanding of how specific reforms can be supported.

INDICATORS

With respect to each area of inquiry, this diagnostic uses a process of reviewing and scoring **key indicators** to develop a thorough analysis. Once as much relevant information as possible is gathered –from written sources, meetings and interviews, and consultation among colleagues—each of the key indicators was scored based on the assessor's best estimate of the issue at hand. To help an assessor determine a score, between 5 and 20 **supporting questions** accompanied each key indicator. These questions themselves are not scored, but are intended to guide the assessor toward a consistent, fact-based judgment from which the key indicator score is then derived.

THE SCORE AWARDED *KEY INDICATORS* ALIGNS WITH THE FOLLOWING CONCLUSIONS:
1 = strong negative
2 = moderate negative
3 = neutral (or having some negative and some positive qualities)
4 = moderate positive
5 = strong positive

The scores are not intended to serve as a standalone, number-based pronouncement on the state of affairs in the country. Rather, they should be read in conjunction with this report as a means of understanding the relative status of certain key indicators of a healthy legal and institutional environment for business and trade, and identifying priorities for reform.

BUILDING A BETTER BUSINESS ENVIRONMENT: THE CRITICAL LINK TO AGRICULTURE

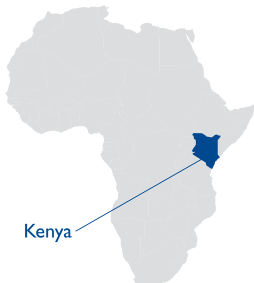
A key fact sets the stage for considering Kenya's journey into middle-income status. In this East African nation of 39 million people—with a labor force of only 17 million—approximately 75 percent of the working population derives its living from the agriculture sector, most as small-scale farmers. There is a second and related key fact: of the country's GDP—$16.1 billion in 2007—around 28 percent comes from agriculture. (By comparison, agriculture contributes just 1.2 percent of GDP in the United States).

Kenya's major agricultural exports include tea, horticulture products, coffee, and increasingly dairy, fish, and meat products. In addition to cash crops, Kenyan farmers grow food for personal and local consumption, mostly cassava, maize, yams, plantain, millet, rice and various fruits and vegetables. However, low productivity on these farms is endemic because, among other factors, high-quality seed is rarely used and poor storage facilities and infrastructure contribute to high rates of post-harvest loss.

In Kenya, as in much of Africa, little processing of locally produced goods takes place within its borders, although the government is striving to improve this situation. Over the course of this diagnostic, a number of issues relating to the business environment and the agriculture sector were identified:

- Kenya's vast difficulties in administering its land use system have resulted in enormous fragmentation of farms and other major constraints to efficient land use.
- The many difficulties associated with joining the formal sector, including the inaccessibility of the Company Registry, the costs associated with formalization (including high taxes), and rampant corruption among local authorities, contribute to very high rates of informality.
- Access to finance for small farmers is a significant problem. The financial sector needs more experience in multiple areas: loan product development for agricultural finance; agricultural insurance; non-standard collateral and terms; infrastructure investments that can reduce weather-related risk; and mobile banking capabilities for rural customers. As a result, the agricultural sector is underserved by the financial community.
- The cooperative model, an important structure for doing business in agriculture, does not work effectively in Kenya. In the 1980s and 1990s, following a period of success in the cooperative market, cooperative scandals became common, and cooperative models became tools for political gain. Embezzlement, mismanagement, and the use of cooperatives for the personal benefits of managers became common stories, resulting in significant losses by cooperative members. While raising the awareness of the membership in cooperatives regarding laws and safeguards could force better management and minimize risks of loss, convincing the public to give these structures another try is proving challenging.
- The quality of Kenyan roads, along with a system of outrageously corrupt police checkpoints, sharply drives up the time and cost involved with transporting agriculture products to market. This results in higher rates of post-harvest loss and diminished competitiveness for Kenyan products.

The past two centuries of global economic growth demonstrate that greater prosperity in a country translates to fewer people engaged in agriculture and less GDP derived from agriculture. This experience is likely to be realized in Kenya. Rises in agricultural productivity will increase incomes and improve health, permitting more Kenyans to turn to skilled labor, entrepreneurship, and other avenues for progress. But even as fewer Kenyans work directly in agriculture, the sector can serve as a stronger and more efficient driver of growth. To the extent that there are ongoing reforms for "doing business" in the agriculture sector, the country will experience greater productivity, entrepreneurial activity, and international trade.



STARTING A BUSINESS

The mechanics of joining the formal economy through registration with the central government of Kenya have been streamlined recently, and will be further streamlined with enactment of the Companies Bill. The only place formal registration may take place, however, is reportedly in Nairobi, presenting a disadvantage to MSMEs located outside of the capital. While some entrepreneurs suggested that applications for registration may be submitted in Kisumu and Mombassa for transfer to the Company Registry in Nairobi, very few private sector individuals were aware of such services, and this could not be confirmed. Moreover, even though registry procedures are clearly posted and relatively straightforward, corruption persists: businesses typically find that bribes to registry officials make the process move faster.

Registration with the national Company Registry is not the only formal aspect of business-start up: all businesses are also required to obtain, on an annual basis, a Single Business Permit from local authorities. Although in some regions this process runs smoothly, in others it can be hampered by bureaucracy, corruption, and delay.

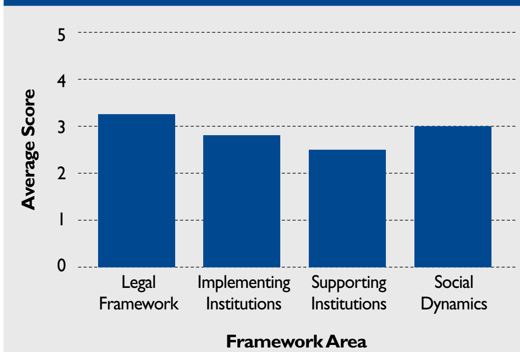
As reflected by the Starting a Business indicator chart above, the BizCLIR scores suggest significant room for improvements across the board. The legal framework is currently the strongest framework area for starting a business. Social dynamics are also relatively strong. However, supporting institutions proved to be the weakest area, suggesting a need to strengthen available resources to assist with business development and increase awareness of these resources.

LEGAL FRAMEWORK

REGISTRATION WITH THE OFFICE OF THE REGISTRAR

The 2009 *Doing Business* survey places Kenya 109th out of 181 economies in terms of the ease of starting a business, improving six positions since 2008. According to the World Bank, it takes 12 procedures and 28–35 days to start a business in Kenya. The average for the region is 10.2 procedures and 47.8 days, respectively.[12]

STARTING A BUSINESS



For many businesses, the registration procedure takes even less than 28 days.

The procedures for starting a business are governed by the **Companies Act,** but these procedures will be revised under the **Companies Bill** currently under consideration. Companies provided for under the law and bill include:

- limited and unlimited companies
- private and public companies
- companies limited by guarantee and having share capital.

KEY LAWS

- Companies Bill (Draft)
- Companies Act 1962
- Local Government Act (authorizing Single Business Permit) 1997, plus amendments

12 See World Bank *Doing Business* website, Starting a Business in Kenya, at http://doingbusiness.org/ExploreTopics/StartingBusiness/Details.aspx?economyid=101.

The bill allots a substantial amount of power to the ministry-appointed Registrar, including the ability to set document authentication requirements beyond those formally posted. The documents for company incorporation must be drawn up by a lawyer, thus adding a variable cost to fees associated with registration that can lead to upwards of KSh 50,000. The registration office is teaming with lawyers whose prices vary and begin at around KSh 10,000 (US$150).

ACQUISITION OF A SINGLE BUSINESS PERMIT FROM THE LOCAL AUTHORITY

While a minority of companies in Kenya register with the national Company Registry, a great many more enterprises adhere to the **Local Government Act,** which requires all businesses, new and established, to acquire, on an annual basis, a Single Business Permit (SBP) from their local authorities. The SBP represents an important source of revenue to Nairobi and to the country's municipalities and counties, and indeed accounts for at least 15 percent of local revenues.

The administration of the SBP, however, is considered to be a significant constraint on business, particularly new enterprises and MSMEs. As further detailed in this report's chapter on Licenses and Permits, local authorities often treat representatives of registering businesses very poorly—tagging on "informal fees" to the SBP process; failing to issue the actual SBP until after it has expired; and in general diverting people away from time that could be spent building their businesses. The World Bank has called for the elimination of the SBP: "By requiring the business permit from all businesses," it has said, "not just those dealing with public safety or posing environmental concerns[,] the government of Kenya is imposing a significant burden on entrepreneurs without an overriding public benefit."[13]

IMPLEMENTING INSTITUTIONS

BUSINESS REGISTRATION

The primary implementing institution for business registration is the **Company Registry.** Located in Nairobi, the Company Registry resides within the jurisdiction of the Office of the Attorney General and is managed by the Registrar General and the Registrar of Companies. Nairobi is reportedly the sole location of the Registry, although some entrepreneurs suggested that deposit of registration applications could also be made in Kisumu and Mombasa. However, these services could not be confirmed so, by most accounts, anyone wishing to register a business must travel there or be represented by an advocate in Nairobi.

KEY IMPLEMENTING INSTITUTIONS

- Company Registry
- City, municipal, country and town councils
- Business development resources

The Company Registry is well organized and easily accessible to those in Nairobi. Inside, counters are clearly labeled to correspond to a particular step in the registration process, and outside a list of all the steps and fees associated with registering a business are posted at the entrance. Although information regarding the processes and fees for registering a business is clearly outlined, the majority of small business owners interviewed acknowledged that for a small "fee" they were able to reduce the time required for the process of registration from three to four weeks (for a business in Nairobi) to one to seven days. A recent survey by the East African Business Council found that Kenya is the EAC country where new businesses are *most* likely to have to pay a bribe in the business start-up process; bribes are estimated to be paid almost 34 percent of the time.[14]

Exacerbating matters, the use of personal connections within the government or implementing institution to ensure paperwork is processed quickly often plays a more significant role than bribes.

13 FIAS (Multi-Donor Investment Climate Advisory Service of the World Bank Group), Doing Business in Kenya: Reform Memo (November 2008) at 7.

14 East African Business Council, *The Business Climate Index—Survey 2008* (October 2008) at 28.

Outside of Nairobi, especially in rural areas, the cost of registering a business can be prohibitively high and time-consuming, due to travel requirements, advocate fees, and other various expenses.

BUSINESS DEVELOPMENT RESOURCES

Business registration is only a piece of the puzzle when it comes to starting a business. Once a company is registered, it faces a variety of new questions and challenges: What special licenses or permits are required? What are the company's tax obligations? What are the company's obligations as an employer? What are the rules and regulations surrounding loans and investment? Currently, institutions available to answer these and other questions surrounding business start-up are scarce and there is not a single, consolidated resource center that can serve as a one-stop shop.

SUPPORTING INSTITUTIONS

BANKING SECTOR

In Kenya, access to finance for entrepreneurs is an issue not because banks do not lend, but rather because business people are often not aware of how to compose a sound loan application. Additionally, many entrepreneurs do not know how to draw up sound business plans. These circumstances present a high-risk situation for banks, thus deterring them from making loans to smaller businesses. A number of other concerns pertaining to access to finance for new businesses are addressed in this report's chapter on Getting Credit.

TAX AUTHORITIES

Taxation poses significant challenges to small and new businesses. The value-added tax (VAT) in Kenya is 16 percent, making it difficult for legitimate businesses to compete with those in the informal sector that do not pay tax. In addition, the income tax for companies is 30 percent, which can be daunting for new businesses. As of January 2008, however, those companies making KSh 5 million a year or less (approximately $64,000 U.S.) are eligible for a tax incentive called the "turnover

tax." This tax charges small companies a flat rate of 3 percent on all sales. Though quite an incentive, the turnover tax is poorly advertised: none of the small business owners interviewed for this diagnostic knew that it existed. Challenges posed by the tax regime are discussed further in this report's chapter on Paying Taxes.

COOPERATIVES

The history of cooperatives in Kenya has had an impact on the way Kenyans think about starting and growing a business. In the recent past, many cooperative societies were plagued with mismanagement, so much so that many collapsed. The devastating losses that many members incurred as a result of these failures are still fresh, and the public is reluctant to give these organizations a second chance. There is a general lack of trust in the business community when it comes to working together to improve efficiency. Many Kenyans are hesitant to work with their "competitors," even though doing so could increase overall efficiency and productivity. The government has recognized this and, in 2003, re-established the Ministry of Co-operative Development and Marketing. The purpose of this ministry is to "develop a vibrant and self-sustaining co-operative movement" within Kenya and to re-establish trust by the public in collective efforts. Some progress has been made since then, especially in the tea and coffee sectors, however there is a long way to go before this success spreads to other sectors.

KEY SUPPORTING INSTITUTIONS
• Banks and other sources of finance • Tax authorities • Cooperatives • Business Incubation Association of Kenya • ENABLIS and other donor initiatives

BUSINESS INCUBATION ASSOCIATION OF KENYA (BIAK)

As part of *Vision 2030,* Kenya's government has begun to take steps to aid small enterprises in their growth and development. The government-sponsored Business Incubation Association of Kenya (BIAK) is a new agency charged with coordinating 10 incubation centers throughout the country. It established a basic set of standards that each incubator must comply with in order to be certified and become a member of the association. As many as 44 more incubators may join within the next few years, according to current plans, which would allow expansion into more rural areas. BIAK also has plans to work with local technical training institutes to provide market-driven trainings to its members.

Incubators under the jurisdiction of BIAK charge a nominal fee to its users of roughly KSh 4,000 (about $50 U.S.) for training and counseling services. Office space is also available at incubators for an additional fee. Part of BIAK's requirements is that incubator members must have their business formally registered in order to participate and must have audited accounts by the end of the three-year start-up period. During their time in the incubator, these businesses learn fundamental practices such as bookkeeping, business plan design, and management.

ENABLIS

Some donors and large multinationals have created their own organizations to address the lack of business development resources in Kenya. One such organization is Enablis, a Canadian-based non-profit organization that promotes networking, engages in capacity building, and provides financing to entrepreneurs. Its goal is to provide assistance to small and medium enterprises looking to take the next step and further grow their business.

The success of Enablis can be seen through the successes of its members. In the latest Business Plan Competition sponsored by Technoserv and the Youth Development Fund, the winner and top 3 finalists were Enablis members. Though Enablis has been able to provide valuable support to serious entrepreneurs, it is currently able to work with businesses only in Nairobi. With additional capacity, Enablis plans to expand to more rural areas and offer financial assistance to its members.

SOCIAL DYNAMICS

ENTREPRENEURIAL CULTURE

One of the primary challenges facing the business community in Kenya is a limited entrepreneurial spirit. However, this should be taken in perspective. Relative to its East African neighbors, Kenya's business community, particularly in Nairobi, exhibits more entrepreneurialism: the number of people who attempt to start their own companies, the larger middle class compared to other African nations,[15] and the sheer number of mid-sized and large local companies participating in the economy is a testament to Kenya's entrepreneurial advancement. But given that Kenya aspires to compete internationally in addition to regionally, it should strive to further encourage entrepreneurs.

Employment at a respectable firm or within the government is still widely viewed as the highest form of success. Furthermore, long-term investment by entrepreneurs in the growth of their companies and to increase market share is uncommon. Instead, most new enterprises in Kenya perform at the micro-level and are used as a short-term solution to get by until an official position with a larger, well-established firm is secured. This is particularly true in regions outside of Nairobi where business development know-how is not widespread. More recently, with

15 New York Times, "Kenya's Middle Class Feeling Sting of Violence," February 11, 2008.

the current global economic climate, starting an informal micro-business has become a quick fix for those lacking employment.

Changing the culture and attitudes surrounding entrepreneurialism will take time. This change could be encouraged through improvements in the education system. Currently, schools neither teach nor encourage business skills and entrepreneurship. Offering courses on basic business skills and incorporating real world business scenarios at the secondary and collegiate level would go a long way toward developing a culture of entrepreneurship.

INFORMAL SECTOR

As noted above, many individuals in Kenya view starting an informal micro-business as short term solution for unemployment. Even those that take a slightly longer view still see their business as a form of employment and a means to support their families, rather than as an investment with substantial growth potential. Because these types of businesses are so prevalent, the informal sector in Kenya is quite large—around 35–50 percent of GDP.[16] Of informal businesses, the vast majority is in the agriculture sector and based outside of Nairobi. The high cost of registering a business outside of Nairobi plays a big part in this. In addition, high tax rates, poorly publicized incentives and resources to assist with formalization, and the cost of acquiring relevant licenses all contribute to the decision of businesses to remain informal.

Though Kenya's informal economy is not as large as many of its neighbors, it is still significant on the international scale. As Kenya looks to become a bigger player in the global business community, it will need to take steps to address the issue. Such steps might include a marketing campaign to publicize existing incentives and resources for entrepreneurs in the formal sector, and an expansion of resources that assist with the formalization process to areas outside of Nairobi.

CORRUPTION

Kenya's struggle with corruption is not a new battle. It affects nearly every aspect of conducting business in the country. From registering a company to acquiring business licenses there are many opportunities for papers to get "lost" by bureaucrats and bribes to be exchanged. While it is possible to register a business without paying a "fee," to do so takes significantly longer. Businesses that work with government procurements and public tenders build the cost of "facilitation" payments into their proposals, and acknowledge that contracts are usually won through personal connections.

There are active attempts to address corruption in Kenya, particularly through the Kenya Anti-Corruption Commission. Signs are posted in every government office, reminding both the public and private sector that bribery is not permissible. Though this is an important first step, it is often ignored, and actions need to be taken to address corruption at higher levels, especially in cases where officials have conflicts of interest. This will begin with the removal of Parliamentary immunity from charges of corruption. The private sector also needs to take a stand against corruption by refusing to make facilitating payments.

PUBLIC-PRIVATE DIALOGUE

The government of Kenya has enacted some policies and programs to support the business environment, but they have been largely underutilized by the MSME sector because of businesses on this level are reportedly left out of much of the public-private dialogue that exists. MSME representatives complains that there is no communication about new policies and programs from which they could benefit. Notably, much of the rest of the private sector speaks highly of the government's various initiatives to promote robust dialogue between the public and private sectors, including the Prime Minister's Roundtable, but these initiatives do not appear to be inclusive of the MSME community. Incorporating micro, small, and medium enterprise representation in such dialogue will be important to ensure that their unique needs are being addressed, particularly as they make up the bulk of the business community.

16 Business Daily, "Michael Porter on Young Kenyan Leaders," June 27, 2007.

RECOMMENDATIONS

Increase availability of—and access to—information about business-friendly policies, business development programs and resources, and basic market statistics to foster the development of new businesses and the growth of existing enterprises.

Increase the availability of information on business-friendly policies and actively strengthen and market current business development programs. Business know-how and entrepreneurial skills have not been well developed within the bulk of the private sector. Accordingly, guidance on where to go, what to do, and how to do it with regard to starting and sustaining a business is sorely needed. Policies such as the turnover tax and business development programs such as BIAK, the Youth Enterprise Development Fund, and the Women's Enterprise Development Fund have all come into existence over the past two years and were designed to provide much needed business support services. The problem, however, is that no one knows about these organizations. They also have little reach outside of Nairobi and face a perception that the YEDF and WEDF are difficult to access. This, combined with the limited amount of funds available, make current efforts to utilize YEDF and WEDF not worthwhile. The government should continue to expand and market the value and accessibility of these and similar programs.

Since its inception in 2006, BIAK has supported the successful growth and operation of business incubators throughout the country. This represents an excellent step but needs more support to continue expanding. In addition to training and supporting entrepreneurs, incubators throughout the country should act as information centers, satisfying the demand for information on trade fairs, packaging and marketing best practices, and facilitating networks within the business community.

In addition to strengthening existing programs and policies, the government must also work to correct the information deficit for MSME entrepreneurs. A low cost and manageable solution is to create a centralized website that houses all information related to starting a business. The most logical location for this would be within the Kenya Investment Authority website, as it is the location for the procedures necessary to register a business. This would allow entrepreneurs to go to one source for all information relating to starting a business and would streamline the information sharing process for the government.

Though internet access is widely available in Nairobi, it is not as prevalent in the more rural areas in Kenya. The government must make an effort to publicize important information regarding business start-up to potential entrepreneurs in all parts of Kenya, and thus must continue to use other media to advertise its policies and programs.

Collect in-depth, detailed market data and make this information easily accessible and available online. Though the Kenya Bureau of Statistics provides some broad market data, such information is not easily accessible and is usually too general to be of much use to entrepreneurs. Without detailed market information, it is difficult to get an accurate picture of start-up costs, inventory costs, business failure rates, and rates of return, among other business indicators. This type of information is essential for entrepreneurs, both foreign and domestic, preparing to start a business in Kenya.

Collecting in-depth information for all markets would be extremely time consuming and costly. A more effective method would be to select two or three markets each year to analyze in detail. Once the markets are selected, registered businesses within the selected markets should be chosen at random to complete a "business census" that would incorporate basic detailed data such as start-up cost, annual revenue, and annual profit. This process could be carried out by the Bureau of Statistics or an outside agency, depending upon capacity and available funding.

Collecting market data is only half the battle. The second part to this recommendation is to make this information publicly available and easily accessible. This could be done easily and cost-effectively by posting the data and analysis on the Kenya Bureau of Statistics website, but to ensure that this information reaches those in need, it should also be disseminated in other ways. The KenInvest website would be a natural place to provide a centralized location for both market information and guidance on business and investment processes and questions. However, it should also be made available to those without regular access to the internet, both in Nairobi and beyond. Branches of business associations that are located throughout the country, such as the various branches of the Chamber of Commerce, could be a partner in providing greater access to such information.

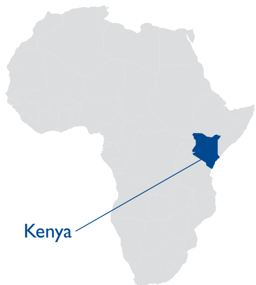
Promote an entrepreneurial culture and through education and business training to decrease unemployment and foster grass-roots growth.

Kenya has one of the highest literacy rates in the region, 85.1 percent. Despite its relatively well educated population, however, youth unemployment accounts for 75 percent of all unemployed in Kenya.[17] This gap between education and employment can be demoralizing for many students and is also a sign that some reform in the education system is necessary. Kenya's culture does not promote business skills and entrepreneurialism, contributing to the high youth unemployment because most youth lack skills that match the needs of the business community or that would assist them in developing successful growth businesses that would in turn create additional jobs.

The first recommended reform initiative within the education system is to enhance business skills and training in business as a vocation within the classroom. This will be crucial to fostering an entrepreneurial spirit and preparing graduates to successfully engage in the private sector. Curricula should incorporate basic business concepts such as cash flow, bookkeeping, and how to incorporate and manage companies. This would not only strengthen the entrepreneurial culture in Kenya, but would build know-how and skills needed to promote formalization in existing and new businesses.

The second reform initiative recommended within the education sector is to make a direct link between the education system and Kenya's industrial demands. As certain industries grow, the curriculum should shift to reflect these changes. For example, as the tourism sector grows, additional focus could be shifted to service industries. This would ensure that Kenya is producing students that are prepared to meet the demands of the current job market. Surveying current growth industries, such as tourism and telecommunications, to determine what skills their staff lack and what their needs are would be a first step in determining how to prepare those entering the workforce to meet existing needs.

17 http://www.youthfund.go.ke/

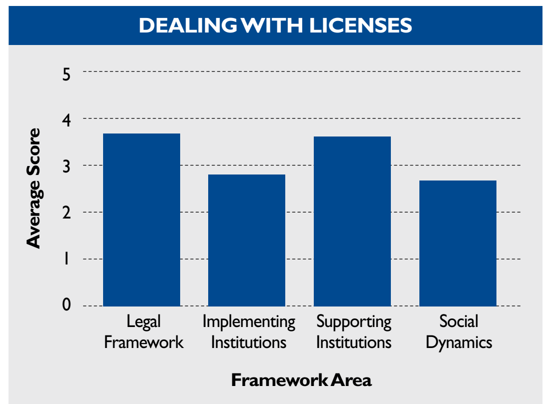


DEALING WITH LICENSES

The exasperation of the lawyer who has long been active in her family's retail business was evident: "How I wish," she asserted during this diagnostic, "that someone would simply give me a list of what I am expected to do, including how long it takes and how much it costs, so that our business can comply with the law."

This unmet desire for clarity, simplicity, and consistency exists throughout Kenya's private sector. MSMEs in particular complain that, aside from their annual procurement of a Single Business Permit—a process that, especially for new businesses, can prove cumbersome and slow, with certain local authorities proving more competent than others—they lack reliable direction about how they can avoid an unpleasant experience or unexpected fine from a representative of a national or local authority. They further assert that their treatment by most government representatives is typically poor: minor, unintentional bookkeeping errors can be treated with the same heavy hand as deliberate obfuscations, one manufacturer reported, and assistance in complying with the law is rarely forthcoming. Abusive, "rent-seeking" conduct on the part of government actors is also rampant, dramatically driving up the cost of doing business.

Existing efforts to provide clarity, though well intentioned, have proven generally unhelpful in practice. For example, a "step by step" guide to business formation created by the Kenya Investment Authority lacks the detail that businesses require (and the website where it is posted is unreliable). An "e-registry" of business licenses spearheaded by the Business Regulation Reform Unit in the Ministry of Treasury is years away from full implementation. Certain "off-the-shelf" commercial products directed at new businesses in Kenya provide general business advice, but contain almost no specific information about the licensing process. Perhaps the best *practical* resource for businesses seeking *specific* guidance about their licensing obligations is a January 2006



"Handbook for Local Investors" developed by the UN Development Programme (UNDP),[18] but which, to be useful now, needs updating, expansion, and wider distribution. Regardless, *no* publication can capture the arbitrariness and uneven quality of regulatory enforcement in Kenya, especially by the local authorities who appear to depend personally on the many fees they are empowered to seek from the private sector.

This chapter addresses the general environment for licensing and regulating businesses in Kenya and finds that implementing institutions and social dynamics pertaining to this area are generally weak. It examines the special concerns of MSMEs—businesses that do not have the resources to attract preferential treatment from the government and that suffer disproportionately from unpredictable, unwieldy regulation. This chapter also looks at certain issues faced by the construction industry, which is the area specifically addressed by the World Bank's examination of licenses in *Doing Business*.[19] The chapter concludes that government-sponsored regulatory reform efforts should be vigorously pursued and

18 UNDP (Mary Mbithi and Jamuhuri Mainga), *Doing Business in Kenya, Procedures and Regulations, Opportunities, Sources of Finance and Incentives—A handbook for local investors* (January 2006) (hereinafter *UNDP licensing handbook).*

19 In its most recent *Doing Business* survey, the World Bank changed the designation of the category "Dealing with Licenses" to "Dealing with Construction Permits," a title that more accurately reflects the scope of its survey. As noted in this report's Introduction, the *Doing Business* areas are the starting point for this diagnostic's close examination of various key areas impacting economic development in Kenya.

supported, but that to achieve short-term, meaningful results, the private sector must play a greater role in promoting and assisting with change.

LEGAL FRAMEWORK

GENERAL REGULATORY ENVIRONMENT

Kenyan businesses face a host of regulations, enforced by a panoply of potential regulators and applying to all aspects of the economy—retail, general import and export, plants and plant production, drugs and pharmaceuticals, livestock trading, animal export, motor vehicles, public transport, scrap metal, fish and fish products, hotels and restaurants, milling, food preparation, dairy production, hides and skins, and many more.[20] The expansion of the number of national ministries in 2008—from 30 to 42—as a result of the governing coalition agreement exacerbates the perception held by businesses that they are both over-regulated *and* poorly regulated. A repeated theme enunciated by businesses interviewed during this diagnostic is that they wish to be able to go about their affairs without the persistent and non-transparent interference of "politicians."

Poor regulation has long been a concern in Kenya. Shortly after the 2002 election, there was a concerted effort to make national and local government institutions more business-friendly, especially to the country's smallest traders.[21] However, implementation of reforms tripped over persistent rent-seeking behavior by local authorities, as well as incoherent content and application of local by-laws (many of which dated from colonial times) and an ambivalence by traders themselves over diminished arbitrariness of government regulation.[22]

More recently, Kenya has taken steps toward streamlining systems for business licensing and regulation. Beginning in 2005, a World Bank-sponsored "licensing guillotine" identified 1,325 business licenses and suggested elimination or simplification of almost 700 of them, because they were found to be to be unlawful, unnecessary, or inappropriately drafted.[23] Through the 2006–07 and 2007–08 budget processes, most of those suggestions were enacted. The **Licensing Law (Repeals and Amendments) Act of 2006** was one vehicle for these changes. The Act eliminated the country's annual trade license, a result which generated considerable good will for Kenya, both within its own business community and on the world stage. In 2007, the Ministry of Finance set up a Business Regulatory Reform Unit (BRRU), an office charged with overseeing the broad-based regulatory reform process.

Although significant licensing reform took place between 2005 and 2007, the perception today is that the momentum behind these reforms has lapsed considerably. For example, at the time of the licensing guillotine, many decisions were "deferred," including those pertaining to the regulatory roles of the following agencies:

1. Kenya Revenue Authority
2. Transport Licensing Board
3. Immigration Department
4. Central Bank of Kenya
5. Kenya Maritime Authority
6. Registrar of Companies
7. Kenya Wildlife Service
8. Kenya Civil Aviation Authority
9. Nairobi City Council and Local Authorities
10. National Museums Board
11. Kenya Dairy Board
12. Ministry of Education
13. Electricity Regulation Commission
14. National Environment Management Authority
15. Export Processing Zones
16. Ministry of Livestock and Fisheries Development
17. Ministry of Health
18. Registrar of Higher Purchase Agreement
19. Kenya Industrial Property Institute
20. Commissioner of Insurance
21. Kenya Airport Authority
22. Kenya Ports Authority
23. Pest Control Products Board
24. Ministry of Agriculture
25. Retirement Benefits Authority

20 *UNDP licensing handbook, supra* note _, at 7-17.

21 *See* Winnie Mitulla, *Street Trade in Kenya: The Contribution of Research in Policy Dialogue and Response* (December 2003) at 15-16.

22 Id.

23 For details on this initiative, *see* FIAS (Multi-Donor Investment Climate Advisory Service of the World Bank Group), Doing Business in Kenya: Reform Memo (November 2008) at __.

26. Kenya Plant Health Inspectorate Service
27. Ministry of Lands
28. Kenya Sugar Board
29. Commissioner of Higher Education
30. Estate Agents Registration [Authority].[24]

Over the past two years, although some of these agencies have taken steps toward licensing simplification, businesses do not perceive any major recent improvements. In fact, some businesses are concerned that de-regulated agencies are finding other ways to collect revenues allegedly lost as a result of the reforms.

KEY POLICY AND LAWS

- **Draft** Regulatory Reform Policy (2009)
- Licensing Law (Repeals and Amendments) Act 2006
- **Draft** Business Regulation Bill
- Local Government Act (authorizing Single Business Permit) 1997, plus amendments
- Key laws pertaining to tax, social security, health insurance, environmental impact of business, export/import, labor, and specific business permits and licenses (construction, food safety, health, tourism, etc.).

Indeed, the enormity of bringing consensus and consistency to the regulatory functions of *all* government agencies is proving somewhat overwhelming. Implementation of key goals of the government's licensing reform program appears to be a long way off. The BRRU has many challenges before it, which are generally set forth in its four-year draft **Regulatory Reform Strategy (2008–12)**.[25] The draft Strategy includes the following key goals:

- Solicitation of stakeholder input, revision, and ultimately enactment of a draft **Business Regulation Bill,** which in its current form would mandate that *all* regulatory requirements be approved by the BRRU following a regulatory impact analysis;
- Creation of an "e-registry" for business licenses, which is envisioned as being the "final word" for licenses in Kenya—that is, "any requirement not included in it shall be deemed not applicable to business activity," according to the BRRU's vision;[26] and
- Targeting of the World Bank's *Doing Business* indicators as specific priorities for mid-term reform, including replication of the *Doing Business* analysis at the local level.

The draft Regulatory Reform Strategy sets forth clear goals along with a plan for how to achieve them. Whether and when it meets these goals will be possible to track, with monitoring and evaluation built into the plan. Furthermore, the draft Strategy acknowledges that dealing with the discretionary and unchallenged way that national and local agencies currently create and enforce licenses calls for a systemic and long-term solution, rather than an ad hoc approach to reform. This point underscores the belief that there must be "considerable investment in changing the conditions for implementation and enforcement" of law, which is a slow and difficult process.[27]

Two key points, however, have not yet made their way into the draft Strategy. First, the diminished momentum in licensing reform of the past two years, and the reasons behind the waning political interest, should be more straightforwardly addressed. Why is the Strategy still in draft form? What more is needed from government leaders and the stakeholder community to reclaim that momentum? According to numerous private sector representatives interviewed for this diagnostic, there is virtually no will to reform the treatment of business licensing and regulation among local authorities, which wield perhaps the most control over MSMEs. Implementation of the Strategy, once formalized, will likely encounter considerable resistance from those individuals and institutions who may perceive reform as taking away their access to funds. Mechanisms for coping with such resistance should be anticipated now.

Second, the draft Strategy is thin with respect to how the private sector is to be involved in licensing and regulatory reform. The draft Strategy contemplates the creation of a Business Advisory Council, but details are sparse, including how businesses will be compelled to participate, how

24 Ministry of Treasury, Business Regulation Reform Unit, *Brief on the Implementation of Licensing Reforms.*
25 *See* Ministry of Treasury, Business Regulation Reform Unit *Draft Business Regulation Bill, Memorandum of Objects and Reasons* (2008).
26 Id.
27 Thomas Carothers, *The Rule of Law Revival,* Promoting the Rule of Law Abroad: In Search of Knowledge (2006), at 11.

interests of rural constituencies and MSMEs will be represented, and how different sectors will be involved. Given the government's overriding goal to improve Kenya's business climate, integration of business itself into the multi-tiered agenda of the BRRU should be more explicitly defined and actively pursued.

LICENSING REGIME FOR CONSTRUCTION PROJECTS

Any construction licensing regime involves a variety of national and local government institutions, including various national authorities, local planning and land registration authorities, and other authorities pertaining to water, electricity, and sewage. Those agencies charged with enforcing the law must be equipped, willing, and able to coordinate their respective licensing processes. The ultimate goal of such a legal framework is to effectively balance opportunities for economic growth and development with a society's long-term interest in sound management of shared resources and public safety.

Kenya has some strengths in its construction licensing regime. Builders perceive that the legal and regulatory framework (including the Building Code, which not all countries have) is generally clear; that utilities are generally responsive; and that a recent emphasis on safety in public works is beneficial to all. The country's most recent *Doing Business* ranking as ninth in the world for "Dealing with Construction Permits" does not, however, reflect the much less complimentary perspective of builders and other businesses involved in construction projects. During this diagnostic, these actors specifically noted the following:

- The **business registration process** for construction companies is perceived as cumbersome and, in the view of a businessman who registered prior to the enactment of the new registration law, aims to "keep out guys [whom registration authorities perceive as] not serious";
- Obtaining a **Single Business Permit** each year can prove time-consuming and full of rent-seeking opportunities on the part of local authorities. Permits, one small business owner claimed, are occasionally not released until after they have expired;
- The process of obtaining a **building permit** from a local authority is unpredictable, slow, and usually requires at least one bribe;
- Though improvements have been made, the system of **public procurement of construction projects** is not transparent and involves payment of bribes to multiple procurement officials. Public officials are often involved in procurements that present obvious conflicts of interest;
- Construction companies that might otherwise **challenge procurement decisions** refrain from doing so because they believe they will be "black balled" from winning future contracts;
- **Inspection of projects** by local authorities is perceived as "not a serious exercise." Although government engineers are considered by their private sector peers as capable and qualified, they "have a poor attitude" and often "want to take money for themselves," according to some builders. Labor inspectors on construction

A SNAP-SHOT OF KENYA'S REGIME OF LOCAL GOVERNANCE

Kenya is divided into seven provinces: Coast, Northeastern, Eastern, Central, Rift Valley, Nyanza, and Western. (The Nairobi area is separate and has special status.) These are subdivided into 63 districts, each headed by a commissioner appointed by the President; provincial administration is closely supervised by the central government. There are two types of "upper" local authorities (municipalities and county councils) and four types of "lower" authorities (urban councils, township authorities, area councils, and local councils). The Nairobi area, administered by a city council, is the direct responsibility of the central government. Many of the councils raise their own revenues through fees and taxes, construct and maintain roads, carry out public health schemes, construct and improve housing, support education, and provide agricultural and social welfare services.

projects are rarely seen; and dangerous habits, including use of unsafe equipment and insufficient protective gear, persist on work sites, particularly on smaller projects.

- **Environmental regulation** is increasingly "aggressive," according to builders, in that the National Environment Management Authority has begun knocking down buildings that are constructed in contravention of the legal requirement for an approved environmental impact analysis. But the fact that construction routinely takes place without environmental approval suggests that the agency is not clearly and effectively communicating its mandate and requirements to its private constituents.

All of these issues warrant careful consideration as Kenya moves forward with its efforts toward licensing reform.

IMPLEMENTING INSTITUTIONS

BUSINESS REGULATORY REFORM UNIT OF THE MINISTRY OF FINANCE

Created in 2007, the BRRU is charged with developing and implementing the next-generation Regulatory Reform Strategy (discussed in the previous section). BRRU officials and staff demonstrate a clear understanding of their mandate and are well versed in the anticipated way forward. The fact that the BRRU is housed within the Ministry of Finance—a relatively strong and powerful institution—supports its ability to corral participation among the many other agencies that its work both impacts and requires.

Some BRRU staff have received training on their future anticipated tasks, including oversight of regulatory impact assessments. Particularly with respect to the regulatory impact assessment task, however, there remains insufficient staff capacity, both within the BRRU and among the regulating authorities that will be asked to perform the assessments. Even if the Business Regulation Bill were to pass in the near future, government staff would not be ready to implement it. Training in this area should continue.

KEY IMPLEMENTING INSTITUTIONS

- Business Regulatory Reform Unit of the Ministry of Treasury
- Nairobi City Council and other local authorities
- *All* government agencies involved in regulation of businesses, including all national and local authorities.

The BRRU is also the home of the **e-registry** for licenses, an ambitious plan to place all government regulations on-line, with the legal effect, if the Business Regulation Bill is enacted, of rendering all licenses that do not appear on the registry unenforceable. The e-registry is under-resourced (just one part-time staff person is assigned to its formal implementation), and, more importantly, its development appears to be generally ignored by all the agencies that could be compelled to list their licenses there. Even if the inventory of licenses prepared as part of the "licensing guillotine" project of 2005–07 is the starting point for entering licenses, it is difficult to envision the point at which every regulation and by-law enforced by local authorities throughout the country will be part of the registry. Nonetheless, the goal of identifying and listing regulations is a worthy one, and, whether the e-registry achieves the vision of serving as the definitive list of Kenya's business regulations, the information that it compiles will be valuable.

The BRRU is currently engaged in a "sub-national" assessment of the *Doing Business* indicators—that is, a review of the ease of doing business in a number of Kenya's regions. With the support of the **Multi-Donor Investment Climate Advisory Service of the World Bank Group (FIAS),** a nationwide survey was launched in October 2008 and compilation of questionnaires and distilling of results was taking place at the time of this diagnostic. BRRU reports a high degree of responsiveness from the local authorities being assessed,[28] and the results of the inquiry will likely be received with interest among both local authorities and the business community. That said, if the sub-national inquiry is confined to the same type of indicators sought by the national project—number of steps in a regulatory process; number of days the process takes; the process's specific, identifiable costs—it may suffer from the same criticisms that the national surveys have experienced in recent years. Specifically, there is increasing concern that preoccupation with "steps" in a process misses some greater issues of business health, including the attitudes of authorities, the degree of corruption, opportunities for innovation, and other, less tangible aspects of the environment for doing business.

THE NAIROBI CITY COUNCIL AND OTHER LOCAL AUTHORITIES

Kenya's most recent *Doing Business* ranking for "Dealing with Construction Permits"—ninth in the world—strikes most business people interviewed for this diagnostic as implausibly high. Rather, they articulated the nearly unanimous view that nearly any regulatory act administered by the Nairobi City Council and many other (though not all) local authorities—construction-related or otherwise—is tainted by arbitrariness, sluggishness, attitudes toward customer service that are not merely unfriendly, but actually hostile, and rampant corruption. "They are hyper-regulators," one lawyer who routinely deals with the Nairobi City Council asserts.

The 2008 Bribery Index prepared by Transparency International Kenya—a survey of 2,400 people from throughout the country—ranks local authorities as the second most corrupt institution in the country (for four years in a row, the police have ranked first) with respect to the bribes they take. The Nairobi City Council ranks seventh.[29]

Examples described by interviewees for this diagnostic may have been amusing if they were not so discouraging. A Nairobi City Council staff member refused service to a lawyer on a land-related matter, once it was pointed out that he was charging too much money for the service. Beyond Nairobi, municipal officials are regarded as "buying time with delay" and using their ability to charge fees as an excuse to avoid improving their internal operations. "Better management of funds," one businessman said, "would lead to less corruption" in the municipal council of Nakuru.

The Nairobi City Council has not enabled the link on its website that promises to provide "licensing information." For citizens to have clear, written information about the services they are entitled to and the costs of those services requires a level of transparency that, perhaps, the office prefers to do without.

OTHER REGULATING AUTHORITIES

The list of 30 public agencies set forth earlier in this chapter is not exhaustive. As mentioned, the government expanded the number of ministries in 2008 from 30 to 42, each with their own individual regulatory authority, most over private actors.

SUPPORTING INSTITUTIONS

PRIVATE SECTOR ASSOCIATIONS

As detailed at several points in this report, Kenya has a vibrant, active business community, both at the national and local levels. Influential groups include the **Kenya Association of**

28 *See* Ministry of Treasury, Business Regulation Reform Unit, *Progress Report on Sub National Doing Business Indicators*.

29 Transparency International Kenya, *Kenya Bribery Index 2008.*

Manufacturers and the **Kenya Private Sector Association;** also, with respect to issues impacting the labor and employment relationship, the **Federation of Kenyan Employers** is very active and influential. These national groups are taking advantage of the opportunity to bring business concerns before the Prime Minister in occasional roundtables that have been held since the government coalition was formed. In addition, there are various active **sectoral associations,** including those for construction, tourism, realty, and others, although company feedback about their relative influence is mixed. For its part, the **East African Business Council** has prepared at the regional level a powerful and influential annual study about regional business conditions, emphasizing in particular the extreme corruption that takes place at roadblocks and weigh stations.[30]

At the local level, **chambers of commerce** are active, but tend to lack the resources they need to achieve their many goals. They also do not yet exhibit awareness of their collective capacity to influence policy at relatively minor expense. For example, it does not appear that local exposure of corrupt officials by private associations take place; nor has Kenya seen such an event as a chamber-sponsored "week without bribes." Rather, individual businesses tend to be resigned to paying bribes as an unavoidable cost of doing business. One owner of a manufacturing company said that he feels less badly about the pressure to pay bribes when the official seeking the informal payment at least says "please."

MEDIA AND GOVERNMENT WATCHDOGS

The persistence of poor governance, especially corruption, is a bit difficult to understand in light of how much publicity it gets. **Newspapers, television, and radio,** though not without their biases, do an effective job of reporting government abuses, and **Transparency International Kenya** makes critical contributions to public discussion about poor governance through its annual Kenya Bribery Index and recently released National Corruption Perceptions survey.

30 East African Business Council, *The Business Climate Index—Survey 2008* (October 2008).

KEY SUPPORTING INSTITUTIONS

- Private sector, including business associations
- Media and government watchdogs
- The legal profession
- Donors

THE LEGAL PROFESSION

Although most small businesses cannot afford legal assistance when going through the more basic licensing procedures, larger, more complex businesses do rely on counsel for various regulatory requirements. Kenya is well supplied with lawyers. Although the "high end" of the legal profession is considered well qualified, pressure to participate in corrupt practices is high. Smaller businesses and individuals who cannot afford the better qualified lawyers are at risk of being exploited through corrupt or self-enriching tactics of unprofessional attorneys.

Donors are active in supporting private sector development with, as previously mentioned, the **FIAS program of the World Bank** most directly engaged in licensing reform. Certain successful private sector initiatives, including those in horticulture and dairy, indirectly support reform of the licensing environment by endeavoring to clarify regulatory procedures to their participants. SMEs would especially benefit from greater donor participation in the clarification and streamlining of sector-specific regulatory regimes, including those in horticulture, livestock, construction, hospitality, and so forth.

Donor coordination in Kenya is relatively strong, with donors convening regularly and the UNDP providing very capable coordination assistance in tracking donor projects. Nonetheless, aid effectiveness remains a concern. Continued, serious consideration of the cumulative impact of donor involvement in Kenya's private sector is warranted, and lessons learned from past experience should be generated and shared, with an emphasis on donor accountability.

SOCIAL DYNAMICS

This chapter's discussion of Legal Framework captures the major social dynamics issues: ambiguity in the licensing environment, a slowing of momentum, and corruption. Beyond these points, certain sectors appear more clearly, consistently, and honestly regulated than others. One private representative with direct experience both in tourism and construction reported that tourism is by far the better regulated area, chiefly due to the heavy presence of foreigners in the industry. His conclusion is that, where foreign investment may be at issue, government regulators are more inclined to follow the rules and avoid practices that may damage the country's reputation among outsiders. A representative of the food service industry said that improvements to regulation have accompanied the advent of ISO standards. In this case, the existence of an international benchmark meant that superfluous standards locally imposed had less credibility and buy-in.

RECOMMENDATIONS

As discussed early in this report, if the private sector waits around for Kenya's national and local governments to implement reforms, it will likely wait a long time. But private sector associations can serve as both a source of information for their constituents and a source of political pressure toward regulatory reform, as detailed in the below recommendations. In addition, motivated agencies can take steps toward reforms. Finally, it is recommended that the BRRU efforts toward broad-based licensing be supported, albeit with clear benchmarks for reform and mechanisms for holding implementers accountable.

Develop short, simple, sector-specific guidance for MSMEs.

Returning to the quote at the beginning of this chapter: why should there not be a straightforward (but detailed) list for MSMEs, particularly those that are just becoming established, identifying the regulatory requirements they face in their respective sectors? If the implementing agencies themselves are unwilling or unable to provide such direction—including specific information such as the amount of fees and the length of time-frames—private sector associations are in a strong position to do so. Such an effort may most effectively take place on a local basis, where sector representatives can develop short guides to regulation within their city, municipalities, or towns. Such guidance necessarily involves perusal and delineation of local by-laws and regulations, which may vary according to jurisdiction. Consultation with government authorities is desirable, but if cooperation is not forthcoming, the private sector can nonetheless provide guidance for its own constituents.

A successful example of such an initiative comes from the business community in Jamaica. The legal framework overlaying Jamaica's construction licensing regime is vast—at least 35 laws and hundreds of regulations pertain directly or indirectly to land use in Jamaica. In 2006, the Jamaican Chamber of Commerce (JCC), supported by USAID, created a comprehensive, loose-leaf Development and Investment Manual. The manual was created for the purpose of clarifying and improving access to the statutory and regulatory framework implicated by the real estate development process. The process of collecting all pertinent laws and regulations proved long and challenging: "[During the process] we discovered just how much was in peoples' heads" rather than in the law, according to one public official.[31]

Following this undertaking, several volumes of the manual (with others planned for the future) were issued in mid-2007, covering the following topics:

- Planning and development
- Environment
- Infrastructure, utilities, and communications
- Hospitality industry and security
- Social infrastructure and waste disposal
- Business facilitation
- Finance

As the JCC noted in its introduction to the manual, the collection of all relevant laws and regulations was merely a first step for reform

31 See USAID/BizCLIR Jamaica Diagnostic (December 2007), available at www.bizclir.com.

of Jamaica's licensing process. The JCC planned for a critical second stage: "a thorough review of the processes…to ensure that all redundancies and duplications, as well as outdated or irrelevant procedures are excised, and that business-friendly procedures are put in their stead."

In Kenya, the inventory of licenses and permits prepared during the 2005–07 "guillotine" process would be an excellent resource on which to base the creation of sector licensing instruction lists. The UNDP licensing handbook[32] is also an excellent resource. (Both sources, of course, need updating.)

Conduct a nation-wide survey of the relative business-friendliness of each major local authority.

The development community long ago reached the consensus that, when it comes to government effectiveness, "What get measured gets done."[33] Tracking of actual processes and functions in the business environment (rather than making do with vague or unsubstantiated representations of performance) results in sharply increased motivation to reform. Indeed, benchmarking processes and productivity—whether through measuring the pace of real property litigation in the courts, documenting the money flows of employee benefits schemes, or ranking institutions of higher learning through a series of objective indicators—can serve as a significant driver of change as institutional leaders become conscious of how their organizations are perceived by the public and how they compare to the "competition."

On a global level, such projects as *Doing Business* or Transparency International's Corruption Perception Index have proven enormously influential in pressuring national leaders to affect change. But this strategy can also be highly influential within a single country. Earlier this decade, for example, the USAID-sponsored Provincial Competitiveness Index in Vietnam surveyed hundreds of local businesses throughout that country to assess why conditions for doing business were stronger in some regions than in others. A relatively low-cost endeavor, the survey covered business establishment costs, land access and security of tenure, transparency and access to information, time costs of regulatory compliance, informal charges, the competition environment, provincial leadership, private sector development services, labor training, and legal institutions.[34] Among the results of this exercise was to show provincial governments how they could improve their performance, "not against some ideal and possibly unattainable standard of good governance, but rather against the best performance already practiced by their peers within the same national political framework."[35] Virtually the whole country paid heed: when the first PCI was published in 2005, results were routinely referenced in the national and local media and cited by provincial authorities as the impetus for reform.

This recommendation should await implementation until after the BRRU-sponsored local *Doing Business* study (described earlier in this chapter) is released. If that study succeeds in revealing the broad-based experiences of local businesses, including specific areas that local authorities should reform *from the perspective of business,* then this recommendation may not be necessary. If, however, that study centers more on the self-reporting of local authorities, or does not use a large sample of inquiry, a local competitiveness initiative may fill certain important gaps.

Building a local authority competitiveness questionnaire need not be an expensive undertaking—designers could begin with the document used in Vietnam—although implementation and gathering of results would be costly and would take no less than three to six months. Payoffs, though, could be enormous.

Engage in highly publicized, collective resistance to regulatory abuses.

Private sector representatives, particularly those coming from the MSME sector, expressed a lack of confidence in their ability to bring about

32 *Supra* note __.
33 Simeon Djankov and Caralee McLeish, *Introduction, Celebrating Reform* (World Bank, April 2007), at 3.
34 USAID/Vietnam Chamber of Commerce and Industry, The Vietnam Provincial Competitiveness Index 2006, Summary Report at 1. Additional information about this initiative developed through conversation with former project staff.
35 Id. at 2.

change. Indeed, the impunity with which Kenyan public officials manage to endure media airings of their corruption validates this cynicism and discouragement. Nonetheless, private companies should be encouraged to keep trying to find ways to hold their public officials accountable. For example, one municipal chamber of commerce official suggested a chamber-sponsored, highly publicized "No-Bribe Week" within a town or municipality. Businesses, particularly MSMEs, commonly assert that, without bribes to government officials (including police officers), they can never get anything done. However, the collective impact of a week-long "strike" against bribes could be significant. Exposing the agencies and local officials who routinely and directly participate in the culture of impunity may be unpleasant, but could also prove cathartic and force leaders to bring change to their respective agencies. A No-Bribe Week could harness the anti-corruption resources of such actors as the media, NGOs (including Transparency International Kenya), and the donor community.

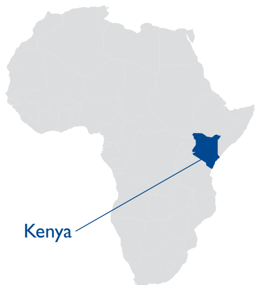
Develop customer service programs for government agencies.

Complaints from the private sector concerning their treatment at the hands of government authorities do not just concern bribes and other methods of corruption. Rather, they concern the widespread behavior of officials who do not view themselves as public servants. Reports of rudeness, haughtiness, stubbornness, slowness, "the runaround," and all kinds of other unhelpful behavior on the part of government representatives were presented throughout this diagnostic.

Agencies that desire to rise above the poor reputation of government generally can begin by adopting private sector practices of customer service. Already, most agencies post their vision statements or missions for public review. However, this effort toward accountability should be extended to the posting of fees and processing timeframes (some agencies do this already)—all as part of a broader push to improve how the government treats its customers. Training in customer service is readily available from local private sector providers, online sources, and other resources. Government actors should not only access this training, but seek customer feedback and reward workers for superior performance.

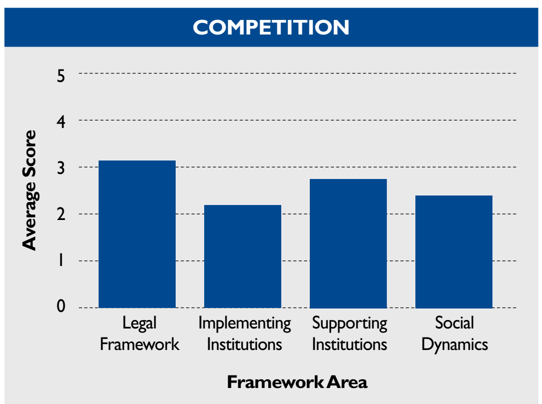
Monitor and support the regulatory reform strategy.

Licensing reform has been on the agenda of government actors and the donor community for nearly five years. The pace of reform, however, is slow, and initiatives launched in 2007, such as the enactment of a Regulatory Reform Bill and the development of the e-registry, have been slow to progress. The monitoring and evaluation aspect of the next stage of the initiative should be taken very seriously. Clear benchmarks for progress should be supported at the highest levels. Where these benchmarks are not met, those charged with meeting them should be able to defend their lack of progress or be replaced by someone who can lead the way forward.



COMPETITION AND COMSUMER PROTECTION

A successful market economy requires, among other things, effective competition and consumer protection policies. Each naturally complements the other and serves to advance economic efficiency, consumer choice and welfare, and overall economic growth and development. Competition forces producers to offer the most attractive arrays of price and quality options in response to consumer demand. When consumers dislike the offerings of one seller, they can turn to others. This ability to shift expenditures—that is, to "spend one's money elsewhere"—imposes a rigorous discipline on each seller to satisfy consumer preferences.



Free markets do not automatically create competitive environments. Like competition on a playing field in any sport, a clear set of enforceable rules must prevent cheating by those who fear the sometimes harsh realities of losing. Left unchecked, firms may engage in practices that undermine competition. When firms engage in such behavior, effective law enforcement is necessary to restore competition.

Law enforcement is a necessary tool, but it is not sufficient to ensure that markets function properly. Rather than breaking the rules, firms may instead seek the assistance of the government to shield them from competition. For example, a firm may ask for regulations that limit the number of market participants or impose substantial regulatory approval costs on new entrants. Such overly burdensome regulations may prove as disruptive as cartelization or other anticompetitive practices. Yet, because they are sanctioned by the government, they do not violate the law and mere legal enforcement is not an option for restoring competition. Accordingly, intervention in the form of competition advocacy may be the only means to ensure that markets continue to function properly.

A consumer protection regime—policy, law, and public and private advocacy—aims to prevent sellers from unfairly increasing sales by misrepresenting their products or by engaging in unfair practices such as unilateral breach of contract. Without a consumer protection regime, widespread and persistent deception by a group of sellers may lead consumers to doubt the integrity of an entire industry or distrust markets generally. Thus, by striving to keep sellers honest, consumer protection laws do more than safeguard the interests of the individual consumer. Namely, they serve the interests of consumers generally and facilitate competition.

KEY LAW

- Trade Practices, Monopolies and Price Control Act (1989)

Kenya lacks well conceived competition and consumer protection policies, laws, and practices. First, it is unclear whether the purpose of Kenya's existing competition law is to protect the competitive process, protect individual competitors, or promote other social goals. Second, the competition law's provisions are often confusing or inconsistent with international best practice, thereby creating legal uncertainty for businesses and making it difficult to enforce the law. Third, there is no competition advocacy mandate in the law to provide a check on, among other things, overly restrictive governmental regulations that may hinder the competitive process. Fourth, Kenya lacks an overarching consumer protection law, thus leaving its consumers unnecessarily exposed to false and misleading information. Consequently, Kenya's competition and consumer protection laws and policies need serious review and revision.

In competition, the legal framework is relatively the strongest framework area, although improvements could certainly be made to the law. As the indicator chart above reveals that implementing institutions are the weakest framework area under competition.

WHO ARE THE STAKEHOLDERS FOR COMPETITION AND CONSUMER PROTECTION IN KENYA?

There are many institutions and individuals with a stake in the development of a sound competition and consumer protection regime in Kenya, including the following:

- Ministry of Finance
- Monopolies and Price Control Commission
- Restrictive Trade Practices Tribunal
- Privatization Commission
- Communications Commission of Kenya
- Capital Markets Authority
- Private businesses
- Private advocates
- Economic and other research and academic institutions, including the Institute of Economic Affairs, CUTS International, Kenya Institute for Public Policy Research and Analysis, and the Center for Law and Research International
- Business and trade associations, including the Kenya Private Sector Alliance and the Kenya Association of Manufacturers
- Consumer groups, including the Kenya Alliance of Resident Associations
- Regional institutions, including the East African Commission and the Common Market for Eastern and Southern Africa
- Universities, including law schools and MBA programs

LEGAL FRAMEWORK

The **Restrictive Trade Practices, Monopolies and Price Control Act** ("Act"), which took effect on February 1, 1989, is the principal law regulating competition in Kenya. The Act was originally seen as a transitional measure as Kenya moved from a price-control regime to a market economy. More recently, however, the Act has been criticized as outdated and in need of reform.[36] In 2005, a Taskforce was established to review the Act and, in August 2006, a report was submitted to the Minister of Finance. The Taskforce's report has not been released to the public, however, which has added to the frustration of many stakeholders who have complained about the lack of transparency in the reform process.[37] Moreover, stakeholders expressed increasing concerns about the fact that the report remains stalled with the Minster.

Even without the benefit of the Taskforce's report, stakeholders contend that the Act is poorly written and in need of a complete overhaul. Among other defects, stakeholders note that the Act fails to set forth a clear purpose or objective; contains numerous substantive provisions that are unclear or inconsistent with international best practice; and provides insufficient investigatory and remedial powers to allow for effective enforcement. Little or no clarification has been provided through guidelines (none have been issued), written decisions (written decisions are not publicly available), or other means (e.g., competition officials do not give speeches explaining their policies and cases). Consequently, many stakeholders are unaware of their legal obligations or otherwise have difficulty

36 *See, e.g.*, CUTS, 2002, *Promoting Competitiveness & Efficiency in Kenya: The Role of Competition Policy & Law, Voluntary Peer Review on Competition Policy in Kenya,* United Nations Conference on Trade and Development (2005); and *Review of Recent Experiences in the Formulation and Implementation of Competition Law and Policy in Selected Developing Countries,* United Nations Conference on Trade and Development (2005).

37 Contrast this to the transparency of the Antitrust Modernization Commission, which was created by statute to undertake a comprehensive review to determine whether the United States antitrust laws should be modernized and whose detailed report is available at www.amc.gov.

in determining whether they are complying with the law. Stakeholders also express concern over the scope of the Act, including its apparent lack of extraterritorial application and overly broad exemptions for certain industry sectors. They also criticize the lack of competition advocacy and consumer protection mandates in the law.

The Act fails to set forth a clear purpose or objective. The Act's purpose, as set forth in its preamble, is "to encourage competition in the economy by prohibiting restrictive trade practices, controlling monopolies, concentrations of economic power and prices and for connected purposes." The Act does not enumerate any of the usual competition objectives, such as increased efficiency, promotion of innovation, or enhancement of consumer welfare. Nor does it clearly enunciate a goal to protect the competitive process rather than individual competitors. The Monopolies and Price Control Commission ("Commission"), however, has taken the position in its Operational Guidelines that "competition policy is meant to promote competition…not to protect individual competitors in their rivalry with other competitors."[38]

Nonetheless, stakeholders remain confused. All stakeholders interviewed for this diagnostic (other than the Commission) were unaware of the Commission's Operational Guidelines. Moreover, they consistently noted that, notwithstanding the Operational Guidelines, various provisions of the Act could reasonably be interpreted as protecting individual competitors or promoting other social goals, rather than protecting the competitive process. Section 4(1) of the Act, for example, defines a restrictive practice to include an act performed by one or more persons which reduces or eliminates opportunities for others to participate in the market. The mere reduction or elimination of an opportunity for a competitor does not, however, necessarily equate with harm to competition. Consequently, broadly prohibiting all practices which reduce or eliminate opportunities may lead to the protection of individual competitors where there is no resulting harm to competition.

Another conflicting example cited by stakeholders concerns the Act's provisions dealing with mergers. Section 30 of the Act specifies three criteria for evaluating whether a merger should be approved or disapproved. While two of these criteria involve traditional competitive factors (increased efficiencies and a reduction in competition), the third factor (protection of jobs) introduces other social goals. International best practice recommends, however, that merger law should "focus exclusively on identifying and preventing or remedying anticompetitive mergers…[and] should not be used to pursue other goals."[39] While these two examples are not necessarily exhaustive, they illustrate that the Act fails to set forth a clear purpose or objective.

The Act's substantive provisions are unclear or inconsistent with international best practice. The Act enumerates various specific restrictive trade practices, including resale price maintenance, market-sharing agreements, collusive tendering and bidding, refusal to supply, discriminatory pricing, and predatory pricing. Some of these prohibited practices are unclear under the Act and no clarification has been provided through guidelines, written decisions, or other means, thus adding to business uncertainty and making it difficult to enforce the law. Moreover, all of these practices are deemed illegal per se, without consideration of important factors affecting competitive conditions in the market, such as ease of entry. Many competition jurisdictions treat certain horizontal agreements (e.g., cartels, price-fixing, and market allocation agreements) as illegal per se. Other such agreements are subject to a competitive effects analysis and condemned only where they have, on net, a significant anticompetitive effect.

Similarly, international best practice generally recommends that dominance or substantial market power serves as a prerequisite for intervention under unilateral conduct laws.[40] Distinguishing between pro- and anticompetitive unilateral

38 Monopolies and Prices Commission Operational Guidelines, reprinted in Criteria for Evaluating the Effectiveness of Competition Authorities (July 2007) and available at http://www.unctad.org/sections/wcmu/docs/c2clp_ige8p02Kenya_en.pdf.

39 *See, e.g.,* International Competition Network's Recommended Practices for Merger Analysis, Part I.A. Comment 1, available at www.internatioanalcompetitionnetwork.org/media/library/Cartels/Merger_WG_1.pdf. Kenya is a member of ICN.

40 *See, e.g.,* International Competition Network Unilateral Working Group, Dominance/Substantial Market Power Analysis Pursuant to Unilateral Conduct Laws, Recommended Practices, available www.internatioanalcompetitionnetwork.org/media/library/unilateral_conduct/Unilateral_WG1.pdf.

conduct can be difficult, so determining whether a firm possesses dominance or substantial market power generally is the first step in evaluating such conduct. In Kenya, however, all unilateral restrictive trade practices are deemed illegal per se, without regard to whether the alleged wrongdoer has a dominant position or substantial market power.

Similarly, the Act's provisions pertaining to mergers are troublesome and largely inconsistent with international best practice. Section 27 of the Act prohibits the consummation of any horizontal merger absent prior approval from the Minister. In contrast, vertical transactions—even those that might result in foreclosure and raise competitive concerns—are not subject to the Act. Additionally, all horizontal transactions are subject to the prior-authorization requirement without regard to the size of the transaction or whether at least two parties to the transaction have appreciable activities within or affecting Kenya. Consequently, the Act requires prior notification and approval for many horizontal transactions that are unlikely to result in appreciable anticompetitive effects within Kenya, while at the same time imposing unnecessary transaction costs and commitment of agency resources without any corresponding enforcement benefit.

In addition, while a horizontal merger cannot be consummated pending the approval of the Minister, the Act does not establish a maximum period for review. Although the majority of merger transactions are approved in two to four months, the lack of a statutory deadline compounds the uncertainty for businesses.

Finally, the Commission has not announced a comprehensive framework (e.g., merger guidelines) for analyzing whether a proposed transaction is likely to harm competition significantly. Kenya's merger regime, therefore, is inconsistent with international best practice, provides too little transparency, and decreases the predictability of enforcement actions.

The scope of the Act is too narrow with respect to extraterritorial application and too broad with respect to exemptions. According to the interpretation of most stakeholders, the Act does not apply to extraterritorial acts or practices that occur outside Kenya but have a substantial adverse affect within Kenya. Additionally, most stakeholders view the Act's provisions exempting industries that are subject to another act of Parliament, as well as certain licensed trades and professions, as too broad and contend that they should be harmonized with the competition law.

The Act provides insufficient investigatory and remedial powers. Numerous stakeholders (not just the Commission) believe that the Act's investigatory and remedial powers are insufficient to provide for effective enforcement. Section 14 of the Act empowers the Commission to compel that documents, information, and other evidence be produced by any person under investigation. The Act does not, however, provide the same authority with respect to third parties. The ability to compel documents and information from third parties is crucial, particularly to ensure that responses are complete, accurate and timely.

The Act also does not allow for unannounced, "dawn" raids. The ability to conduct dawn raids is crucial to carrying out investigations of alleged cartels and minimizing the opportunity for the destruction of evidence. Nor does the Commission have the authority to employ a corporate leniency program. Leniency programs have contributed significantly to effective cartel enforcement in other jurisdictions such as the United States and South Africa.

The Commission's remedial powers are similarly insufficient. For example, Sections 15-17 of the Act appear to establish a three-step settlement process for alleged restrictive practices: (1) voluntary cessation; (2) consent agreement; and (3) formal order. If an investigation reveals the existence of a restrictive trade practice, the Commission must first offer the alleged wrongdoer the opportunity to voluntarily cease the practice. The Commission has no discretion to seek a consent agreement or formal order no matter how egregious the challenged practice. The Commission can proceed to the second option (a consent agreement) only if the wrongdoer fails to respond or fails to implement the voluntary remedial action. Similarly, the Commission may seek a formal order only if the alleged wrongdoer refuses the consent agreement or fails to abide by its terms. Moreover, the Act only provides penalties for the failure to comply with final orders, and those monetary penalties are not likely a sufficient deterrent. Persons who violate a final order are guilty of an offense punishable by a fine not exceeding one-hundred thousand shillings (about $1,250 U.S.).

The Act lacks a competition advocacy mandate. The Act does not contain a competition advocacy mandate. As noted, competition advocacy helps educate consumers, businesses, governmental officials and others about the benefits of competition to individual consumers and to the economy as a whole. Competition advocacy is an important tool with which a competition agency, having expertise in how markets function, can examine and expose the sometimes harsh impact of existing and proposed rules and advocate for pro-competitive policies rather than burdensome forms of regulation. Competition advocacy also lends itself to larger issues, such as privatization policy and whether, and how, to reform policies toward regulated industry sectors.

Kenya lacks an overarching consumer protection law. Competition can motivate sellers to provide truthful, useful information about their products and services, and drives them to fulfill promises concerning price, quality, and other terms of sale. Consumers can punish a seller's deceit or its reneging on promises by switching to other sellers. But robust competition alone may not be sufficient to punish or deter seller dishonesty or reneging. For example, some products are purchased so infrequently that consumers' decisions to shop elsewhere do not provide a sufficient check on sellers' behavior. For certain other products, usually called "credence goods," it is difficult or impossible for consumers to assess whether the seller's claims are true (e.g., whether consuming the product reduces the risk of cancer). Additionally, other sellers may engage in outright consumer fraud. Consumer protection works to ensure that consumers can make well-informed purchase decisions about their choices and that sellers fulfill their promises about the products and services they offer. By striving to keep sellers honest, consumer protection policy safeguards the interests of the individual consumer and facilitates competition and the interests of consumers generally.

Kenya, however, does not have an overarching consumer protection law. Past efforts to introduce a consumer protection law have been met with resistance from the business community. More recently, however, a draft consumer protection bill has been written (the Consumer Protection Bill, 2009) and is expected to be tabled in Parliament this year.

IMPLEMENTING INSTITUTIONS

The Act provides for four implementing institutions: (1) the Minister of Finance; (2) the Commission; (3) the Restrictive Trade Practices Tribunal ("Tribunal"); and (4) the High Court. No competition matter has ever gone before the High Court; only two have been brought before the Tribunal. Shareholders voice concern about the Commission's and Tribunal's lack of independence, transparency, and predictability. They also contend that these institutions are in serious need of assistance in capacity-building to help detect, investigate, analyze, and remedy anticompetitive acts and practices.

The Commission and Tribunal lack sufficient autonomy. The Commission is headed by a Commissioner who is responsible for the day-to-day control and management of the Commission. While the Commissioner oversees investigations and makes recommendations, the Minister has the sole authority to issue orders.

The Tribunal hears appeals from persons aggrieved by a decision of the Minister, but the Minister appoints its members, determines their pay, and makes the rules and procedures for, among other things, hearing an appeal. Stakeholders are concerned about the lack of institutional independence in this process and view decisions as politically based rather than premised on a sound analytical framework grounded in economics.

KEY IMPLEMENTING ISTITUTIONS
• Minister of Finance • The Monopolies and Price Control Commission • The Restrictive Trade Practices Tribunal • The High Court

The Commission and Tribunal lack transparency and predictability. Transparency helps promote consistency, predictability and compliance with the law. Kenya's implementing institutions, however, have done little or nothing to foster transparency. They have not published their decisions, issued enforcement guidelines, or provided other formal guidance to the business and legal communities. The Commission's Web site (www.treasury.go.ke/department.php?debtID=8) contains only a limited amount of information and resources.

Stakeholders also assert that the Commission's investigative process is a "black box." That is, in their view, the Commission engages in little dialogue about its investigation and, in particular, its theory of competitive harm. This lack of transparency has contributed to the perception that decisions are sometimes politically driven and created less certainty for stakeholders.

Commission and Tribunal lack capacity to conduct sound, economics-based analysis. Stakeholders unanimously expressed the view that the Commission staff lacks the skills and experience needed to conduct a comprehensive competitive-effects analysis grounded in sound economic principles. This may be because many of the Act's substantive provisions are deemed illegal per se and do not require any competitive-effects analysis. But other provisions, such as the merger provisions, do require at least some competitive-effects analysis and, should the Act be brought into line with international best practice, more of these analytical skills will be required. The same view was expressed about the Tribunal, except that stakeholders noted that the Act added to the Tribunal's capacity shortage because it does not set forth any qualifications for the members of this supposedly "expert body," other than that its Chairman be an advocate with at least seven years experience.

SUPPORTING INSTITUTIONS

MINISTRIES AND OTHER GOVERNMENTAL AGENCIES

Shareholders consistently identified the Ministries and Members of Parliament as the two most important stakeholders necessary to the successful implementation of a culture of competition in Kenya. At the same time, however, stakeholders perceived most Ministries and Members of Parliament as politically driven or, at best, insufficiently informed about the benefits of competition to consumers and the economy as a whole. Most stakeholders opined that Kenya's law and policymakers need to be sensitized about the proper role of competition policy in a market economy.

NONGOVERNMENTAL TRADE AND INDUSTRY ASSOCIATIONS

This group of supporting institutions has done little to advance the economic efficiency and consumer welfare goals of competition. They have not been actively involved in training and educating their member businesses about the need for and benefits of competition, nor have they taken much of an active role in encouraging the government toward a better balance between regulation and competition. Indeed, several stakeholders opined that trade and industry associations were more likely to seek protectionist legislation than trade liberalization.

EDUCATIONAL AND RESEARCH INSTITUTIONS

This group of supporting institutions has done the most to support the economic efficiency and consumer welfare goals of competition in Kenya. Research institutions like the Kenya Institute of Economic Affairs and CUTS International have conducted several workshops and research projects on Kenya's competition policy over the years. Unfortunately, however, their work product has been largely confined to a core group of individuals within those institutions. These supporting institutions need to do more to educate other stakeholders (particularly Members of Parliament and Ministries) about the benefits of effective competition and consumer policies for Kenya.

KEY SUPPORTING ISTITUTIONS
• Ministries and other governmental agencies • Nongovernmental trade and industry association • Educational and research institutions • Consumer groups

CONSUMER GROUPS

As explained earlier, consumers are the ultimate beneficiaries of well-conceived competition and consumer protection policies. Consumers, however, are the most under-represented stakeholders when it comes to having a voice with Kenya's policymakers. Supporting institutions must fill this void by educating consumers about their rights and creating a mechanism for consumers to have input into competition and consumer protection policies and laws. While some supporting groups (e.g., the Kenya Alliance of Resident Associations) have begun to push for more consumer representation and advocate for, among other things, a consumer protection law, much more representation is needed.

SOCIAL DYNAMICS

GOVERNMENT AND POLITICAL LEADERSHIP

The general view among stakeholders is that governmental leaders have been largely unresponsive to the needs of business and consumers. Most stakeholders believe that Kenya's political leaders are unaware of the role of competition and consumer protection policy in a market economy and the benefits that it can bring to consumers and the economy as a whole. Consequently, governmental leaders are slow to implement major changes that could fundamentally reshape the competitive landscape in Kenya, such as removing burdensome forms of regulation that hinder a well-functioning marketplace.

BUSINESS AND LEGAL COMMUNITY

Stakeholders generally believed that businesses are either unaware of their legal obligations or otherwise have difficulty in determining whether they are complying with the law. Moreover, many businesses (particularly small and medium sized businesses) are not proactive in seeking clarification of their obligations and rights, and have failed to exert pressure on governmental leaders and others to create a sound competition policy in Kenya.

RECOMMENDATIONS

Review and revise the Act giving consideration to international recommended best practice and taking into account the specific needs of Kenya.

The Act should be revised and made more responsive to international recommended best practice, regional community requirements (i.e., East African Community and Common Market for Eastern and Southern Africa), and Kenya's needs. Revisions should be drafted in consultation with experienced competition agencies that can provide important input on substantive and practical issues that may not be readily apparent to the drafters, advise them where proposed revisions are inconsistent with international norms, and identify the benefits and consequences of the various choices under consideration. At the same time, it should be acknowledged that no single model is suitable for all jurisdictions and that Kenya may need to deviate from best practices in some areas. The process should be sufficiently open and transparent to allow all stakeholders the opportunity to participate. With this understanding, the following revisions, some of which are discussed in more detail in the body of the report, should be considered.

1. The Act should state that the sole objective (or at least the principal objective) of competition law is the protection of competition rather than the protection of individual competitors or promotion of other social goals.
2. The Act should establish autonomous implementing institutions. Among other things, senior members of the Commission and Tribunal: (a) should be required to possess minimum qualifications or experience as experts in competition law and economics, or related fields; (b) serve multi-year, staggered terms so that not all members are replaced at one time, causing a loss in institutional knowledge and continuity; and (c) should only be subject to removal for cause.
3. The Act's substantive provisions should be revised giving consideration to international recommended best practice, including the following: (a) subjecting to per se illegality only those horizontal practices that always, or almost always, harm competition (i.e., higher prices, lower output, or reduced innovation); (b) subjecting unilateral practices to an initial dominance or market-power test based on a comprehensive consideration of factors affecting competitive conditions in the market rather than market shares alone; (c) expanding the law's merger provisions to include non-horizontal transactions; (d) establishing merger notification thresholds with an appropriate "local nexus" provision to screen out transactions that are unlikely to result in appreciable competitive effects in Kenya; (e) establishing clear and understandable merger notification thresholds based on objectively quantifiable criteria that are readily available to the merging parties; (f) establishing an appropriate and realistic time period in which to complete merger reviews, including procedures for the expedited review and clearance of transactions that do not raise material competitive concerns; (g) expanding the Commission's investigatory powers to include, among other things, the ability to compel third party documents and information and to conduct "dawn" raids; (h) providing the Commission authority to seek immediate formal orders; and (i) strengthening penalties for noncompliance with requests for documents and information and violations of final orders.
4. The Act should be revised to include a competition advocacy mandate. Additionally, the Commission should be given authority and the necessary legal tools to conduct research to advance the development of competition law and policy. In particular, it should be allowed (1) to organize hearings and public workshops to examine emerging issues in the economy and important competition-related topics, and (2) to conduct fact-based studies of particular industries or markets.
5. Draft a comprehensive consumer protection law with the assistance of experienced consumer protection agencies.

Implement a long-term capacity-building program for the Commission and the Tribunal.

Donors should support a long-term capacity-building program to help the Commission (and Tribunal) detect, investigate and remedy anti-competitive acts and practices. Capacity-building is particularly important because some areas of competition law (e.g., merger review) involve predicting future economic behavior, not merely assessing past conduct. Consequently, these implementing institutions must learn to identify likely effects on competition and consumers, isolate the material competitive issues, conduct efficient and effective investigations, and develop workable remedies. The range of capacity-building activities should include, among other things, assistance in legislative drafting (see Recommendation 1); short-term training programs; long-term resident advisors; and staff exchanges with experienced foreign counterparts.[41] Each of these is described in more detail below.

Foreign competition agencies are best suited to provide these capacity-building programs for at least two reasons. First, they can draw on their institutional strengths and experiences to provide assistance that is comprehensive in its scope, emphasizing the pragmatic over the theoretical and focusing on transferring institutional skills and experience in investigating, analyzing and remedying anticompetitive behavior. Second, they can foster valuable working relationships that continue well after the capacity-building program has ended.

A. Short-Term Training Programs

A series of short-term programs, each ranging from one day to one week in length, are needed to train Commission and Tribunal personnel in the substantive legal principles, analytical frameworks, investigative techniques, and agency operations needed for the success of a competition law enforcement regime. These training seminars should be conducted by experienced members of foreign competition authorities and cover the following topics: competition economics and law; practical and analytical skills for cartel, abuse of dominance, and merger investigations; remedies; data collection, confidentiality and transparency; administrative aspects of case handling; strategic planning and priority setting; and international and regional cooperation.

1. **Competition economics and law:** This training should provide a basic grounding in the theory and practice of competition law, including an introduction to basic principles of the economic theory of competition policy. It should explain and provide tangible examples of how competition and competitive markets provide consumers with the best range of goods and services at the lowest prices and in response to consumer demands. Additionally, the training should provide an overview of the basic economic principles of supply and demand that are the underpinnings of competition law.
2. **Basic investigative techniques for cartels, abuse of dominance, and mergers:** These training sessions should consist of a series of three separate, one-week programs that provide a platform for understanding the legal and economic underpinnings of the three types of conduct that characterize competition law worldwide: anticompetitive agreements—especially cartels; abuse of dominance; and anticompetitive mergers. Each session should provide participants with training on substantive issues (e.g., defining a relevant market, assessing competitive effects, etc.) and an overview of the key legal and economic issues of each topic examined. The training should employ interactive case studies to simulate actual investigations and aid participants in the development of practical investigative skills, e.g., writing an investigational plan, drafting and reviewing document requests, interviewing witnesses, analyzing competitive effects, assessing defenses and efficiencies, and developing remedies.
3. **Remedies:** This training should include a discussion of the goals of remedies—restoring competition, deterrence, and punishment. It should also provide an overview of the range of remedies to competition violations and include some hands-on training in applying remedies to specific fact patterns.
4. **Data collection, confidentiality and transparency:** Effective competition analysis, like good economic analysis generally, depends heavily on having access to good information and data. Specific training in this area should include: (1) identifying potential sources of business and industry information and recognizing the strengths and weaknesses of these different sources of information in terms of type, quality, completeness, and reliability; (2) developing

41 While these recommendations largely pertain to the implementing institutions for competition law and policy, donors should recognize that similar assistance will be required with respect to the drafting of consumer protection legislation and capacity building at the institutions responsible for implementing the consumer protection law.

tools and methods for collecting information and data; and (3) learning to apply sound economic research methodologies and statistical tests, including: (a) defining relevant product and geographic markets; (b) identifying and measuring market power; (c) quantifying economic harm; and (d) assessing potential efficiencies.

5. **Administrative aspects of case handling:** This training should focus on the administrative aspects of handling a case, from its initiation as a complaint to its final resolution. It should include practical discussions of case tracking, document management, and software available to control and analyze documents. Using electronic tools to analyze and sort documents is critical to efficient and accurate examination of evidence and to meeting potential chain-of-custody concerns. The training should also discuss general record keeping requirements for official records and filings in a case, both when it is in active investigation or litigation and at its conclusion. Methods for keeping records of the agency's internal deliberations and reasons for making a decision should also be addressed.
6. **Strategic planning and priority-setting:** It is unlikely the Commission will ever have sufficient resources to address every alleged violation of the competition law or to take advantage of every opportunity to educate business, consumers, and the media about the advantages of a robust competitive market place. It is therefore critical for the Commission to establish priorities and plan, at least on an annual basis, how it will target its limited resources. Among other choices, it may choose to focus on a limited number of especially pernicious forms of anticompetitive conduct, or it may look at a broader range of potentially anticompetitive conduct but in a limited number of economic sectors that are especially critical to Kenya's economy or the well-being of its consumers. This training should address how to narrow the range of violations and sectors to target, how to draft strategic plans, and how to formulate measurable results. It should also address how to budget for the staffing of individual investigations and cases, especially cases with significant documentary evidence and large numbers of potential witnesses, and cover techniques for effectively managing ongoing investigations.
7. **International and regional cooperation:** This training should provide an overview of the various instruments used by competition agencies to cooperate in investigations and cases, such as "soft" bilateral cooperation agreements and mutual legal assistance treaties, and also discuss the ways in which agencies cooperate effectively on an informal basis. The training should also provide an overview of the various multilateral organizations that currently address competition policy issues, such as ICN, the OECD, and UNCTAD, and review some of the major work product of such groups, including the ICN's Recommended Practices for Merger Procedures and the OECD's hard core cartel recommendation. Particular emphasis should be given to any obligations involving the EAC and COMESA.

B. Long-Term Resident Advisors

Foreign competition agencies should assign experienced staff as long-term legal and economic resident advisors to the Commission for periods of three to six months, or longer. While short-term training missions like those outlined above are necessary to the development and maintenance of the Commission's capacity requirements, a resident advisor can help train staff and promote a culture of competition by working directly with the staff on their actual investigations. A long-term, in-country commitment will also allow an advisor to become more familiar with Kenya's competition regime and relevant market developments, thus contributing to more focused counseling. Additionally, by working closely with staff on a day-to-day basis, an advisor will be better able to identify other capacity-building needs and priorities, and establish a working relationship that continues long after departure from the country.

C. Staff Exchanges with Foreign Competition Authorities

Select Commission staff should be offered internship opportunities with foreign competition agencies. Ideally, internships should last three to six months, thus providing ample opportunity for Commission staff to participate in all phases of the host-agency's investigations and enforcement actions, and gain a valuable firsthand appreciation of the practices and approaches used in other jurisdictions.

Increase the transparency and predictability of the Commission and Tribunal.

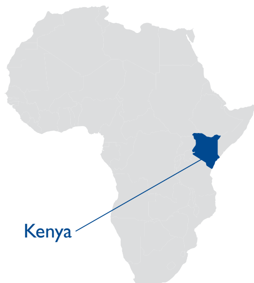
One common theme unanimously expressed by stakeholders is that the Commission and Tribunal lack transparency and predictability in their investigation and decision-making processes. These implementing institutions can take various steps, ideally with input from foreign counterparts, to remedy these problems.[42] Among other things, they should:

1. Prepare internal operating manuals establishing, among other things, procedures and timelines for investigations.
2. Prepare regulations, guidelines and best practices to aid legal practitioners and businesses in understanding their legal obligations and to improve transparency and predictability.
3. Write and publish well-reasoned decisions supported by adequate facts and analysis to explain why the challenged practice is (or is not) harmful to competition.
4. Engage in ongoing consumer and business education and training.
5. Resume the publication of annual reports.
6. Develop and maintain a user-friendly Web site with all relevant laws, forms, regulations, guidelines, press releases, decisions, consumer and business education materials, and other relevant materials.

Engage in a systematic educational campaign to sensitize stakeholders to the benefits of a well-conceived competition and consumer protection policies to consumers and to the economy as a whole.

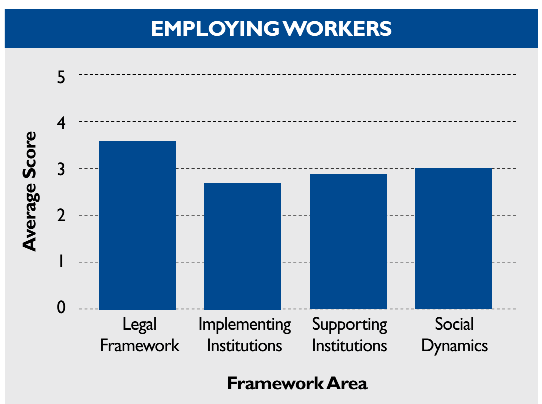
This diagnostic revealed that few stakeholders are aware of, and fewer understand, Kenya's competition law and policy. Consequently, there is much need for an educational campaign to sensitize stakeholders about the role and benefits of competition and consumer protection laws and policies in a market economy. Educational efforts should include a series of short workshops (half-day and day-long programs) targeted to specific stakeholder audiences, including business groups, consumer groups, governmental entities (including law and policymakers) and the media. Moreover, outreach should not be confined to the Nairobi area, but include programs in several outlying cities. Outreach efforts should include specific, tangible examples from Kenya and other countries showing how competition and consumer protection serve to advance economic efficiency, consumer choice and welfare, and overall economic growth and development. Where possible, examples should provide quantifiable evidence of such benefits.

42 Some of these recommendations may not be possible absent a change in the law.



EMPLOYING WORKERS

Although labor relations in Kenya are generally sound and the Kenyan labor market is more flexible than that of most African countries, a package of five new labor laws enacted just weeks before the December 2007 election represents to employers a difficult and costly turn of events. The practical implications of a number of new worker-friendly provisions, including increased allowances for leave and disability, remain highly contested. Employers' vigorous opposition to the laws has resulted in ambiguity in whether, when, and how the laws are to take effect. Already, certain aspects of the new law have been invalidated in Kenya's High Court. Although the first quarter of 2009 has shown some resolution of these issues, prolonged ambiguity, along with sluggish implementation of those aspects of the law that are uncontested, undermines both employer and worker confidence in the labor law regime.



Indeed, Kenya faces a number of challenges that go beyond the issues examined by *Doing Business,* which looks exclusively at the ease with which workers can be hired and fired and other specific indications of labor-market flexibility. The fact that the vast majority of Kenyans do not work for formally registered companies (75 percent are employed in agriculture, mostly informally), means that the regime of new labor laws has, and will have, little practical application to them. But all enterprises, whether formal or informal, face the central challenge of the quality, responsiveness, and readiness of the Kenyan workforce. All levels of Kenya's educational system should be more responsive to the shifting needs of both the public and private sectors. The arrival of an undersea fiber-optic cable to East Africa this year will present a rapid increase in the use of broadband technology as a mechanism for doing business, and the opportunities it presents include the rapid development of business process outsourcing as a major new service industry.

The BizCLIR indicator scores illustrate the major points detailed in this chapter: Although the new labor legislation is better than average, both implementing and supporting institutions need to do more to improve the relationship between workers and their employers.

LEGAL FRAMEWORK

ACCESS TO THE LEGAL FRAMEWORK

Where Kenya fails at fully publicizing the licenses and regulations that its business community is subject to (see this report's chapter on Licenses and Permits), it does a far better job in publishing its laws. Kenya's National Council for Law Reporting maintains a website that is responsible for publishing all of Kenya's operative laws, as well as other important resources such as court decisions, draft laws, and some regulations. Each of the major labor laws are found at this site; they are also published on the website of the Ministry of Labor. This example of accessibility of legal texts should serve as a model for the region.

Again, however, the great majority of Kenya's workforce is employed outside of the formal sector, so the actual reach of the labor market laws and institutions discussed here extends to a small fraction of the economy. This highlights how essential it is for Kenya to shape and administer its labor and other regulatory reforms with the goal of minimizing barriers that keep microenterprises and their workers locked into the informal economy. Such workers need social protections at least as much as those in the formal sector.

KENYA'S NEW LABOR LAW REGIME

Just weeks prior to the December 2007 election, a set of five draft laws pertaining to labor relations were seized from the drawing board—where they had been in development for at least five years—and, to the delight of the nation's labor unions, were quickly debated and enacted. At the time, there was indeed a great need for an updated regime of labor laws, which had barely been touched since Kenya's independence. In the early states of the legislation's development, there had been considerable stakeholder involvement, including employer, union, and government representation, and many aspects of the new laws were uncontested by both sides. But the quick enactment of the laws was very sorely received by the employer community, which had not agreed with several changes and was not significantly consulted during the 2007 enactment process. "The law they passed was a draft," one employer representative contends. "It was a work in progress—the [legislative drafting] process did *not* work out."

The five new laws are a mix of basic labor principles that bring Kenya into line with international labor standards, and additional provisions that make formal employment in Kenya a very generous proposition. First, the new **Employment Act** addresses the minimum terms and conditions of employment in Kenya. It specifically prohibits forced and child labor, sexual harassment, and discrimination on the basis of disability, HIV/AIDS status, and other known conditions. The act increases the age of a "child" from 16 to 18 years, thus harmonizing the definition within the Employment Act with Kenya's Children's Act.

Although employers do not object to many of the core provisions of the Employment Act, they contend that a number of its provisions will drive up the cost of formally employing workers. Through representative associations and the media, employers have specifically objected to the creation of an insurance scheme to benefit employees who are made redundant and the rapid conversion of "casual" workers into workers with formal term contracts. These provisions, they contend, do not reflect the reality of sporadic or seasonal work and make the market for workers less flexible, and therefore more costly. Although employers generally do not object to the mandatory 21 days of annual leave for all employees, they have been especially vocal in their opposition to the new provision of three months maternity leave for female workers and two weeks' paternity leave for male employees. "I am less likely to hire a woman" due to the long maternity leave requirement, one company owner stated during this diagnostic.

The **Labor Relations Act** generally aspires to bring Kenya into compliance with the major labor rights endorsed by the International Labor Organization. The act secures the freedom of association for both employees and employers; streamlines registration of workers' and employers' organizations; promotes democratic practice in lawful collective groups; asserts individual and collective group rights; and provides guidelines pertaining to the right to strike. The act also attempts to streamline trade dispute resolution mechanisms and gives specific time-frames for dispute disposal.

The **Labor Institutions Act** establishes and strengthens institutions which deal with labor relations, such as a new National Labor Board, the National Industrial Court, wages councils, and employment agencies. One aim of the act is to decentralize the National Industrial Court, a division of the Ministry of Labor which is currently based only in Nairobi and, until relatively recently, has only employed one judge.

The **Work Injury Benefits Act** endeavors to update the level of benefits due to workers who are injured on the job. However, it also contains certain provisions to which employers objected and were deemed invalid by a High Court ruling in March 2009. For example, in its original form, the act provided for 96 months of full pay to workers who are disabled on the job, a provision that employers called onerous. The act also placed arbitration of disability claims in the jurisdiction of a National Labor Court and disallowed claims pertaining to these issues before the regular courts.

In all, the High Court nullified nine sections of the act, including a requirement that employers offer compulsory insurance for workers from a pool of underwriters approved by the Ministry of Labor. The court also invalidated a provision that allowed employees injured in a workplace to seek a medical exam from a physician of their choice without a reference from the employer's doctor. The decision leaves the issue of insurance coverage for workplace injuries unresolved.[43]

The **Occupational Health and Safety Act** aspires to update worker health and safety law and practice in Kenya. Among other provisions, the law expands the coverage of health and safety law to all workplaces, rather than the relative few that were previously covered; abolishes employment of children in workplaces; encourages entrepreneurs to set safety targets for their enterprises; promotes reporting of workplace accidents, dangerous occurrences, and ill health; and aspires to promote a "safety culture" at workplaces through education and training. Although employers have not vocally opposed most of these provisions, there does appear to be a lack of awareness about how they will be implemented. Employers have also asked that the new provisions be phased in over time, rather than enforced immediately.

KEY LAWS

- Employment Act (2007)
- Labour Relations Act (2007)
- Occupational Safety and Health Act (2007)
- Work Injury Benefits Act (2007)
- Labour Institutions Act (2007)
- National Social Security Fund Act (1965, with subsequent amendments)

Since their enactment in 2007, implementation of the new labor laws has been slow. A lawsuit filed by the Federation of Kenyan Employers resulted in the delay of their official entry into force by several months. The recent nullification of key provisions of the Workplace Injury Act increases the uncertainty of that law's implementation, with many questions pertaining to workplace insurance specifically unresolved. According to the Ministry of Labor, regulations have been crafted for each of the laws, but employers indicate that they do not yet agree to the terms of implementation. In short, the regime for labor law is currently plagued by a number of major ambiguities.

IMPLEMENTING INSTITUTIONS

MINISTRY OF LABOR

The Ministry of Labor, charged with implementing and enforcing the new labor laws as well as addressing other key workplace issues, lacks the staff and resources it needs to effectively assume these roles, particularly in regions beyond Nairobi. Although facilities in the capital are adequate for most ministry workers to do their jobs effectively, field offices typically lack computers and other important tools, and most field staff do not have access to e-mail.

The ministry has a number of core responsibilities, including the following:

Labor relations. Although ministry representatives wish that both unions and employers were

43 Daily Nation (Smart Company Weekly Business Magazine), "Ruling on workplace injury could cause more labour pains," March 10, 2009 at 1.

more flexible in their policy demands, Kenya happens to have a healthier environment for labor-management dialogue than many other countries in Africa and beyond. The major representative institutions (on the union side, the **Coalition of Trade Unions,** and on the employer side, the **Federation of Kenyan Employers**) are well represented and fully understand the issues before them. Both sides wish that the ministry would see things more closely to their own perspective, but the nature of labor relations is such that this will likely always be the case.

The ministry is also home to the **National Industrial Court,** a surprisingly unsophisticated institution, particularly in light of Kenya's size and history. Only recently has the industrial court expanded beyond just one judge. Since the enactment of the Labor Institutions Act, it now aspires to open offices beyond Nairobi but has few resources to do so. Moreover, its use of automation is minimal and it makes very little pretense of independence. Perhaps the low-key nature of this tribunal to date reflects an environment for labor in Kenya that, though not without its issues and disputes, is at relative peace.

A new tribunal, the **National Labor Board,** was created in the 2007 labor legislation for the purpose of advising the government on specific labor issues. This board has not yet been fully established, but it has begun to take shape. However, at this time there is proportionally very little employer representation on the board, a fact that troubles the private sector community. Meanwhile, various agencies from within the Ministry of Labor are heavily represented on the NLB. Unions are also represented.

Occupational safety and health. Although Kenya has clarified and strengthened its law pertaining to workforce safety (expanding protections from a relatively narrow set of workplaces to all workplaces, estimated to number at least 100,000), the ministry has very few resources with which to enforce the law. Businesses state that they are rarely, if ever, visited by labor inspectors and, when they are, the inspections are perfunctory. The labor inspectors employed by the ministry lack the tools and resources necessary to properly do their work. Just 40 percent of the 2,400 ministry positions allocated for labor inspectors are filled.

The new health and safety law will rely heavily on self-enforcement by companies according to the best practices of their respective sectors. In light of the ministry's lack of resources, this is a sensible approach. The ministry now faces the enormous challenge of educating employers and workers about their health and safety rights and responsibilities, one that it does not yet appear to have the resources to carry out. The ministry is eager to receive technical assistance from international and national institutions that are engaged in the issues of workplace safety, including the International Labor Organization and the National Institute of Occupational Safety and Health in the United States.

KEY IMPLEMENTING INSTITUTIONS

- Ministry of Labor
- National Industrial Court
- National Labor Board

Industrial training and human resources development. The ministry supports a number of worker training initiatives in Kenya, including several dedicated vocational institutions located throughout the country. Although the ministry is aware of the need to match skill-building with employer needs, practical application of this notion is weak, and, in the eyes of many employers, "the curriculum in most vocational institutions is too primitive."

For example, vocational schools lack the facilities they need to train students in current topics in technology. Access to computers and the internet is especially weak outside Nairobi. A plan for preparing Kenya to meet the increased needs of a business process outsourcing industry is spoken of, but little if any implementation is yet taking place.

MSME development. The ministry takes seriously its charge to support the establishment and growth of small formal and informal businesses, viewing entrepreneurship as an important alternative to formal employment. But the ministry's role in MSME development is mixed in with many other national, regional, and local initiatives aimed at supporting entrepreneurship, among them microfinance funds for women and youth, government-supported business development incubators, the resources of the national investment agency (KenInvest), various donor-supported initiatives (including those dedicated to specific value chains), and several other players in the field. As mentioned previously in this report, there is an immediate need in Kenya for far stronger coordination among agencies that support the development of MSMEs. The Ministry of Labor can certainly bring a helpful perspective to the issue, but it should not continue to do its work in a virtual vacuum.

Engagement in policy issues. As an agency that is directly involved in issues impacting the livelihoods of Kenyan citizens, the ministry feels that it is often overlooked when other branches of government or the donor community are seeking to address issues of economic growth. Beyond its limited work with MSMEs, the ministry is not significantly engaged with private sector development issues even though, it argues, it can serve as an important contributor and facilitator. "We know the importance of investment," one ministry official contends, "and we can help."

SUPPORTING INSTITUTIONS

NATIONAL SOCIAL SECURITY FUND

Since 1965, Kenya has aspired to provide a social safety net for its citizens, adopting a system in which employers and employees jointly pay into a fund that, upon the employee's retirement, returns the money after years of investment. The NSSF has been a parastatal institution since 1989, along with other funds established for government workers, local authorities, and police. (They all are regulated by the **Retirement Benefit Authority**). At this time, the NSSF applies its mandate to the formal sector only—that is, companies that employ five workers or more—and, although three million workers are registered, only about one million workers in Kenya actually participate, out of a workforce of 17 million. The NSSF aspires to bring others into the system, including informal workers, although doing so has proven challenging.

KEY SUPPORTING INSTITUTIONS

- National Social Security Fund
- Labor unions
- Federation of Kenyan Employers
- Private and secondary education
- Universities
- Vocational education

The NSSF has a list of reforms it wishes to achieve, if it could only get the attention of the country's Parliament. First, NSSF officials would like the system to become a pension scheme—that is, a source of periodic payments to retired workers—and abandon its current system of simply paying a single lump sum (as invested, plus 5% interest) upon the employee's retirement. The NSSF also seeks the authority to bring more informally employed and casual workers into the system, so that they, too, could have some expectation of a safety net when they are old. The NSSF would also like to formally create a voluntary pension scheme, so that even people who are not required to pay into the system may do so if they choose.

Advances in Kenya's social security schemes are not, however, a priority of government. Efforts to introduce reform legislation have failed for several years in a row. As the family loses its viability as a financial support unit in Kenyan society, this suggests that the country is not adequately investing in the country's future. Alternatively, it means that Kenyans will need to continue to share their own earnings with their family members at the expense of the new businesses they might be creating.

LABOR UNIONS

The labor movement in Kenya has a long and politically influential history, and unions are credited most recently with joining in the grass-roots efforts to prevent continued violence following the 2007 elections. Organized labor is considered an important voting bloc, as evidenced by the swift enactment of Kenya's new labor laws just prior to the 2007 election. The unions endeavor to keep their memberships informed of changes in the law and the impact of those changes on workers.

As a force that influences the daily workings of Kenya's businesses, however, the unions are not especially strong. High unemployment in Kenya means that many workers are willing to work without a union contract or are not aggressive about enforcing their rights. Even large companies, moreover, skirt important labor legislation, such as the social security law, because they do not fear consequences. For example, workers at large hotels are often casually paid and do not receive the benefits they are entitled to, and unions have little power to help them.

EMPLOYERS

The **Federation of Kenyan Employers** is the organization that, according to its own by-laws and many pieces of national legislation, is charged with representing the interests of employers throughout Kenyan society, including on legislative committees, ministry taskforces, the new Prime Minister's Roundtable, and other institutions. In the past, according to observers on both the union and business sides, the FKE has been a relatively weak representative of employer concerns, tending instead to go along with most initiatives of organized labor. This, however, is reportedly changing. Under new leadership, the FKE has been more aggressive recently in asserting the concerns of the private sector and has succeeded in delaying implementation of the new labor laws and publicizing employer concerns more effectively in the media.

PRIVATE AND SECONDARY EDUCATION

Kenya did the right thing in 2003 when it eliminated fees for primary education, but this change brought about stresses to the system that still need to be addressed. With free education, class sizes rapidly expanded, but the budgets for teachers and supplies did not. Private alternatives to public education are booming, and although increased access to education cannot be viewed as a bad thing, the differences in opportunity afforded poor children versus wealthier ones are widening. Although fees for public secondary schools were significantly reduced in 2008, there are still costs associated with this tier of education that make it unaffordable for many. One area that Kenyan primary schools should continue to emphasize is fluency in the English language. The ability to communicate in the world's most widely used language of business provides advantages in such fields as tourism, technology, and other services.

UNIVERSITIES

Kenya's system of higher education is one of the strongest in Africa, and demand for places in the public universities is especially high. The best (and often the most privileged) students find places in the public universities, with private institutions taking the next level of students. Scholarship in the public universities is thriving. Economics has grown as a discipline, becoming its own department at the University of Nairobi and expanding from a three-year program to four. At the same time, all universities in Kenya could use more resources and research facilities.

Kenya's system of legal education could do more to respond to the needs of Kenya's commercial sector. Under new leadership, the University of Nairobi Law School is endeavoring to build a stronger and more relevant core of commercial law courses into its curriculum, to match its historic emphasis on human rights and constitutional law.

VOCATIONAL EDUCATION

Kenya operates a number of institutions throughout the country dedicated to training workers in a variety of fields, including engineering support, food service and hospitality, pharmaceuticals, tailoring, agricultural support services, and many other trades. The national institutes are a well run alternative to university education, and have in recent years embraced more rigorous and professionally oriented curricula. Like so many other government institutions, however, Kenya's vocational schools lack sufficient resources. In particular, technology education is falling behind and students are not yet prepared for the changes in employer demands that will accompany greater access to internet and technology-related services.

KENYA'S WORKFORCE PROFILE	
Population	39 million
Labor force	17 million
Approximate number of employees formally employed (based on estimates of workforce formality)	1.5–2.5 million
Percentage of workforce employed in agricultural sector	75%
Percentage of workforce employed in industry and services	25%
Unemployment rate	40–60%
Literacy (Male)	91%
Literacy (Female)	80%

SOCIAL DYNAMICS

POLITICAL AMBIVALENCE OVER THE INFORMALITY OF WORK

A number of reasons explain why the Kenyan government takes a relatively forgiving attitude toward employers that do not register their companies, fail to pay social security and health benefits, or otherwise refrain from abiding by the regime of labor legislation. Chiefly, the informal sector provides employment to a great many Kenyans who might not otherwise find work—indeed, the informal sector "is often, by far, the most important source of employment in many developing countries as the formal sector—both private and public—has struggled to generate sufficient employment."[44] Informality represents a coping strategy for both wage-earners and non-wage earners (entrepreneurs) that results in a form of "employment substitution" for people who are unable to find work with companies that are formally registered, hold required licenses, and pay taxes and social security.[45]

In one report, the UNDP cites the urban dwellers in Thailand who turned to informal street-vending during the economic crisis of the late 1990s as an example of informal actors contributing to the economy when there were no significant alternatives.[46] In Egypt, the informal sector has been found to be the country's largest employer, providing work for about 8.2 million people, compared to 6.8 million employed by the private sector and 5.9 employed by the government.[47] Given the very high rate of agricultural employment in Kenya, as well as the costs associated with business formality, these issues are also familiar there.

Another reason why the Kenyan government may resist increases of formality of the workforce—through, for example, application of its social security law to businesses of fewer than five people—is that informal earnings can "provide a considerable boost for the official economy"—up to 66 percent of all earnings in Germany and Austria, one study posits.[48] In addition, some observers cite employment of

44 Niels-Hugo Blunch et al., *The Informal Sector Revisited: A Synthesis Across Space and Time* (World Bank Social Discussion Paper Series, July 2001).

45 United Nations Development Programme, *Unleashing Entrepreneurship, Making Business Work for the Poor* (2003).

46 Id.

47 Amhed Galal, *The Economics of Formalization: Potential Winners and Losers from Business Formalization in Egypt*, Development Outreach (Egyptian Center for Econ. Studies, Working Paper No. 95, March 2004) (*citing* Alia El Mahdy, The Labor Absorption Capacity of the Informal Sector in Egypt (final report presented to Economic Research Forum for Arab Countries, Iran, and Turkey (2000); Soad Kamel, *The Informal Sector in Egypt: Basic Characteristics of Firms and Workers* (Center for Econ. & Finan. Research & Studies, Cairo U., Working Paper Series No. 28 2003)).

48 Bruno Frey and Fredrich Schneider, Informal and Underground Economy (2000) at 9.

disadvantaged groups as a rationale for tolerating certain "gray" employment markets. As noted by the UNDP, "In societies that limit the economic [participation] of women, home-based enterprises provide women with opportunities to earn money."[49] This issue has particular relevance in Kenya, which is ranked 88th out of 130 countries recently surveyed by the World Economic Forum in terms of the relative equality of women with men in the areas of economic participation, political participation, education, and health. (In fact, Kenya has fallen 15 spots in the WEF Gender Gap Survey since 2007).[50]

An analysis of informal markets performed in 2004 by McKinsey & Company asserts that "well-intentioned policymakers" who seek to avoid compromising opportunities for employment and imposing heavy tax and regulatory burdens on already struggling MSMEs "underestimate what they can and must do to correct all of the sources of informality."[51] Very few informal businesses, once they become active, cross over to the formal sector, the McKinsey analysis finds; rather, they "become trapped in a self-reinforcing dynamic that confines them to subscale, inefficient, low-productivity work." Thus, in light of its findings that the long-term negative impact of informal businesses outweighs short-term employment benefits, the McKinsey report argues that early enforcement against gray businesses and strong social pressures against informality are urgently needed.

In its *Doing Business* initiative, the World Bank has similarly underscored the damaging long-term economic impact of high levels of informality and encouraged a variety of reforms that would bring more companies into the formal sector. Summing up the many negative implications of doing business in the gray economy, the World Bank says:

> *[Workers] enjoy no social benefits and cannot use pension plans and school funds for their children. Businesses do not pay taxes, reducing the resources for the delivery of basic infrastructure. There is no quality control for products. And entrepreneurs, fearful of inspectors and the police, keep operations below efficient production size.*[52]

According to the economist and author Hernando de Soto, whose ground-breaking work on the importance of property rights has illuminated the importance of company formalization,[53] governments in the past have done very little to understand and quantify their informal sectors so that they can develop a strategy for change.[54] As de Soto has further noted, entrepreneurs who refrain from entering the formal regulatory system are likely to remain similarly estranged from the political system, thus undermining a country's access to the benefits of stability and democratic participation.[55]

PRIVATE SECTOR INFLUENCE

Some private sector factors may offer a more positive influence on the conditions of work in Kenya than either unions or government agencies. During this diagnostic, a number of examples were cited in which such factors have resulted in improved occupational safety and health with the assistance of employers. Specifically, in the manufacturing sector, employers have found that their insurers set more rigorous conditions for factory safety than those enforced by Kenya's labor inspectors. Similarly, in the food processing sector, the desire to achieve International Organization for Standards (ISO) standards so that products may be exported has led employers to become more conscientious about workplace health and safety conditions.

REGIONAL OPPORTUNITIES

Kenya's workforce is strong relative to the labor pools in other countries in the region, and opportunities abound for Kenyans to seek their fortune in nearby countries (with the exception of Tanzania, which seems to make a point of restricting the influx of Kenyan workers or services). In 2007, to meet its needs for a more skilled workforce, Rwanda abandoned its requirement that Kenyans obtain work permits to work in Rwanda. Not long thereafter, Kenya reciprocated.

49 UNDP, *Unleashing Entrepreneurship, supra* note __.
50 World Economic Forum, Gender Gap Report (2008).
51 Diana Farrell, *The Hidden Dangers of the Informal Economy,* 3 McKinsey Quarterly 2004.
52 World Bank, *Doing Business in 2004, available at* www.doingbusiness.org.
53 Hernando de Soto, The Mystery of Capital (2000).
54 Jeremy Clift, *Hearing the Dogs Bark* (interview with Hernando de Soto), Finance and Development (December 2003) at 11.
55 *See* World Press Review, *Interview: Peruvian Economist Hernando de Soto* (October 15, 2003).

RECOMMENDATIONS

Resolve outstanding disputes pertaining to the new regime of labor laws as soon as possible.

Although a consensus about the parameters of the new labor legislation may never be achieved, much can be done to find more common ground that will allow employers to accept key aspects of the new labor regime and move forward with their implementation. This, in turn, will increase the level of predictability in Kenya's business environment: domestic and foreign investors alike can more effectively anticipate the costs of meeting their legal obligations.

The Ministry of Labor or the Prime Minister can begin by placing more private sector representatives not only on the National Labor Board, but also on various other policymaking bodies, to demonstrate a commitment to private-sector led economic growth in Kenya. Currently, the National Labor Board seems to carry the same ambivalence about private sector participation in policymaking that is found in the government's licensing reform program (see this Report's chapter on Licenses and Permits).

The call by Kenyan employers for a multi-year phase-in of certain new labor provisions, such as new health and safety standards, should then be accepted. There seems to be no strong case for enforcing unfamiliar provisions immediately, especially when Ministry of Labor enforcement capabilities are so weak. The next 3–5 years can be a time of educating workers and employers, building consensus in various sectors about best practice reforms, and making general improvements in worker safety provisions. This period of learning and safety integration will benefit of not only Kenyan workers, but also Kenyan businesses, which will experience improved safety records, thus making them better candidates for lending and investment.

The issue of paid parental leave should be revisited because it threatens to disadvantage women. Men and women in Kenya should be provided with equal amounts of parental leave. Also, a three-month time period may be more acceptable to employers if the entire period is not required to be paid. In revisiting this issue, Kenya should resist looking at how wealthier and more generous economies handle the issues, and rather consider approaches that balance the needs of parents with those of the business sector (including, for example, the Family and Medical Leave Act in the United States).

Working through these and other issues, with leadership from the top levels of government, is critical. Continued ambiguity in the labor regime causes uncertainty in the investment environment. A government that is committed to economic growth should solve these problems and move on to other key investment issues.

Integrate labor expertise into programs and policies pertaining to private sector development.

In Kenya and beyond, there is a perception that labor and employment issues are "soft' policy matters that tend to be at odds with the "hard" topics of business development and investment. Perhaps pro-growth policymakers and donor-supported private sector developers believe that the demands of the formal labor law serve mainly to add costs to the business environment, therefore diminishing the country's competitiveness. Thus, they tend to avoid integrating issues of labor (except for some matters of worker training) into many of their initiatives.

This is an opportunity missed. Although there are costs associated with labor law compliance, there are also significant benefits, and labor experts (such as those at the Ministry of Labor) are well suited to advise on both. The benefits begin with labor peace: employees who feel that their core rights are being respected are far more inclined to be productive and loyal. Compliance also provides for a more direct link between the skill demands of employers and the labor institutions, including vocational schools and other training centers, that can help meet those demands. Adherence to the labor law also lowers many costs: insurance companies, for example, are far less likely to offer affordable plans at workplaces where health and safety conditions are poor. Companies with strong labor law adherence are more attractive to outside investors because they are perceived as well-informed and reliable business partners.

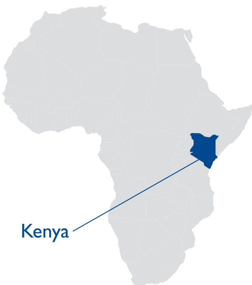
During this diagnostic, the Ministry of Labor signaled its strong desire to be more effectively integrated into government and donor-sponsored private sector development initiatives. For the reasons listed above, this interest should be captured.

Launch a reform of the national social security system.

As previously discussed, the National Social Security Fund is ready to lead the reform of the social security system for private workers, but the government has tied its hands. Legislation that allows for engagement of informal workers and voluntary payment into the system will offer greater security to those Kenyans who seek it. Enforcement of the existing law is also necessary. Many multinational companies operating in Kenya are widely known to avoid their social security obligations, but would never think of doing so in their home countries. Finally, transforming the system into a pension scheme, rather than its current lump-sum payment method, would be a sensible, long overdue change.

Increased private participation in the social security system can support economic growth in a number of ways. First, increased participation provides the government with more money to invest in projects that benefit the public, including building of roads, schools, affordable housing, and hospitals. (Of course, sound and honest management of these funds must be the ultimate priority; a perception that contributions will get lost in Kenya's system of spoils and corruption is an absolute disincentive to participate.) Second, a balanced, well-run system of social security diminishes poverty. Not only are retired workers better off, but their families are less financially stretched and able to use their personal resources for other purposes, such as entrepreneurialism.

USAID has significant experience in assisting pension reform programs, particularly in Eastern Europe. Even if spearheading an independent program is not within its means, USAID can, based on lessons from past experience, contribute to improved public dialogue on this important issue.



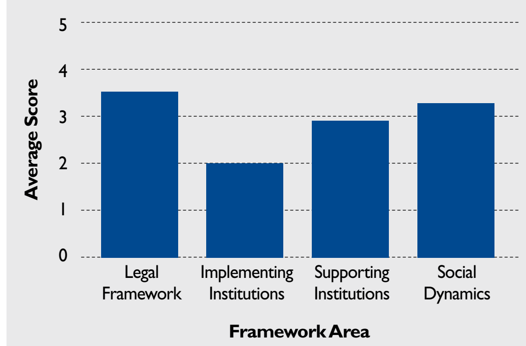
REGISTERING PROPERTY

The BizCLIR diagnostic addresses three types of property rights that are fundamental to a sound and growing commercial economy: real property, movable property, and intellectual property. Movable and certain intangible property is addressed in this report's chapter on Getting Credit.

The different regimes for real and intellectual property rights in Kenya illustrate the dramatic changes the country is undergoing, and the complexity of reform. On the one hand, the legal regime for recognition and protection of intellectual property rights is generally well developed, following international standards and linked to international organizations. The primary implementing institution is well respected and reasonably well staffed. On the other hand, the legal regime pertaining to land and real estate is an historic tangle of confusion, regulated by some of the least respected institutions in the country. Both categories of property rights suffer from a lack of public awareness, resulting in significant negative consequences for economic growth.

The BizCLIR scores, which address both real property rights and intellectual property rights reflect a finding reached several times in this report: that implementing institutions are in the greatest need of improvement and support.

REGISTERING PROPERTY



REAL PROPERTY RIGHTS

LEGAL FRAMEWORK

Kenya aspires to modernize and harmonize its legal regime for real property. The current situation has been well characterized by the Ministry of Lands in its draft *National Land Policy* (the Policy):

> *Kenya has not had a single and clearly defined National Land Policy since independence. This, together with the existence of many land laws, some of which are incompatible, has resulted in a complex land management and administration system. The land question has manifested itself in many ways such as fragmentation, breakdown in land administration, disparities in land ownership and poverty. This has resulted in environmental, social, economic and political problems…*[56]

The problems of the primary laws have been studied extensively by domestic and international experts, with findings used for formulation of the draft land policy. Little additional value can be added through yet another review. Accordingly, this analysis focuses on subsidiary and collateral laws, with brief mention of strategic issues related to the policy and legal reform process.

The Policy has been under development since 2004, with the draft only recently submitted to the Council of Ministers for official review. The

KEY LAWS AND POLICIES

- National Land Policy
- National Land Policy (Draft)
- Registered Land Act (1963, consolidated 2002)
- Transfer of Property Act (1882)
- Landlord and Tenant Act (1965)

56 Ministry of Lands, *National Land Policy* Secretariat, National Land Policy (Draft), May 2007, p. iv. (Available at www.ardhi.go.ke.)

speed of deliberation has been appropriate and exemplary, as the process has incorporated a high level of participation across a representative cross-section of stakeholders, thus providing a basis for consensus building on a wide range of controversial issues. Once the Policy—which covers public, community, and private land—is settled, it will be possible and necessary to replace the existing tangle of separate laws with an overarching land law to reflect the Policy. Yet much of the groundwork of legislative drafting can be done in parallel with policy development and finalization, so that a new law can be proposed shortly after the Policy is adopted. This work should begin now. The final Policy and accompanying legal changes will require extensive public education and awareness campaigns. Production of the materials and messages can begin now as well.

The Policy will provide the basis for new land laws, but separate work is needed to establish a policy on land use. Land use policy is needed as part of the national development agenda, and is vitally important as ownership issues are settled because use restrictions have direct impact on the development of land for residential, commercial and agricultural purposes. Consequently, it is appropriate to begin a land use policy development program as soon as resources are available. Government officials have indicated a need for assistance in this new effort.

Subsidiary laws and regulations are, in general, just as out-of-date as the various land laws. These include laws and regulations governing:

- Zoning
- Environmental impact
- Valuation of property
- Real estate agents
- Flats and condominiums
- Landlords and tenants (2007 draft currently under public review)
- Mortgage
- Eviction
- Taxation
- Inheritance

Kenyan real property professionals note that many of these laws are inappropriate or out of date. In addition, these and other regulatory regimes have given rise to a plethora of institutions, often with opaque or inefficient requirements that must be navigated for approvals of various development or maintenance projects. Users of these various services complain that agencies often issue, change, or ignore regulations without warning and with impunity. This indicates the need for a transparent, participatory system for developing and adopting new regulations.

Each of the areas mentioned merits a more comprehensive review. Several specific items are worth noting as examples. First, *eviction* is a significant problem for mortgage lending. Some laws prohibit eviction for non-payment of a mortgage (one permits it under some land regimes, but it is not followed in practice), but permit the lender to seize and sell the land, at which point the buyer can evict the occupant. These practices have a strong negative impact on mortgage lending and should be revisited.

Second, hidden inheritance claims make it difficult to obtain mortgages on agricultural land. Unless interests in land are clearly captured by law or through registration, most lenders are unwilling to take on the risks inherent in conflicting systems, such as statutory and customary law. Reforms are needed to ensure that agricultural land can be fully financed for development.

Third, there are significant gender disparities in ownership. On paper, Kenyan land laws give women equal rights with men to own and inherit property. However, this conflicts with custom in many regions; women are often dispossessed of their rightful land interests through male-dominated Land Control Boards who are responsible for approving or disapproving transfers of land rights within communal property regimes. Although it is technically possible to appeal inappropriate transfers of real property, few village women have the resources to bring a challenge, even if they are aware of their rights. Bringing practice into line with law will require extensive public education, legal aid, and restructuring of Land Control Boards to ensure female participation as a counterweight to current male dominance.

IMPLEMENTING INSTITUTIONS

In light of the number of laws, regulations, and overlapping regimes, there are several institutions with a mandate to enforce and implement various aspects of the land and real property laws. The **Ministry of Lands** has overall authority for development of the National Land Policy, and, presumably, any legal reforms arising from the Policy, once adopted. The ministry and many of its sub-units are respected for their work on the Policy, but the general perception in Kenya is that the ministry may be too thinly staffed for its mandate and needs technical assistance to shepherd the many upcoming reforms through the system. Indeed, various ministry personnel from sub-units have expressed a desire for technical assistance in land use policy, public education, and legal drafting.

KEY IMPLEMENTING INSTITUTIONS

- Ministry of Lands
- Land Registry
- Nairobi City Council and other local authorities
- Courts

The ministry is also responsible for the mapping of Kenya. Many maps date to 1903, although some zones had significant updates in the 1960s and early 1970s. Today, most maps are out of date, with no indication of the land improvements and changes that have taken place over the years. Although maps could be updated when surveyors register their improved maps, this information is not captured. Such issues may be part of projects to improve cadastres and records with the Land Registry; if not, separate programs are needed.

The **Land Registry** has primary responsibility for maintenance of the national cadastre and land records, as well as for registration of title, transfers, and claims against land. Its work has placed Kenya at 119 out of 181 countries in the World Bank's *Doing Business* rankings for "Registering Property." The registry is widely reviled by realty practitioners who complain of lost records, incomplete and inconsistent information, poor service and a high incidence of rent-seeking. Real estate professionals note that the registry's poor performance creates uncertainty of titles (when titles can be produced), which has negative implications for commercial and agricultural land development.

Fortunately, a project is underway to digitize the records of the registry. Most stakeholders are aware of the efforts, but impatient for results. It is not clear, however, whether the project intends to provide for the much-needed overhaul of the registry systems, management and staffing. The problems described are not simply issues of record-keeping; they will require extensive re-engineering of the institution in line with its mandate, economic importance, and new technological tools.

The Land Registry is not the worst of the implementing institutions working on land issues. That distinction goes to the **Nairobi City Council,** which stakeholders felt was far worse. Although recognizing that some of the services offered—such as review of subdivision plans—are quite good technically, stakeholders find it extremely difficult to obtain any services in a timely manner and without bribes. All respondents addressing the topic of the NCC complained of corruption, poor service delivery, and incompetence (except as noted). The problems are exacerbated by the NCC's opaque authority to issue regulations without apparent public notice or involvement, frequently in ways that result in new rent-seeking opportunities—such as requiring approvals for house painting or hedge trimming. The NCC has a reputation for approving illegal construction on government land as well as failing to enforce the use of plans as approved for legal construction. These weaknesses undermine the real estate market and public safety. A number of stakeholders suggested that reform of this highly politicized institution will require significant outside pressure from foreign governments and donors because of internal resistance to reform. As one stated, "The government does not respond to reason. They respond to pressure."

THE COSTS OF CORRUPTION

According to respondents, obtaining a land title requires "hustle and gifts." Anticipated "gift" requirements ranged from 14,000 KSh at the NCC to as much as 30,000 KSh at the Land Registry. In total, total bribes could reach 60,000 KSh in order to get all approvals for a title within three months, versus up to two years without bribes.

Another implementing institution in the field of real property is the **court system.** During this diagnostic, the judiciary received mixed reviews in terms of quality, but most respondents contended that the problem of delays is quite serious. "The courts have become a hiding place for debtors," according to one respondent. Even so, the system is producing some positive results. Several years ago, it was common for debtors in default proceedings to complain that the terms of their loan agreements were unfair and should be revised. This allowed for extensive delays in enforcement. However, over time, the courts have found for the lenders so that this ruse is used far less frequently. The National Land Policy anticipates extensive disputes once the Policy and corresponding laws are in place. Consequently, creation of a **Land Tribunal** is foreseen to ease the burden on the courts and provide for specialized services.[57] This may help bring discipline to the **Land Control Boards,** as noted above, if structured properly to provide redress for women dispossessed of their lawful rights. For more on courts, see this report's chapter on Enforcing Contracts.

SUPPORTING INSTITUTIONS

Kenya has no significant gaps in its supporting institutions for real property. Services and organizations exist over the full range of needs, from initial mapping to development and eventual sale. These organizations, however, tend to be concentrated in Nairobi, so that it is not clear whether needs in more rural and remote areas are sufficiently addressed. Even so, the basic foundation is strong.

First, **land-related services** are offered on a competitive basis. **Mappers, surveyors, engineers, builders, developers and real estate agents** generally compete with one another. Indeed, several complain that minimum fees set by various regulatory bodies are often ignored due to strong price competition for some of these services. (There was also mention of illegal competition by government employees who sometimes use government equipment during their workdays to offer competing services such as surveying. The extent of such unethical behavior was not clear, but mechanisms are needed to combat this.) Each area tends also to have its own **professional or trade association.** The strength of these organizations varies from trade to trade, with some better funded and more service-oriented than others. Of the weaker groups, one practitioner explained the problem quite simply as "we pay little, so we get little."

KEY SUPPORTING INSTITUTIONS

- Land-related services
- Professional and trade associations
- Land control boards
- Media

Not all trades offer the same level of competition. There were indications of possible competition issues in the construction industry, which bear further examination. High costs of construction, however, may be due to other factors than market concentration. Construction loans are considered expensive, which is a function of problems in the overall lending environment (see this Report's chapter on Getting Credit), and imported construction materials suffer from high costs imposed by the port in Mombasa, as well as the failure of revenue authorities to honor VAT refunds in the purchase and use of various

57 An existing Land Arbitration Tribunal was established in 2001 as a special purpose body for hearing claims against the government from a single law. It does not appear to have the capacity currently to handle the broader range of disputes that are expected to arise from the National Land Policy and its ensuing legislation. See discussion of the LAT at www.ardhi.go.ke.

construction materials. Tax reform, port reform, and transportation reform are all needed to reduce costs of real estate development, reduce delays, and eliminate bribes imposed by various governmental institutions.

There is a vibrant real estate market in Nairobi. Companies provide property management, valuation, leasing, and listing and sales services. There is no multiple listing service, however, because realtors have not found a way of protecting their listings from poaching by others. This reduces market efficiency for buyers and sellers, and will need regulatory changes to be addressed. Real estate agents must pass a test to qualify for a license, so the industry is maintaining a minimum standard of quality.

Despite solid trade and professional associations, information on the numerous requirements at each step of real estate development is fragmented, if available at all. This is in part due to poor service culture and pervasive lack of transparency in various government agencies. One interviewee told of requesting that a list of requirements from an agency be sent by e-mail, only to be told that the 9-item list was "too large" for such a format. Similarly, information is not effectively updated. For example, Kenya Power and Light tends to have good maps of installations, but their updated maps are not captured by the Land Registry or other agencies. Consolidation of information might be addressed effectively through projects with industry associations.

As noted, **Land Control Boards** play an important role in the management and transfer of rural and communal lands. Quality varies from place to place, and the boards can be subject to manipulation. Greater oversight, training and accountability of such boards are needed.

The **Kenyan media** is aggressive, but not necessarily well versed on real property issues. Respondents noted that there enough competing media outlets to avoid political control of news reporting, but that their coverage of issues

related to land is often based on a poor understanding of the issues. Consequently, press training is needed as a component of reform and public education programs.

SOCIAL DYNAMICS

Land issues vary with the type of land in question. Rural and agricultural land is often tied to communal and customary property regimes quite different from those in an urban or peri-urban setting. Yet in all circumstances, property rights are fundamental to growth and security.

Despite its size, Kenya's land mass is not fit for much farming. Arable land comprises approximately 10 percent of the total, and demand for that land is not matched by the supply. The average Kenyan farmer is a smallholder with less than 2.5 acres of land, and many have no more than an acre. Fragmentation through inheritance continues to whittle down the average size of farms, and smaller plots increasingly fail to provide sufficient food and income for the families farming them. There is little consolidation of land holdings.

Many believe that the primary reasons for attachment to small plots are psychological or cultural. "Kenyans love land," it is said. No doubt, there is a cultural attachment to land, sustained by practices such as burying family members on family land. Thus property becomes all but sacred. But there are also strong economic reasons for the reluctance of poor families to sell or lease their land and move to a town where they can find other ways to earn money.

First, there may be little or no market for small plots, unless a number of contiguous plots are being sold at the same time. Second, there may be no jobs available in towns or cities. Third, there may be no decent housing for a family of six or so in an urban or semi-urban area. Thus, many owners of small farms reason that rural poverty is preferable to urban poverty. Even if owners can sell their farms at an attractive price, the alternatives are not good. The same applies for leasing out small plots. In all, land reform is part and parcel of overall economic growth. Consolidation of land will take time, and will likely occur on a voluntary basis. (The poor track record of involuntary consolidation—as witnessed in Ethiopia, Tanzania, and other developing nations—should remove that option from consideration.)

Not all rural land is held by small farms, however. Some individual owners possess thousands of acres, many of them unused—that is, not under agricultural production—but important in many cases to the maintenance of natural resources and ecosystems. In general, these large holdings are considered to be the result of historical and political injustices still in need of vindication. However, such landowners tend to be politically and economically powerful, and unlikely to support extensive land redistribution. The National Land Policy has wisely suggested that taxation be used to make non-producing landholdings more costly, so that owners can either cultivate them—producing jobs for many of the landless or smallholders—or either sell or lease holdings to others. This approach could work, but would eventually need to be placed within the context of more comprehensive tax reform strategies.

Taxation plays an especially powerful role with regard to land issues in Kenya. Many of the agencies having some form of authority over land use, development, or transfer use fees as their primary source of revenue. In other countries, such fees are often held low because the agencies are funded either from general tax revenues or from land taxes. Indeed, a common practice worldwide is to use annual or periodic land taxes as the basis for funding local government, schools, and even some social services. In Kenya, however, rural land is not taxed, and there is little tax on urban land. The 4 percent transfer fee on real estate transactions thus seeks to capture revenues in a single moment that other countries spread over years. Punitive land taxes intended to reduce land hoarding represent a useful strategy, but over time taxation will need to be considered on a more comprehensive basis as part of land use policy.

Rent-seeking in land-use agencies—i.e., the solicitation of bribes by a public representative—is a serious issue. Unfortunately, it reflects more than poor regulation; it is a legacy of both colonialism and post-independence abuses of government power. Under colonialism, the role of government was to extract wealth from a large population in favor of a foreign elite. That elite could and did move thousands of Kenyans off their ancestral lands in favor of privileged settlers. After colonialism, this system was not reformed, but simply nationalized, with a privileged local elite replacing foreigners. As a result, predatory or extractive government is still the default model of political economy in Kenya. One respondent opined that few children growing up in Kenya today would expect government officials to provide services without being bribed. The relationship between citizens and their government needs to be redefined. The National Land Policy, for example, has implicitly adopted an approach more in line with modern social contract theory. However, such concepts need to become explicit and more widespread in Kenya, if the relationship between the governed and the government is to be sufficiently renegotiated.

The nature of problems in urban land markets often overlaps with those of rural markets when it comes to dealing with agencies, but there are somewhat different dynamics with regard to economic pressures. Urban land has doubled in value in Nairobi in the last 10 years, yet little of the land has been improved; most has no sewerage, electricity, or road infrastructure to support development. Private investments in improvement often involves "gifts and hustle" for approvals of government permits, which increases the cost of development. The recent collapse of the Kenyan and international stock markets has also increased demand for land as an investment due to its inherent stability. As a result, there is a great deal of upward pressure on residential and commercial property prices, but overall income levels and individual wealth are not keeping pace. These conditions are squeezing the middle class. Unfortunately, significant changes in personal income are a function of economic freedom and the business environment, which are still far too constrained in Kenya. Part of the solution for the growing housing shortage is extensive reform of the business environment, including reform of those agencies that are constricting economic activity.

Whatever reforms are undertaken—rural, urban, government or private sector—there is a great need for public education and information. Without knowledge of reforms, rights on paper cannot become rights in practice. For example, the ongoing problem of inheritance rights of women is in part a function of public education. Many women do not know that the law gives them a right to inherit. Under customary law, the eldest son inherited all of the father's property, but in trust for the family. That is, the rights were accompanied by an obligation to take care of other survivors. Under this tradition, women were not in a position to claim inheritance without awareness that their status has changed. They now have the right to take responsibility for themselves with their own assets, not merely to be the financial responsibility of a relative. Likewise, without general knowledge of the law, many elders may not know that they should ascertain rights of widows before giving a title to another relative. Communities, meanwhile, need knowledge both to adapt to the shift in custom and to hold the elders and Land Control Boards accountable.

Many of the upcoming reforms will introduce radical changes. These must be taught as part of relevant curricula in law, business, and other schools, as well as through continuing education programs for lawyers, judges, officials, business people and—especially—journalists. Otherwise, many of the reforms may falter soon after the passage of legislation. Awareness lubricates the machinery of reform.

RECOMMENDATIONS

One may assume that the National Land Policy process and the revision of the Land Registry will continue as planned with sufficient funding and technical assistance. These are the two highest priorities. It is also assumed that the Land Registry will be reorganized to provide effective services with a customer service orientation. If this is not currently foreseen, then such reorganization and re-engineering should be addressed.

Update and harmonize laws affecting land rights.

Although the National Land Policy will act as the framework for land laws, it is not necessary to wait for its final approval and passage (which are likely to take several years) to begin the hard work of fixing the legal framework (which is also likely to take several years). The problems with both are well known by legal practitioners and real property professionals. A project can be launched now, incorporating the good practices employed in development of the National Land Policy, with the following activities:

1. **Identification of existing laws that affect real property followed by separation of laws into primary legislation and secondary legislation and regulation (such as zoning, registration, taxation)**

2. **Primary Laws—Analysis and Drafting**
   - Analysis of existing primary laws for flaws, contradictions, and weaknesses
   - Preparation of a preliminary draft uniform law covering public, communal, and private property, and tracking the structure of the National Land Policy
   - Identification of areas subject to change based on a final version of National Land Policy

3. **Primary Laws—Public Discussion and Vetting**
   - Identify stakeholder groups nationwide and appropriate forums for discussion
   - Hold series of stakeholder sessions to explain law and elicit feedback
   - Incorporate feedback into draft
   - Prepare preliminary outline of public education and materials needed once law is passed

4. **Primary Laws—Submission for Adoption**
   - After National Land Policy has been adopted, adjust draft to final version of Policy
   - Submit to appropriate government offices for formal adoption procedure

5. **Secondary Laws & Regulations**
   - Create working groups for each area or group of areas to be reformed
   - For each group, analyze existing laws in relation to existing needs
   - Follow reform procedures above—preparation of preliminary drafts or policies, vetting with affected stakeholders, revisions and submission for adoption
   - For laws, simultaneously prepare all necessary implementing regulations, education and public education materials
   - Identify any institutional changes needed for the reforms to be effective and implement a program of reform for relevant agencies and organizations

Develop a national land use policy.

The National Land Policy will define rights of ownership, but will not provide a national program for land use, including zoning, national parks, and environmental sustainability. Reform of land use should use the same approach employed for the National Land Policy. Assuming institutional capacity, this can begin immediately.

Engage in a public education campaign for the National Land Policy.

The Ministry of Lands has expressed a desire for assistance in creating a national program of public education and dissemination for the National Land Policy. The exercise could easily take a year, and thus should begin while the Policy is still being approved. The program must include identification of numerous target audiences and the various messages relevant to their rights and interests.

Reform the Nairobi City Council.

The NCC is notorious for its poor service and over-regulation of various services and activities related to land. Eventual reform will require political will, but much of the identification of problems and preliminary analysis of solutions can be conducted even if the NCC does not wish to be involved. For example, it is possible to identify and critique existing regulations (such as restrictions on house painting) and practices (such as failure to enforce building plans) based on the experience of those using NCC services. It would be best to involve the NCC from the outset, but lacking that, an analysis can provide the platform for advocacy and concerted pressure to change the NCC. Analysis should include research on the economic impact of the existing NCC system and the benefits of reforming it. Aided by sufficient political will, an exposé by local media could prove helpful in promoting reform.

Collect and disseminate existing requirements.

The lack of information regarding required registrations, procedures, and filings constrains efficient development of the real estate market. Although a few agencies now post requirements, many do not. During this diagnostic, several instances were cited of clerks obstructing information access. The private sector, through industry associations, can gather and disseminate information with or without official cooperation, although the latter is preferred. A project to identify requirements, including the legal basis (if any) for them, then disseminate the information to the industry, reformers, and the media could help new practitioners navigate the systems while creating momentum for reform. If agencies are involved, then requirements can be publicly posted as well. The Ministry of Lands could conceivably lead the effort based on its Service Charter, a posted declaration of Ministry intentions in providing customer service, including information on how to report corruption. (See the Ministry website at www.ardhi.go.ke.)

INTELLECTUAL PROPERTY RIGHTS

LEGAL FRAMEWORK

The legal framework for IPR in Kenya is solidly founded on local legislation reflecting international best practice. Kenya is also a member of or adheres to the Agreement on Trade Related Aspects of Intellectual Property (TRIPS); the Paris Convention of 1967 relating to the protection of industrial property; the Berne Convention of 1971 relating to the protection of literary and artistic works; and other important international agreements.

KEY LAWS

- Anti-Counterfeit Act (2008)
- Copyright Act (2003)
- Trade Marks Act (1957)
- Industrial Property Act (2001)

In 2008, Kenya passed an **Anti-Counterfeit Act,** which provides the basis for stringent action against producers, distributors, and sellers of counterfeit goods, including medical counterfeits. This law deputizes a wide range of law enforcement agents to participate in the seizure of counterfeit goods and arrest of counterfeiters, with significant penalties of prison and fines for those convicted. The draft law was presented for public comment and input prior to adoption and enjoys strong buy-in.

In general, there are no significant gaps in the framework legislation. There is debate—part of a larger international debate—whether software should be protected by copyright or patent law (it is currently protected by copyright), with a strong current in favor of a shift to use of the patent regime, but protections do exist under copyright law. There is also no franchise law in Kenya, with franchise-type arrangements being established through contractual agreements and trademark protections. The country could probably profit from the efficiencies of a franchise law, but this does not appear to be a major constraint to investment by foreign companies through franchise.

More troubling is Section 58 of the Patent Act, which permits the government to allow parallel importation of protected products (primarily pharmaceuticals) at subsidized prices to compete with the rights holders, in the public interest. "Public interest" can be used broadly to undermine legitimate businesses. Even so, international firms import their goods and hope that the government will not exercise this option. The option should either be eliminated or severely circumscribed to avoid discretionary and damaging decisions.

Another specific problem for imported goods is in certification and labeling. The Kenya Bureau of Standards (KEBS) requires all imported consumer goods related to health and safety (currently foods, electronics, infant ware and toys) to qualify for and display an import standardization mark. While not strictly an IPR issue (it also qualifies as a non-tariff barrier to trade), this requirement does have an impact on trademark design and packaging and was raised by respondents from an IPR perspective. It highlights a problem in the IPR and regulatory field of agencies developing and implementing policy without warning and stakeholder input. The requirement increases costs for consumers (one firm alone spent over $100,000 last year re-labeling its Kenya-bound products) without corresponding benefit.

Despite the strong basic regime, intellectual property is underdeveloped in Kenya. Additional laws are not needed, although improvements noted above are useful, if not critical. Instead, there is a great need for public awareness and enforcement.

IMPLEMENTING INSTITUTIONS

The principal implementing institution for protection of IPR is the **Kenya Intellectual Property Institute** (KIPI). The institute is well respected among intellectual property practitioners and the business community for its quality work in the registration of IPR. It is staffed with a number of well qualified professionals, including eight officials holding master's degrees in intellectual property from the US, Europe, and Asia. There is internal training sufficient to meet the needs of the organization, and services, in general, meet current demand.

KEY IMPLEMENTING INSTITUTIONS

- Kenya Intellectual Property Institute
- Courts

KIPI has a useful, up-to-date website that provides information and prices for registration of property. It is not yet possible to register on-line, however; nor can approved applications and filings be accessed on-line. There are plans for this, but currently funding is insufficient. Recent reforms and improvements have been effective in reducing a backlog of unregistered and unprocessed applications. Users of the services expressed general satisfaction with KIPI's responsiveness, but also felt the institution could play a stronger role in promoting intellectual property awareness and protection.

KIPI's role in enforcement of IPR is limited to analysis of claims regarding infringement, a duty it performs effectively. Pro-active enforcement is carried out through other institutions, primarily the courts, Customs and police, as well as the Board of Standards, and the Pharmaceuticals and Poisons Board. Enforcement efforts tend to be driven by complaints of the private sector IPR holders, not any identifiable internal program of the government or its agencies. Counterfeiting and piracy are extensive, but there seems to be little directed effort to contain them.

As implementing institutions, the **courts** received mixed reviews. The procedure for enforcement is relatively straightforward, in that an IPR holder who discovers an infringement can bring an action to enforce. If relatively straightforward, an injunction will be issued within two months, which can then be taken to the police for enforcement against the infringer, primarily through confiscation of infringing goods. If the judge or magistrate finds the case uncertain, it can languish in process for a year or more. IP experts generally believed that magistrates were poorly trained in IPR issues, and hence not particularly reliable. First instance judges were seen to be generally competent, but expertise is lower at the High Court level. Anecdotes recounted by respondents highlighted particular problem areas, such as failures of judges to understand the difference between counterfeit and piracy. All respondents felt that greater training and education is needed for judges. Moreover, judges should consider professional testimony of KIPI dispositive for determining whether an infringement has occurred.

Enforcement also breaks down at the level of the police and prosecutors, it was reported. Practitioners cited incompetence and possible corruption of the enforcement process, such as warnings to violators in advance of a product seizure or disappearance of evidence after a trial began. There appears to be little general understanding of the impact of IPR violations on the economy, or the potentially devastating impact of counterfeit drugs on the health of individuals and the general population. In addition, customs agents, who exercise a police function for identification and seizure of counterfeits and pirated goods, are felt to be generally unconcerned with IPR unless it affects the collection of duties. If an infringing importer pays duties, or if the infringing products are duty-free, it is generally believed that customs agents will not bother with enforcing IP protections.

SUPPORTING INSTITUTIONS

IPR protection and enforcement is not simply a matter of government initiative. For the most part, even well intended officials are often not in a position to monitor a dynamic economy sufficiently to identify and target IPR violators. Therefore, the private sector has a significant role to play.

Kenyan manufacturers are increasingly well represented through the **Kenyan Association of Manufacturers,** which has actively engaged the government on numerous issues, including intellectual property rights. KAM, however, does not necessarily take up the cause of local or foreign companies who import fast-moving consumer products (FMCPs). Associations of foreign investors exist, but some investors are hesitant to use these for advocacy lest the collaboration be misinterpreted as cartel behavior. It would be helpful if the Ministry of Trade and Industry were to create a taskforce or working group that could serve as a focal point for association and individual participation in reform and support efforts.

KEY SUPPORTING INSTITUTIONS

- Kenyan Association of Manufacturers
- IPR lawyers
- Information resources
- Customs agents
- Patent drafters
- Courts

IPR lawyers, while not abundant, seem to be sufficient at this juncture to handle the demand for such services. Many of these lawyers are highly experienced and have completed advanced coursework and training programs to maintain or elevate their expertise. Some even teach the subject at local universities. There is need for increased education, however. In the business curriculum, IPR is an elective and does not necessarily comprise a full semester course. Law schools, business schools, associations and IPR lawyers would do well to work with the Ministry of Education to better incorporate IP education into the Kenyan educational system.

Information on IPR laws could be improved. Laws are generally available on-line after passage, but amendments are not consolidated into existing legislative language. Instead, practitioners must cut and paste any changes into older laws. The legislature should introduce consolidated amendments, but, failing that, KIPI might provide a useful role by working with legal practitioners to provide consolidated versions of amended laws.

Qualified **patent drafters** are in short supply. This is not altogether surprising—one IP attorney reported never having registered a domestic patent, only foreign patents previously registered in other countries. As demand for domestic patents increases, more drafters will need to be trained and employed. There appears to be time for this to develop naturally in response to market pressures.

Customs agents are essential for slowing the import of counterfeit and pirated goods at the border. Unfortunately, their interventions to date have not been sufficient for the need. Industry experts report an "avalanche" of counterfeit consumer goods coming from Uganda, a regular flow of counterfeit pharmaceuticals arriving at the airport, and under-taxed legitimate goods coming from Tanzania to undercut Kenyan investments. Various theories are offered to explain the porous borders; all of them point to the need for improved enforcement by Customs.

SOCIAL DYNAMICS

Public outcry is an important fuel for reform throughout the world. In Kenya, there is far too little awareness of the damaging impact of IPR violations to inspire such public pressure. Pharmaceuticals providers note that the general population cannot differentiate between the impact of a fake Rolex—which tells time accurately but wears out rather quickly—from a fake anti-malarial drug. One is cheap but effective, the other may or may not be cheaper, but can cause the death of the user. (Counterfeits may not be cheaper—they are often sold at or minimally below normal retail prices, with a higher profit margin to producers and traders, not consumers.) Local pharmaceuticals experts report that counterfeit anti-malarial medications are reducing the effectiveness of legitimate drugs by accelerating resistance to treatment: medicines that should be effective for five years are becoming ineffective after only two years. The impact on public health is serious.

On the economic side, lack of public awareness about the benefits of IP protections causes many Kenyan entrepreneurs and inventors to forego those benefits, including both local and international sales and revenues that can come from new products, works, and designs. KIPI estimates that millions of dollars are being lost because Kenyan entrepreneurs are not registering their intellectual property. The Kenyan government has announced a desire for Kenya to become a leader in information technology, but without appropriate awareness of the benefits of IP registration and costs of failing to register, it is likely that benefits to Kenyans and the Kenyan economy will be limited.

Industry leaders feel that there is also a poor understanding of these issues among government officials who should be pursuing more effective enforcement and protection regimes. Although the new Anti-Counterfeit Law suggests an improved level of government support for IPR issues, there is concern that the level of ignorance regarding the importance of this and other acts will undermine implementation and enforcement of the new law. In the meantime, domestic and foreign companies in Kenya are losing millions of dollars in sales, making it more difficult for them to succeed, and making Kenya less attractive as an investment location.

The problems of IPR cannot be addressed solely on a national basis. As noted, much of the problem originates across the Kenyan borders. Most of the counterfeit pharmaceuticals are being manufactured in China, India, and Turkey. Many counterfeit consumer goods are coming from Uganda, which does not have a cohesive law against counterfeiting, unlike Kenya and Tanzania. Consequently, part of the solution lies in pressuring other countries to address these issues at their sources, while also trying to interdict the flow of goods into Kenya.

Stopping IPR infringement involves a large number of players in a coordinated effort. Legitimate manufacturers and importers are best placed to monitor the market and complain of violations. But enforcement involves courts, bureaus, police, prosecutors and even the Ministries of Foreign Affairs and Trade & Industry. Addressing only one point in the system is unlikely to have a meaningful impact, and piecemeal reforms may simply erode before another piece is put in place.

RECOMMENDATIONS

Several individual issues were addressed in the Legal Framework section. These should be taken up on a demand basis by interested stakeholders. Concerted effort is needed for some of the larger programmatic issues: public education and counterfeit interdiction.

Engage in public education.

Until there is better understanding of the benefits of IPR and IPR protection, it is unlikely that popular and political will can be galvanized to carry forward the needed reform interventions. In addition, lack of understanding is causing many Kenyans and their companies to miss out on increased income and investment. This can and should be addressed through a multi-pronged public education campaign, tailored to different interest groups, as well as development of formal curriculums for business and law schools, and even high schools. For example:

1. **Target Group 1: General Public**
    - Message: Basic education on what patents, copyrights, and trademarks are, and why they are important
    - Media: Television, radio, newspapers
    - Lead: KIPI
2. **Target Group 2: Kenyan inventors and software developers**
    Message: Financial benefits of registering and protecting IPR
    - Media: Trade, business, and professional associations, plus television, radio, and newspapers.
    - Lead: KIPI
3. **Target Group 3: Policymakers (ministries and parliamentarians)**
    - Message: Economic impact of IPR protection and its importance for Kenya's regional leadership
    - Media: Briefing papers, think-tank studies, public-private dialogue sessions
    - Lead: Ministry of Trade and Industry
4. **Target Group 4: Business community**
    - Message: Business and financial impact of IPR protection and development
    - Lead: Business associations (with assistance from KIPI)

These examples are illustrative. Additional education is needed for enforcement, as noted below, and the general public (for example, on the dangers of counterfeit drugs) as well as parties such as prosecutors, police, customs officials, the KEBS, the Pharmaceutical and Poisons Bureau, judges, and lawyers.

Engage in counterfeit interdiction.

The recent Anti-Counterfeiting Act of 2008 provides the legal foundation to address counterfeiting problems, but the law alone will do little in light of the poor overall understanding of IPR and the numerous holes in the existing enforcement framework. Effective curtailment of dangerous counterfeit pharmaceuticals will require, at least, the following interventions:

Trade policy. The Ministry of Foreign Affairs will need to organize pressure among African and European governments to persuade China, India and Turkey to increase efforts to shut down counterfeit operations.

International enforcement. Arrest and seizure of products and suppliers at the borders of counterfeit producing countries and along trade routes will also require collaboration among national enforcement agencies, Interpol (as is currently underway) and other international enforcement agencies, the Kenyan Ministry of Interior, and Kenyan police force.

Customs. The most efficient spots for seizing incoming counterfeits are at ports and airports. This will require training for Customs agents as well as systemic changes that can allow identification of trustworthy versus questionable importers.

Other enforcement agents. The Anti-Counterfeit Act deputizes a number of officials—including the police and agents of KEBs and the Poisons Bureau—and authorizes them to seize goods and arrest individuals. These officials need to be trained in the law and practice of enforcement.

Prosecutors and judges. Unless the courts function properly, they will undermine the efforts of all other actors to stem the flood of counterfeits.

Business community. Businesses must take a role in protecting themselves and should be informed of how they can report and prosecute infringement of their IPR. This will require both education and active coordination with the various enforcement authorities.

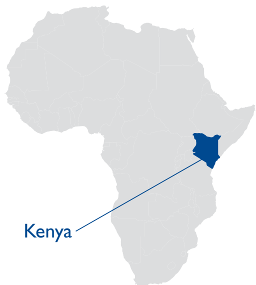
Medical community. Hospitals and pharmacies are the end target for wholesale distributors of counterfeit drugs. Various personnel in the pharmaceutical supply chain should be trained in how to identify and report counterfeits.

General public. The victims of counterfeit pharmaceuticals are the individuals who take them in hopes of being cured. They need to know that counterfeits can kill and disable, and should be educated on how to confirm that the drugs they buy are authentic. They also need to know which suppliers are most likely to be providing counterfeits, such as unlicensed pharmacies or local suppliers.

Journalists. Ongoing media coverage will be needed to expose the problem, run exposés on corruption and fraud, and generally educate the public on the problems and solutions.

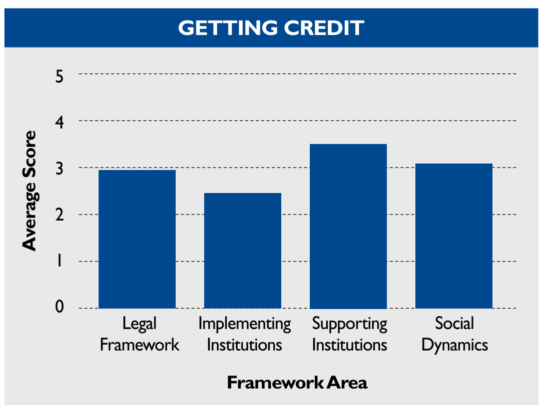
A program for counterfeits of fast-moving consumer products could follow a similar outline. However, the primary cross-border focus in the short term should be aimed at pressuring Uganda to adopt and enforce an anti-counterfeiting law.

These programs should include detailed analysis of gaps in the enforcement system and recommendations for how an anti-counterfeiting campaign can be coordinated across the many agencies and stakeholders to ensure that efforts do not become fractured.



GETTING CREDIT

Access to finance is the catalyst that allows an economy to effectively and efficiently allocate resources. Individuals need finance to fund housing, education, and healthcare that will raise their standards of living and improve their productivity. Farmers need access to finance to invest in infrastructure, fund agricultural inputs, and bridge their incomes between harvest and sale. Manufacturers and service firms require finance to expand production and enhance productivity. Entrepreneurs require finance to fund new ventures that spur innovation and competition. Financial firms, meanwhile, act as a mechanism to distribute resources to their most effective use.



Kenya, like much of the developing world, requires significant, yet achievable, reforms to transform its financial system into the efficient resource allocation engine that it should be. Once these reforms take place, Kenya should expect to see increases in domestic and foreign investment, more firm start-ups, increases in employment, and greater GDP growth.

In many ways, the recent history of access to finance in Kenya represents a good news story. Private financial institutions are growing, competing, innovating, and expanding into areas previously viewed as "unbankable." Though access to financial services, especially in rural areas, remains still too limited, the recent expansion is encouraging. Foreign banks continue to enter the Kenya market. Kenyan microfinance institutions have developed into, and been licensed as, commercial banks. Over 5,000 Savings and Credit Cooperatives (SACCOs) continue to provide financial services, specifically in the rural areas, and are flourishing. The regulatory oversight of both microfinance institutions (MFIs) and SACCOs is being strengthened. Non-banks are even wading into the financial waters with innovative products that are providing improved services oriented to the needs of the average Kenyan. Notwithstanding these advances, one could still argue that the success in the financial sector has occurred in spite of the business enabling environment, rather than as a result of it.

Typical loan transactions for any financial institution incorporate a few basic steps. First, the lender must have the ability to assess the risk of lending to a given borrower. Once it has agreed, based on this information, to extend the credit, the lender next must be able to secure the debt by registering a lien on a given piece of collateral. After the lender disburses the funds, if the borrower defaults, the lender must be able to take possession of the collateral under the authority of an effective commercial court system.

In Kenya, the institutions that should buttress such a system are insufficient for a growing economy. First, credit information remains weak. New licensing standards for private bureaus represent a positive step toward setting standards. However, the system does not require financial institutions to supply positive information—that is, information evidencing a creditor's successful meeting of past loan terms and other evidence of good credit behavior. In addition, the bureaus can not collect and disseminate non-financial data, such as utility payments. Furthermore, Kenyan laws prohibit the sharing of data across different types of financial institutions (i.e. banks, MFIs and SACCOs). The weaknesses in the system result in additional costs for banks conducting their own due diligence or, in most circumstances, an unwillingness to lend to potentially credit-worthy borrowers.

Second, although the laws support collateralized lending, the institutions, in effect, do not. The registries where creditors should be able

MAKING SENSE OF ALL THE NUMBERS

Over the last ten years, the proliferation of rankings and indicators to measure development results and stimulate reforms has turned into a cottage industry. It can at times be difficult to ascertain much out of any of them, as they often seem to contradict one another. Kenya provides a perfect example. The charts on the right are only a sampling of the many indicators that are available. The World Bank's *Doing Business Report* ranks Kenya 5th globally in the area of Getting Credit. Kenya is tied for 1st in the legal rights index with Hong Kong, Malaysia and Singapore. In contrast, the World Economic Forum's (WEF's) Global Competitiveness Report and the World Bank's Enterprise Surveys rank access to finance as the 2nd most burdensome constraint to doing business in Kenya. So which acclaimed source is right? Actually, both are.

The two index variables from the *Doing Business Report* that lead to such a high ranking examine the laws and regulations on the books that provide legal rights to creditors, and the requirements for credit information-sharing. Kenyan laws meet all 10 of their criteria indicating strong creditor rights, and 4 of the 6 criteria indicating strong credit information. The WEF and Enterprise Surveys arrive at their conclusions by surveying a large sample of firms. The firms report their most problematic constraint; their responses identify access to finance being among the top two in each survey. Part of the story is that all firms would like more finance at better terms. Nonetheless, there are real problems in accessing finance in Kenya.

For example, though creditor rights are protected in the law, the ability of Kenya's courts to efficiently and transparently enforce the law leaves much to be desired. In fact, it was estimated that the commercial court has a backlog of 800,000–1,000,000 cases in its queue. The docket for 2009 is already filled and the 2010 docket is yet to be opened—new cases cannot even be filed. Though the laws may protect the legal rights of creditors, the institutions tasked with implementing them fall considerably short in their duties. Another example focuses on credit information. Although the Central Bank of Kenya recently implemented regulations enabling licensing of private credit bureaus, the new laws only require reporting of negative information (reporting of positive information is voluntary). The information can be shared only among similarly licensed institutions. Thus, the information cannot be shared with non-banks (e.g. MFIs, SACCOs, utitilities). Although the licensing is a step in the right direction, the laws and regulations must move toward a more inclusive information-sharing regime.

Achievement in a particular ranking or indicator should not lead policymakers to declare victory. In fact, they should look to such rankings and indices only to gauge relative success of the business environment. When policymakers target a specific ranking as their goal, reforms are distorted to impact the selected proxy. Reformers must focus on the holistic nature of the policy challenge.

to register a security interest in property (land, chattel, motor vehicle, or securities) are paper-based systems which are time-consuming to search and to use. These cumbersome processes embed extra time and cost into formal lending.

Finally, Kenya's commercial courts are not an efficient and transparent arbiter of disputes relating to finance. The courts are backlogged, with approximately one million unresolved cases. When banks do not have confidence that they can efficiently collect on defaulted loans, they are

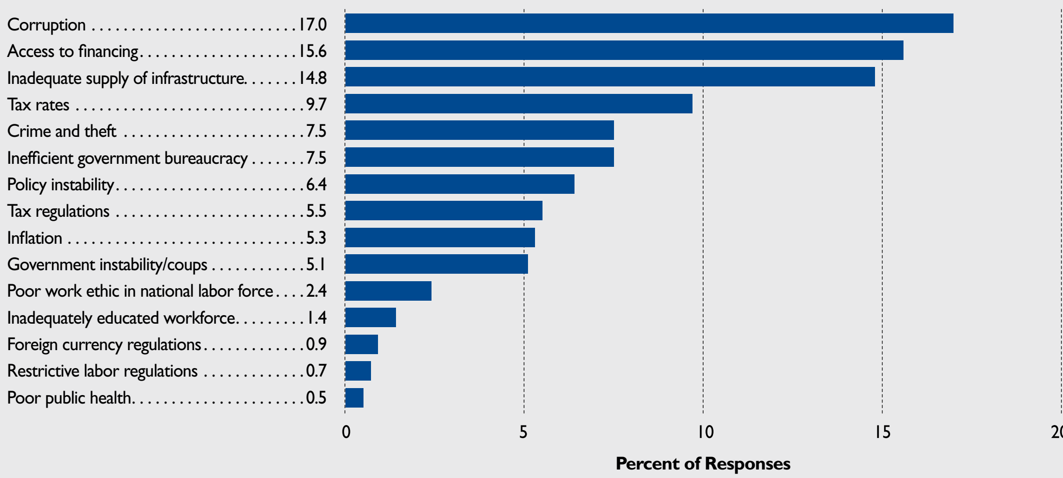
WORLD BANK'S *DOING BUSINESS* (2009)

Doing Business Indicators	Percentile Rank	Indicator Value	Income Group Average	Region Average
Getting Credit Legal Rights Index	99.4	10 of 10	4.3	4.5
Getting Credit Information Index	64.6	4 of 6	2.1	2.3
Getting Credit Private Bureau Coverage (% adults)	56.7	2.1%	3.0	39.3
Getting Credit Public Registry Coverage (% adults)	53.9	0.0%	2.7	3.6

OVERALL GETTING CREDIT RANKING: 5 OF 181

WORLD ECONOMIC FORUM'S GLOBAL COMPETITIVENESS REPORT (2009)

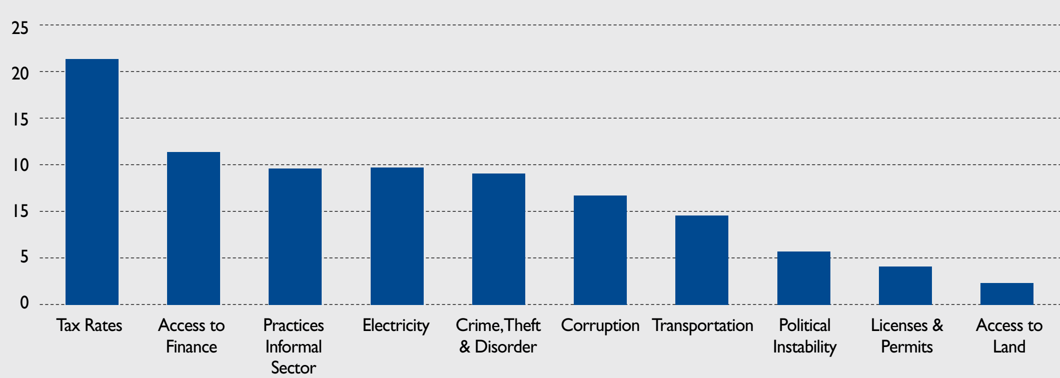
THE MOST PROBLEMATIC FACTORS FOR DOING BUSINESS



Note: From a list of 15 factors, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their ranking.

WORLD BANK'S ENTERPRISE SURVEYS (2007)

TOP 10 CONSTRAINTS TO FIRM INVESTMENT IN KENYA (2007)
% OF FIRMS IDENTIFYING PROBLEM AS THEIR GREATEST OBSTACLE



less likely to take risks that could lead to default. When instances of default do end up in Kenya's courts, the cases are not resolved in a timely manner. Thus, the funds at issue cannot be repurposed to more efficient locations in the economy.

This chapter focuses on these and other constraints to and opportunities for accessing finance in Kenya. Recommendations are put forth at the end of the chapter suggesting approaches to lower transaction costs per loan and expand finance. The BizCLIR scores show that, while supporting institutions are increasingly healthy, the other areas of inquiry—legal framework, implementing institutions, and social dynamics—need continued emphasis on reform.

LEGAL FRAMEWORK

BANKING, MICROFINANCE, AND SACCOS ACTS

The legal structure regulating the financial institutions in Kenya is undergoing significant change. A draft **Banking Act,** overhauling the existing one, has been under review for several years. The **Microfinance Act** was passed in 2008 and the Central Bank of Kenya (CBK) has since licensed the first two deposit-taking microfinance institutions.

KEY LAWS AND REGULATIONS

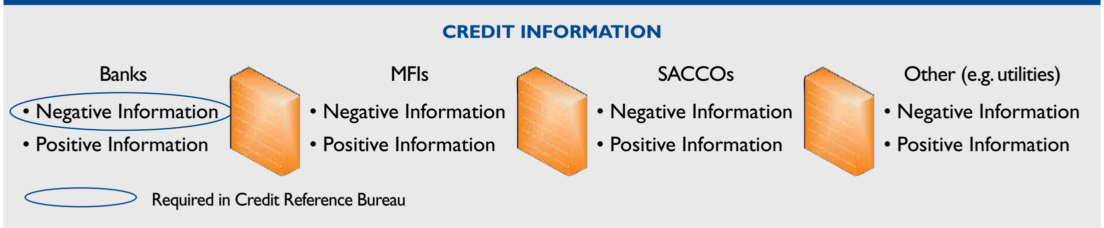
- Banking Act (1989)
- **Draft** Banking Act
- Microfinance Act (2006)
- SACCOs Society Act (2008)
- The Banking (Credit Reference Bureau) Regulations (2008)
- Auctioneering Act (1998)
- Central Bank of Kenya Act (1966, plus amendments)
- Agricultural Finance Corporation Act (1999)
- Chattels Transfer Act (1930, plus amendments)

In addition, the recently enacted **SACCOs Society Act** provides for improved standards and supervision that were previously lacking. The new act establishes the SACCO Regulatory Authority (SRA) which will take on regulatory oversight for the SACCOs. The taskforce guiding the development of the SRA includes participation from CBK staff. With respect to this area, a question remains: Why establish a new regulatory body to oversee financial institutions, the SACCOs, separate from the regulatory body that oversees the banks and MFIs? By setting up a different regulatory institution with different standards, funds are being spent on parallel oversight mechanisms, which will hold the SACCOs to a different standard. If SACCOs were simply small institutions with limited public risk, this issue would not be so significant. In fact, there are over 5,000 SACCOs in Kenya, some with several billion Kenyan shillings in assets. By holding these institutions to lower standards of regulation than banks and MFIs, the financial system is exposed to unnecessary systemic risk. In the short term, the duplicate regulatory structure may be wise, as there are likely a number of problems that may be identified among the SACCOs with the increased supervision. If the CBK were linked to these issues, their reputation might suffer which would be detrimental to confidence in the Kenyan market. However, in the long term, governance, reporting, and supervision should be harmonized under a single institution for efficiency and risk mitigation.

CREDIT INFORMATION

As noted, the recently enacted Credit Reference Bureau regulations provide a mechanism to set consistent standards and basic reporting requirements for banks. The Central Bank and other stakeholders recognize that this is only a first step, as many additional elements of credit information compose a complete credit history, including both positive and negative information from banks, MFIs, SACCOs, and other institutions, such as utility companies. The new credit reference bureau regulation establishes a requirement only for negative information. Though banks can, and many will provide positive information without a legal requirement for such information, the data will not be complete. Also, the credit information-sharing provisions in

MISSING CREDIT INFORMATION IN CREDIT REFERENCE BUREAUS



the law allow for sharing of information among like institutions. In other words, banks can share with banks, MFIs with MFIs and SACCOs with SACCOs. The legal framework needs to enable unfettered sharing of credit information across financial sub-sectors.

Although most MFIs and SACCOs may not have the capacity to meet the credit reporting standards of the credit bureau regulations, this should be the goal. Under current law, an individual that develops a strong credit history with a SACCO or MFI will be unlikely to obtain credit with a commercial bank because the bank will not have easy access to the borrower's credit history. As MFIs and SACCOs have been more successful at providing services to the agricultural sector, women, and the poor, such arbitrary barriers hinder the ability of these constituencies to seek cheaper financing and a broader variety of products from commercial banks.

Finally, not only should credit bureaus be able to provide information from non-financial institutions, such as payment history with companies, but also non-financial institutions should have a mechanism to access credit bureaus for legitimate purposes (e.g., assessing the ability to pay rent). Although the recent regulation is a step in the right direction, a phased plan for comprehensive, cross-institution data-sharing must be developed and implemented.

SECURED FINANCE

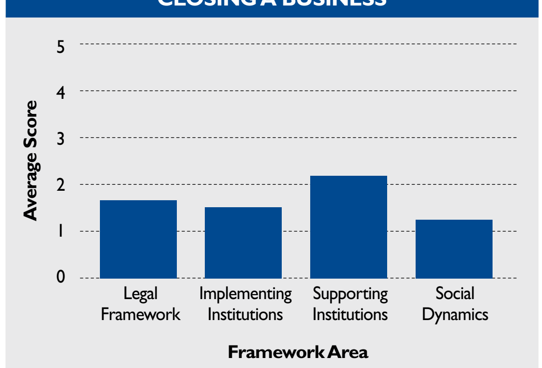
Kenya's laws allow for creditors to take security interests in borrowers' collateral and to register those interests at a registry. In case of default or bankruptcy, the interest is to be honored in court. Kenya would benefit from an overhaul of its secured finance law and institutions, specifically to enable a web-based pledge registry. Such a registry would allow banks to search for existing liens in a matter of seconds, a process that currently takes days to weeks at the existing registries. Moreover, lenders could register their security interests on line, which currently takes too long, especially for those institutions not located in Nairobi. A web-based pledge registry could save time and reduce transaction costs for every secured loan.

CLOSING A BUSINESS

Kenyan insolvency law is based on the English Bankruptcy Act of 1911. In the Act, the concept of the rehabilitation of business entities through a reorganization process is wholly unknown: companies that fail are either put into receivership by their secured creditor or liquidated. The process of receiverships can be interrupted by the filing of injunction proceedings in the High Court which, if successful, can delay the winding up of a business for months if not years.

The entire bankruptcy process has an unseemly aura in Kenyan society. Bankruptcy is regarded as "a place to hide" and the honest debtor "is a

CLOSING A BUSINESS



rare creature." When a debtor is placed in liquidation, the administration of the case is handled through the Office of the Attorney General.[58] A debtor's property is frequently split up in kind among the debtor's creditors at a creditors' meeting presided over by representatives of the Attorney General's office. The liquidation of property not disposed of in that manner is turned over to a small number of auctioneers. The system is widely regarded as suspect.

Major legislation for a complete revamping of the bankruptcy process, including the adoption of a reorganization statute, has been pending for several years. Drafted by a German academic, the statute would be a complete revision of bankruptcy law in Kenya. Whether this wholesale revision is likely to pass Parliament any time soon is purely conjectural, although a less ambitious revision (with a simple provision for the rehabilitation of a business) would be very likely to be easier for the overworked Kenyan court system to implement.

THE LEGAL REFORM PROCESS

The legal reform process for the financial sector is considered to be inclusive of all stakeholders. The CBK and private sector constituencies, such as the Kenya Banker's Association, work closely on the reform agenda. The primary issue as it relates to legal reform is that of delay. It took nearly ten years to get the Credit Reference Bureau's regulations in place. The draft Banking Act was prepared several years ago and is still under review. The Anti-Money Laundering Bill has been under review for at least two years. Legal changes are necessary to expand access to credit and improve the business enabling environment. Policymakers must seek efficiencies in the legal reform process.

IMPLEMENTING INSTITUTIONS

BANKS, MFIS, AND SACCOS

Kenya's financial sector is competitive and diverse with 45 licensed banks, hundreds of MFIs, and over 5,000 SACCOs. Recent years have witnessed new entrants, consolidation, and conversion of MFIs into commercial banks. Around ten years ago, many commercial banks pulled out of rural areas because the profit margins were proving too low. Certain fast-growing institutions, such as Equity Bank, have since demonstrated that with the right business model, many previously "unbanked" constituencies can be profitable customers. Accordingly, many of the large commercial banks have returned to the rural areas to compete with Equity, other smaller banks, MFIs, and SACCOs. The competition among the various types of financial institutions is healthy. The government should focus on building the institutional framework to lower transaction costs and increase transparency of product terms to enable customers to find the best fit for them. Again, to allow customers with strong credit histories developed in MFIs and SACCOs to access credit through commercial banks, the ability for all financial institutions to access a complete credit history is essential.

During this diagnostic, one of the key issues noted by leaders was that of human capital. With such rapid growth, the availability of workers adequately trained to meet the needs of banks, MFIs, SACCOs, and other financial institutions will be stretched. All financial institutions must

58 Attorney General Amos Wako has been in office for over 18 years. He was first appointed under the one-party government of President Daniel arap Moi, who was succeeded by President Mwai Kibaki in 2002. Attorney General Wako's removal from office has been sought by, among others, the Law Society of Kenya. President Kibaki has not acted on this request.

develop a stronger concept of the competencies they require for various positions and work with education and training institutions to ensure that their curricula adequately prepare students to enter the labor force. The Financial Sector Deepening Trust is currently working on a study to better understand the demand for labor in the financial sector. Kenya School of Monetary Studies (KSMS) and other institutions should leverage this study to hone their offerings.

CREDIT REFERENCE BUREAUS

At least two private credit reference bureaus are pursuing licenses under the new credit reference bureau legislation. Both firms have been operating in Kenya for some time. One comes from a credit rating background and the other from a background of debt management. The competition between the two, and other new entries over time, will be good for the market and will certainly spur innovation. Though the laws currently prohibit sharing across institutions, the credit bureaus should be working now on models that allow for system-wide data-sharing. Furthermore, with central banks in East Africa already collaborating on cross-border supervision, opportunities for regional credit reference bureaus should be explored.

KEY IMPLEMENTING INSTITUTIONS

- Banks, MFIs, and SACCOs
- Credit reference bureaus
- Collateral registries
- Central Bank of Kenya
- Courts
- Kenya School of Monetary Studies
- Ministry of Cooperatives
- Agricultural Finance Corporation
- Mobile telecoms

COLLATERAL REGISTRIES

The collateral registries in Kenya oversee paper-based registration processes that are both time-intensive and costly. These costs are passed along to customers, thus increasing the cost of accessing finance. Multiple financial institutions stated during this diagnostic that they often disburse loans before registering, because waiting for the registration would be a major inconvenience to the customer and an impediment to doing business. Other institutions, especially SACCOs, MFIs, and smaller banks operating outside of Nairobi, stated that they typically complete the chattel transfer documents and have them signed and witnessed by an attorney, but do not go through the registration process because of cost and time.

These barriers keep many financial institutions from pursuing small collateral-backed loans because the transaction costs erode their profit margins. For chattel, the inability to effectively search existing registrations leaves banks unable to confirm their position as the first lien holder. Again, these risks keep many banks from pursuing loans that otherwise would be made. As noted, a web-based collateral registry supported by the necessary legal reform would allow real-time search and registration via the web. The transaction costs for secured lending would be drastically reduced, as would the risks for banks. A web-enabled pledge registry, supported by the law, should also enable rapid enforcement in the commercial court system, though clearly this presumes reforms in the courts.

COURTS

Enforcement of contracts in Kenya is a critical problem. With 800,000 to 1,000,000 cases backlogged in a system that has too few resources and antiquated procedures, few have faith that cases will be resolved efficiently and transparently. These issues are discussed at greater length in this report's chapter on Enforcing Contracts. The implications of this problem cannot, however, be overstated. Financial institutions will avoid risks if they feel they will have to depend on the courts for resolution. Moreover, funds caught up in legal disputes can not be repurposed within the financial system to more efficient uses. Although perhaps not viewed as a component of the financial system, judicial reform may have a greater impact on access to credit than reforms viewed as firmly within the financial sector.

CENTRAL BANK OF KENYA (CBK)

The Central Bank of Kenya is the primary regulatory and supervision authority of banks and MFIs in Kenya. It is viewed favorably by most actors in the financial sector as a positive force for progressive reform and transparency. In collaboration with other stakeholders, the CBK publishes an interest rate comparison for lending and savings products for all banks. This example of encouraging transparency and competition, supported by FSD, is just one example of the CBK's progressive stance.

The CBK collaborates closely with the Kenya Bankers Association and the Association of Microfinance Institutions on financial sector reform issues. It also recognizes where it needs to grow. For example, the rapid uptake of mobile telecom products for money transfer, and in some situations more robust mobile finance, are currently not formally regulated. Though mobile technology payments and transfers are in some instances less risky and more trackable than cash transactions, the lack of a formal regulatory infrastructure is a concern. Further, the CBK, along with EAC regulators more broadly, should be moving to a regulatory environment that enables interoperability across networks and nations. Such an environment will not only facilitate small-scale transactions but also facilitate regional trade.

The **Kenya School of Monetary Studies,** originally set up by the CBK, provides the opportunity to build human capacity for banks, regulators, and non-bank financial institutions in Kenya and across the continent. The school has been evolving based on the needs of the sector. It offers a variety of programs including a master's degree in banking, diploma courses, and professional courses. The school can be the hub for building human capacity for the financial sector across the EAC and the whole of Africa.

MINISTRY OF COOPERATIVES

The Ministry of Cooperatives currently oversees the SACCOs. As previously stated, the new SACCO bill authorizes a SACCO Regulatory Authority to regulate and supervise the SACCOs moving forward. The CBK is collaborating with the ministry to develop this new institution.

Regulation and supervision of the SACCOs is critical as they hold billions of Kenyan shillings in assets for a vast number of Kenyans. The requirements under the new bill represent a step in the right direction. The optimal solution should be moving towards a uniform regulatory structure; however, having the CBK take on this responsibility before having a more complete understanding of the underlying risk could damage, unnecessarily, the reputation of the CBK, which would be detrimental for confidence in the market. In the short term, the CBK should continue to collaborate with a view to a more uniform supervision structure in the long-term.

AGRICULTURAL FINANCE CORPORATION

The Agricultural Finance Corporation, established under the Agricultural Finance Corporation Act, was formed to "assist in the development of agriculture and agricultural industries by making loans to farmers, co-operative societies, incorporated group representatives, private companies, public bodies, local authorities and other persons engaging in agriculture or agricultural industries." Like many development finance institutions, unfortunately, the Agricultural Finance Corporation has proven less than successful. Burdened with nonperforming loans made in past years, the institution has largely stopped making loans. At the same time, some private financial institutions have begun entering the agricultural lending sector, though slowly. Recent efforts to recapitalize the corporation and lend at subsidized levels will only erode the competition in the sector. If the government has decided definitively to subsidize agricultural lending, rather than to address the risks in the area that keep interest rates high and lenders wary, all banks should have the opportunity to lend at these subsidized rates. If the government wants to expand agricultural lending, it should focus on removing the barriers and risks that have kept banks away from agriculture.

One example is the need to support human capacity development in agricultural lending. The financial sector needs more experience in loan product development for agricultural finance, agricultural insurance (such as the pilots being led by the Financial Sector Deepening Trust), non-standard collateral and terms, infrastructure investments that can reduce weather-related risk, and the capabilities of mobile banking for rural customers. A focus on agricultural finance is needed as the sector is underserved by the financial community. Undercutting the sector with unsustainable lending practices, however, is not the solution.

MOBILE TELECOMS

Mobile telecommunication companies have entered the financial services arena recently. Their products have filled a gap in the provision of financial services that has often left rural communities completely unserved. Most of the focus has been on money transfer services; however, some companies are beginning to develop more robust platforms. Though regulation and oversight is necessary, especially given the rapid customer uptake and the volume of transactions, the focus should be on how innovations can continue to expand access to financial services at a reasonably low risk. Related legal and regulatory work on anti-money laundering and the stability of the national payments systems should take into account issues of mobile finance.

SUPPORTING INSTITUTIONS

BUSINESS MEMBERSHIP ORGANIZATIONS

The **Kenya Bankers Association** is the lead business membership organization in Kenya's financial sector. It collaborates openly with the CBK and other government agencies on reform. For example, the association is co-leading a taskforce to implement the credit reference bureau data collection framework. The **Association of Microfinance Institutions** and **Kenya Union of Savings and Credit Cooperatives (KUSCCO)** also both play an active role in advocating for their constituents. Each is a key stakeholder in all reform initiatives.

DONORS

The donor community, through both bilateral and multi-donor forums, plays an essential role in catalyzing reform. Whether by supplying the technical assistance to push through legal and regulatory reform; staging demonstration projects, such as FSD's work on index-based weather insurance; or drafting topical white papers, these programs influence policymakers to take action and support ongoing reform.

KEY SUPPORTING INSTITUTIONS
• Business membership organizations • Donors • Third-party shared service providers

THIRD-PARTY SHARED SERVICE PROVIDERS

Most banks in Kenya rely on third-party service providers for collections, auctions, appraisals, armored carrier services, as well as other standard aspects of their operations. Reportedly, these sectors are competitive and provide adequate service for the needs of the institutions.

SOCIAL DYNAMICS

HIDDEN FEES AND FINANCIAL EDUCATION

Many stakeholders in Kenya's financial sector report a perception that commercial banks intentionally use complicated contracts fraught with hidden fees. Much of this perception can be attributed to individuals accustomed to the less formal finance procedures used by MFIs and SACCOs. In most countries, loan documents are multiple pages of legal language that the average individual does not fully understand. Some of this perception could be resolved with customer-service training focused on explaining the salient points of the loan documentation. Financial education programs within business membership organizations could further contribute to greater understanding.

THE EVOLUTION OF THE FINANCIAL SECTOR

The rapid evolution of the Kenyan financial sector is likely to continue in the near future. SACCO regulation and supervision will strengthen with the SRA; licensing, regulation and supervision will contribute to a stronger and more stable microfinance sector; more microfinance institutions will seek to become commercial banks; and the large commercial banks will continue to try to expand their customer base to new regions and sectors. Kenyans should expect the entry of more new banks from Africa and beyond to enter the marketplace, as incumbents demonstrate the profitability of the market. The advent of a stronger credit information system will contribute to greater lending with lower risks and reduced asymmetries of information between lender and borrower. Innovations such as M-PESA's introduction and rapid expansion will challenge banks to compete with new types of competitors. It will also challenge regulatory authorities to provide oversight for areas in which they have limited experience.

As previously mentioned, however, a real systemic risk exists in having the SACCOs under a separate regulatory structure than the banks. That said, a historical reality must be considered. The banks departed the rural areas while the SACCOs stayed and grew. Although the banks have stronger governance and more rigorous supervision to ensure financial stability, many Kenyans do not trust the banks, while they do trust the SACCOs. Any move to harmonize the regulatory structure, which could result in consolidation among, and closing of, some SACCOs, must keep in mind this trust gap.

RECOMMENDATIONS

Build the capacity of credit information resources.

The implementation of the Credit Reference Bureau Regulations is a significant achievement. Clearly, the CBK and other stakeholders recognized that allowing for credit information-sharing of negative information among commercial banks is the most reasonable first step. Yet much more remains to be accomplished.

First, all stakeholders must work toward an efficient acceptance of the credit reference bureau data model and the implementation of the data collection mechanism among banks. The CBK and KBA taskforce should move as quickly as possible to harmonize the data model and implement it for all licensed banks.

Second, the legal and regulatory changes necessary to allow for unfettered sharing of positive and negative credit information across financial and non-financial institutions should be put in place. Consumer protection concerns must be accounted for in such changes.

Third, an advocacy program focusing on the importance of credit information for society should be designed and implemented. The initial focus should be on those SACCOs and MFIs that were reticent in the past to establish credit information-sharing outside of commercial banks. At the same time, a broader program should inform the public of the benefits of such a system.

Fourth, a capacity-building program on the implementation and use of credit information should be designed and implemented (KSMS would be a logical institution within which to embed such a program). The program should cover:

1. Mechanisms for incorporating credit information and credit scoring into the underwriting process;
2. Implications for portfolio risk management with greater information about customer risk;

3. Product development and customer acquisition strategy given reduced risk; and
4. Technology capabilities for integrated systems.

Finally, a phased implementation for credit information-sharing for MFIs and SACCOs must be put into place. Credit information-sharing is critical for lowering the cost of lending and expanding access to finance across the population. The recent achievement of enacting the credit reference bureau legislation is important, but the work is far from complete.

Reform the collateral registry.

In Kenya, the time and cost associated with searching registries and registering secured interests in collateral is exorbitant. Collateral registry reform should be among the financial system's top priorities, including implementation of a web-based collateral registry and the associated secured finance laws and regulations that legally establish it. This effort should begin with a short fact-finding trip, including an international expert in the field, to analyze laws and regulations, evaluate the existing registries, and liaise with stakeholders. During this trip, the team should identify local attorneys with expertise in finance and drafting. The trip should conclude with a strategy for implementation, including the identification of the local champion agency that will partner with Kenya on reform.

With a strategy in place, the next step should be a widely publicized kickoff event where all stakeholders are introduced to the team, the web registry concept, and the timeline for implementation. The team would then proceed with the registry design and legal drafting necessary. With a draft law, the team could pursue the legislative process concurrently with training of bankers, registry, and court staff.

The last remaining step would be legal implementation. The initial scope should focus on moveable property and then consider land at a later date.

Concurrent with the web-registry initiative, efforts should be made to embed secured finance into the curricula of law and finance institutions to ensure that the next generation of bankers, attorneys, and judges are educated in the modern secured finance system. The finance/banking curricula should include training in product development and portfolio risk management under the new regime.

Finally, across the national registries—land, chattels, securities, motor vehicles—analysis should be done to evaluate the capabilities (technology, staff, and processes) in place. The focus should be on sharing best practices and transitioning them all into customer service-oriented institutions. More information on the land registry is set forth in this report's chapter on Registering Property.

Reform courts to expand access to finance.

Court reform is critical to expanding access to credit in Kenya. Though the recommendations pertaining to Kenya's courts are set forth in other chapters, suffice it to say that without fair, efficient, transparent courts, access to finance will remain limited.

Address key issues pertaining to the Agricultural Finance Corporation.

Increasing access to finance in the agricultural sector is of critical importance to the Kenyan economy. Without finance, upgrading of the sector and desperately needed improvements to productivity will not occur. However, subsidized loans through a government institution with past issues of nonperforming loans are not the solution. Many financial institutions in Kenya are beginning to venture into agricultural lending. For the Kenyan government to compete with these institutions erodes competition and weakens the sector. Policymakers should instead focus on the barriers to agricultural lending, such as:

1. Supporting the pilot index-based weather insurance work currently underway;
2. Supporting training in agricultural finance through an institution like KSMS;

3. Supporting warehouse receipt programs, such as the one operating with the East Africa Grain Council; and
4. Supporting long term finance on infrastructure, such as drip irrigation, that lowers the risk for bankers.

Subsidized lending for agriculture using public funds is analogous to bailing water out of a boat with an existing hole.

Strengthen SACCO oversight and engage in scenario-based stress testing.

The recent experience of the pyramid schemes among the SACCOs emphasizes the need to improve the oversight in a sector with thousands of institutions, holding billions of KES in assets. With regulatory inconsistencies among banks, MFIs, and SACCOs, a weaker oversight model for the SACCOs could attract corrupt individuals looking to launder money or engage in pyramid schemes. Furthermore, some institutions may simply be poorly governed, which leaves exposure for other members and the financial sector more broadly. Although the creation of the taskforce to analyze the pyramid schemes and the development of the SRA are important steps, more is necessary. A comprehensive regulatory comparison of the banks and MFIs under the CBK, and the SACCOS under the SRA (based on the plan as it is not yet in place) should be undertaken to identify all gaps. For each gap, a risk analysis should be completed to assess exposure for the financial system. Where risk exists, mitigation plans should be developed and implemented. Though the long term goal should be harmonized regulatory oversight, it is unlikely to be a near term reality.

A secondary analysis that should be conducted is a "stress testing" of the Kenyan financial sector. Using simple simulation tools, a series of stress tests could be run on the Kenyan financial sector based on the balance sheet information of various institutions. Such a model would allow for a variety of scenarios, such as:

1. Regional agricultural collapse due to drought brings down local institutions;
2. Global financial crisis leads to job loss and increase in loan defaults system wide;
3. Poorly governed SACCO collapses; and
4. Rapid increase in lending based on reduced transaction risk (perhaps from one of the previous programs).

Conducting such simulation-based quantitative analysis can help policymakers pinpoint systemic risks and take steps ahead of time to intervene with solutions.

Promote mobile finance interoperability.

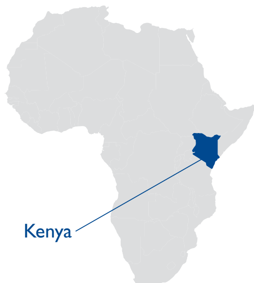
The entrance of mobile telecommunications firms into what have been historically financial services, such as money transfers, is transforming commerce. M-PESA, specifically, has experienced customer uptake of millions in only a few years. Banks, SACCOs, and MFIs are working to integrate mobile services into their business models. Some are simply trying to allow M-PESA account holders to pay loans or make savings deposits. Retail businesses are seeking opportunities to allow payment for goods using these services. No longer do such businesses have to be concerned with bounced checks or the security issues associated with carrying large amounts of funds. The private sector is clearly better off with these and competing innovations. Nonetheless, regulators must still work toward four goals in the area of mobile finance: limited systemic risk, increased competition, interoperability across providers, and interoperability across borders.

Although CBK and Safaricom have ongoing informal consultations regarding the M-PESA business, a more formal system of oversight needs to be considered. Admittedly, the central bank is not currently staffed with the resources to formally regulate this new technology. An analysis should be conducted examining other markets with more advanced m-banking systems. The telecommunications, banking, payments, and anti-money laundering legislation for these markets should be evaluated for the risks being regulated and best practices for doing so. This white paper should be the basis for a proposed strategy for the EAC, with Kenya being the pilot. (Some of this work could be accomplished under the Africa Economic Research Consortia's ICT program.) The regulatory environment should enable competition among, and interoperability across, providers without punishing innovation.

Furthermore, capacity-building in telecoms, financial institutions, and retail businesses could be accomplished via regional workshops offered by KSMS or like institutions. Such capacity-building could disseminate best practices on products, business models, and internal risk management. The goal would be to expand access to financial services using available technology at limited risk.

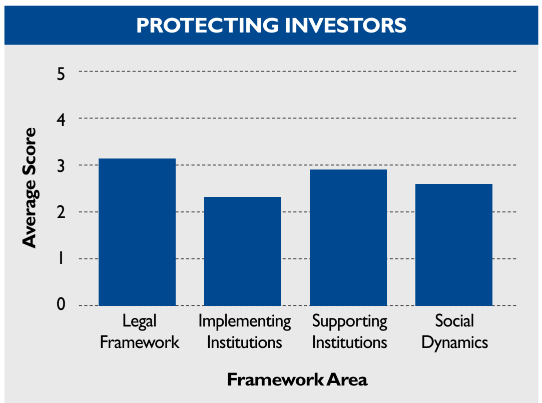
Support regional financial markets.

The goal of a regional market is to have goods and labor flow freely across borders, and it is imperative that the financial sector operate just as efficiently as its counterparts in the real sector, if not more so. Central banks already collaborate on supervision exercises across borders, stimulating learning and best practice dissemination. Institutions such as credit bureaus and collateral registries should not be rebuilt for each country. Instead, solutions should be replicated across the EAC, thus reducing the overall cost of reform. Harmonization of the regulatory framework for finance is already on the EAC agenda; these efforts should be supported and accelerated.



PROTECTING INVESTORS

Investors seek opportunities where they can succeed, and to determine those opportunities, investors must be able to accurately predict chances for success and weigh risks. In predictable environments where risks are manageable and minimized, investors will flock.



Despite political risks, instability, and insecurity, Africa continues to attract investors, but the focus of such investors remains largely limited to extractive industries and other high-value activities that provide a quick return on investment, to account for the risks undertaken. Such investments are not designed for sustainability and provide limited benefits to a country's overall economy and the well-being of its population.

Kenya has benefited in recent years from the interest in investing in Africa because of its strategic location and its position as the most advanced country in the eastern region. The country is not yet competitive on a global level, however, because it remains politically unpredictable and its business environment is difficult to navigate. Based on recent events both within Kenya and beyond, the country can no longer afford to rely on its geographical advantage to sustain it. Investment, both local and foreign, is exiting. Violence following the 2007 election has rekindled fear and uncertainty in what was recently considered a secure environment, and the global financial crisis and food crisis have caused investors to further hedge their bets worldwide.

The country has also already suffered from the global trend of consolidation in multinational companies. Several major companies have shut down processing or reduced production lines in Kenya in the past few years as they move toward relying on fewer production locations. If Kenya continues to have business costs that are globally uncompetitive, this trend will continue to have a detrimental impact on the country. Additionally, corruption—a major cause of unanticipated costs and risks for both local and foreign investors—is endemic.

Because of the gravity of global challenges to investment today, it is imperative that Kenya reduce the disincentives that can be controlled and put systems in place to safeguard investments. Kenya can take advantage of its regional appeal and strategic position and maximize its opportunities by taking real steps to improve the environment for business, or it can squander its opportunities and watch as increased security risks and corruption cause investors to start considering neighboring countries. Such countries have taken efforts lately to improve their investment appeal.

This chapter addresses issues that impact decisions to invest and the protection of existing investments. It reviews risks posed from the outside—corruption and insecurity—as well as those from the inside—poor corporate governance practices. It concludes with recommendations for reform activities to improve investment protections and appeal. The BizCLIR scores generated during this diagnostic illustrate the key points made in this chapter: while Kenya's legal framework is improving, the institutions that support investment and the social dynamics of this issue are in need of continued reform.

LEGAL FRAMEWORK

Investors are affected by the entirety of the country's commercial legal framework. This section concerns laws that specifically address or affect investing and the protection of investment.

CORPORATE GOVERNANCE

Corporate governance refers to the policies and practices that dictate the manner in which the resources of corporate bodies are managed, authority is exercised, and rights and responsibilities are enforced. Without sound corporate governance practices, investments are susceptible to loss from mismanagement and poor business decisions. The use of companies in Kenya to perpetrate fraud, witnessed in several recent scandals, has highlighted the need for awareness and enforcement of better governance standards within both public and private sector entities.

To the extent that good corporate governance practices are required of companies in general, those requirements are captured in the current **Companies Act.** This dated legislation, drawn almost entirely from the 1948 Companies Act of England, includes only the most basic corporate governance provisions, and even those provisions are not enforced. According to private sector representatives, the Companies Registry is the institution responsible for compliance with these provisions, but its only method of enforcement is to apply a fine when companies re-register if noncompliance is evident at that time. Further, the penalties applied at this stage are too minimal to create an incentive for timely compliance. Director duties outlined in the Companies Act may also be enforced through the courts, with both civil and criminal sanctions possible, but enforcement in this manner is quite challenging due to the backlog in the courts as well as the many available defenses for directors in the law and a doctrine that limits liability to proven fraudulent intent. The limited liability doctrine was central to recent political scandals wherein fraudulent companies were used to raise credit, including the Goldenberg and Anglo-leasing cases. The Companies Act also fails to provide adequately for derivative actions by shareholders on behalf of the company, further limiting safeguards against such abuses.[59]

Companies that practice sound governance typically do so for other reasons, such as enforcement by other regulators, where applicable, or to appease banks for lending purposes or to satisfy trading partners. Nevertheless, the law is in need of an update. A new Companies Bill is currently under consideration in order to improve corporate governance provisions as well as company registration processes. The Bill provides clearly for sanctions applicable to noncompliance. Once passed, education for small businesses and shareholders on the new provisions and their implications for rights and recourses, will be necessary, and improved enforcement mechanisms should be put in place. Provisions for governance of cooperatives should similarly be enhanced.

KEY LAWS

- Companies Act 1962
- Capital Markets Act 2000
- Anti-Corruption and Economic Crimes Act 2004
- Investment Promotion Act 2004

CAPITAL MARKETS

The Nairobi Stock Exchange (NSE) is the oldest and largest stock exchange in Sub-Saharan Africa. The NSE, brokerage firms, and listed companies are regulated by the Capital Markets Authority (CMA). The CMA was created by the **Capital Markets Act of 2000.** Based on recent scandals involving stock brokers and the NSE, it is apparent that gaps and weaknesses in the CMA's legal framework exist. The CMA has several initiatives underway, with donor support, to address these issues, including efforts to make the CMA's Corporate Governance Guidelines enforceable, changing licensing standards for brokers to require individual as well as company-level licensing, and instituting various risk management standards such as online submission of investments. This review and subsequent changes in the CMA's laws and regulations must carefully

59 Lois M. Musikali, "The Law Affecting Corporate Governance in Kenya: A Need for Review." International Company and Commercial Law Review, Vol. 19, No. 7, pp. 213–227 (2008).

consider how to better incentivize good management, and enforcement of stricter penalties for mismanagement is needed. CMA hopes that new corporate governance regulations will be passed by the end of 2009. CMA's sanctions regime was strengthened in 2007, which should impact the effectiveness of more stringent requirements as well. The public remains wary of investing in the NSE in the wake of major losses caused by corruption among brokers. The donor community and the government should facilitate these legal reforms promptly and build public awareness of the changes instituted in order to rebuild investor confidence and allow the NSE to rebound.

CORRUPTION

Corruption affects investment in multiple ways. As discussed above, fraudulent use of companies puts existing investors at risk, and perceptions of corruption within the public and private sectors are a disincentive to new investment or expansion of existing investment. Corruption is poisoning the Kenyan business community and the country's overall governance. Much more could be done in terms of laws and regulations to eliminate the many loopholes that create opportunities for rent seeking to flourish. Throughout this report, references are made to specific areas where such issues can be addressed, such as through automation of the Companies and Land Registries. The Kenya Anti-Corruption Commission (KACC)—established in 2003 by the **Anti-Corruption and Economic Crimes Act**—is the country's answer to corruption on a national level. As discussed further below, the effectiveness of this institution is hampered by its limited capacity and mandate, as well as backlog in the courts.

INVESTORS

The **Investment Promotion Act of 2004** governs both local and foreign investments in Kenya and established the Kenya Investment Authority (KenInvest) to promote and facilitate investment in the country. This institution, which replaced the Investment Promotion Center, is discussed further below. The Act applies to investments reaching a threshold of US$100,000 for foreign investments and KSh5 million for local. While the 2004 Act states that such investments are required to be registered with KenInvest, this requirement has recently been removed, but certain benefits are offered only to those holding an investment certificate. One such benefit is that the investment certificate allows the holder to commence operations immediately by providing a 12-month grace period during which the investor may pursue any other necessary licenses. The certificate also entitles investors to entry permits for expatriates, but this entitlement is reportedly not always respected by the immigration authorities which can prove a challenge for foreign investors in particular.

Foreign investors are, for the most part, subject to the same standards and options as local investors, with a few exceptions. Some limitations exist for foreign investors, for example, with respect to ownership of companies listed on the stock exchange, land ownership, and investment in certain sectors. However, these limitations were not cited as problematic by private sector representatives consulted in this diagnostic, and solutions such as reliable long-term leases reportedly diffuse any challenges posed by these constraints. Yet the reasonable legal framework for investment has done little to compensate for the challenges posed by corruption and political insecurity, or by the high cost of business due to poor infrastructure and energy.

IMPLEMENTING INSTITUTIONS

KENYA INVESTMENT AUTHORITY (KENINVEST)

KenInvest is a semi-autonomous government agency established in 2004 (but operational only since 2006) to promote investment, facilitate investment, and conduct policy advocacy on investment issues. Its mandate expands on that of its predecessor, the Investment Promotion Center, although KenInvest has a limited capacity thus far to fully perform these activities. The government appears committed, however, to expanding KenInvest's abilities and has increased the institution's budgets by four-fold this year. As a result, KenInvest is reportedly on track to have a functional one-stop shop for investors by June, and its website (currently providing only limited information) should be robust by July.

With the one-stop shop, KenInvest will transition from providing only information and guidance as to how and where to obtain necessary licenses and information pertaining to investments, to co-locating officers with authority to administer licenses from a variety of key government offices (including the Company and Land Registries and the Kenya Revenue Authority). KenInvest is beginning to compile profiles in certain sectors to improve access to potential market information. While these efforts are still at an early stage, they should be useful in developing should be a valuable resource for local and foreign investors alike, as lack of market information is a common complaint.

While KenInvest already has useful services and information to offer, its resources are still quite unknown in the investment community. Even investors who are aware of its services are frequently skeptical of the agency's usefulness. As public sector representatives suggested, businesses are more likely to pay a lawyer to provide these services than to approach KenInvest, which can provide them for free. KenInvest could look to the older and more robust investment promotion agency in neighboring Uganda—the Uganda Investment Authority—for ideas of how to better promote and expand its own services.

KENYA ANTI-CORRUPTION COMMISSION (KACC)

The KACC, the national agency aimed at combating corruption, investigates corrupt activities, provides preventative services, and seeks to educate the public about corruption issues. Since becoming operational in September 2004, the KACC has conducted more than 4,000 investigations and recorded KSh4 billion in corruptly acquired assets. However, due to extreme backlogs in the court system and its reliance on the Attorney General to prosecute corruption cases, the ability of the Commission to effectively impact corruption through investigation is severely curtailed. KACC relies on the Attorney General to pursue prosecution, and there are reportedly few incidences where the Attorney General has declined to prosecute a case recommended by the KACC. Thus, while several stakeholders suggested that KACC's lack of prosecutorial powers is problematic, it would appear that court delays are the real constraint, and corruption within the courts themselves poses greater challenges still. Furthermore, public perception is that the KACC's investigations address primarily petty and low-level corruption.

Although Kenya's political leadership has been vocal about supporting the commission, KACC is widely perceived to lack the authority or political support to effectively fight high-level corruption, which remains widespread, and recent legislative efforts have reportedly whittled down the powers of the commission.

KACC has insufficient capacity to fulfill its mandate, particularly with regard to preventative services and public education. In education, KACC conducts various training programs on governance, but this work requires a long term commitment. The Preventative Services Department has a mandate to enter and review institutions to detect and recommend solutions to corruption risk factors. During these reviews, KACC staff spend approximately three months within an institution reviewing policies, procedures, and governance structures to determine where loopholes that enable corrupt practices exist. In determining which institutions to review, KACC considers corruption perception rankings, such as Transparency International's index, reports received from the public, and which institutions are in key positions in the government. Upon conclusion of the institutional review, KACC makes recommendations for methods to reduce rent-seeking opportunities. While institutions are obliged to implement KACC's recommendations, no enforcement mechanism or penalty for noncompliance exists, and KACC does not currently have adequate staff to conduct such reviews. KACC also prefers to review only those institutions which invite the reviews, and thus far certain key institutions (including the police force and judiciary) have refused to do so.

Effective anti-corruption programs are challenging in societies with entrenched cultures of corruption. Although the KACC reports that there has been a reduction in abuse and improved perceptions, according to public surveys, these findings were not reflected in stakeholder meetings held during this diagnostic. Kenya certainly faces an embedded culture of corruption, but lessons could be learned from other countries, such as Rwanda and Ghana, which have had effective anti-corruption initiatives driven by strong leadership.

KEY IMPLEMENTING INSTITUTIONS

- Kenya Investment Authority (KenInvest)
- Kenya Anti-Corruption Commission (KACC)
- Capital Markets Authority (CMA)
- Nairobi Stock Exchange (NSE)

CAPITAL MARKETS AUTHORITY (CMA) AND THE NAIROBI STOCK EXCHANGE (NSE)

After several boom years of increased investment and local engagement, public confidence in the NSE has recently plummeted. In addition to the effects of the global economic crisis and insecurity concerns based on violence following the 2007 elections, corrupt practices of stock brokers in several high-profile incidents resulting in significant investment losses have caused investors, both local and foreign, to flee the market. CMA has responded with plans to enhance regulation of companies and licensing requirements for brokers. A key consideration in this effort should be clarifying the roles of board members and management within companies, and providing stronger penalties for failure to comply with corporate governance requirements. According to the CMA, corruption is being addressed through increased transparency and automation within the authority. While CMA is perceived to have rigorous admission requirements for listed companies, enforcement of corporate governance practices thereafter is reportedly not occurring. Because the board of the NSE is composed of stockbrokers, a conflict of interest exists that poses a challenge for effective regulation as well. CMA has plans to increase the NSE's independence by decentralizing this control. Professionalism of brokerage firms is also a concern, although public sector representatives assert that the increase in competition among stockbrokers is leading to better practices. CMA is well aware of current shortcomings and has plans for several initiatives to address them. The challenge will be to coordinate efforts with donors to ensure that reforms are completed and complementary, and that companies, brokerage firms, and investors are educated about the effects of new policies and procedures.

Regarding education, investors are in need of greater financial literacy so that they are aware of the risks they face and can play a role in preventing corruption. CMA has been conducting investor awareness programs over the past four years in order to enlighten the public and investors and empower them to push for better corporate governance to protect their investments. These efforts should be enhanced in order to rebuild confidence in the market and bring investors back.

SUPPORTING INSTITUTIONS

PRIVATE SECTOR

Kenya's business community boasts several important private sector institutions, including the Kenya Association of Manufacturers, Kenya Chamber of Commerce, and Kenya Private Sector Association. These bodies are now engaged in dialogue with the government at the highest levels via the Prime Minister's Roundtable. However, many private sector representatives are growing weary of the process, reporting that while the dialogue is robust, implementation of reforms has been slow in coming. While business associations cannot force change, they can and should monitor promises of reform and push for implementation. Business leaders interviewed for this diagnostic held positive views about being able to effect change on the local level—for example, addressing crime in Nairobi's city center and obtaining improvements to key roads. Yet, on the national policy level, this type of success is lacking. Private sector associations should step up pressure for real action by the national government on serious impediments to the business environment, such as corruption. Furthermore, the private sector must also play a role in addressing these challenges. It must not tolerate rent-seeking activities within the business community or in dealings with the government, and its leaders must communicate that message publicly. Currently, many within the private sector see corruption as a reality to be tolerated. As long as this is the message from the business community, the battle over corruption will not be won.

KEY SUPPORTING INSTITUTIONS

- Private Sector
- Legal profession
- Accounting profession
- Courts
- Centre for Corporate Governance in Kenya (CCGK)
- Banks
- Media

LEGAL AND ACCOUNTING PROFESSIONS

A good investment environment requires reliable, affordable, and skilled business support services, including legal and accounting professionals. Kenya has an adequate number of firms in both of these categories. Indeed, the country likely suffers from having more lawyers than there is work to support them. While the high end of the legal profession is regarded as well-qualified and capable of handling complex commercial transactions, the legal profession in general is perceived to be highly corrupt. The practice of commercial is highly competitive in Kenya, so lawyers are under pressure to get results quickly, and this reportedly leads to corrupt practices. Small businesses and individuals who cannot afford top-end lawyers are also at high risk of being exploited by unprofessional attorneys. With respect to the accounting profession, private sector representatives were generally satisfied with the quality of accountants, and Nairobi has representation from several well-respected international firms.

COURTS

The courts in Kenya are perceived to be exceedingly slow, unreliable, and highly corrupt, and this continues to be a major source of concern for both local and foreign investors. The courts must be improved not only to reduce corruption within dispute resolution processes, but also to allow the successful prosecution of corruption in other matters. This major issue is explored at length in this report's chapter on Enforcing Contracts.

CENTRE FOR CORPORATE GOVERNANCE IN KENYA (CCGK)

The CCGK is a membership organization that conducts training and advocacy on corporate governance. Although originally supported primarily by donor funds, CCGK is becoming increasingly independent by raising funds through trainings directly. Institutions of this sort are important in the effort to build a corporate governance culture in Kenya and improve public understanding of the positive roles of corporate governance. The CCGK has seen an interest in its trainings not only by directors and board members of large companies, but also increasingly by smaller businesses. However, awareness and understanding of corporate governance within MSMEs in Kenya remains limited.

BANKS

Because banks are not confident in the courts and cannot rely on them to enforce loan obligations, many banks, and some microfinance institutions, have adopted a policy of rigorous due diligence before making loan decisions. This has become a strong incentive for good business practices and sound management in firms seeking loans. Some banks include a thorough review of corporate governance practices and compliance in their due diligence. As long as other incentives for good corporate governance practices do not exist in Kenya, this will remain critical for ensuring that healthy businesses continue to develop and grow.

MEDIA

The press in Kenya is clearly much freer than it was under the prior government. This is evident from newspaper headlines every day. Media coverage of corruption and scandals, even involving criticism of the national government, is common. Many private and public sector representatives hailed the increased freedom of the press as one of the most important developments since the change in government in 2002. Although this progress should not be discounted, some caution is still warranted. Coverage of scandals remains highly political and shallow. Investigative journalism is not advanced. Furthermore, there is a perception that the major media houses in Kenya are politically controlled. The media is even perceived by some within the private sector to have played a role in inciting violence following the 2007 elections.

SOCIAL DYNAMICS

Investment in Kenya is affected by a variety of factors beyond the applicable laws and institutions. This section considers the effects of the business environment at large, as well as other broader environmental challenges, on the appeal of investing in Kenya and the safety of investments made.

The security situation in Kenya was highlighted by numerous private sector representatives as one of the primary disincentives to conducting business in the country. Historically, Kenya was viewed as a dangerous location where security costs—both in preventative measures and loss of assets—impacted the bottom line of businesses. This added cost sometimes made the difference between a profitable and unprofitable venture, and it had a significant impact on the ability of Kenyan firms to compete in the region and worldwide. In more recent years, the country had the benefit of appearing politically stable, unlike many of its neighbors. However, the violence that broke out following the elections in 2007 cost the country its reputation for stability. Although safety in the country, particularly in Nairobi, had reportedly been improving, the politically driven outburst of late 2007 and early 2008 more than offset those gains, scaring off local and foreign investment alike.

The violence following the elections was linked to ethnic tensions that were exploited and incited during the 2007 campaign. Ethnic differences have long dominated Kenya's national politics, and such differences have resulted in varying levels of development in different ethnic areas of the country. Reportedly, the Nyanza Province, the stronghold of the opposition for many years, has suffered neglect in terms of infrastructure development and, due to political risk, has seen more difficulty in obtaining credit for investment in the region. In light of this history, and the fact that Nyanza was the hardest hit by the violence in 2007, its development is far behind other parts of the country. Fearful of such risks, even local investors in Nyanza are leaving their homes to build elsewhere in Kenya. Kisumu, the provincial capital and third largest city in the country, has the resources of Lake Victoria to offer, and it could have much to offer the business community in Kenya if these challenges were addressed.

These challenges are not limited to certain regions, however, and ethnic tensions are still being exploited on a national level. Members of the private sector reported to this diagnostic that hate messages are being broadcast by some groups via cell phone text messages, and pressure within different communities to vote for and support one's own is common.

The current coalition government has done little to alleviate the effects of the recent political upheaval or address its causes. Accordingly, many investors view the upcoming election in 2012 with great concern. If the government fails to take significant steps to lessen the discord that remains, many investors will not be around to risk it. Some in the private sector are already advising clients to remove their assets from the country by 2012. Much depends on what the government does between now and the next election. Unfortunately, factions within the coalition government have shown an inability thus far to work together to push through reforms. This affects the country's stability and ability to overcome the wounds of 2007, and also affects a variety of business reforms that are stalled. The coalition government, and the plethora of new ministries created to appease various political factions, need to do a more effective job working together for positive change. The government must also show the private sector that dialogue leads to progress on reforms. Improved dialogue with the private sector is happening, and this is important, but without effective implementation, it will only frustrate the business community.

As mentioned earlier in this chapter, corruption remains out of control in Kenya, and it is a problem not only within the public sector, but it is deeply entrenched within the private sector as well. Petty corruption is endemic and poses serious costs to MSMEs, which are easily taken advantage of. Corruption also occurs at high levels, involving conflicts of interest and exploitation of positions of influence. On both levels, corruption hinders the competitiveness of businesses that operate according to the rules.

Corruption is built into Kenyans' culture at an early age: bribing a petty official to obtain one's driver's license or watching one's parents pay their way out of a traffic citation would not be uncommon. Society is marked by a lack of trust and poor governance practices, and this has proven detrimental to the business community. Both the public and private sector, at the highest levels, must work together and send the message that corruption will not be tolerated, and they must follow up by not capitulating and allowing it to occur. Today, resistance to change is common in both sectors because many are benefiting from existing rent-seeking opportunities. Accordingly, the public must ensure that there are consequences for such actions.

Cooperatives, for example, have failed repeatedly in Kenya. In the 1980s and 1990s, following a period of success in the cooperative market, cooperative scandals became common, and cooperatives became tools for political gain. Embezzlement, mismanagement, and the use of cooperatives for personal enrichment became common stories; cooperative members incurred significant losses. These scandals resulted from a failure of governance within the structure of cooperatives. While a better informed cooperative membership could force stronger management and minimize the risks of financial losses, convincing the public to give these structures another try is proving challenging. Indeed, today all forms of collective business efforts are viewed with skepticism by the general public. Even getting farmers to buy and sell together to promote efficiency and economies of scale is difficult. The tea sector has made strides in recent years in bringing growers together with significant success, and the coffee industry is beginning to organize growers again as well. These examples can help rebuild trust and underscore the benefits of working together.

All of these issues, along with poor infrastructure and high energy costs, contribute to Kenya's poor investment environment by reducing predictability and increasing risk. By some accounts, the infrastructure situation has been improving in the past two years, and investor confidence was up in 2003 following the change in government. Increased freedom of the press, consumer confidence, and privatization fueled boom years in Kenya. However, after a few years of increasing investor confidence, progress in reform slowed down, politics took center stage, and corruption increased. These events culminated in the eruption of corporate and political scandals and violence. If this trend is not reversed, Kenya will not only fail to become a competitive economy on a global scale, it will lose its edge even within the region.

A good example of the precariousness of gains made in recent years is the construction of the East African Submarine Cable System, a major public-private partnership that was launched in 2003 and is projected to bring costs of broadband down significantly and open up the potential of business process outsourcing as an industry. While this project is expected to be operational within the next six to twelve months, the government's failure to pay contractors on time is reportedly putting this huge and important investment at risk. If this project is successfully completed, however, it could do much to reduce business costs in the country and build the foundation for new profitable ventures.

RECOMMENDATIONS

Although many activities could be conducted to enhance Kenya's investment appeal and improve the security of existing investments, the recommendations below focus primarily on addressing corruption, which remains a central threat to investor confidence in the country.

Enhance KACC's ability to fight corruption through preventative services.

KACC has insufficient capacity to fulfill its mandate, particularly with regard to preventative services and public education. The Preventative Services Department has a mandate to enter and review institutions to detect and recommend solutions to corruption risk factors. During these reviews, KACC staff spend approximately three months within an institution reviewing policies, procedures, and governance structures to determine where loopholes exist that enable corrupt practices. In determining which institutions to review, KACC considers corruption perception rankings, such as the index of Transparency International, reports received from the public, and which institutions are in key positions in the government. Upon conclusion of the institutional review, KACC makes recommendations for methods to reduce rent-seeking opportunities.

While institutions are obliged to implement KACC's recommendations, no enforcement mechanism or penalty for noncompliance exist. KACC also does not currently have adequate staff to conduct these reviews and prefers to review only those institutions that invite review. Thus far certain key institutions (including the police force and judiciary) have refused review.

To be effective and to avoid political interference, preventative reviews should be required for every institution within the next three to five years. To limit duplication of efforts, a limited version of this review could be used for those institutions that undertake effective internal corruption controls. In such cases, KACC could review the institution's internal anti-corruption program to determine whether it is thoroughly and effectively addressing corruption. Mandatory reviews for all institutions would require significantly greater capacity within the Preventative Services Department, so capacity-building—in terms of both staff numbers and training—should be a priority. A thorough review of the current capacity and capabilities of the Preventative Services Department should be conducted, followed by an analysis of what training and staffing would be necessary to effectively and efficiently conduct a review of all government institutions in the next three to five years and to engage in follow up technical assistance to assist in implementing recommendations. The Anti-Corruption and Economic Crimes Act should be revised to require preventative reviews by the KACC every three to five years—with the time frame dependent upon the capacity analysis—and to create penalties and enforcement mechanisms for recommendations made by Preventative Services. Penalties could include fines or denial of federal funding, both of which KACC would be empowered to easily administer, with fast-tracked enforcement by the courts if compliance is not forthcoming.

While the government at a high level must be on board to enact reforms of this nature, the donor community and private sector are in a position to exert pressure on the government on the need for action. Additionally, the donor community could provide technical assistance and support to conduct analysis of the needs of the Preventative Services Department to conduct these activities and streamline the institution review process.

Revise the Public Officers Ethics Act to increase transparency of public officer assets and better regulate conflicts of interest regarding public sector involvement in business.

Disclosure of assets by government officials is key to reducing the chance for corruption; it enables anti-corruption authorities and the public to trace ill-gotten wealth. While the Public Officers Ethics Act of 2003 requires officers to declare their assets and those of their spouses and minor children, the law is not clear regarding who audits these reports and what action, if any, can arise from suspicious information within these declarations. Additionally, this information is kept confidential by the relevant commission and is not available to the public in any form. Without any auditing of these disclosures, both for accuracy and for suspicious information about personal wealth, the disclosure requirement itself is toothless. The Act should be revised to make public all assets declarations so that the public can monitor irregularities, and should be more detailed regarding what assets and interests must be declared.[60] It should also include provisions for inspection of assets declarations and referral of suspect information to KACC for investigation.

The Public Officers Ethics Act also fails to adequately address conflicts of interest by public officers, and former public officers engaged in activities within the private sector (not activities of the public sector). Additionally, current provisions regarding conflicts while in office are limited and do not appear to have impacted the incidence of government involvement in business activities. "Indeed, the Kenyan political elite is the cream of the private sector."[61] The lack of effective provisions in the law restraining public sector representatives from engaging in business activities, during and following public office, has enabled a situation wherein public and private sector activities are not conducted at arms length, allowing ample room for corrupt activities and personal enrichment by government employees who can exploit their positions. The Public Officers Ethics Act should be revised accordingly, to create effective governance of conflicts of interest between the public and private sectors. Public sector officers, particularly senior executives of the government, should have significant restrictions on engaging in business activities and investments while in office and for a period of time following departure from office, and allowable engagement in the private sector should be highly regulated for transparency.

Increase civil and criminal sanctions for fraudulent acts by company management and mismanagement of company assets, and increase ability to enforce such sanctions.

Weak corporate governance checks in Kenya have allowed for rampant scandals and mismanagement in companies in Kenya. The Companies Registry takes a passive role in corporate governance enforcement, and the CMA reportedly does not actively enforce corporate governance as well. Penalties applied are too minimal to create an incentive for compliance. While the

60 *See* James Luh, Transparency International—Kenya/Harvard Law School, *Public Officer Ethics Act Provisions for Declarations of Income, Assets, and Liabilities: Evaluation and Recommendations* (July 31, 2003).

61 Global Integrity Report, 2008 Assessment, Kenya Integrity Indicators Scorecard, http://report.globalintegrity.org/Kenya/2008/scorecard/34.

CMA is currently revising its legal framework to address such insufficiencies, stakeholders should be put in a position to promote enforcement of good corporate governance as well. The Companies Act should be revised to make it easier for shareholders to succeed in enforcing penalties for fraud and gross mismanagement in court. Penalties should be stricter to ensure that an incentive exists for sound management and good corporate governance. In addition, a dual objective and subjective standard should be put in place for director liability, to lower the threshold for guilt from its current requirement of proving strict fraudulent intent. Provisions on derivative actions should be revised as well to clearly allow shareholders to bring suit on behalf of a company. In addition to making these legal changes, stakeholders should be educated on shareholder rights, director responsibilities, and options for addressing noncompliance. Such training could be conducted by donors or by private sector institutions. The Centre for Corporate Governance in Kenya conducts several corporate governance trainings currently and would probably be a good resource for these activities.

Of course, without improvements in the court system that address backlogs, inefficiencies, and corruption, the reforms noted above would remain largely ineffective. For information on the necessary reforms for Kenya's court system, see this report's chapter on Enforcing Contracts.

Work with Kenya Investment Authority to build its capacity for promoting investment in Kenya.

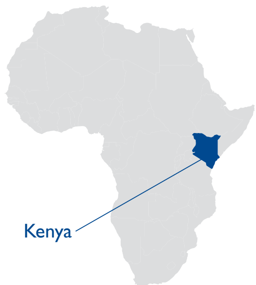
KenInvest is a young institution with unrealized potential for promoting investment. Its capacity is currently limited, and even the services it offers are little known in the business community. This recommendation includes three activities for enhancing KenInvest's investment promotion capacity.

While work has begun on compiling sector-specific information for potential investors, this project has not advanced far. Donors could contribute by funding research on targeted sector areas that would compile overview reports (20-30 pages) of issues relevant to investment, or by funding a local consultant to conduct this research over a one year period. Any efforts in this area would need to be coordinated or refined in light of KenInvest's existing sector profiling. Each sector overview report should include information on existing investments and activity, the relevant legal and regulatory framework, regulatory institutions, and requirements and processes for investments. It should also identify someone within the authority who can be contacted regarding additional questions on investment.

Additionally, KenInvest must do more to promote its offerings within the business community. KenInvest should have regular representation at meetings of private sector associations, including Kenya Private Sector Alliance (KEPSA) and the Kenya Chamber of Commerce, where it can update the private sector on the resources and services it provides. Radio and newspaper advertisements should be considered as well because one of its main problems as an institution is that its services—despite being useful and free—are unknown or unfamiliar. This would be a great benefit to the business community.

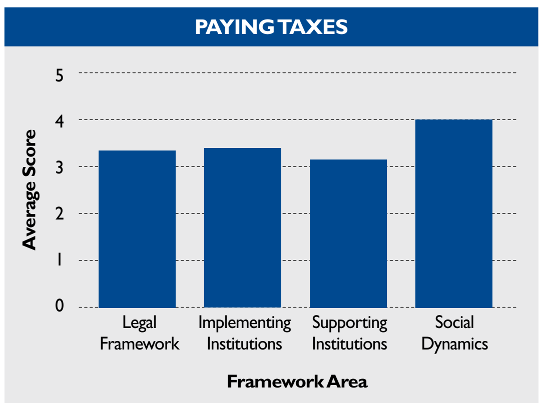
KenInvest should also enhance its activities and representation in areas of the country that have strong investment potential but have been historically disadvantaged. Nyanza Province is a good example of such a location. With access to Lake Victoria and proximity to trading partners in the region, Nyanza has significant investment potential. However, investment has historically been limited there, and the climate remains challenging following election violence in 2007 which hit the province hard. KenInvest could work with the local branch of the Chamber of Commerce to develop information on investment opportunities in Nyanza and to enhance KenInvest's representation in Kisumu to enable the institution's facilitation services to be available to the local business community.

KenInvest should increase in influence as it grows. With support, it can become a strong resource for the private sector and a key linkage between the business community and the government. The institution should look to other established investment authorities for information and guidance on expanding its role and capabilities. The Uganda Investment Authority (UIA) is a good example from within the region of a strong and dynamic investment authority that is well respected by both the public and private sectors for its influence and assistance. KenInvest should take opportunities to learn from UIA and other successful investment authorities how to build networks within the private sector and creatively facilitate investment.



PAYING TAXES

Taxpayers in any system of taxation are continually faced with the choice of being honest in their tax affairs, or engaging in a course of conduct that involves deception and deceit. Taxpayers consider many factors when they are confronted with the decision whether to comply with the law. These factors include: the rates of taxation, including the total tax rate when all taxes, levies, and charges are considered; the fairness or perceived fairness of the system; the efficiency and effectiveness of the tax agency; the ease of filing and paying; the complexity of the tax laws; the extent of corruption, real or perceived; and the fiscal integrity of the government and its wise (or wasteful) use of public funds.



Although high tax rates and cumbersome tax laws can have a negative effect on taxpayers' willingness to comply with all the requirements of the law, no single factor encourages or discourages compliance more than the attitude of the taxpayer, as he examines the fairness and efficiency of tax officials and procedures. When taxpayers believe that the tax agency is fair in its dealings with taxpayers, and is efficient in how it conducts operations, they are more inclined to be honest in their tax affairs.

When taxpayers are honest, compliance rates climb and revenue collections increase. Increased revenue collections can lead to improved government service—including in such key areas as education, infrastructure, and health care—and ultimately a reduced tax burden.

Respondents in this diagnostic believe the total tax rate in Kenya is too high, and the difficulties of filing and paying were described by some as enormous. The attitudes of taxpayers, however, have been improving in recent years, as the Kenya Revenue Authority has embarked upon an initiative designed to increase the fairness of the system and improve the efficiency of its operations. While the KRA can be considered progressive, committed, professional, and technically advanced, it still falls short of meeting international best practice in many areas.

The recommendations section of this chapter describes several administrative improvements that can be made to further advance the fairness and efficiency of the KRA's operations and move them closer to international standards. Implementation of these recommendations will instill greater taxpayer confidence in the system and result in greater taxpayer participation, and, as a result, increase revenue collections. Fortunately, the area of Paying Taxes shows relative promise: the BizCLIR scores for Paying Taxes are the highest in this report, with each area of inquiry showing generally positive trends.

LEGAL FRAMEWORK

The legal framework for taxes in Kenya consists of 14 different taxes administered by the KRA.

The three principal laws, which provide for 99% of total government revenue, are:

- The Kenya Income Tax Act, enacted in 1973 (replacing the East Africa Income Tax Management Act).
- The Kenya Value Added Tax, enacted in 1989 (replacing the Sales Tax Act).
- The Customs and Excise Act, enacted in 1978.

Other laws that provide about 1% of total revenue are:

- The Road Maintenance Levy Fund Act of 1993
- The Widow's and Children's Pension Act
- The Air Passenger Service Charge Act
- The Parliamentary Pensions Act
- The Entertainment Tax Act
- The Stamp Duty Act
- The Traffic Act
- The Betting, Lotteries, and Gaming Act
- The Transport Licensing Act
- The Directorate of Civil Aviation Act
- The Second Hand Motor Vehicle Purchase Act

A breakdown of the revenue provided by these acts, which has generally been consistent over the last few years, reveals the following:

Tax	Income	VAT	Excise	Import	Other	Total
%	37%	30%	19%	13%	1%	100%

The corporate income tax rate, which was originally set at 45 percent, has been reduced over the years, and in 2000 was fixed at 30 percent for residents. For branches of non-resident companies, the rate is 37.5 percent. For small businesses with a turnover of less than KSh5 million, the rate is 3 percent of gross sales. This replaces the corporate tax and the VAT. The personal income tax rate is based on a graduated scale ranging from 10 percent to a maximum of 30 percent. Kenya also has a Pay As You Earn (PAYE) system, where employers deduct taxes from their employees' wages. VAT is 16 percent, reduced from 17 percent in 2006. Import duties on some 5,000 classified items range from 10 percent to100 percent.

Prior assessments of Kenya have identified the country's tax burden as excessive compared to other countries. When all taxes, levies, and charges are considered, the total corporate tax burden is about 50 percent. In addition, the burden of gathering and analyzing financial data, filing all the forms required, and making all the various payments throughout the year is massive and extremely time-consuming. Although these burdens have been noted and widely publicized, and numerous recommendations made to improve the situation, nothing has been done to implement the recommendations.

In addition, the tax laws of Kenya are considered cumbersome, outdated, and difficult to navigate, even for experienced tax professionals. In spite of this criticism, the basic legal framework is generally sound, although modernization is needed.

With respect to the collection of taxes, Kenya practices self-assessment. The tax is considered to be assessed upon the filing of a tax return, unless there are computational errors, which the KRA will adjust and apply to a new assessment. Audits, conducted on a periodic basis after the returns have been filed, may also adjust the assessment, which is usually upward, although some taxpayers report frequent "no change" audits, where there is no additional assessment.

This indicates that there was no reliable basis for selection of the return for audit.

Appeals are provided for by law, but the process is inefficient and unfair. This chapter's recommendations describe a replacement system that would raise the KRA to international best practice.

IMPLEMENTING INSTITUTION

The Kenya Revenue Authority was established in 1995 as a semi-autonomous institution charged with the responsibility of assessment and collection of revenue and the administration and enforcement of all revenue laws. The KRA is governed by a Board of Directors which makes policy decisions to be implemented by KRA management. The Chairman of the Board is appointed by the President. The Chief Executive of the KRA is the Commissioner General, who is appointed by the Minister of Finance.

KEY IMPLEMENTING INSTITUTION
• Kenya Revenue Authority

The vision of the KRA, according to its Taxpayer's Charter, is to "be the leading revenue authority in the world, respected for Professionalism, Integrity, and Fairness." As early as 2003, the KRA began to implement reforms designed to meet this vision. The KRA embarked upon a series of reform plans with several titles, such as the 1st, 2nd, and 3rd Corporate Plans. The current reform process is known as the Revenue Administration Reform and Modernization Program (RARMP). The objectives of the reform plans were to develop a professional team, re-engineer the business process, improve taxpayer service, enhance revenue collection, and beef-up enforcement.

To implement the reforms, the KRA recruited several tax professionals from the "Big Four" accounting firms to provide guidance at the executive level. Over the last few years, numerous reforms have been implemented, and many are currently underway. In summary, the KRA has:

- Established a **Large Taxpayer's Office** (LTO) to manage, monitor, and control more than 830 taxpayers who contribute about 75% of all domestic tax revenue
- Established an **Enforcement Division,** with a staff of more than 150, to provide for a deterrent to evasion by initiating prosecution of taxpayers who willfully violate the tax laws. This division has the ability to create a perception in taxpayers' minds that there will be serious consequences to face for willful non-compliance, including a possible term of imprisonment
- Established an **Internal Affairs Division** to create a deterrent to abuse of office, and to provide for administrative disciplinary actions, as well as prosecution, against those who do. Over 80 employee conduct investigations have been initiated since inception.
- Issued a **Taxpayer's Charter or Bill of Rights and Obligations** for both taxpayers and the KRA to follow.
- Established a **Taxpayer Service Division** to provide education and service to taxpayers.
- Enacted electronic tax registers requirements.
- Initiated electronic filing on a pilot basis with plans for universal implementation.
- Established audit divisions for the LTO and the Domestic Taxes Division.
- Devised an audit selection plan in the LTO based on the fundamentals of risk analysis.
- Established an appeals process with three levels of appeal.
- Reduced clearance times at the Mombasa port of entry with "24/7" hours of operation.
- Established a one-stop processing center at KRA headquarters for import/export documents.

In addition, the KRA maintains an impressive web site in English that describes its mission, vision, and commitment to integrity, professionalism, and corporate and social responsibility. The site describes all the departments and their functions in detail, along with all of the KRA's efforts to modernize over the years. The site includes profiles of the executives in charge of the major divisions.

The KRA has demonstrated a strong will to reform and has taken continued action to reflect its will. In August 2008, the KRA issued a draft "Enforcement Strategy Paper" outlining its strategies to increase taxpayer compliance through obtaining better data, simplifying the tax laws, providing quality service, improving enforcement techniques, creating better forms of information reporting, and making better use of technology tools.

The KRA consists of a highly motivated and professional work force, dedicated to enhancing customer service and improving voluntary compliance. Still, roadblocks exist which will impede its progress toward total reform and accomplishment of its vision. These include a lack of funding for total computerization, and "second best" administrative procedures in the areas of audit selection and the appeals process.

The KRA does not have a computerized "master file" of all taxpayer interactions, including tax assessments, penalties, interest, fines, payments made, and so forth. The master file is the foundation of effective tax administration. Also, the KRA does not maintain a database of historical audit results, which could assist in identifying high sectors of noncompliance and resource allocation. Such a database could also form the baseline for a sophisticated audit selection model employing probability analysis as a means of predicting which returns are more likely to be incorrect.

The current criteria for audit selection are based on a generalized risk analysis by audit managers who personally review the returns. This is one reason that there are often "no change" audits, because audits are often directed at taxpayers when there is no specific, articulable, and quantifiable suspicion that an adjustment might be necessary.

Widespread abuse of office represents another major impediment to total reform. The KRA has described abuse of office as being "rampant," but is quite aware of the steps needed to address corruption, and is moving in the right direction.

The KRA appeals process, which first involves an in-house appeal to the same senior leadership that authorized the additional assessment, is inefficient and unfair. Moreover, taxpayers resent the KRA claiming that the process is fair. This chapter's recommendations propose a replacement system that would raise the KRA to international best practice.

Another significant roadblock to enhanced tax reform is the judicial system, which is overloaded with a severe backlog of docketed cases, including those involving disputed tax assessments. Years pass with no resolutions in sight. The appeals replacement system, in essence, would essentially eliminate the roadblock caused by judicial delay.

In addition, the judiciary does not share the KRA's vision that selective prosecution of high-level targets, who in effect commit robbery of the vault of the Ministry of Finance, helps achieve compliance by placing a serious cost on tax evasion. Tax evasion is treated as "petty theft", and handled by the lower courts instead of the high courts. Upon conviction, only fines are ordered as punishment. To date, although the law has provisions for imprisonment, no taxpayer has ever been sentenced to a term of imprisonment. Therefore, taxpayers do not see a disincentive to comply, and revenue collections suffer as a result.

SUPPORTING INSTITUTIONS

There is considerable support within Kenya for immediate and effective reform of the system of taxation. Many influential stakeholders are involved, including two associations representing chartered accountants and certified public accountants, the Institute of Economic Affairs (a think-tank), the Big Four accounting firms, law schools, and university professors.

The KRA activity encourages stakeholder involvement, and has invited representatives from the private and public sectors to become involved in a partnership to improve the overall tax climate for investors and taxpayers throughout the nation. The KRA reform initiative (RARMP) was created under the leadership of the Commissioner General, who chairs quarterly meetings.

KEY SUPPORTING INSTITUTIONS
• Chartered accountants and CPAs • Institute of Economic Affairs • Big Four accounting firms • Law schools and universities

RARMP has a Steering Committee that provides overall guidance and direction for the reform program. The Steering Committee is represented by commissioners from all KRA departments, and also draws its membership from the public and private community, including representatives from the Big Four accounting profession. The vision of the KRA is to implement reform that transforms the authority into a modern, flexible, and integrated revenue agency. The Steering Committee encourages the reform team to be creative, adopt best practice project management approaches, expand skill sets, and take appropriate levels of risk in the pursuit of its vision.

There is little doubt that the KRA has the appropriate intentions and vision for reform and modernization, although funding issues and the cooperative will of the Ministry of Finance represent serious challenges that could limit the success of the KRA in their efforts.

SOCIAL DYNAMICS

Kenya is aware of the role that tax reform and modernization can have upon the social dynamics of the tax regime. The KRA has assumed an active leadership position as a champion of reform, and is committed to transforming the agency into a highly professional, efficient, and active organization working in partnership with stakeholders to achieve its vision.

The KRA aims to promote compliance with Kenya's tax, trade, and border legislation and regulation by promoting the standards set out in the Taxpayers Charter, and through responsible enforcement and administration by a highly motivated and professional staff for the purpose of maximizing revenue collection at the least possible cost for the socioeconomic well-being of Kenyans.

Virtually all stakeholders that participated in this diagnostic expressed their views that the KRA has been successful in its reform approach. All agreed, however, that additional efforts will be required before the KRA can meet its aspiration of becoming "the leading Revenue Authority in the world respected for Professionalism, Integrity and Fairness."

In order to complete the reform process, efforts beyond those of the KRA are needed. Kenya still has one of the highest tax burdens in the world. The requirements to prepare, file, and pay are stiff and time-consuming. The tax laws are outdated, complex, and difficult for even tax professionals to navigate. This situation has not changed despite repeated recommendations by trusted stakeholders and donors. The political leadership of Kenya has a strong bias against legal reform, a stance that undercuts all the valuable efforts put forth in administrative reform by the KRA.

RECOMMENDATIONS

This section presents a series of recommendations that are designed to improve the capability of Kenya to encourage, attract and retain foreign investment and local entrepreneurship. Some of the recommendations identify policy changes that will require high-level governmental decision making for implementation. Others identify specific changes designed to strengthen the administrative capability of the KRA to interface with taxpayers and fairly and efficiently administer the tax laws. This latter set of recommendations, purely administrative in nature, can be implemented by the KRA.

Enact past recommendations that remain unaddressed.

The following policy changes were recommended by both donor organizations and private associations in recent years:

- Policymakers should reduce the corporate tax rate.
- Policymakers should review and reduce or eliminate the excessive number of taxes, charges, and levies that businesses are subject to.
- Policymakers should reduce the customs tariffs and the number of bands.
- Policymakers should reduce the number of payments and filings, which require an excessive amount of time to comply with.
- Policymakers should convene a taskforce to draft new tax codes for both the income tax and customs levies that will be clear, unequivocal, and straightforward.

Although these recommendations have been on the table in Kenya for years, to date no action has been taken to address them, with the exception of some minor policy changes that have had minimal impact on the overall situation. These recommendations cover major areas in tax policy that clearly and significantly affect the investment decisions of prospective investors. The situation today in Kenya is the same with regard to these areas of tax policy as it was several years ago. In short, the overall tax burden on corporations is brutal.

Therefore, these recommendations are presented again, simply because the problems continue to exist. Policymakers should immediately begin the course of action necessary for their implementation.

Recommendations for specific rate reductions are not made here, since the revenue impact of different rate reductions is unknown, and no such studies are known to have been performed. The differing impacts must first be analyzed by revenue forecasting units, with the results provided to policymakers. Reducing the overall tax burden should increase the corporate reward for efficient and productive efforts and create job growth and foster national prosperity.

Policymakers know all the taxes, charges, and levies and what the rates are; they also know what and how many forms and payments are required; and they know the exact frequency they are required. Specific recommendations are not being made for the exact number of reductions, since the revenue impact of any reductions compared to the administrative burden of administering and collecting the taxes, charges, and levies has not been analyzed. Some small taxes and levies may not provide sufficient value in terms of revenue collections, compared to the administrative cost of ensuring compliance. Prior to considering any reductions, policymakers should undertake a study to analyze and compare the administrative burden placed on the KRA to collect small amounts of revenue. Those taxes deemed not to be worth the effort should be immediately eliminated.

Of course, some control is needed over issuing licenses or business permits, no matter what the burden turns out to be.

It is no surprise that the consensus in Kenya is that the tax laws are complex and confusing, and need an overhaul. Identifying specific sectors that need to be revised would turn this assessment on taxation into a mini-novel. One executive-level tax consultant commented that the income tax code was so outdated and so confusing that it needed to be completely revised. Numerous senior professional tax consultants and large corporate taxpayers commented that the tax codes are too complex, too outdated, and too difficult for even a tax professional to navigate, much less a small business owner. Several tax professionals and large taxpayers commented that the Customs code is too detailed to easily comply with and too rigidly enforced.

Strengthen the KRA through a number of policy initiatives.

Prior assessments by donors and private associations have recommended, in general, that the administrative capacity of the KRA be strengthened and streamlined. For the most part, however, the recommendations did not set forth specific areas where definable improvements could be made, nor did they identify how administrative reforms relate to encouraging, attracting, and retaining foreign investment and local entrepreneurship. Prior recommendations merely suggested that the KRA "simplify procedures." The administrative capacity of the KRA refers to how the personnel of the KRA relate to taxpayers, as the KRA follows, or does not follow, established procedures. For example, taxpayers who complain of high tax rates do not see the tax rates in "person." They only see the rates as a number. When tax inspectors appear at their doors, however, they see the image of the KRA in person. The tax inspector represents the face of the KRA, and a taxpayer's entire perception of the agency is based on the actions of the inspector and the administrative procedures he or she follows.

Investors, as well as local businesses, want to deal with a professional and highly efficient revenue organization. Facing a high tax rate structure is already a burden on businesses, and they certainly do not want the further hassle of dealing with inefficient and unfair tax inspectors who may be following cumbersome, unfair, or outdated operating procedures.

The impact of perceptions of unfairness and inefficiency cannot be underestimated. It is extremely important that investors and businessmen have a high degree of confidence in their tax agency. When taxpayers are confident that the tax agency is conducting operations with a high degree of efficiency, and that taxpayers are being treated as "honest unless proven otherwise," taxpayers are more inclined to be honest in their own tax affairs, and, therefore, more likely to be in compliance with the requirements of the tax laws.

Taxpayers' behavior will be influenced by any perception that their system treats them unfairly. The perception of unfairness results in decreased compliance. Also, if taxpayers believe that noncompliance by others is widespread, and that enforcement to address noncompliance is lax or nonexistent, they have no incentive to comply. Thus, the image the tax inspectors leave in the taxpayer's mind, based on their actions and the procedures they follow, either contributes to higher compliance, or fosters reduced compliance. This link is of critical importance in the quest to achieve greater voluntary compliance.

When taxpayers have confidence that the tax agency is highly efficient in spending public funds, that it is fair in its treatment of all taxpayers, and that it has an effective strategy to address noncompliance, the image of the agency becomes more positive and the rate of compliance will increase. When overall compliance increases, the tax base is expanded. When the tax base is expanded, revenue collections rise. When revenue collections rise, more and better public services can be provided by the government. In addition, with greater revenue collections, reductions in the overall tax rates are possible.

To build confidence by taxpayers that the KRA is efficient, fair, and vigorous in enforcement, the following recommendations are made to improve the administrative capacity of the KRA to conduct operations.

1. **Create a "Focused Audit Selection System" as the foundation for a computerized model designed to identify incorrect tax returns as they are filed and processed, using specific, established quantitative criteria.** The KRA's Large Taxpayers Office is responsible for collecting tax revenue from the largest taxpayers in Kenya, estimated to be around 830 taxpayers that provide 75 percent of domestic tax revenue, and 40 percent of the total revenue. The LTO presently has in place procedures for identifying tax returns that LTO staff believe may be incorrect. The staff employ a series of criteria, based on a generalized risk analysis, that leads them to believe that some returns may be incorrect.

The selection for audit is based on a hands-on review by LTO managers of tax returns that are perceived to be risky; the managers personally decide which returns should be subject to audit. While this system has structured criteria that lead the LTO in the right direction, taxpayers perceive that no such criteria exist. In addition, the criteria are far too general to allow the KRA to efficiently identify returns that are incorrect.

Taxpayers are often confused as to why they have been selected for an audit. During this diagnostic, some taxpayers commented that they believed the KRA simply uses random selection or turnover as a basis. Representatives of some firms wondered why other firms similarly situated were not audited. Some cited pure "fishing expeditions" as the audit basis, while others cited refund returns, amended returns, score-settling, political gain, or perhaps use of an "enemies list."

When taxpayers are so confused or harbor deep suspicions as to audit selection criteria, their confidence level in the ability of the KRA to be fair quickly shrinks. Again, reduced confidence is inconsistent with higher compliance rates.

The first step in creating an audit selection model (Focused Audit Selection System, or FASS) is for the LTO and the DTD to establish a baseline of the relation of major expense accounts to gross sales. From there they can develop a norm for each expense account, which will serve as a baseline to measure deviations from the norm. These norms can be developed by using historical audit results. The results of historical audits of expense accounts will be assumed to reflect, in general, the true and reasonably correct amount of expenses for each account. Of course, the audit may not have discovered all the facts, or may not have addressed certain expense accounts. Then, the results may not be reflective for the entirety of that audit, although for some expense accounts it may be. However, when the sample of historical audit results is sufficiently large, any bias will be minimal.

The relation of expense accounts to gross sales is that if expenses are overstated, then the ratio will be higher than the true ratio, when the correct amount of expenses and sales are reported. If the true and correct amount of expenses are reported and deducted, but gross sales are understated, then the ratio will higher than the true ratio. This process can detect either inflated expenses, or unreported sales.

The baseline, or norms, can represent a specific percentage, or a range, such as, for example, the generally true labor expense from the results of audits of 2,000 taxpayers in XX industry is 10 percent, or is in the range of 9-11 percent. If a return for the current year is filed and processed, and the model identifies labor expense on the return as 14 percent of sales, then some suspicions would be raised as to whether or not the expense account is overstated, or sales are understated. A decision must then be made as to whether or not this is sufficiently suspicious to justify the employment of audit resources, or other returns are more suspicious, and therefore, more likely to return greater audit yield in terms of additional assessments.

In our hypothetical example, 14 percent is fairly close to the high end of the range, and may not be considered to be that overly suspicious of being incorrect. Suppose, however, that another return is filed and processed, and the model identifies labor expense as 21 percent of sales. Then, the degree of suspicion that the labor account is either greatly inflated, or that sales are greatly under reported, is much higher. This return at 21 percent is much more suspicious than the one with only 14 percent for labor.

When the number of taxpayers in the sample is large, a probability distribution can be prepared. The probability distribution ranks all the various ratios obtained from the audit results for each account. This will measure the extent of the deviation from the norm for each expense account. By doing so, the probability that any given account is overstated, or that sales are understated can be determined with some high degree of probability, particularly when the deviation from the norm is substantial.

A large sample of audit results allows for a probability to be calculated that any given expense account is incorrect. For example, if the labor expenses were 28 percent, and the norm were 10 percent, depending on the dispersion of the sample from the norm, a probability of a certain percent can be calculated. A substantial dispersion, such as 28 percent, could likely be calculated as 90 percent certain of being incorrect.

When ratios and their deviations from the norms are determined for each major expense account, then a probability that the entire return that is filed and processed is incorrect can be calculated. For example, if 7 of 9 major expense accounts represent deviations that are far in excess of the norms for those accounts, the probability that the entire return is incorrect can be calculated, and that probability would be high.

All returns filed for the current year are processed through the audit selection model, and relative scores are given depending upon the degree of suspicion that the return is incorrect. All of the returns are ranked by the model, and those where the score for the degree of suspicion is high are given the highest priority to be assigned for an audit. Those that are ranked lower on the scale of suspicion are the last to be selected for audit, and may, in fact, never be selected, either because the scores are too low, or because all the available manpower has already been assigned to more suspicious returns.

So, the FASS model predicts which returns would provide the greatest additional assessment, and which returns would provide the least amount of additional assessment. This type of risk analysis eliminates audits where minimal or no additional taxes can be assessed. Therefore, taxpayers who are generally compliant will be rewarded with no audit, a truly fair outcome.

The Domestic Taxes Department (DTD), which monitors small and medium taxpayers, and accounts for about 25 percent of domestic tax revenue, uses some general criteria for selection of returns for audit, but it is far less sophisticated than that of the LTO. The process described above, which represents state of the art methodology, should also be implemented for the Domestic Taxes Department.

Ideally, the KRA should develop a separate model for each major industry, since expense ratios differ widely, depending on the industry. In addition, it is recommended that a special "Audit Selection Unit" be established to develop the model for each major industry, for use by both the LTO and the DTD. This unit will refine the norms on a regular basis to ensure that the FASS model is as reliable as possible.

Once such a mathematical model is developed and placed into service, taxpayers can be notified that the process for selection of a return for audit is done by a computer, based on specific quantitative data developed in the past. They can be advised that no human hands personally selected the returns, and that the selection is completely free from any personal bias. They can also be notified that the selection process focuses on suspicion, which is completely objective, open, and non-arbitrary.

The media relations office of the KRA should then mount a public relations campaign to promulgate this selection process, intending to reach as many taxpayers as possible. When taxpayers understand that the process is objective and accomplished without personal intervention by KRA personnel, their belief in the fairness of the system will rise.

In addition, the KRA should publicize how efficient this process is, by advising the public that the computer model uses numerous objective criteria, based upon a mathematical formula, to identify returns that are the most suspicious of being incorrect, criteria that have proved reliable over the years in tax agencies throughout the most developed countries. Of course, the exact criteria can never be revealed, because it would give dishonest taxpayers an advantage so that they could arrange their business affairs to fall just under the radar of the "Focused Audit Selection System" (FASS).

In addition, once FASS is placed into service, it naturally forms the basis for development of the national audit plan, which, surprisingly, the KRA does not have. FASS would identify, in ranking order, the most highly suspicious returns, continuing on down to those that are less suspicious. Those that are the most highly suspicious would be the first to be assigned for audit. The total number of audits that could be conducted during the year would be based on the number of inspectors available, the complexity of the audit, and the estimated length of the time to conclude the audit. Having in place a national audit plan also would increase the efficiency of operations of the KRA, and taxpayers will take notice.

The media campaign could actually take place in advance of the KRA creating the FASS, since the criteria used by the LTO is, in general, objective, but still performed by human hands. Since creating a FASS could be a fairly lengthy process, the KRA should considering a limited campaign, with notification of the course of action they are about to undertake to advance the selection process even further.

When taxpayers learn that the KRA has increased its efficiency by using a computer model to not only select returns for audit, but to form the foundation for establishment of a national audit plan, their confidence in the efficiency of KRA will increase rapidly. In addition, when they also observe that audit selection criteria are objective, and audit selection is accomplished without the aid of human intervention, their confidence levels in the fairness of KRA will substantially increase.

When taxpayers have the perception that the KRA operates in a fair and efficient manner, taxpayers will become more honest in their own tax affairs. This will result in significant improvement in revenue collections, leading to greater investor confidence, and ultimately lower tax rates.

2. **Establish an independent administrative appeals unit within the KRA that reports directly to the Commissioner General and is charged with "settlement authority."** Taxpayers have little or no confidence that the KRA operates its appeals process fairly or efficiently. When taxpayers appeal to the first level of appeals, they know that they are in fact appealing to the senior leadership that authorized the additional assessment in the first place. Taxpayers view this as a waste of time and money, and resent KRA claims that this process is fair and independent. Taxpayers therefore immediately form a negative impression of the KRA, a perception that leads to a lowered confidence level.

Although the ad hoc appeals board consists of individuals who are not employees of the audit division, their true independence is often questioned by taxpayers, because their mandate is to assess whether the tax auditor obtained sufficient facts to sustain the assessment, and whether or not the proper course of law was followed. The board operates more as a checker of the auditor's work than as an independent reviewer considering the merits of the taxpayer's position. In other words, if the KRA is right, then the taxpayer must be wrong.

Almost always, the first level of appeals sustains the auditor's additional assessment. This forces taxpayers who desire to continue their appeals to pay all of the income taxes due when they appeal to the Local Committee, or one half of the assessed VAT, if they appeal to the Tribunal, which handles VAT. As described below, this advance payment is unfair, and should be repealed.

The current appeals process should be transformed into an administrative appeals unit that has "settlement authority." This means the KRA and the taxpayer arrive at a mutual agreement as to the issues involved and amount of tax to be paid. The KRA and the taxpayer should attempt to agree to a resolution somewhere between fully sustaining the assessment and fully conceding. Mutual concessions are made considering the relative strength of each other's positions, and the tax controversy is settled on a basis that fairly reflects the merits of the opposing views. In short, the KRA would agree to receive less in return for a quick settlement and a rapid closing of the appeal at the first level.

This is one of the basic principles by which the appeals unit should be managed. Such appeals units around the world stress quick settlement and generally expect to settle around 85 percent of all appeals at this level.

There are three basic reasons why the KRA should agree to settle, as opposed to affirming the auditor's assessment:

First, the KRA must consider the time value of money. It may be better to collect money earlier than later, even if the amount is less. When a taxpayer appeals to the second level, a decision by the Appeals Committee or Appeals Tribunal could take years. In the meantime, assuming the law regarding advance payment is repealed, the KRA would not have collected any revenue, and the value of the Kenyan shilling could erode during this time. And, if the taxpayer appeals to the courts, it could be many more years before any collections are made.

Therefore, the KRA should consider which issues raised by the auditor are the most sound and firm, based on the facts and supporting law, and which issues countered by the taxpayer have the most merit. Attempting to reach an agreement as to what amount would be reasonable is beneficial for both parties. Rarely are the taxpayers' appeals without some merit on at least some, if not all of the issues.

Second, the appeals unit should attempt to quickly close cases, and proceed toward the next case. The efficiency of collection is a major consideration in modern tax administration, and the quicker the turnover, the greater the amount of revenue that is collected. Efficiency refers to obtaining the most in terms of outputs (collections), for the least amount of inputs (time expended). There is little to be gained arguing that the KRA is right and the taxpayer is wrong, when the appeals officers could quickly close out the appeal through a mutually agreeable settlement and proceed to hear other cases.

Third, the potential hazards of future litigation should be considered, since there is always a risk of uncertainty as to the outcome at trial. The hazards of litigation are unknown at the outset of a trial, but they can negate a successful outcome either in full, or in part, on an issue-by-issue basis. There can be factual hazards, where there is uncertainty as to the Court's findings of fact, or legal hazards, where there is uncertainty as to the Court's interpretation of the law. Sometimes, the evidence may be incomplete or not factually sound. Or, witnesses may be unable to recall key facts, vacate the jurisdiction of the Court, or be extremely ill or deceased. Such factors are unknown when the assessment is made, and there is uncertainty as to whether or not they could occur. In such instances, the question is whether a trial is worth the risk of losing all or part of an assessment, or whether a mutually agreeable settlement is the best course of action.

Experienced and well trained professionals often disagree on issues of substance, including the applicability of certain facts or the meaning of a law. To avoid serious hazards, attempts must be made to arrive at a mutually agreeable resolution during the initial administrative appeal.

Some appeals, however, should never be settled in the administrative appeals unit. The KRA should stand firm on cases where:

1. The issues are of such monumental significance that the same issues could have a major impact on other taxpayers who may attempt to proceed down the same path. Such issues may involve new areas of law, or loopholes where taxpayers attempt to escape the true intent of Parliament. The KRA should want a favorable court decision to stand as a test for future taxpayers

who may want to pursue a similar course of action, but would not, if the KRA were upheld by the High Court.

2. The appeal has little or no merit or is unfounded on fact. Some taxpayers make silly arguments that would have zero chance of being upheld by a court. The KRA should never settle with taxpayers who raise such frivolous issues because it would open the flood gates for numerous similar issues, thereby wasting time.

When taxpayers discover that their first level of appeal is to a unit not connected with the official that authorized the original assessment, their confidence will increase that the KRA is trying to be fair and not interested in wasting time and money. Also, when taxpayers realize that the KRA is interested in resolving a tax controversy early by recognizing the merit in the taxpayer's position, they will come to believe that the KRA is operating in a fair manner, and not being repressive. In addition, taxpayers will soon realize that by settling cases during the first level of appeals, the degree of efficiency of operations is increased, and greater amounts of revenue can be collected earlier.

The administrative appeals unit should be a single unit that handles appeals for both the income tax and VAT. The tax laws require that all or a portion of the tax in dispute be paid prior to the appeal. Although the KRA has indicated that this practice is not always followed, the law should be changed to eliminate this requirement, since it is unfair to taxpayers, who are resentful of the KRA for this requirement.

As a result of creating an administrative appeals unit with settlement authority, taxpayers' confidence in the KRA will substantially increase, and compliance will rise.

3. **The KRA should become more aggressive in identifying taxpayers who willfully and intentionally evade taxes, and vigorously pursue prosecution of taxpayers on a selective basis.** The Investigation and Enforcement Division presently attempts to identify and pursue taxpayers who commit willful violations of the tax laws. The division should become more aggressive in this area, however, and openly publicize, through public relations campaigns, that taxpayers found to have committed willful violations of the tax laws could be subject to prosecution. The perception must be created in the minds of taxpayers that if they are not compliant, there could be consequences to face, and that those consequences could include imprisonment.

The entire process of criminal prosecution for a violation of the tax laws needs to be overhauled. The Attorney General's office and the judiciary need to be educated as to the importance of tax prosecutions as means of collecting revenue to fund government. Presently, tax crimes are treated as "petty theft," when in reality tax crimes represent a wholesale robbery of the vaults of the Ministry of Finance. When the Attorney General and the judiciary understand how important it is for the collection of revenue to create a perception that a person could go to prison for willful evasion of taxes, then their efforts to pursue and punish taxpayers will increase.

Compliant taxpayers expect that those who steal from the vault of the Ministry of Finance should be punished. And firms that are honest in their tax affairs expect their dishonest competitors, who engage in unfair competition through decreased tax bills, should also be punished as a means to stimulate fair competition.

Selective prosecution establishes the fairness of the system of taxation. When taxpayers see that the KRA has a vigorous process of prosecution, their confidence is increased, and then so will be their compliance.

To avoid any appearance of impropriety, the KRA should adopt a prosecution policy, where clear and objective criteria are established before a recommendation is made to the Attorney General that a taxpayer be prosecuted. This is to prevent rogue investigators from using this powerful tool to target their enemies or seek a payoff. The criteria should include such elements as the amount of taxes involved, the accumulation of acts of concealment, the notoriety of the taxpayer, and the complexity of the scheme to evade. The specific criteria should never be made available to the public, but the public should be notified that the KRA does, in fact, have specific and objective criteria to identify a taxpayer as a legitimate prosecution target.

4. **The KRA should engage in more aggressive enforcement of instances where tax inspectors abuse the power of their office.** The KRA admits that abuse of office is rampant in the KRA. More than 80 instances have been identified by the KRA since inception of their Internal Affairs Division in 2007, and more than 50 of these have been referred to the Disciplinary Board for possible administrative punishment. Several were referred to the Kenya Anti-Corruption Commission for possible prosecution.

Taxpayers and tax professionals agree that corruption is generally widespread, but indicated that small and medium taxpayers are affected more often than large taxpayers. Also, it is believed that corruption is more common in Customs than in the tax departments, since there are generally more frequent one-on-one interactions between inspectors and taxpayers there.

To be more aggressive, the KRA could run undercover "sting" operations in instances where tax inspectors are suspected of fishing for a payoff. This policy would begin with a publicity campaign advising taxpayers that if they believe that a tax official is attempting to solicit a payoff, then the Internal Affairs Division (IAD) should be notified. The division will seek the cooperation of the taxpayer to gather evidence of the solicitation and ultimate payoff.

The KRA should publicize its intentions to both notify the public and deter potential bribe-seekers. Then, the results of any successful prosecution should be publicized, so that the public can see the KRA is serious about cleaning its own house. When taxpayers are convinced that the KRA is serious about addressing the rampant abuse of office, then their confidence level will increase.

Prospective investors will notice a serious attempt to curb rampant abuses in the KRA. Of course, proper legislation should be introduced to clarify the authority of the KRA IAD to engage in evidence-gathering through electronic surveillance.

5. **The KRA should improve its outreach to small and medium taxpayers through the publishing of instructional booklets that explain various sections of the tax law in friendly and easy to understand language.** Many tax professionals indicated that the tax laws were difficult for even experienced professionals to easily follow. If the KRA Taxpayer Service Division published a series of instructional booklets on numerous sections of the tax laws, the capability of small businesses to comply with the requirements would increase, and compliance would rise. Modern tax agencies may have as many as one hundred or more such booklets. The booklets should be readily available in all the offices of the KRA.

6. **Policymakers should create legislation that establishes third-party reporting requirements to the KRA, with internal KRA verification. Third-party reporting is when establishments such as banks are involved in a financial transaction that has tax implications, and the result of the transaction is then reported electronically to the KRA.** When the KRA receives in advance the results of transactions that will have an impact on the tax liability of a taxpayer, they can match the results of the transactions to the taxpayer's tax return to determine if the taxpayer correctly reported the transaction. Certain transactions would qualify, such as interest that a taxpayer earns on savings account, or fees received for contract work on a non-employee basis.

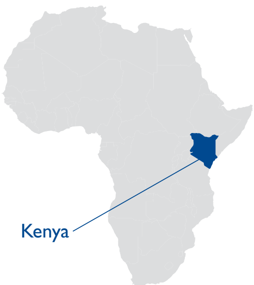
When the taxpayer knows that a third party is required to advise the KRA that the taxpayer received the interest income, or the fees paid, then the taxpayer is more likely to honestly report these transactions on his tax return. If the taxpayer is not honest, the matching of the third party's data with the taxpayer's return will reveal his dishonesty, and penalties will accrue.

Third party reporting increases the efficiency of operations of the KRA. When taxpayers see that the KRA is more efficient, then their confidence levels will increase.

7. **The KRA should establish a clean "Master File" for all transactions between the KRA and the taxpayer. This should include all assessment, fines, penalties, and payments made by the taxpayer.** Although the KRA has a master file of all transactions and assessments, the file is not always current. During this diagnostic, many taxpayers and their representatives complained that the KRA frequently inquired about whether or not a taxpayer had made a payment. It appeared that the KRA was trying to clean up its master file, after some payments were not posted. One senior tax professional called the KRA master file "garbage." Of course, increased computerization is needed to complete this task, but maintaining a clean and accurate master file is of tantamount importance in tax administration. When taxpayers discover that their master file is garbage, they become disappointed, and their confidence in KRA is reduced.

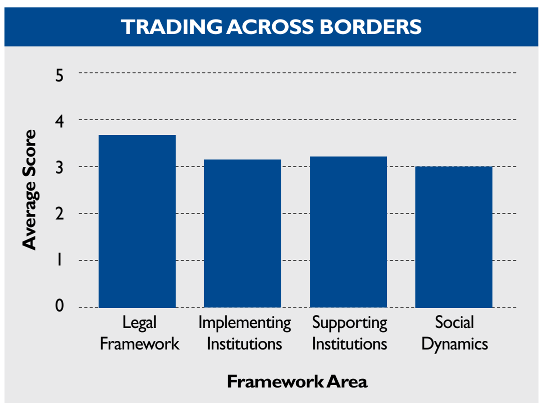
8. **The KRA should adopt a single PIN for both income taxes and VAT.** Having dual PIN's is inefficient and places a greater burden on taxpayers. A single PIN policy should be adopted.

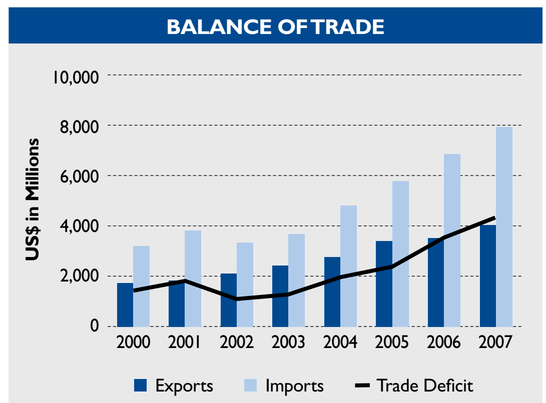
9. **The KRA should speed up the adoption of e-filing.** E-filing is still in the pilot stage, and only a few firms participate. One senior tax professional commented that it would be 3-5 years before e-filing reaches out to the masses.



TRADING ACROSS BORDERS

In recent years, Kenya has enhanced its trade potential by incorporating international and regional agreements into its legal and regulatory frameworks. The country is a founding member of the World Trade Organization (WTO) and a charter member of the East African Community (EAC). In 2005, Kenya took the significant step of establishing an EAC Customs Union along with Uganda and Tanzania (Rwanda and Burundi joined in June 2007). Kenya adopted the EAC Common External Tariff (CET), replacing a four-band tariff structure with a simplified three-band tariff structure of 0, 10 and 25 percent. Kenya has also undertaken significant and largely successful reform efforts within its Customs agency; efforts that, if sustained, could lead to tangible rewards in the future.





This chapter is divided into two parts: Trade Policy and Trade Facilitation. Trade policy pertains to Kenya's commitment to building formal trade relations with both its immediate neighbors across the African continent, and with international markets, through such mechanisms as mutual tariff reductions and streamlining of trade processes. Trade facilitation refers to the simplification and harmonizing of a country's international trade procedures to bring them in line with current best practices and globally accepted standards. Such an environment is required for a country to seize the opportunities offered by the global trading market and to fully participate in the economic benefits that can reduce poverty.

The BizCLIR scores for International Trade confirm persistent weaknesses in the implementing and supporting institutions, but very promising social dynamics.

TRADE FACILITATION

The "hard" infrastructure problems underlying the high costs of international transactions on the major transport corridors within Kenya and the East African Community are well known and are generally being addressed. Road, rail and port improvements alone, however, will not increase the competitive position of Kenya or its EAC neighbors. As a critical complement to such reforms, border processes must be harmonized, simplified, and automated. Estimates are that 40

TABLE 1: TREND OF KENYA'S EXPORTS (AS A PERCENT OF TOTAL EXPORTS)	2001	2002	2003	2004	2005	2006	2007
Food, Beverages and Tobacco	51.3%	54.2%	53.0%	46.2%	52.4%	45.1%	42.8%
Fruit and Vegetables	7.8%	11.8%	14.4%	12.7%	13.0%	10.1%	10.3%
Coffee, not roasted	6.1%	5.4%	5.2%	5.7%	7.5%	7.5%	8.6%
Tea	28.4%	28.3%	27.2%	29.7%	34.9%	39.0%	38.5%
Basic Materials, Minerals, Fuels and Lubricants	24.0%	18.6%	18.2%	24.4%	21.9%	19.0%	20.0%
Cut Flowers	7.2%	8.5%	10.6%	14.5%	15.1%	16.1%	17.4%
Petroleum Products	10.2%	3.2%	0.1%	0.9%	5.6%	5.6%	8.5%
Manufactured Goods	23.9%	26.6%	28.0%	29.1%	25.3%	35.6%	35.8%
Miscellaneous	0.8%	0.6%	0.8%	0.2%	0.3%	0.2%	1.4%

Source: Kenya National Bureau of Statistics, Statistical Abstract 2008

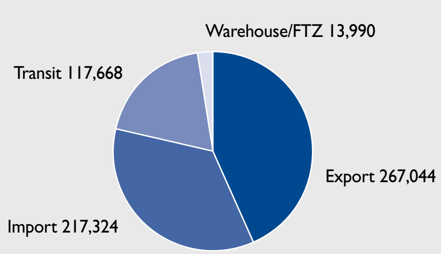
percent of transport costs are attributable to these "soft" infrastructure issues.

Kenya's border processes are generally predictable and transparent. Informal facilitation payments reportedly take place only on occasion. Many initiatives to simplify the processes have succeeded in reducing delays and costs. These include electronic processing of customs declarations; "24/7" operating hours at major entry points; a relatively expeditious export clearance procedure; and implementation of a reform program within the Customs Service Department (CSD or "Customs") of the Kenya Revenue Authority (KRA). In addition, efforts to develop an electronic single-window approach to integrate border processing are underway.

Despite these positive changes, the pace of reform has been slow and modern border processes are not yet institutionalized in Kenya. For example, document review continues to be intensive and repetitive. Overlapping jurisdictions of public agencies, along with a dearth of selective processing options, remain major impediments, and Kenya's elected leadership has not yet updated laws that would permit meaningful reform in these areas. Furthermore, limited engagement of private actors in reform design has resulted in ineffective and unsustainable implementation. Dual systems of electronic and paper processing have emerged, thereby negating the potential of technology to streamline procedures. Adequate capacity on how to implement best practice is lacking.

Another critical constraint on trade facilitation in Kenya is the lack of a comprehensive trade facilitation strategy which is properly sequenced, provides measurable goals and accountability, and incorporates all public border institutions. The current approach, driven by individual agencies, is fragmented and provides no clear authority to resolve cross-ministerial issues. High impact only occurs where all aspects of a transaction are included in reform. As detailed in this chapter, Kenya should strive to adopt a comprehensive strategy.

CUSTOMS DECLARATIONS BY TRANSACTION TYPE: JULY 2007–JUNE 2008



LEGAL FRAMEWORK

Like other EAC members, Customs operates under the **EAC 2005 Customs Management Act (CMA).** Unfortunately, this regional source of authority does not fully align with the World Customs Organization (WCO) Revised Kyoto Convention, which lays out the key legal components of a modern customs operation. Moreover, the EAC's slow pace in developing implementing regulations for the CMA has resulted in continued inconsistencies in border practices throughout the EAC. Ambiguous provisions result in excessive officer discretion, particularly with respect to penalties. Because the CMA provides only for maximum amounts, fines in practice often prove excessive and vary widely within the EAC. Over the course of this diagnostic, penalties ranging from $250 to $2,000 for inadvertent errors were repeatedly cited.

KEY LAWS

- EAC Customs Management Act (2005)
- WCO Agreement on Customs Valuation
- Kenya Plant Protection Act (1978)

Contrary to international best practice, the CMA lacks an established appeal system. Instead, Kenya relies on a tribunal outside the agency that only hears valuation cases. Consequently, an impediment to expeditious clearance is often the failure to release goods under bond pending resolution of issues. Although provided for in the CMA, this lack of clarity on enforcement results in the current practice of requiring full payment for such releases. Often traders are unable to secure the necessary funds and their goods are forced to remain in Customs custody, thereby incurring storage charges.

Another pitfall for trade is that the CMA requires vessel manifests to be filed 24 hours *after* arrival, while the current international standard is to file 48 hours *before* arrival. As a result, clearances are often delayed, since neither the port nor Kenyan Customs can release cargo without that data. Further, although the CMA does not require an importer or exporter to use a clearance agent (pursuant to best practice incorporated into the WTO Trade Facilitation Measures), in practice such use is mandatory since access to the Kenya's Customs clearance IT system is restricted to licensed agents only.

As a member of the WTO, Kenya has accepted the World Customs Organization **Agreement on Customs Valuation (ACV).** Pertaining directly to the duties charged on imported goods, the agreement calls for the greatest possible use of transaction value, i.e., the price paid or payable for imported goods. In fact, Kenya generally adheres to this ACV-endorsed practice, thereby supporting stability, predictability, and transparency for the trade sector. Furthermore, Kenya is building a valuation database for use in the future. Care must be taken that the database is used only as a reference in determining proper valuation.

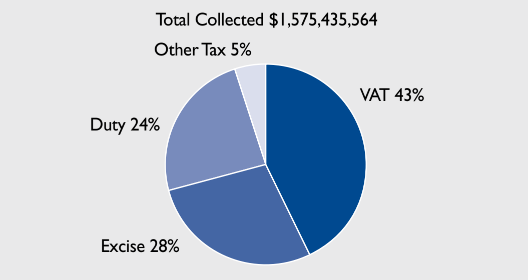
REVISED KYOTO CONVENTION

The International Convention on the Simplification and Harmonization of Customs Procedures—known as the **Revised Kyoto Convention**—was adopted by 114 Customs administrations attending the World Customs Organization's 94th Session in June 1999. It came into force on February 3, 2006, three months following India's becoming the 40th signatory to the Protocol of Amendment; 61 countries have formally consented to the Convention as of April 2009. The RKC establishes the key components of a modern Customs law and is an excellent basis on which to facilitate trade, ensure economic growth, and improve the security of the international trade system. It is a practical blueprint for modern and efficient Customs procedures throughout the EAC. At this time, the only EAC country to have acceded to the RKC is Uganda (June 27, 2002).

Finally, a critical issue within Kenya's legal framework is the overlapping legislative mandates for regulating products, particularly in the area of food safety. A minimum of three agencies conducts independent verification, sampling, and testing of food products. This delays clearance of goods.

The **Kenyan Plant Protection Act** dates from the late 1970s. There has been little progress on amending to bring it in line with international best practice. The Act is particularly weak with respect to quarantine issues; one of the most glaring omissions is the lack of legal authority given to KEPHIS (Kenya Plant Health Inspection Service) to control or inspect any import *other* than commercial shipments. Instead, the agency must rely on Customs to refer non-commercial

CUSTOMS COLLECTIONS BY CATEGORY: JULY 2007–JUNE 2008



shipments and passengers to its jurisdiction. As a short-term remedy to this problem, KRA training should include a segment alerting officers on what to look for in areas that directly relate to food safety.

IMPLEMENTING INSTITUTIONS

The **Customs Service Department** is the core border agency in Kenya. Employing about 1,400 staff, Customs is the largest department within the KRA. Two locations, Mombasa and Kenyatta International Airport, account for 90 percent of the agency's workload and 95 percent of its revenue. Customs' primary function is revenue collection, although trade facilitation is also considered an important part of its agenda. An ongoing, IMF-proposed reorganization of the CSD should improve policy development and strategic long-term planning. Hiring is fairly free of political influence and new recruits undergo two years of training.

In recent years, Customs has been the leader among Kenyan border agencies in improving its trade facilitation performance. Customs has introduced IT applications; "24/7" centralized processing; a comprehensive reform program with designated headquarters champions; and expedited clearance initiatives for reliable traders. Notwithstanding these advances, the Customs Modernization and Reform Program lacks a clearly defined prioritization and sequencing of actions. The program also does not sufficiently engage robust participation of both Customs field officers and the private sector trade community in development of reform initiatives. Management accountability is assigned but could be improved by the inclusion of incentives for meeting and exceeding goals. Performance indicators are generally timelines for implementation, rather than clear measurable targets that assess impact and gauge sustainability. Increased capacity in development and management of strategic plans, coupled with more awareness of how to adapt modern best practices to the Kenyan environment, is needed to accelerate and sustain reform initiatives.

Efficiency of processing varies by the type of transactions, with exports receiving the most expeditious treatment. All transactions (export, import and transit) must first be transmitted electronically by direct trader input (DTI) into Custom's web-based automated system, known as "Simba." Submissions are reviewed online for all technical issues by a centralized Customs processing unit where discrepancies are resolved and payment authorized. Hard copies of documents are required in all cases and can only be submitted at import/export locations after electronic verification is complete and payment is made.

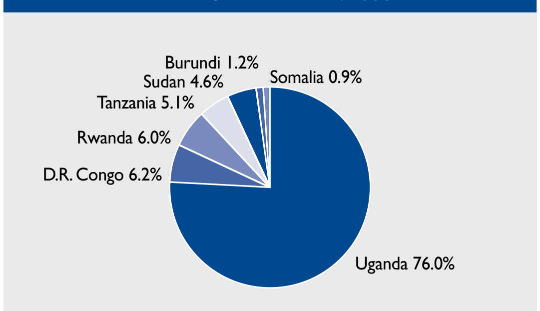
KEY IMPLEMENTING INSTITUTIONS

- Customs Services Department of the Kenyan Revenue Authority
- Kenya Bureau of Standards (KEBS) within the Ministry of Industrialization
- Kenya Plant Health Inspection Service (KEPHIS) within the Ministry of Agriculture
- Port Health Services of the Ministry of Health.

Field review serves two purposes: to verify cargo is as invoiced, and to ensure that hard copies match system data (although discrepancies are rarely noted). An extensive document review of the paper declaration occurs. Simba designates three levels of review. Existing channels are ranked green (which stands for immediate release after document review); yellow (for document review with the degree of physical examination left to officer discretion); and red (for a 100 percent cargo examination). Numerous signatures and stamps are required by multiple national agencies involved in regulating international trade, particularly transactions at Mombasa through its one-stop shop. These requirements cause delays in releases and increase costs as each certification involves a fee.

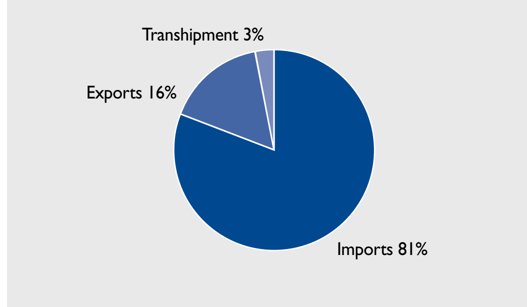
Actions by Customs in Mombasa have improved facilitation and relieved port congestion. Documents are filed centrally and distributed by the regional CSD office to eliminate contact between the reviewing officials and clearance agents. A one-stop shop, incorporating representatives of six border agencies, has eased the approval process. However, determining the exact location of containers and expediting movement by the Kenya Port Authority (KPA) to examination sheds continues to be problematic. Nonetheless, once goods are available for examination, an inspection can be completed and release given within 24 hours. Current inspection findings are generally not significant, due to the lack of a well developed risk management system and the lack of proper examination facilities and tools to conduct quality inspections. The three cargo scanners at Mombasa are underutilized with the one at the port screening only about 20 containers per day. Incorporating use of this advanced technology for preliminary scanning could reduce the level of examinations.

TRANSIT MARKET: 2008



Use of internationally accepted best practices for risk management (RM) to achieve a proper balance between facilitation and control is in a preliminary stage. A **National Targeting Unit,** the first pillar of RM, is now being established, with a working unit now in place in Mombasa

PORT THROUGHPUT: 2008



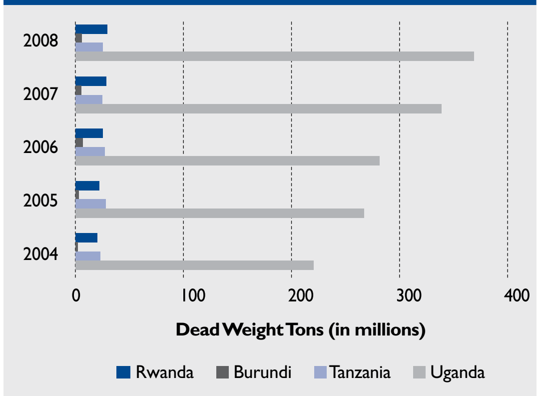
which reviews about 600 declarations per day, representing about 90 percent of the total CSD workload. A **Post-Audit Department,** the other essential component of a comprehensive RM methodology, is more institutionalized with a staff of 26 auditors conducting about 200 audits per year. To date, however, such audits are used principally as another method of verification.

The implementation of Simba has made significant improvements in border processing. The application's current configuration, however, cannot accommodate modern processing methods, provide real-time data, or issue useful management reports. Moreover, modules are not integrated to provide a centralized database for users.

RADDEX, the IT link that integrates the various EAC Customs operating systems currently operational at the Malaba land border, has reduced delays. Greater utilization of RADDEX by Customs authorities and clearance agents would decrease processing times and improve compliance.

Mombasa receives the vast majority of international trade shipments for the landlocked countries within the EAC. Processing of EAC transit traffic at the port is intensive by international standards and includes extensive document review, and scanning and examination of selected shipments due to incidents of illegal diversion into Kenya, which are conservatively estimated to be 10 percent of the total traffic. High-risk goods must be escorted by the CSD to the border. Although COMESA has a regional bond guarantee system whereby one bond covers a shipment to destination, this is not being

TRANSIT TRAFFIC BY COUNTRY



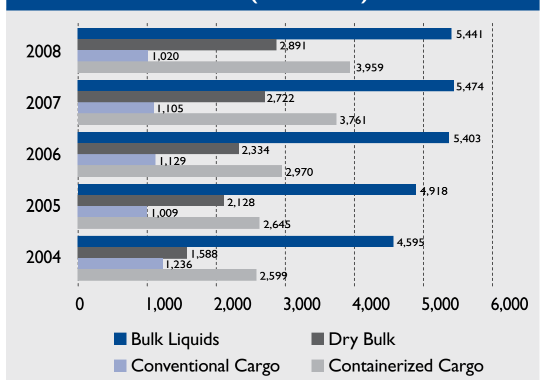
used extensively due to lack of buy-in by clearance agents. The continued need for a separate bond from each country of transit contributes to border delays and increased costs—about $350 for a typical shipment. The process by which Customs returns closed bonds to the agent for cancellation is also inefficient. Kenya's CSD is piloting a GPS-based container tracking system to better control transit movements, although to date efforts to expand this practice throughout the EAC Customs Union have not been successful.

Efforts to improve trade facilitation by Customs often do not result in significant advancement because of infrastructure constraints and the lack of improved efficiencies among the other border agencies. Although there are various initiatives underway to create some type of automated "single window" for use by all border agencies—most notably the One-Stop Border Post (OSBP) supported by the Japanese government—the relevant ministries have not agreed to develop an integrated approach to border management and streamlined processing. Issues related to elimination of repetitive verifications by agencies should be resolved before automating the process. If not, further entrenchment of inefficient practices will result.

Most of these other border agencies deal with food security issues. Their activities impact about 30 percent of all imports. The three most prominent agencies for food safety are the **Kenya Bureau of Standards** (KEBS) within the **Ministry of Industrialization;** the **Kenya Plant Health Inspection Service** (KEPHIS) within the **Ministry of Agriculture;** and **Port Health Services** of the **Ministry of Health.** All have adequate staff at the major border posts. They each extract samples for laboratory testing. None employ any type of selective processing.

Of the agencies involved in food security, KEPHIS has the most advanced IT processing system. KEPHIS is capable of issuing SPS certificates electronically, but a low level of trader acceptance has reportedly prevented implementation. Affected shipments are held pending laboratory results which normally take10 working days to receive. Better equipment for field diagnostic testing could reduce the number of shipments held for laboratory results.

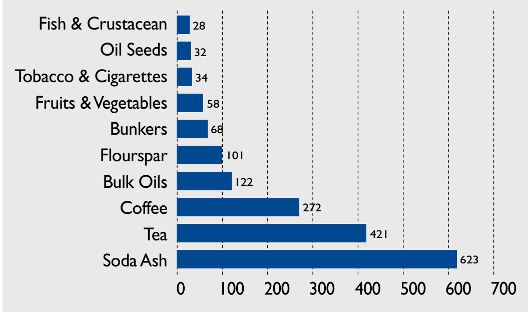
CARGO PROFILE ('000' DWT): 2004–2008



KEBS operates a Pre-Verification for Conformity (PVOC) program under Legal Notice 78 of July 2005 which mandates inspection of high-risk goods, including agricultural products such as wheat, maize, sugar and processed food; and textiles, chemicals, and electrical goods prior to export to Kenya. Costs for certification are approximately 0.475 percent of FOB value not to exceed $2,600. Goods considered as higher risk, such as food products, are generally sampled again upon import, a process which negates the facilitation benefits of the PVOV program.

Port Health Services has an overlapping responsibility with KEBS for food quality controls. Its only intervention is at time of arrival in Kenya. Its inspectors are not authorized to release any cargo but merely draw samples for testing at the **National Public Health Laboratory.**

TOP 10 EXPORT COMMODITIES ('000' DWT):2008



EAC products are generally subject to the same controls by these agencies as international arrivals, despite policies to reduce interventions. Although mutual acceptance of SPS certification regionally is mandated, in practice KEPHIS related products undergo the same treatment as goods entering from outside the region. KEBS continues to perform physical inspection and at the discretion of its inspectors sends samples for testing, although its PVOC requirements for EAC products were eliminated in late 2008. Any facilitation gained by recognition of approved Bureau of Standard marks on regional products will not impact treatment of EAC goods by the Port Health Service. This demonstrates the need for inter-agency cooperation and coordination. In the current environment of reduced budgets and reduced border staffing, achieving gains from improved interagency cooperation should be a priority.

SUPPORTING INSTITUTIONS

MOMBASA PORT

The Mombasa port facilities, managed by the **Kenyan Port Authority** (KPA), are critical to the movement of international trade not only for Kenya, but also for the region, as the vast majority of east African trade transits this facility. Port throughput continues to increase and exceed capacity. At the same time, the rate of empty throughput, at 31 percent of total volume, is significantly above the global average of 21 percent. This fact reflects the trade imbalance between imports and exports, one that doubles import transport costs.

Mombasa's infrastructure issues, including a lack of adequate space and equipment, are the greatest impediments to a more rapid pace of improved service. Initiatives are underway to expand container capacity and increase road access to the port. Further constraints include Mombasa's imposition of higher handling fees than neighboring ports and the lack of an IT port system to fully integrate port activity, receive and post manifests, and track movements. Implementation of an anticipated Port Community-Based System in late 2010 might address these issues.

Despite these constraints, Mombasa's increased reliability and strengthened level of service continue to make it the port of choice within East Africa. The most notable indicator of improved facilitation is the increase from 12 to 24 moves per hour, although this rate is still at the lower end of international standards. Other improvements include effective use of weekly stakeholder meetings and expanded use of Container Freight Stations (CFS), with 95 percent of all imports transferred there for clearance. Although CFSs expedite cargo movement from the port, delays are encountered in both the transfer of containers to these facilities and processing within the CFS. Some are not sufficiently equipped to handle assigned cargo, which should be more effectively determined in the approval process.

EXPORT PROCESSING ZONES

Kenya's EPZ's have been in place since 1990. Currently 42 are in operation, accommodating 76 enterprises. Most EPZ companies manufacture textiles destined for the United States market under AGOA. Since inputs are not sourced locally, there is concern about what will happen after 2015, when the fabric must be produced in the manufacturing country to qualify for this trade preference. An impact study should be completed to determine the benefits of expanding the EPZ concept to incorporate special economic zones, such as those operating successfully in countries like Mauritius and Botswana. This would require lifting current restrictions on agricultural and fish-processing operations and permitting existing companies to operate within EPZ's.

KEY SUPPORTING INSTITUTIONS

- Mombasa Port
- Export Processing Zones
- Licensed Customs clearance agents

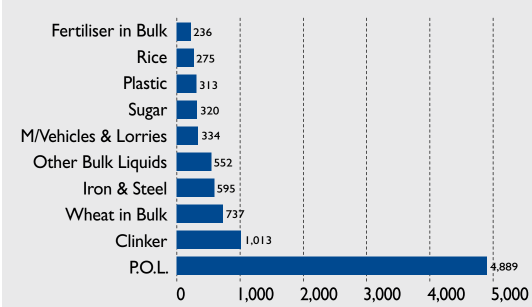
Licensed Customs clearance agents, about 1,300 in number and the largest such sector in the region, are represented by one national organization, the **Kenya International Freight Forwarders and Warehouse Association (KIFFWA) (Chart C).** About 10% of the largest companies account for 60 percent to 70 percent of transactions. A regional formal training initiative by Customs and KIFFWA, supported by donors, has been successful in increasing professionalism within the sector. However, an MOU between Customs and KIFFWA, which establishes rights and obligation of parties with the goal of moving some oversight and disciplinary responsibility to the private sector, is not well known among the clearing agents. Additionally, the MOU does not include a clearly stated obligation on the part of the agent to report suspicious interactions with the trader.

SOCIAL DYNAMICS

Advances in trade facilitation depend directly on the quality of leadership and commitment to the effort not only at the border agencies but, more importantly, at the top levels of government. It is the responsibility of a nation's leaders to create an enabling environment for reform and to have the vision, credibility, and mandate to bring border agencies together to meet the established goals. This diagnostic revealed many doubts over whether such leadership exists and to date no lead agency or inter-ministerial body has been designated with this responsibility. It is also apparent that the current parliament is unable to pass the legislative mandates to eliminate overlapping functions which are necessary to expedite clearances and to address some of the other trade impediments such as pre-arrival manifest filing and immediate release procedures upon electronic filing of declarations.

Reform champions exist in some key departments. The KPA, the Ministry of Transport, the KRA, and Customs have been recognized by the trade community for their reform initiatives. The KPA has reacted positively to demands for improved service and is a good example of how to achieve an effective public-private partnership. Customs' recent decision to implement a reorganization to oversee reform and implement policy initiatives demonstrates a commitment to change. Efforts at reform nonetheless remain stymied by the lack of agency coordination and the lack of a comprehensive approach to reform. Although designated reform champions within agencies are committed to improved trade facilitation, they often lack the required skills to implement modern programs which can be sustained with the current staff. In addition, many of the border agencies related to public safety have not adopted needed reform agendas.

TOP 10 IMPORT COMMODITIES ('000' DWT):2008



Sustained initiatives at the KRA have significantly reduced corrupt practices within the autonomous agency. A code of conduct is in place, dismissals have occurred for transgressions, and processes have been redesigned to reduce officer discretion and contact between the trade community and Customs officers. To improve compliance, action now must be taken to expand such practices to private sector stakeholders and especially customs clearance agents.

Private sector associations are critical to successful implementation of trade facilitation initiatives. They are instrumental in organizing advocacy for change, providing guidance to their sector on how to market and meet international standards, and developing solutions to trade-related issues. In Kenya, however, such groups are not capable of providing this level of service. Too much reliance is placed on governmental development of solutions, rather than on accepting responsibility to develop better trade practices among private stakeholders. This impedes the building of an effective public-private partnership, an essential element in improved and expedited trade facilitation.

RECOMMENDATIONS

Strengthen the KRA's Customs Modernization and Reform Program to streamline clearance processing at both the Mombasa port and the nearby Container Freight Stations.

Create a team charged with streamlining the clearance process at Mombasa with emphasis on import and transit processing, the most time-consuming clearances. Many opinions exist on why dwell times are about 13 days at Mombasa, and finger-pointing is rampant. To date, there has been no comprehensive study on the entire process from arrival to clearance, including how the involved parties interact and where delays occur in the steps required for release. A team including representatives of all stakeholders should be formed and charged with conducting such a time-release study. This is necessary to ensure an integrated approach and to establish a true public-private partnership for reform. Moreover, involvement of field personnel that process and prepare the documentation is necessary to create the needed buy-in for successful implementation. Separate teams for the port and at each major Container Freight Station may be warranted, although such efforts should be well coordinated. Leadership of the teams should be shared by public and private-sector representatives to secure full and open participation, although all members must understand the core responsibilities of the public agencies.

A time-release study should first pinpoint trade chokepoints. The WCO has developed a methodology to identify both bottlenecks in clearance procedures and the impact new processing measures would achieve. This approach should be used. Then, based on an effective diagnosis of the situation, practical solutions can be developed. Clear, measurable objectives should be established. These could include reductions in processing times, elimination of some documentation and approvals, and improved timeliness and quality of document preparation. To gauge results, customer satisfaction surveys and a post-implementation time-release study could be used.

Improve the Customs reform program through effective use of strategic planning, measurable indicators, program sequencing and prioritization, incentives, and methods of securing "ownership" of reforms at the implementation level. A full partnership between field staff and the private sector must be incorporated into the Customs reform program; a partnership which would gain their support and include their idea in order to give them critical ownership over the effort. A designated reform team such as a stakeholders' steering committee should be established in concert with KIFFWA and designated field officers. This group would assist in the development and implementation of reform as well as monitor progress. Current practice is a top-down approach that involves field input, both public and private, only prior to implementation, despite the widely accepted principle that engagement of the private sector in all phases of reform is critical.

Project champions should be identified at every stage of development and implementation. Crediting these champions when successes are achieved is also important. Rewards could take various forms, including, awards for exceptional service, time off from work, or, if the budget permits, cash awards.

Clear performance measures must be adopted. The current indicators are geared to dates for implementation without measuring impact. The reform team must define the objectives it wants to achieve and, from there, determine how to quantify whether these results have been fulfilled. The IT system must be programmed to provide the statistical data required for such analysis. Criteria will vary depending on the initiative but could include the following:

- levels of inspections
- decreases in processing time
- elimination of redundant paperwork,
- increased revenue collections and fraud detection as a result of more targeted inspections
- an increase in the number of declarations processed through fast track clearances.

Revenue targets are especially critical since ministries must have confidence that reform efforts will not decrease collections. The trade community must be involved in evaluation of initiatives.

Customs reform must take a more holistic approach. There is need for broad-based consensus on the following:

- sequencing of events
- prioritization of projects
- integration of initiatives into IT system redesign
- focus of capacity-building and training

To achieve these goals, WCO's East and Southern African Regional Office for Capacity Building might assist by identifying experts who have worked in similar environments in sub-Sahara Africa and who understand what is required for a successful modernization strategy. In addition, the USAID Regional Office has provided training to the COMESA Secretariat on program implementation, monitoring, and evaluation, including how to prioritize action and devise a results-based program. The curriculum for this program could be adapted for CSD training.

Conduct a quality audit of Simba to identify changes needed to accommodate modern customs processes and improve data security. Develop and implement a plan of priorities for system upgrades to coincide with advances in processing methods. Customs' current IT system—known as Simba—seriously impedes trade facilitation progress. At this time, system updates take place through ad hoc modules; there is no overriding plan to integrate new information into the central processing database. The current server cannot handle existing demands and management reports are often delayed by days or weeks, limiting the analytical capacity of managers. Real-time research is not available and multiple files need to be accessed to compile a complete picture of a transaction or account.

Furthermore, the current system cannot accommodate a dynamic risk-management program or identify low-risk filers or approved audit traders for fast clearance. Risk-management officials must manually compare each declaration with existing risk profiles. Not only does this labor-intensive process prevent immediate release of goods, but as workloads increase, such human intervention will become impossible. Manual reviews also increase officer discretion with little checks and balances. Results of examinations cannot be quantified to determine effectiveness. Random sampling of low-risk shipments to provide a compliance check does not take place.

These issues represent only a few of Simba's limitations. Qualified system analysts familiar with Customs processing should be employed to address Simba in concert with broader agency reforms.

Provide training in the principles of the Revised Kyoto Convention. Customs management is not sufficiently knowledgeable of modern trade facilitation practices and the details of how to develop and implement them. In particular, reformers need to be acquainted with the processes outlined in the Revised Kyoto Convention. Key officials need to know goals for their respective organizations and why they are important.

Training in Kyoto can be provided by the donor community; for this, experts are readily available. The regional WCO hub could lend assistance in this area.

Institutionalize risk management as a core business process within Customs.

Increase capacity within the CSD for implementation and operation of a dynamic risk management methodology. Risk management is a widely recognized method for achieving the proper balance between trade facilitation and control over imports. Well prepared risk profiles determine the level of risk of shipments, which then drive selective document review and inspection. Although Customs currently employs some degree of selectivity, particularly at Mombasa, this takes place through a laborious process of entry-by-entry analysis, rather than through national development of risk profiling. Document review is too intensive, parallel paper and electronic systems continue in place, and the ratio of findings to inspections is low.

Customs is in the preliminary stages of taking the next step in developing its risk management but needs technical assistance. Resistance among staff and management to adoption of risk management principles is well embedded. There is fear that reform might jeopardize the primary agency mission of revenue generation.

A National Targeting Unit has recently been established to perform risk assessment. This is a good preliminary step, although further infrastructure modifications will be required. First, a Risk Management Committee of both field and headquarters staff should be established for the purpose of reviewing new risk criteria. Next, a risk management strategy outlining the objectives and priorities for the program must be developed with measurable criteria. Kenya needs a risk management policy that details procedural requirements. Immediate release on verification and payment of electronic declarations for low risk goods should be a major objective.

The National Targeting Unit needs assistance in how to conduct a threat assessment and categorize levels of risk; how to gather, chart and analyze intelligence data to prepare valuable risk assessments; and how to use electronic manifest data in developing its profiles. To measure success of risk management initiatives, indicators should include the increase of paperless releases, reduction in number of inspections, and increases in discrepant findings during the inspection process.

The donor community has provided risk management training previously. JICA has some on-going effort in concert with its OSBP initiatives. To date this training has not been utilized effectively, however, because Customs did not have the proper infrastructure in place. With the National Targeting Unit now formed and its staff being allocated, this is the time for a more effective intervention. A longer term expert (30 to 60 days) is needed to work directly with the team in risk-profiling, as well as with management to develop a sound risk management strategy and policy. This effort should encompass training on the value and effectiveness of risk management for the purpose of establishing buy-in from both management and staff.

Increase the effectiveness of the Post-Audit unit and expand simplified procedures for authorized traders as major components of RM. Audits are an essential component of risk management. They provide an in-depth picture of specific transactions or clients and provide a method of measuring compliance of traders, both of which directly contribute to the risk profiling process. To date, however, audits have been used by Customs as another means of verification, rather than as a means of identifying low-risk, high-volume candidates for expeditious clearance. Even approved Authorized Economic Operators, a program under the WCO Framework of Standards to Secure Global Trade, are subject to quarterly audits and receive no expedited treatment. The risk management strategy and policy must include audits as a primary tool to identity high-volume compliant traders who will receive immediate release on arrival with random, system-generated inspections used to verify compliance periodically. The audit plan should target at least 50 percent of its workload at high-volume clients until a substantial percentage of Customs' overall volume has been reviewed. Incentives such as fast-track clearance must be guaranteed to compliant traders to reward their behavior and entice others to seek those advantages through improved compliance.

Customs' audit department has a well qualified staff hired specifically for their audit credentials. Specialized training has been provided by the U.S. Embassy's Customs and Border Control Office and by other donors. Nonetheless, the current staff lacks sufficient knowledge of customs valuation, classification, and rules of origin principles. The KRA training institute should develop a course for that purpose. Knowledge of customs applications would improve the efficiency with which auditors conduct reviews, give them more credibility with their clients, and produce more reliable findings.

Review the EAC Customs Management Act for compliance with the Revised Kyoto Convention and assist development of implementing regulations to accelerate harmonization of procedures and EAC adoption of international best practice.

Provide a Kyoto expert to review of EAC Customs Management Act (CMA) in conjunction with legal staff from the affected countries to ensure its compliance with the international principles set forth in the WCO Revised Kyoto Convention (1999). Kyoto is considered the international blueprint for trade facilitation. Its provisions outline basic principles for customs practices and provide the foundation for implementing regulations once a legal framework has been set in place. Although some attempt was made in drafting the CMA to comply with Kyoto, full compliance was not accomplished. To set the proper legal framework for advancement of the EAC Customs Union, revision of the CMA must take place. Otherwise, continued facilitation efforts will be stymied by lack of legal authority.

In view of the current competitiveness of the international market place, traders demand that transparent, predictable, and prompt customs procedures be embedded in legislation. This gives them the confidence that legal recourse to address improper practices will be available to them. A competent review of the CMA would detail its deficiencies, recommend corrective action and result in amended legislation that meets international standards. Passage of the modifications is only required at the EAC level, a process which is generally more expeditious than having to pass amended laws in each country.

Provide technical assistance to expedite the development of the EAC Customs Union CMA implementing regulations. Lack of trust and inadequate understanding of modern practices have contributed to the slow pace in promulgating CMA implementing regulations. This has allowed inconsistencies in procedures to persist. Outside expertise could accelerate the development of regulations and serve as an impartial and knowledgeable voice of best practice outlined in the Kyoto provisions. The end result would be the required legal framework and regulatory practices to begin the process of accession to the Kyoto convention, which would indicate to the business community and potential investors that the trade practices within the EAC are in line with international best practice.

Improve coordination between border agencies to streamline import/export processing.

Review current mandates of border agencies to identify areas of overlapping jurisdiction to determine the costs of such duplication, and to develop solutions for reducing or eliminating redundancies at the border. Competing jurisdictions of various federal ministries, particularly in the area of food safety, delay border releases and increase costs. A review is needed to identify the redundant processes and their costs to both the trader and the government. Although review could be undertaken using the legal expertise available in Kenya, recommendations for resolving competing authority issues would be judged more impartial if experts from outside the country were used. Such an initiative must be supported at the highest level of government to ensure commitment to this reform. If EAC quality standard institutions such as the Bureau of Standards can agree regionally to accept certification from a neighboring county's institution, it would be difficult to maintain that one Kenya department cannot accept certification of another.

Identification of what duplication at the border costs Kenya in such areas as laboratory testing and border staffing could serve as an attractive incentive for corrective action. If support for legislative change cannot be secured, joint agreements on shared testing, designation of product focus, and so forth might be adopted between the affected agencies. Public support for such an initiative is crucial and impacted trade associations must be energized to advocate for the needed changes.

Create an inter-agency taskforce with the authority to resolve border-related issues and provide a structure for consultation at the local level, and for reporting on outstanding issues and enacted reforms. Although there are many instances of informal cooperation at the local level among the border agencies and within the private sector, there is no designated authority or policy initiative for structuring coordination and integration of border management or resolving issues with national implication. This leads to a disparity in operations among the border posts, with field initiatives driving the effort. Local issues remain unresolved and best practice is not publicized to determine applicability to other posts. In addition, a national approach is needed to sort through the multiple initiatives underway for development of a single IT window that all agencies can use for review of documentation.

Creation of an inter-ministerial committee of the border agencies with stakeholder participation could provide the needed structure for national direction, a forum for problem resolution on overarching issues, and a strategy to achieve a more integrated approach to border management.

Train border agencies other than Customs in the use of risk management principles so they can employ selectivity in processing. 100 percent inspection, sampling, and laboratory testing at the border still occur on most products regulated by agencies other than Customs. Risk management principles could be employed especially when required by EAC policy on items regulated by KEPHIS. National authorities must ensure that their obligations under the EAC Customs Union are implemented.

Resistance to selectivity, even when items involve food safety, is evident. Although it has a pre-inspection system in place to certify goods that meet quality standards prior to export, KEBS continues its destination inspections, which retest the same goods on import.

The possibility of accepting quality certifications from reputable export authorities in lieu of import testing should be considered. Technical experts knowledgeable of successful risk management applications applicable to food safety issues should be assigned to work with the major border agencies to demonstrate how risk management can be employed without jeopardizing public safety. Visits to other African countries which employ such strategies would be helpful. Selective processing would reduce clearance times with success measured by the number of shipments released without interventions.

Promote further professionalism of the clearance agents and promote partnership between clearance agents and Customs to improve compliance rates.

Develop ethical standards for the clearance agents, including a code of conduct and move more responsibility for self regulation to the sector. The clearance sector needs to assume more responsibility for policing and education of its members. KIFFWA leadership is attempting to develop an integrity training course but needs assistance in finalizing the training material, hosting the classes, and developing trainers. The curriculum would focus on the agents' responsibility to present accurate and complete data, the consequences for failure to comply, and acquaintance with what might constitute suspicious behavior to be reported to Customs.

After the agents understand their obligations, all should be required to adopt a standard code of conduct that includes a provision for a revocation of a license for fraudulent behavior. Such a program should be designed to be self-sustaining though assessment of fees that cover costs.

An effort to professionalize customs agents must include close partnership between Customs and KIFFWA. Efforts directed at integrity training and code of conduct adoption would require outside technical assistance from representatives of a more experienced clearance agency association, which could be contacted through either the Federation of East African Freight Forwarders or the International Federation of Customs Brokers Association (IFCBA). Measurable results could be improved compliance rates and number of reported incidents of irregular behavior.

Map the document preparation process of the clearance agents to determine the causes of delays and devise solutions to reduce. One of the major impediments to speedy clearances is extensive documentation preparation time, almost 50 percent of the total clearance time (13 out of 29 days for export, and 11 out of 26 days for imports, according to the most recent World Bank *Doing Business* report). The key sector involved in this process is the clearance agents. KIFFWA should conduct a review of the chokepoints involved in formalizing a declaration and develop a strategy to address the issues. Due to its limited resources, KIFFWA would need support to conduct such a study. Although Customs could have a place at the table for this effort, KIFFWA should take the lead. Incentives should be offered and credit given when successes are achieved.

TRADE POLICY

International trade has become increasingly important to Kenya's economy. Kenya participates in two regional trade agreements: the East African Community[62] and the Common Market for Eastern and Southern Africa (COMESA).[63] COMESA is the leading market destination for Kenyan exports, accounting for 38.2 percent of total exports in 2007. Kenya's exports to the EAC account for just more than 22 percent of total exports. Combined the COMESA and EAC regions import more than half of total Kenyan exports, which are mainly comprised of horticultural products, coffee, tea, petroleum products, and manufactured goods.

OVERVIEW OF TRADE SECTOR IN KENYA

As Table 1 shows, Kenya has been running a trade deficit since 2000 and at an increasing rate since 2003. Imports are expected to continue to outpace exports through 2009. As a percent of total exports, the trade deficit has increased from 54% of total exports in 2002 to 106.4% of total exports in 2007.

TABLE 2: TOP MARKETS FOR KENYAN PRODUCTS

	2001	2002	2003	2004	2005	2006	2007
COMESA	38.5%	34.1%	30.7%	33.3%	34.5%	35.9%	38.2%
EAC	25.2%	19.6%	16.9%	19.0%	20.6%	19.7%	22.4%
EU	32.8%	34.2%	37.8%	35.1%	29.7%	28.8%	27.7%
USA	2.8%	2.5%	2.0%	2.6%	5.7%	8.9%	7.2%
Other	0.7%	9.6%	12.6%	9.9%	9.5%	6.7%	4.5%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Kenya National Bureau of Statistics, Statistical Abstract 2008

62 The member states of EAC are Burundi, Kenya, Rwanda, Tanzania, and Uganda.

63 The member states of COMESA are Angola, Burundi, Comoros, DRC, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, and Zimbabwe.

TABLE 3: TREND OF KENYA'S IMPORTS (AS A PERCENT OF TOTAL IMPORTS)	2001	2002	2003	2004	2005	2006	2007
Food and Beverages	10.6%	6.2%	5.6%	6.1%	6.0%	6.1%	6.8%
Industrial Supplies	29.8%	33.4%	32.6%	33.1%	32.8%	30.9%	32.4%
Fuels and Lubricants	20.3%	19.0%	24.9%	26.5%	22.8%	23.9%	21.1%
Machinery and Other Capital Equipment	13.1%	13.9%	14.5%	15.0%	12.8%	13.8%	16.1%
Transport Equipment	19.8%	20.2%	13.8%	11.7%	18.9%	18.4%	16.2%
Consumer Goods	6.4%	7.4%	8.6%	7.6%	6.8%	6.9%	7.4%
Others	6.4%	7.4%	8.6%	7.6%	6.8%	6.9%	7.4%

Source: Kenya National Bureau of Statistics, Statistical Abstract 2008

EXPORTS

Table 1 shows the trend of Kenya's exports since 2001. Overall, Kenya's exports are heavily dependent on the food and beverage sector, although the share of total exports by the sector has declined significantly from 54.2 percent in 2002 to 42.8 percent in 2007. In its place, manufactured goods have increased from 23.9 percent of total exports in 2001 to 35.8 percent in 2007. Regarding commodities, tea exports have increased over time from 28.4 percent of total exports in 2001 to 38.5 percent in 2007 and tea accounts for roughly half of total food and beverage sector exports. Cut flowers and petroleum products are two potential growing export sectors for Kenya. Cut flowers increased its share of total exports by about 10 percent over the 2001-2007 time period. Conversely, the share of total exports represented by petroleum products decreased slightly over the same time period, although with significant fluctuations over the years.

KEY MARKETS FOR KENYAN EXPORTS

COMESA, EAC, and the EU are Kenya's key trading partners as seen in Table 2. By country, Kenya top export partners are Uganda, the United Kingdom, Netherlands, and Egypt. These four countries account for roughly 37 percent of Kenya's total exports. Tanzania, Pakistan, and Rwanda follow, contributing 9 percent to Kenya's total exports. In general, COMESA, the US, and the EAC to a lesser degree have been growing markets for Kenya since 2001-2002 while Kenyan exports to the EU have decreased over time.

IMPORTS

Imports to Kenya are mainly comprised of industrial supplies, and fuel and lubricants. Table 3 shows the trend in imports to Kenya since 2001. While most categories stayed consistent over time transport equipment decreased from roughly 20 percent in 2001-2002 to 16 percent in 2007. Food and beverages also decreased from more than 10 percent in 2001 to roughly 6 percent in 2007.

LEGAL FRAMEWORK

In 2007, the Kenyan Ministry of Trade and Industry drafted a Trade Policy report as part of the country's overall development strategy *Kenya Vision 2030*. *Kenya Vision 2030* aims at making Kenya a newly industrializing "middle income country providing high quality life for all its citizens by the year 2030."[64] The strategy is based on maintaining a sustained economic growth rate of 10 percent per annum over the next 25 years (Pillar 1, Vision 2030). International trade and the government's overall trade policy will play a critical role in contributing to the first pillar of *Vision 2030*. The Ministry's Trade Policy Report aims to realize these goals through the following actions intended to enhance overall trade policy:

- Promotion of decent, protected and recognized informal trades
- Establishment of vibrant businesses supported by well established and functioning infrastructure and social amenities
- Expansion of Kenyan exports to generate jobs and prosperity

64 Republic of Kenya, Kenya Vision 2030, July–August 2007.

- Transformation of Kenya into a regional service hub
- Enhancement of E-opportunities[65]

INTERNATIONAL TRADE AGREEMENTS

Kenya is signatory to a number of multilateral and bilateral trade agreements as part of its trade policy. Kenya is a member of the World Trade Organization (WTO), allowing Kenya's products access to more than 90 percent of world markets at Most Favored Nation (MFN) treatment.

REGIONAL TRADE AGREEMENTS

Kenya is also a member of the Free Trade Area of the COMESA, the EAC, and the EAC Customs Union. COMESA is currently the largest regional grouping in Africa, consisting on 19 member states, almost half the total number of African countries. COMESA was preceded by the Preferential Trade Area for Eastern and Southern African States, established in 1982. The Treaty establishing the Preferential Trade Area was signed in 1981 and came into effect on September 30, 1982 to take advantage of a larger market and to allow for greater social and economic co-operation between the countries in the region. The ultimate goal was the formation of an economic community. The treaty called for the gradual reduction and eventual elimination of customs duties and non-tariff barriers and provided for the transformation of the Preferential Trade Area into a common market. This was achieved with the establishment of COMESA, which was signed in Kampala, Uganda in 1993 and ratified in 1994.

The treaty establishing the EAC, comprising Kenya, Tanzania and Uganda, was signed in 1999 and was ratified in July 2000. Its objective is to widen and deepen political, economic, and social cooperation among the partner states. As a result, tariff barriers were removed among the three East African countries. In late 2004, Kenya, Tanzania and Uganda ratified a Customs Union (CU) Protocol which came into effect in early 2005. With the establishment of the CU came the introduction of the Common External Tariff (CET) and internal tariffs for extra regional imports and intra-regional trade. Rwanda and Burundi joined the EAC in 2007.

The CET adopted for non-EAC countries is a three-tier tariff system that paves the way toward a common market. Under the protocol, EAC member states apply zero duty for raw materials and inputs, 10 percent for processed or manufactured inputs, and 25 percent for finished products. For intra-regional trade, the import duty (internal tariff rate) ranges between 0 percent and 25 percent, with a gradual phase out by 2011. A selected list of sensitive items, comprising 58 tariff lines, has rates above 25 percent for certain goods including milk and milk products, corn, popcorn, rice, wheat, and wheat flour.[66]

KEY POLICIES, AGREEMENTS AND LAWS

- International trade agreements
- Regional trade agreements
- Rules of origin
- SPS standards

Although regional integration is critical to enhancing trade, the overlapping regional trade agreements have posed some problems. The EAC customs union has had difficulty in promoting the free internal movement of goods between EAC countries, because border controls are necessary to ensure that EAC preferences are not accidentally granted to Southern Africa Development Community (SADC) and COMESA countries, which frequently trade with Kenya. Some of these countries, however, are also members of EAC and must be granted preferential treatment. This issue of overlapping regional trade agreements has added extra costs and delays to the trading process. In addition, it is not feasible for Kenya to join the customs unions of both EAC and COMESA, because the two trade agreements have different customs and CET requirements.[67]

Increased coordination, cooperation, and commitment to ease of trade within EAC is needed to achieve harmonization and standardization

65 Ministry of Trade and Industry, Draft Trade Policy, KSMS July, 2007.

66 USTR, "National Trade Estimate Report on Foreign Trade Barriers: Full Report," 2008.

67 *Uganda Diagnostic Trade Integration Study*, 2006.

of trade facilitation efforts and to sustain them. Kenya's commitment to regional integration needs to be elevated and reinforced in recognition of the mutual benefits to be derived.

In October 2008, the EAC, COMESA and the SADC announced an intention to form a single free trade bloc and a single customs union, stretching from South Africa to Egypt, and from the Democratic Republic of Congo to Kenya. The three organizations agreed to create a road-map for the free trade area within six months, a proposed legal framework, and a list of specific measures to facilitate the movement of business people (trade in services). A tripartite Council of Ministers is charged with convening in one year to determine the timeframe for implementing the free trade zone. Whether this six-month goal was achieved by April 2009 is worth noting, because that benchmark represents the actual commitment of the participants.

MARKET ACCESS

The great majority of exports originating from Kenya to the European Union enjoy preferential market access to the EU market. Trade preferences include duty and quota-free entry of all agricultural products including coffee beans, tea, edible nuts, fresh and processed fruits and vegetables. In addition, a wide range of manufactured products also enters the EU market duty and quota free.

Kenya qualifies for duty-free access to the United States market under the African Growth and Opportunity Act (AGOA) enacted by the U.S. Kenya's major products that qualify for export under AGOA include tea, coffee, edible nuts, other agricultural products, textiles, and apparels and handicrafts.

Under the Generalized System of Preferences (GSP), a wide range of Kenya's manufactured products are entitled to preferential duty treatment in the developed markets of the United States, Japan, Canada, New Zealand, Australia, Switzerland, Norway, Sweden, Finland, Austria, as well as other European countries. According to the latest Market Access Trade Tariff Restrictiveness Index (including preferences), Kenya is ranked 103rd out of 125 countries, with Kenya's access to international markets comparable to the regional average and only slightly better than that of the average low income country.[68]

BARRIERS FACED BY KENYA TO EXTERNAL MARKETS:

Nontariff Barriers (NTBs). The EU, which is the largest importer of African goods, maintains restrictions affecting textiles, agricultural goods, and coal. Other barriers affecting market access to the EU are rules of origin, cumulation, environmental regulations, and SPS issues. AGOA tariff preferences to Kenya by the US have been perceived to be eroded by the use of anti-dumping actions, countervailing, and safeguard measures, which have been compounded by tightened US borders resulting from national security policies.

Other NTBs faced by Kenya are broader in scope. In order of importance, they are (i) poor infrastructure, including roads, railways, telecommunications, (ii) political instability, and (iii) insufficient product diversification, including dependency on raw materials. Studies have shown that high freight costs are a much more restrictive barrier to exports than tariffs.

68 World Bank, Kenya Trade Brief, 2008.

Rules of origin. Preferential trade agreements use rules of origin to ensure that non-members do not benefit from preferential treatment that members are granted. For example, rules of origin specify the amount of processing a product must undergo in a partner country so that it can qualify for market access under the preferential agreement.

In reality, rules of origin are more often perceived as a NTB because they are difficult for industries to understand and because the application of rules of origin is often applied with a certain amount of discretion. In theory, the EAC Customs Union should obviate the need for rules of origin on intra-regional trade; however, implementation has been slow.

Sanitary and Phytosanitary (SPS) Measures and Standards. Quality controls imposed by the EU and other export markets, including sanitary and phytosanitary measures (SPS) on agricultural products and technical barriers to trade (TBT) imposed on non-food products serve as another NTB facing Kenyan exports. For example, Kenya has struggled to reconstruct its fishing industry after facing several SPS-related bans from EU buyers who wanted eco-friendly fish harvesting and processing from suppliers.

Kenya needs to build SPS and TBT compliance capacity to maintain trade with outside markets. The country lacks the institutional capacity and technical expertise to carry out conformity assessments for product standards and production processes. The existing laboratories are not considered capable of testing and verifying product standards due to the lack of necessary technical information, equipment, and trained staff.

BARRIERS IMPOSED BY KENYA ON OTHER MARKETS:

Nontariff Barriers. NTBs remain a problem within Kenya and within the EAC. The East Africa Business Community prepared the following list of NTBs experienced by businesses conducting intra-EAC trade: (i) customs and administrative documentation procedures, (ii) immigration procedures, (iii) cumbersome inspection requirements, (iv) police road blocks, (v) varying trade regulations, (vi) varying, cumbersome and costly transiting procedures, (vi) duplicated functions of agencies involved in verifying quality, quantity and dutiable value of imports and export cargo, and (viii) business registration and licensing.[69] (The report also indicates that Kenya's level of investment and business optimism is reduced by low expectations relating to improvements in infrastructure, access to land, and profitability in business.)

Trade barriers in the agricultural sector. High import duties and Kenya's value added tax (VAT) also pose trade barriers, especially in the agricultural sector. Kenya's import regulations on agricultural products are sometimes altered to reflect fluctuations in domestic supply and demand as well as political factors.

Bound Lines. A country that commits to other member countries not to raise tariffs above an agreed amount is said to "bind" its tariffs. If the country does raise tariffs above the agreed amount it must then compensate the country accordingly. For Kenya, only 14.6 percent of its tariff lines are bound, thus indicating that Kenya has not fully committed to tariff liberalization.

Export Subsidies. The Kenyan government has several programs aimed at helping exporters. The Manufacturing Under Bond (MUB) program encourages manufacturing for export by exempting enterprises operating under the program from import duties and VAT on imported raw materials and inputs and providing a 100 percent investment allowance on plant, machinery, equipment, and buildings. Goods produced under the MUB system will be exported and if they are not will be subject to a 2.5 percent surcharge and the applicable duties to all imported inputs.

The Export Processing Zones Authority (EPZA) is designed to offer a variety of fiscal and tax incentives to companies producing goods for

69 East Africa Business Council, "Monitoring Mechanism for Elimination of Non-Tariff Barriers in EAC," 2009.

export (they are also allowed to sell up to 20 percent of their output on the domestic market). Fiscal incentives offered in the EPZs include: a 10 -year tax holiday and a flat 25 percent tax for the next 10 years; exemption from withholding taxes during the first 10 years; exemption from import duties on machinery, raw materials, and inputs; no restrictions on management or technical arrangements; and exemption from stamp duty and from the VAT on raw materials, machinery and other inputs. The Export Promotion Programs Office, set up in 1992 under the Ministry of Finance, administers the duty remission facility.

Kenya currently has 39 EPZs in operation with the number of enterprises in operation increasing from 66 in 2003 to 74 in 2004, declining to 68 in 2005 following the end of the Multi-fiber Textile Agreement, before increasing to 71 in 2006 and 74 in 2009. The increase in the number of apparel factories was largely due to the preferential access and duty free status accorded to Kenyan apparel exports into the US under AGOA. Kenya's major exports under AGOA include apparel and handicrafts.

IMPLEMENTING INSTITUTIONS

Some of the factors that have influenced the level of policy implementation in Kenya are the effectiveness and the capacity of key institutions such as the **Ministry of Trade, Export Processing Zone Authority, Kenya Investment Authority, Customs Department, Port facilities,** and **Customs and Excise Department.**

KEY IMPLEMENTING INSTITUTIONS

- Ministry of Trade
- Export Processing Zone Authority
- Kenya Investment Authority
- Customs Department
- Port facilities
- Customs and Excise Department
- Export Promotion Council

The capacity of these institutions takes into account both the human resource base as well as capital support base in terms of adequate facilities to conduct trade policy. Generally, the Kenyan civil service training and employment schemes are well established. There is wide variation, however, in the level of skills within the professional staff at the Ministry of Trade and supporting institutions. To be globally competitive, professional staff needs further training in the analytical tools and analyses needed for effective policy negotiations at the international level. Also, political factors relating to incentives and appointments for top staff positions need to be revisited; incentive structures that lend themselves to non-meritorious appointments limit the ability of these institutions to function effectively.

The **Export Promotion Council** (EPC) is a key publicly funded private institution working to promote Kenya's export trade. The EPC's primary objective is to address bottlenecks facing exporters and producers of goods and services for export with a view to increasing the performance of the sector. The EPC is the focal point for export development and promotion activities in the country. The EPC focuses it efforts in the following six sectors as prioritized in the National Export Strategy (NES): (i) horticulture and other agriculture, (ii) textiles and clothing, (iii) commercial crafts and SMEs, (iv) fish and livestock products, (v) other manufactures, and (vi) services other than tourism. The EPC appears to be working effectively to promote Kenyan products abroad through advocacy, promotion, and marketing assistance.

SUPPORTING INSTITUTIONS

The private sector is represented, amongst others, by two important organizations: the Kenya Private Sector Alliance (KPSA); and the Kenya Chamber of Commerce. KPSA is an umbrella body, formed in 2003 and representing 258 organizations, 75 percent of which are SMEs. The Chamber of Commerce has 68 regional offices, with Nairobi as its headquarters, and represents all parts of the business community from

KEY SUPPORTING INSTITUTIONS

- Kenya Private Sector Alliance
- Kenyan Chamber of Commerce
- Donors

SMEs to large businesses. Eighty percent of the Chamber's representation is SMEs. The distinction between KPSA and the Kenyan Chamber of Commerce is not entirely clear (although the Chamber of Commerce is a KPSA member), and a clearer mandate for each organization's role and responsibilities would be helpful.

With respect to private sector and government consultation on policy issues, KPSA regularly dialogues with the relevant line ministries and KPSA has an office within the Prime Minister's office for continued dialogue. It is less clear to what extent KPSA or the Chamber of Commerce consults with government on trade policy issues.

Donors play a significant role in promoting exports. In Kenya's case, donors are already involved in many key areas of trade policy. In general, donors provide assistance in the following areas: (i) assisting to build the government's analytical and statistical capacity with respect to trade policy, and (ii) assisting on SPS measures and standards to enhance market access. Given the extent of the SPS and TBT problems and the potential trade benefits, donors are helping the Kenyan government to upgrade SPS and TBT quality control capacity.

In the areas of trade policy capacity-building, DFID has a project aimed at improving public sector capacity to analyze the impact of trade reforms on different segments of the population as well as to assist the government to be able to better formulate effective trade negotiating positions. The European Commission has a project with the Ministry of Trade aimed at implementation of an Economic Partnership Agreement between Kenya and the European Union. As part of the project, trade policy would be fully integrated into the government's economic development policies; however, there is no reference to capacity-building within the government ministries.

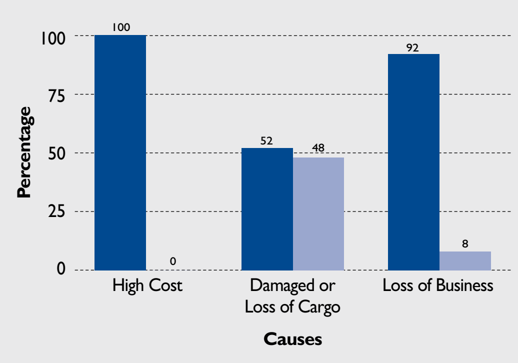
Regarding upgrading SPS and TBT quality control capacity, the United Nations Industrial Development Organization (UNIDO) and the Norwegian Agency for Development Cooperation (NORAD) have conducted an assessment of regional and national SPS and TBT challenges affecting key export products. Similarly, the European Commission has established an SPS enquiry point at the Kenyan Plant Health Inspectorate Services (KEPHIS).

Infrastructure is another key area where donors can provide assistance and one which plays an important role in enhancing trade flows. The European Commission has three ongoing roads projects aimed at construction, maintenance and upgrading of roads in Kenya, with an emphasis on rural roads. The African Development Bank (AfDB) is also a key donor in the area of roads and transportation projects.

SOCIAL DYNAMICS

Kenya is the most important economy in eastern Africa, the hub of the EAC and an important COMESA member. Uganda and Tanzania are Kenya's two leading export markets and Kenyan manufacturers are the principal beneficiaries. All three countries require cooperation in transport, energy, the management of Lake Victoria and cross-border trade.

EFFECTS OF POOR ROADS AND RAIL TRANSPORTATION SYSTEMS



Source: KAM Trade Facilitation Study; Field Survey, 2007

Uganda in particular relies heavily on transport through Kenya to access foreign markets. Inefficiencies, ongoing delays, and corruption allegations at the Port of Mombasa have implications beyond the Kenyan border, with Uganda being the most affected.

INFRASTRUCTURE

Poor infrastructure is a major inhibitor to trade flows within Kenya and across the region. Infrastructure issues noted as urgent in Kenya include: (i) inadequate road maintenance causing major delays, (ii) trucks subjected to passing through six weighbridges along the transit corridor with poor working conditions at the weighbridges, (iii) the level of automation of the Rift Valley Railways systems is low thus causing delays, (iv) inadequate pipeline capacity to transport fuel, forcing trucks to travel all the way to Mombasa to collect fuel and adding on to costs of petroleum products. The effects of poor transportation systems on Kenyan businesses are shown in the following graph.

CORRUPTION

Transparency International's (TI) 2008 Corruption Perceptions Index places Kenya 147th among 180 countries surveyed. Compared to its 2007 TI rating, Kenya improved three positions from 150th out of 180 countries. According to the International Finance Corporation's Investment Climate Assessment for Kenya, corruption was rated as a severe or major obstacle by three-quarters of firms surveyed, with two thirds of respondents stating they were expected to pay bribes for government contracts. Within Sub-Saharan Africa, Kenya ranked 19th out of the 48 sub-Saharan African countries on The 2008 Ibrahim Foundation's Index of African Governance, prepared by Harvard's Kennedy School of Government.

Allegations of corruption and ongoing delays in cargo handling at the Port of Mombasa continue to add unnecessary costs for exporters. In October 2006, the government pledged to begin 24 hour, round-the-clock customs service at the Mombasa port, in response to demands from Kenyan exporters.

RECOMMENDATIONS

Strengthen the capacity of all government agencies involved in trade policy and trade facilitation.

With respect to the Ministry of Trade, training should be directed at professional staff to enhance their analytical skills and trade modeling capability to better inform their negotiating positions at international forums. By better understanding the dynamics of international trade negotiations, the Ministry of Trade can enter into trade regimes that are of benefit to Kenya.

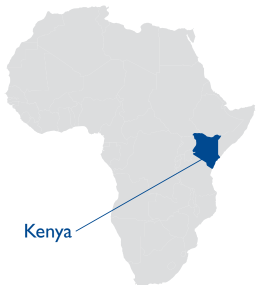
As part of USAID's Competitiveness and Trade Expansion (COMPETE project), Kenya will receive support in this area.

Enhance market access for Kenyan goods.

Given the extent of the SPS and TBT problems and the potential trade benefits, donors should consider providing technical assistance to upgrade SPS and TBT quality control capacity.

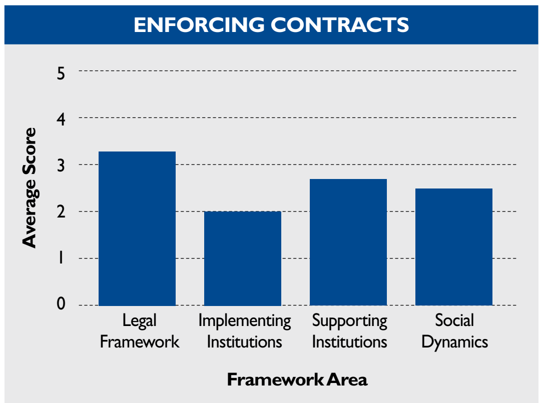
The presence of information asymmetries ensures that Kenyan producers do not receive adequate information to keep up-to-date on SPS and other quality controls. Lack of effective telecommunication throughout the country is an infrastructure problem, but it has far-reaching implications for producers wishing to sell overseas as well.

Kenya also lacks the institutional capacity and technical expertise to carry out conformity assessments for product standards and production processes. Existing laboratories are not considered capable of testing and verifying product standards due to the lack of necessary technical information, equipment, and trained staff. UNIDO, NORAD, and the European Commission are providing some technical assistance in this area.



ENFORCING CONTRACTS

Judicial proceedings in Kenya are notoriously slow. This fact poses a significant impediment to economic development because it operates as a barrier to investment in the country and prevents the prompt resolution of commercial disputes for parties within Kenya, leaving them unable to redeploy their assets in an efficient manner.



There are four principal reasons for the slowness of legal proceedings:

- an inadequate number of judges and magistrates;
- inadequate compensation levels for magistrates and court staff;
- adherence to internal operating systems by the judiciary which may once have been adequate but which have become dysfunctional; and
- a legal culture which tolerates delay.

The BizCLIR scores show that Enforcing Contracts is one of the weakest areas studied in this report. All aspects of the system, the courts as implementing institutions in particular, are in need of dramatic reform.

LEGAL FRAMEWORK

As established by the country's Constitution, the Judicature Act, and the Law on Magistrates Courts, the Kenyan judiciary consists of a Chief Justice, the Court of Appeal, the High Court, and magistrates. There is no Supreme Court. The Chief Justice and judges of the Court of Appeal and High Court are appointed by the President of the Republic with no Constitutional requirement of vetting or confirmation by another body.

The appointment of judges completely lacks transparency. Magistrates are appointed by the Judicial Service Commission, whose members are appointed by the President.

KEY LAWS

- Constitution of Kenya
- Judicature Act (1967)
- Law on Magistrates Courts (1989)
- Civil Procedure Act (1924)

Procedure in all civil cases in Kenya is governed by a modestly amended Kenyan version of the Indian Civil Procedure Code of 1897. While this venerable procedural code is well understood by sophisticated practitioners and the judiciary, it is full of technical traps for the unwary and extraordinarily difficult for *pro se* litigants to navigate. Cases are regularly decided on procedural technicalities, which diminishes public respect for the entire legal system. (In Uganda, the Constitution has been amended to prohibit the determination of legal cases on purely technical procedural grounds.)

A vastly simplified small claims procedure should be implemented. Procedural rules amendments are now under consideration.

IMPLEMENTING INSTITUTIONS

COURTS, JUDGES, AND MAGISTRATES

None of the courts in Kenya are adequately staffed. The Commercial Court in Nairobi, a

division of the High Court which was designed to provide prompt resolution of commercial disputes and was originally staffed by seven judges, is now served by only three judges, just one of whom was an experienced commercial litigator in private practice. Although Parliament has authorized an increase in the number of High Court judges from 50 to 70, and an increase in the number of Court of Appeal judges from 11 to 15, none of the additional judgeships had been filled by the President as of the time of this diagnostic (although several appointments were made in early April 2009). Fewer than the previously authorized 50 High Court judges were actually serving as of March 2009. Of 500 magistrates authorized by law, only 268 were serving as of March. By comparison, Canada—a country with a similar English-style judicial system and a similar population size—has some 900 judges in active service.

The judges and magistrates who are in place are wholly unable to handle the caseload which confronts them. For example, the civil hearings calendar for 2009 is fully booked: except for emergency matters, a case filed in March 2009 or later cannot be scheduled for hearing in this calendar year, and the diary for 2010 will not be open until October 2009. A normal civil case cannot be expected to be completed for years after it is filed, and anecdotal evidence suggests that cases can drag on for a decade or more.

KEY IMPLEMENTING INSTITUTIONS

- Courts
- Judges and Magistrates
- Court staff

Compensation for High Court **judges** begins at KSh 200,000 per month, which is generally regarded as an acceptable pay rate. High Court judges are also provided with housing and a car and driver.

Starting **magistrates** earn KSh 30,000 per month, approximately $375 U.S., which is significantly less than first-year associates in Nairobi law firms. Chief Magistrates' compensation caps out after some 16 or 17 years of service at KSh 100,000 per month, roughly $1,250 U.S.

The low compensation for magistrates creates a series of interlocking problems: Unless a person of considerable ability is extraordinarily committed to the administration of justice, he or she is unlikely to be attracted to a position whose compensation is insufficient to support a family at a middle class standard of living. Thus, the magistracy's ranks tend to attract younger and less successful lawyers. Also, a majority of magistrates are women. In addition to low pay, magistrates work under uneven and, in some instances, appalling physical conditions. Morale among magistrates tends to be low.

Pay for **court staff** is even lower than that for magistrates, and working conditions are similarly mixed. These factors, particularly when combined with the country's reliance on sitting magistrates as court administrators and the fact that court files are kept entirely on paper, yields a situation in which mischief becomes possible. Because the system works slowly (which is often to one party's advantage in litigation), the "losing" of files, or "improper filing" of pleadings within files, becomes a rent opportunity for magistrates and, to a far greater extent, court staff. It is not unknown for pleadings or entire court files to simply disappear, or even for fraudulent documents to appear in files. Because there is virtually no computerization, the system has no method of assuring the integrity of files.

Commercial law firms in Nairobi employ clerical staff whose entire function is to "reconstruct" court files so that cases may proceed. The process of reconstructing a court file such that it is accepted by the court can easily consume six months.

The Kenyan judicial machinery is largely unchanged from the systems which were in place at the time of independence in 1963. The chief administrators of the High Courts are sitting magistrates, each of whom has his or her own docket to service. As a general proposition, the skill sets necessary for a good judge are quite different from those needed for an efficient administrator. The tendency of judicial officers thrust into secondary administrative duties is to let things run as they always have—a tendency which stifles innovation and exacerbates the potential rent-seeking problems discussed above.

None of the Kenyan court records are computerized. This makes judges' preparation for hearings extraordinarily cumbersome and the conduct of hearings unnecessarily slow. If a file cannot be found, or if critical pleadings cannot be located within the file, then the hearing at which they are to be considered must be rescheduled. As noted above, this may force substantial delays, even into the court's next calendar year and beyond.

The High Court's daily calendar, or diary, is almost entirely under the control of the clerk's staff. It is divided into mentions (essentially status or scheduling conferences), chambers summonses (matters traditionally heard in chambers because they were regarded as not important enough to be heard in court but are now heard in court), notices of motion (matters always heard in court), and hearings (evidentiary in nature). These are typically heard in the order presented, although no rule of court requires such. A typical diary may have 25 or 30 cases, and it is unusual for a judge to be able to complete a full calendar in the hours available. However, it is common for at least one party to seek a continuance of a matter—which the court is generally willing to give, since it cannot complete the calendar otherwise. The national press regularly contains complaints about the many continuances given, which are apparently necessary under the circumstances confronting the judges. This pattern of delay through continuance further erodes public confidence in the administration of justice.

One of the most extraordinary features of Kenyan judicial practice is the requirement that the judge or magistrate keep—in longhand—the official record of proceedings before the court. Judges everywhere do, of course, take notes—for their own use in reaching decisions. But for judges to keep the official court record requires them to be scriveners as well, which enormously delays proceedings, and opens up endless risks that the record as taken down can omit critical elements of a party's case, whether through fatigue, inattention, or some more malevolent reason. On appeal, the record kept by the judge (and subsequently typed up) is the only admissible record which can be considered.

The Hon. Mr. Chief Justice J.E. Cicheru authorized a pilot project between June 3 and December 11, 2008, for the live recording of proceedings before the Chief Magistrate's court in Nairobi. Those proceedings were recorded on equipment provided by the German development agency (GTZ), partially funded by the World Bank, and transcribed by the National Council for Law Reporting. The project was successful: a 26-page report on the project was submitted to the Chief Justice in March 2009 and implementation as a broader trial in a division of the High Court is anticipated.[70] As with many of the projects undertaken by the judiciary, however, very little information about this project has been shared with the public or with the Law Society of Kenya

70 It is highly likely that the procurement contracting process for the equipment necessary to implement this technology will be viewed as a significant rent opportunity by those politically connected.

(the mandatory bar in which all advocates authorized to practice law in Kenya belong).

The assignment of judges and magistrates to various duty stations is entirely within the prerogative of the Chief Justice. When judicial officers are transferred, there is frequently very little advance warning given; a judge will simply be informed by letter that, starting the following week, his or her duty station will be somewhere else. This, of course, creates terrible risks for lawyers and litigants with respect to cases—often the most complex and time-consuming—which are partly tried. Should one start over again and thereby lose the judge's accumulated knowledge of the case, perhaps to the detriment of one side? Should one ask the judge to keep the case, presumably at the expense of his or her new docket? Or should one start where we left off, relying on the former judge's notes for the prior record, thereby losing all credibility determinations made by the prior judge but not necessarily recorded on the notes he or she kept?

The disruptions caused by the relocation of judges—especially judges in the Commercial Court, where the cases are almost by definition more complex than most—further diminishes the popular impression of the judicial system generally. There is at least anecdotal evidence that some movement of judicial officers has been undertaken as politically motivated punishment for disfavored rulings by the judge involved. And although High Court and Court of Appeal judges enjoy tenure of office, magistrates do not, and the threat to reduce or suspend compensation to magistrates has been a feature of Kenyan political life.

The courts' annual calendars include holiday schedules which were originally designed to accommodate the desire of English judges to return home for frequent visits from their duty stations in East Africa. Continued into the 21st century, these holiday schedules are remarkably generous. They include three weeks at Easter, six weeks for summer holidays in August and September, and three weeks in December and January. (Located as it is on the equator, Kenya has no "summer" as such, and August and September are not the hottest months of the year.) Judges also receive 30 days' annual leave, to be taken at time(s) approved by the Chief Justice. In the aggregate, these holiday schedules leave the public impression that the judiciary does not work very hard.

SUPPORTING INSTITUTIONS

PARLIAMENT

Many of the problems of Kenya's judiciary are directly attributable to the wholly inadequate resources which have been provided to the courts. The judiciary budget has not been debated in Parliament since the creation of the Republic of Kenya in 1963. The judiciary has simply been treated as one more executive department—which under the Constitution it is not—and debate has been consistently cut off under the parliamentary guillotine clause. The same budget allotment has been provided for many years—an amount of less that 0.01% of the national budget. Most recently, budget requests for KSh 2 billion have been slashed to KSh 800 million, the rough equivalent of US$10 million. Viewed in this light, it is little wonder that there are inadequate compensation levels for magistrates and court staff, that rent-seeking problems continue to present themselves, and innovation is unaffordable.

KEY SUPPORTING INSTITUTIONS

- Parliament
- Donors

DONORS

Unfortunately, something of a standoff between donors and recipients of assistance to the courts in Kenya has formed, in which donors wish to donate particular products (viewed as both insensitive to Kenyan needs, and with a perception that the donors are giving inferior products produced by favored manufacturers) and in which recipients wish to receive cash (which donors view as too risky, and with a cynical idea that recipients' favored suppliers will rake off significant fees and charges). As with the gap between the judiciary and the bar, this standoff can only be resolved through franker and more open communication.

SOCIAL DYNAMICS

POLITICS

The many issues involving the judiciary can only be understood in the broader context of Kenyan politics, which is well beyond the scope of this discussion. Suffice it to say that political tensions between the partisans of President Mwai Kibaki and those of now-Prime Minister Raila Odinga, who competed for the presidency in 2007, were papered over rather than resolved in the Grand Coalition between the two factions negotiated by former United Nations Secretary-General Kofi Annan in early 2008. Tensions remain high and the political currents surrounding the 2012 elections are forming startlingly early.

A LEGAL CULTURE WHICH TOLERATES DELAY

Perhaps because they have few alternatives, lawyers in Kenya have become tolerant of delay. Like lawyers everywhere, Kenyan lawyers make do with the system they have, so consent to the granting of continuances is habitual. Kenyan judges are far too tolerant of oral arguments which go on and on: originally designed to save the time which would be necessary for preparing and reading written submissions, lawyers regularly consume vast amounts of time in making arguments which are more blather than edification. Serious interaction and open conversation between bench and bar, better training of judicial officers, and the adoption of more pointed professionalism standards would go far to correct this problem.

A NEED FOR GREATER COMMUNICATION BETWEEN THE COURTS AND KENYAN SOCIETY

Kenya enjoys a robust press with two national daily newspapers that focus great attention on the courts. Court institutions are at an inherent disadvantage in responding to public criticism: ethical constraints prevent comment on many matters, and judges (and this judicial system) have no discernable public relations program. Frustration with court processes has, among other things, prompted the Law Society of Kenya to seek the removal of Chief Justice Cicheru. President Kibaki has not addressed the Law Society's petition, although Prime Minister Odinga has indicated that he believes that the Chief Justice should leave office.

A number of court reform initiatives have been started in the recent years under Chief Justice Cicheru's administration. Little known to the bar and public, these include:

- **Court open days.** Started in Nairobi in February 2007, a court "open house" which invited the public to visit, ask questions, and learn, was a considerable success. It was repeated successfully in 2008 and held nationwide in all 16 High Court venues on 20 March 2009.
- **Digital audio recording of hearings.** The 2008 test program in the Chief Magistrate's court in Nairobi, discussed above, was successful and should be more broadly implemented.
- **Peer review committees.** Peer review committees have been successfully implemented in the Court of Appeal and in several High Court jurisdictions. In the most successful, judges have met at retreats and have established peer pressure tools to encourage all judges to perform at a high standard. The object of such committees, which should be institutionalized, is to change collective mindsets and to establish standards for court management systems.
- **Creation of Judicial Training Institute.** Launched in 2008, the board of directors for the institute was appointed in March 2009, consisting of two Court of Appeal judges, two High Court judges, with a principal who is a High Court judge and former head of the Kenya School of Law. When implemented, the institute will train new

and sitting judges in both substantive and procedural matters.

- **Creation of case tracking system.** Court diaries for Nairobi hearings are now available online. The National Council for Law Reporting is developing a computerized system for case tracking.

These programs have not generally been discussed between the bench and bar, and there appear to be few opportunities (institutional or informal) for communication between judges and practicing lawyers. This lack of communication is truly unfortunate; it prevents the creation of that degree of transparency necessary to create trust among stakeholders and thereby contributes to the dysfunctionality of the Kenyan legal system.

RECOMMENDATIONS

Two significant changes—pertaining to judicial budgetary authority and corruption—and a number of incremental changes are necessary to bring the Kenyan judicial system up to world-class standards.

Establish independent budgetary authority for the judiciary.

The judicial budget needs to be separated from the budgets of the executive agencies of government. This will require the cooperation of the President, the Prime Minister, and Parliament, and necessary preconditions include pressure from the Law Society of Kenya and civil society, especially the business community. It is difficult to see how the necessary levels of trust can be created in light of the alienation between relevant stakeholders, like that between the Law Society and the Chief Justice. It will be almost impossible to implement a budget process which is viewed as open and transparent without professional management within the judiciary itself.[71]

Launch an anti-corruption initiative that directly addresses the Kenyan courts.

The second significant change is an attitudinal one. Kenya simply must become intolerant of corruption among public bodies, great and small. Public disgust with rent-taking, both grand and petty, is manifest in the national press. It is, of course, not only those who "take chai" who are to blame for the rent-taking attitude in public bodies; those who *offer* chai are equally to blame. It is understandable why a clerical person not being paid a living wage would be tempted to accept "something extra" to process a paper, or cause one to go missing—but he or she who offers that something extra is equally culpable. The solution to this attitudinal crisis is generally outside the influence of donors, however well-intentioned. As with the required change in budgetary authority, an organized and consistent effort by the business community will be necessary to push through this reform.

Increase efficiencies and reduce opportunities for rent-seeking and delay in court cases through specific, targeted reforms in court system.

1. **Increase significantly the number of judges and magistrates.** Although judicial authorities have tied increases in serving judicial officers to the need for new courtrooms,[72] judicial officers can sit in makeshift space and administer justice in the short run.
2. **Increase significantly the compensation levels of magistrates and court staff.** Increased salaries diminish the incentive for rent-seeking.
3. **Computerize court records.** Of all the programs whose implementation would quickly increase judicial efficiency and performance, this is the most obvious and the one lacking a donor partner.[73] Because of justifiable mutual suspicions with respect to the integrity of the procurement process discussed above, successful implementation of a computerized court records system will require sensitive negotiations. USAID has a long record in assisting judiciaries, including civil, commercial and criminal courts, in strengthening their

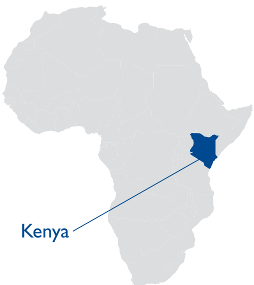
71 Prior offers of professional assistance from British sources have been declined.
72 It is exemplary that 52 new courtrooms are to open nationwide in 2009.
73 One veteran judicial officer commented during an interview that he would be perfectly prepared to keep taking down the official court record forever if the court files can just be made available to him on a timely basis.

use of technology. In considering possible interventions in Kenya, lessons from Egypt, Indonesia, Bosnia, Russia, and other countries should be considered.

4. **Employ professional court administrators at all levels of the courts.** Assigning administrative duties to magistrates precludes their attention to judging and deprives the system of professional management. The skills necessary to be a good judge are simply not the same as those necessary to be an efficient administrator.
5. **Restructure hearing calendars.** Judges and magistrates should have greater control in setting their diaries. The establishment of efficient diary systems is one of the early functions of professional court administration.
6. **Adopt a system for professional court reporting.** Judges should be removed from the role of court reporters either through an expansion of the 2008 pilot program in Nairobi or through some other methodology. This will free up enormous amounts of judicial time and will allow judges to focus in the courtroom on the evaluation of evidence, not the transcription of testimony and argument. Again, prior USAID experience in this area, such as in Kosovo, should be considered and lessons from previous experiences should be integrated.
7. **Assign judges to duty stations consistent with their expertise, and for defined terms.** The rapid and frequent transfer of judges works havoc on the efficient administration of justice. In particular, the consistent staffing of the Commercial Court with commercially sophisticated judges is essential to the creation of a business climate which encourages investment and the taking of entrepreneurial risk. Judicial officers should never be transferred for political reasons.
8. **Adopt a modern judicial calendar.** Court calendars should reflect the business practices of 21st century Kenya. This does not include "summer holidays."

Develop a bench-bar communication model.

Expand upon the Court Open Days program to include formal and informal venues where lawyers and judges can have candid conversations about issues of procedure and practice. The judiciary's best ally in budgetary matters will be a bar that understands the judiciary's needs. Some courts have implemented help desks in their lobbies at which persons interested in a case can receive some guidance and assistance; this program should also be expanded.



APPENDIX A:

COMPILATION OF RECOMMENDATIONS

	STARTING A BUSINESS
1.	Increase availability of—and access to—information about business-friendly policies, business development programs and resources, and basic market statistics to foster the development of new businesses and the growth of existing enterprises
2.	Promote an entrepreneurial culture and through education and business training to decrease unemployment and foster grassroots growth
	DEALING WITH LICENSES
1.	Develop short, simple, sector-specific guidance for MSMEs
2.	Conduct a nation-wide survey of the relative business-friendliness of each major local authority
3.	Engage in highly publicized, collective resistance to regulatory abuses
4.	Develop customer service programs for government agencies
5.	Monitor and support the regulatory reform strategy
	COMPETITION AND CONSUMER PROTECTION
1.	Review and revise the Act giving consideration to international recommended best practice and taking into account the specific needs of Kenya
2.	Implement a long-term capacity-building program for the Commission and the Tribunal
3.	Short-Term Training Programs
4.	Long-Term Resident Advisors
5.	Staff Exchanges with Foreign Competition Authorities
6.	Increase the transparency and predictability of the Commission and Tribunal
7.	Engage in a systematic educational campaign to sensitize stakeholders to the benefits of a well-conceived competition and consumer protection policies to consumers and to the economy as a whole
	EMPLOYING WORKERS
1.	Resolve outstanding disputes pertaining to the new regime of labor laws as soon as possible
2.	Integrate labor expertise into programs and policies pertaining to private sector development
3.	Launch a reform of the national social security system

	REGISTERING PROPERTY
1.	Update and harmonize laws affecting land rights
2.	Develop a national land use policy
3.	Engage in a public education campaign for the National Land Policy
4.	Reform the Nairobi City Council
5.	Collect and disseminate existing requirements
6.	Engage in public education
7.	Engage in counterfeit interdiction
	GETTING CREDIT
1.	Build the capacity of credit information resources
2.	Reform the collateral registry
3.	Reform courts to expand access to finance
4.	Address key issues pertaining to the Agricultural Finance Corporation
5.	Strengthen SACCO oversight and engage in scenario-based stress testing
6.	Promote mobile finance interoperability
7.	Support regional financial markets
	PROTECTING INVESTORS
1.	Enhance KACC's ability to fight corruption through preventative services
2.	Revise the Public Officers Ethics Act to increase transparency of public officer assets and better regulate conflicts of interest regarding public sector involvement in business
3.	Increase civil and criminal sanctions for fraudulent acts by company management and mismanagement of company assets, and increase ability to enforce such sanctions
4.	Work with Kenya Investment Authority to build its capacity for promoting investment in Kenya
	PAYING TAXES
1.	Enact past recommendations that remain unaddressed
2.	Strengthen the KRA through a number of policy initiatives

TRADING ACROSS BORDERS	
1.	Strengthen the KRA's Customs Modernization and Reform Program to streamline clearance processing at both the Mombasa port and the nearby Container Freight Stations
2.	Institutionalize risk management as a core business process within Customs
3.	Review the EAC Customs Management Act for compliance with the Revised Kyoto Convention and assist development of implementing regulations to accelerate harmonization of procedures and EAC adoption of international best practice
4.	Improve coordination between border agencies to streamline import/export processing
5.	Promote further professionalism of the clearance agents and promote partnership between clearance agents and Customs to improve compliance rates
6.	Strengthen the capacity of all government agencies involved in trade policy and trade facilitation
7.	Enhance market access for Kenyan goods
ENFORCING CONTRACTS	
1.	Establish independent budgetary authority for the judiciary
2.	Launch an anti-corruption initiative that directly addresses the Kenyan courts
3.	Increase efficiencies and reduce opportunities for rent-seeking and delay in court cases through specific, targeted reforms in court system
4.	Develop a bench-bar communication model

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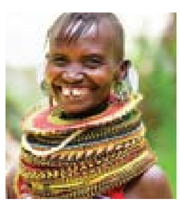
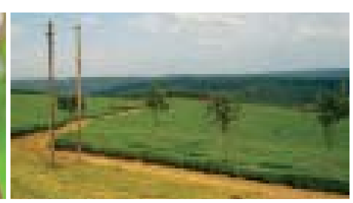
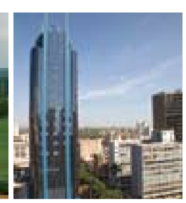


BIZCLIR Business Climate Legal & Institutional Reform

KENYA'S AGENDA FOR ACTION

JUNE 2009