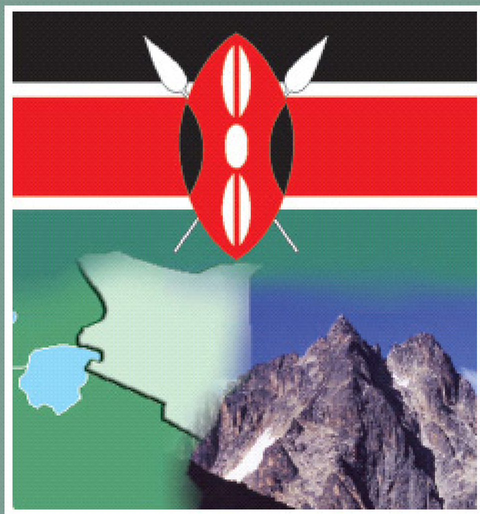
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

REPORT ON THE IMPLEMENTATION OF THE INVESTMENT POLICY REVIEW

KENYA



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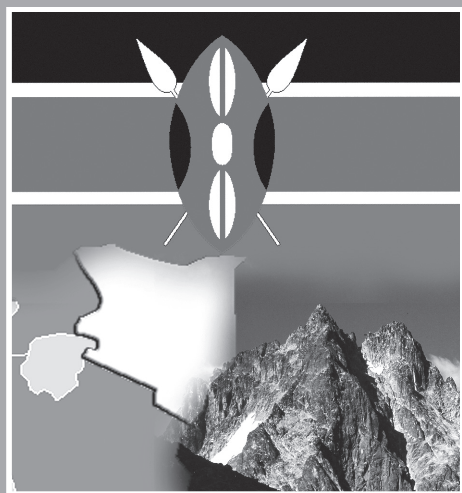

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ABBREVIATIONS

AGOA	African Growth and Opportunity Act
APRP	Annual Public Roads Programme
BIT	bilateral investment treaty
COMESA	Common Market for Eastern and Southern Africa
DTT	double taxation treaty
EAC	East African Community
EACC	Ethics and Anti-Corruption Commission
EPZ	export processing zone
EPZA	Export Processing Zones Authority
ERSWEC	Economic Recovery Strategy for Wealth and Employment Creation
FAA	Federal Aviation Administration
FDI	foreign direct investment
ICT	information and communication technology
ILO	International Labour Organization
ILRIS	Integrated Land Rent Information System
IPR	Investment Policy Review
KenInvest	Kenya Investment Authority
KEPSA	Kenya Private Sector Alliance
KAMA	Kenya Association of Manufacturers
KPA	Kenya Ports Authority
KRA	Kenya Revenue Authority
M&A	merger and acquisition
MRA	mutual recognition agreements
OECD	Organization for Economic Cooperation and Development
PPP	public–private partnership
RRI	Rapid Result Initiative
SEZ	special economic zone
SME	small- and medium-sized enterprise
SOE	State-owned enterprise
TEU	twenty-foot equivalent unit
VAT	value added tax

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1. CONTEXT AND MAIN FINDINGS

The UNCTAD Investment Policy Review (IPR) for Kenya was published in 2005. At the request of the Government, the assistance provided by UNCTAD under the IPR programme was aimed at improving investment policies and providing impetus to attract foreign direct investment (FDI) and achieve higher development gains from FDI. To this end, the report made recommendations to improve the investment framework. It also suggested a strategy to advance Kenya's role as a regional centre for manufacturing and services, and to promote its global competitiveness.

In 2011, the Government of Kenya requested that UNCTAD assess progress made in implementing the recommendations set out in the IPR. To this end, a mission was conducted in March 2012, the findings of which are detailed in this report.[1] The UNCTAD team consulted with relevant ministries, agencies and private stakeholders; and in particular the Kenya Investment Authority's research section. The remainder of this section provides some background information on Kenya's economic and social conditions and highlights the implementation status of the IPR recommendations.

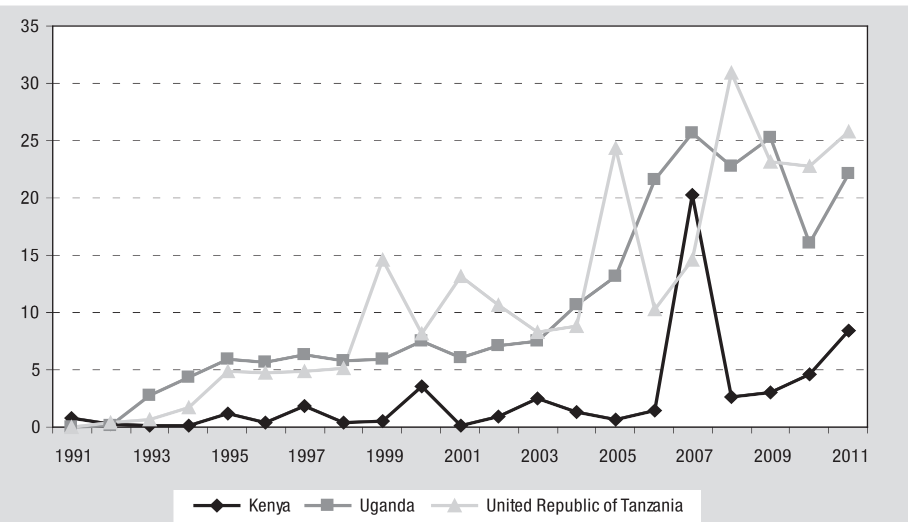
The Republic of Kenya encompasses a landmass of 586,650 square kilometres (8.1 per cent arable) on Africa's eastern coast. Its population was estimated at 43 million in 2012, with an annual growth rate of 2.4 per cent. Nairobi (3.1 million people) is the capital and is situated in the most densely populated region; it is also Kenya's main centre of commercial activity. According to the most recent census, Kenya's population is relatively young: 42.2 per cent is under 15, 51.1 per cent between 15 and 64 years and 2.7 per cent 65 or older. More than 40 per cent of Kenyans live below the poverty line, on less than $1.25 a day. The most vulnerable populations are families living in urban slums, in the arid lands of northern Kenya and in areas of the country worst affected by HIV. These are also areas with high child mortality and low school enrolment.

The performance of Kenya's overall economy has been mixed since 2005. The growth momentum was strong in 2005 through 2007, but a range of external and internal shocks interrupted its positive pace in 2008 shortly after a severe political crisis culminated in violent events in December 2007. In addition, the country suffered from a serious drought. As a result, GDP growth fell from a record high of 7 per cent in 2007 to 1.5 per cent in 2008. The global economic crisis further weakened the country's economy. To mitigate the impact of these shocks, the Government implemented several measures. It implemented the economic stimulus programme, by funding public projects in agriculture, services, infrastructure, health and education. The Government also supports economic activity by facilitating the private sector's access to affordable credit. These macroeconomic measures, together with a recovery in international markets and improved rainfall, supported economic recovery to 2.6 per cent in 2009 and 5.8 per cent in 2010. However, GDP growth slowed to 4.4 per cent in 2011 due to high international oil and food prices, depreciation of the Kenya shilling and high inflation.

Services, including banking, tourism, transport and communications, continue to be the largest contributors to GDP with an estimated share of 52.4 per cent in 2011. Agriculture is crucial to the overall socioeconomic performance, in terms of its contribution to GDP (22 per cent in 2011), foreign exchange earnings and livelihood to rural populations. However, traditional farming techniques and overreliance on rain-fed agriculture limit the sector's potential. Mining activities remain marginal in the economy. The manufacturing sector, which accounts for about 10 per cent of Kenya's GDP, faces the challenges of inadequate raw materials and high costs of production. A member of the East African Community (EAC) and the Common Market for Eastern and Southern Africa (COMESA) economic groupings, Kenya is generally considered to be the finance, trade and transport hub of East Africa. Its economy is the largest among the EAC countries, with 40 per cent of the region's GDP. However, the country is faced with the challenge of an inadequate transport infrastructure, as a result of which transport costs amount to 40–50 per cent of the total of production costs. Consequently, despite its relatively advanced level of development, Kenya had historically performed poorly in terms of FDI attraction, with inflows per capita being lower than in other East African Community's (EAC) countries (figure 1).

Against this challenging internal and external background, the authorities have embarked on an ambitious reform programme, guided by an overall development strategy — *Vision 2030.* The new Constitution adopted in 2010 and Vision 2030 are meant to provide a solid institutional and administrative framework in order to guide the country on the path to higher and sustained economic growth and social development.

Figure 1. FDI flows to Kenya and comparator economies, 1991–2011 (Dollars per capita)



Source: UNCTAD, FDI/TNC database.

Vision 2030 took on board many of the IPR recommendations and the authorities have started to implement it in a concerted and resolute manner. In this regard, most of the legal reforms suggested in the IPR have been adopted by the parliament or are in the process of being approved.

So far, the most notable progress has been achieved in areas such as competition policy, tax administration and labour legislation. For instance, further to the adoption of a modern Competition Act in 2011, Kenya is now the only other country of the EAC, with the United Republic of Tanzania, to have a competition authority. Likewise, the entire body of laws regulating labour conditions has been reviewed and aligned with modern practice and International Labour Organization (ILO) standards. Kenya has also made progress in the implementation of IPR recommendations in other areas.

- In terms of governance and institutions, initiatives have been taken to reduce discretionary powers and improve the delivery of public services. Positive examples include the introduction of clear guidelines and rules in the areas of taxation, land and immigration, as well as the establishment of performance contracts for public administration. These are already resulting in efficiency gains.

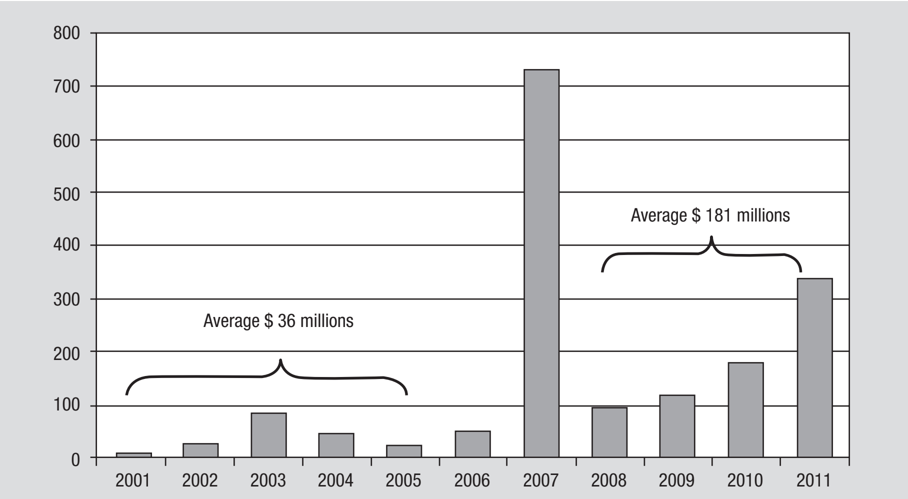
- The strengthening of human capital has been among the priorities of the Government over the past years. In this respect, efforts have been made to improve vocational training and to provide students at different levels of education with the skills required by the economy. The process to permit foreign work remains a bottleneck to attracting foreign talent.

- The implementation record to enhance infrastructure is mixed. The information and communication technology (ICT) sector has improved due notably to increased private sector involvement, whereas energy costs and ports congestion have remained top concerns for investors. Likewise, road infrastructure has improved but progress has been slow.

- Mixed results were also observed in areas related to FDI attraction and promotion. Whereas the Investment Promotion Act was amended to reflect the country's openness to FDI, the diversification of FDI activities in EPZs was the only pillar of the strategic agenda proposed in the IPR which was fully implemented. Efforts to attract FDI in manufacturing, services and agro-processing have been limited and institutional weaknesses related to investment promotion still need to be addressed.

Notwithstanding the challenges that Kenya still faces, the reform effort has started to pay in recent years. The country has been experiencing an increase in FDI inflows since 2006 (figure 2). The 2007 upsurge in FDI flows, which amounted to $729 million was attributed to the two largest FDI deals in the country's history, namely, the coming of a new mobile telephone operator and the privatization of Telkom Kenya.[2]

Figure 2. Annual FDI flows to Kenya, 2001–2011 (Millions of dollars)



Source: UNCTAD, FDI/TNC database.

FDI impact data further indicate that job creation by foreign companies has also been increasing (table 1). These positive results, achieved despite the recent economic and political challenges, are illustrative of the large and yet unexplored potential for FDI attraction to Kenya.

Table 1. Number of FDI projects and related employment, 2007–2011

Year	Number of projects	Employment (in thousands)	Number of employees per project
2007	55	2,847	51.8
2008	73	4,341	59.5
2009	121	37,045	306.2
2010	129	15,753	122.1
2011	145	13,289	91.6

Source: KenInvest, April 2012.
Note: Data only include projects processed by KenInvest.

Kenya is also actively involved in making cross-border investment in Africa (table 2). The main investments from Kenya have been in the banking sector, retail stores, the cement industry and marketing. EAC countries are the main destinations for Kenyan investments. A Kenyan oil marketing company, Kenol Kobil, has established a presence in the Democratic Republic of Congo, Mozambique and Zambia. Wholesale and retail supermarket chains (Nakumatt and Uchumi) have opened stores in East Africa; while in banking, two leading commercial banks, i.e. Equity Bank and Kenya Commercial Bank (KCB), are present in East Africa and in South Sudan.

Table 2: Inward and outward FDI in Kenya, 2006–2011 (Millions of dollars)

Type	2006	2007	2008	2009	2010	2011
Stocks						
Inward	1,164	1,893	1,989	2,129	2,262	2, 618
Outward	163	199	243	289	306	
Flows						
Inflows	51	729	96	141	133	335
Outflows	24	36	44	46	18	9

Source: UNCTAD, FDI/TNC database.

2. FDI-SPECIFIC REGULATORY FRAMEWORK

In 2004, while the IPR was being conducted, the Government adopted the Investment Promotion Act, which included a new minimum capital requirement of $500,000 and required foreign investors to apply for a certificate of investment. The new requirement ran counter to the Government's objective to increase the attractiveness of Kenya as a destination for FDI. Thus, the IPR recommended that the Act be amended to exempt investors not applying for incentives from the investment certificate requirement. It also recommended that the minimum capital requirement for receiving a certificate be lowered to $100,000, to avoid discouraging small and potentially beneficial investments. The Government reacted quickly and enacted an amendment in line with the IPR's recommendations.

Regarding specific measures for FDI attraction, as per the IPR's recommendation, Kenya extended its network of international investment agreements, including with some key FDI source countries. The new bilateral investment treaties (BITs) include agreements with Switzerland (2006), France (2007), Libya (2007), Finland (2008), Burundi (2009), the Islamic Republic of Iran (2009) and Slovakia (2011). Among them, only the BIT with Switzerland has come into force. Kenya is also a member of the Multilateral Investment Guarantee Agency (MIGA) and the African Trade Insurance Agency (ATIA), which guarantees investors against non-commercial risks, and the International Centre for Settlement of Investment Disputes (ICSID).

3. GENERAL REGULATORY FRAMEWORK

The IPR concluded that in order to attract more FDI in support of economic diversification and social development, the Government needed to modernize the regulatory framework for investment in several areas. The IPR made concrete recommendations to improve the overall investment climate in the areas of taxation, competition, governance, human capital and infrastructure. In what follows, the overarching legal and institutional environment of investment is briefly highlighted. Progress in each thematic area is then reviewed.

Constitutional and institutional frameworks

The IPR recognized that a significant modernization of the investment framework would be a lengthy process and recommended that, initially, focus be placed on making the existing body of laws work more effectively. As highlighted below, the pace of implementation of IPR recommendations across the different thematic areas of the business environment has been varied. Furthermore, the new Constitution adopted in 2010 has implications on the legal and administrative framework. The Constitution introduces a two-tier legal and administrative framework, namely national and county levels, a new public finance system and an expanded concept of human rights. A Constitutional Implementation Oversight Committee and a Commission for the Implementation of the Constitution have been created to oversee its full application within a five-year period. While the implementation of the Constitution constitutes the top priority of the Government, Kenyan authorities also recognize the need for modernization of the laws mentioned in the IPR. Many of them are indeed undergoing extensive review in order to ensure they conform to the Constitution and are in line with *Vision 2030*.

Kenya's institutional and legislative framework governing investment is still to be found in the Investment Promotion Act (IPA) of 2004. The Act aims at promotion and facilitation of investment by assisting investors in obtaining the licences necessary to invest, and providing other assistance and incentives for related purposes. Investment policy and most investment related institutions in Kenya including Kenya Investment Authority (thereafter the Authority), the agency responsible for promotion and facilitation of both local and foreign investments in Kenya, remain under the oversight of the Ministry of Finance.

The Authority issues an investment certificate, which allows the holder a legal entitlement to certain licences. A certificate holder is also entitled to three entry work permits for management and technical staff, as well as three others for owners, shareholders, partners and dependants. Both are for an initial, but renewable, two-year period. Capital repatriation and remittance of dividends and interests are guaranteed to foreign investors under the IPA.

Other conditions that may be considered include whether such investment will achieve any of the following: technology transfer; increase in foreign exchange, either through exports or import substitution; use of domestic raw materials, supplies and services; value addition in the processing of local, natural and agricultural resources; and the utilization, promotion, development and implementation of ICT and any other factors the Authority considers beneficial to Kenya.

Important regulatory institutions on investment in Kenya include the Central Bank of Kenya (CBK), which provides, inter alia, opportunities for investment in treasury bills and bonds; the Export Processing Zones Authority (EPZA), which provides investors with tax incentives, a facilitating operating environment and good physical infrastructure; the Capital Markets Authority (CMA) on regulation of portfolio investments; and the Nairobi Securities Exchange (NSE) for securities trading and listed companies. Other key institutions are the National Environment Management Authority for environmental certification and audit and the Communications Commission of Kenya on regulation of investments in the ICT sector. Ideally, regulatory authorities in any sector of the economy serve to ensure adherence to the existing laws and regulations. Investments that may have adverse effect on health and security are subject to scrutiny before approvals are granted.

Taxation

The IPR found Kenya's tax regime to be generally appropriate and competitive with the exception of a few issues to be addressed. One of them was the double taxation on profits or income from operations within the region. Several tax measures were recommended: (1) extending the network of double taxation treaties (DTTs) and providing unilateral foreign tax credit in the absence of a DTT; (2) lowering withholding taxes on service fees in regional DTTs; (3) extending investment deductions available on fixed assets in manufacturing to services; (4) lowering the corporate tax rate on foreign source income; and (5) reducing the 5 per cent withholding tax on agency fees to 1–2 per cent of invoice value. With the exceptions of two new DTTs signed with France (2007) and South Africa (2010) and the increase of the withholding tax on services from 5 to 10 per cent, these recommendations were not implemented. The increase in the withholding tax on services was in response to an inordinate amount of people registering as consultants for tax evasion purposes.

The IPR also made recommendations with regards to the administration of the value added tax (VAT), tax concessions and transfer pricing rules. The Government has made progress in these areas, and sometimes has even surpassed expectations.

The IPR identified the inefficiency of the tax administration in the areas of VAT refunds, duty drawbacks and clearance times as being one of the most recurrent complaints by investors in Kenya. In order to address these issues, the IPR recommended that clear performance benchmarks be established and enforced for the Kenya Revenue Authority (KRA). This recommendation was fully taken on board as part of an overall performance contract programme introduced by the Government (section 4.2). Furthermore, the KRA is also in the process of automating and modernizing the tax system for users. Tax registration and returns can thus be handled online. There is an internal compliance interface to speed analysis and audits, and the customs system is being automated.

The problem of VAT delays is linked to the system for assessing refunds and transferring payments between the Ministry of Finance and the KRA. Often the KRA runs short of funds to repay VAT. In order to address such shortcomings, the VAT law is being amended. The new law will define a much shorter list of exemptions (400 in the existing law) and will contain performance benchmarks, including for refunds, which are to be provided within 60 days. In doing so, and in line with the IPR recommendation, the new bill seeks to improve administration and compliance and minimize revenue losses linked to exemptions. The VAT withholding regime was also stopped as of 2012.

VAT is levied on all imported or locally produced goods and services. A standard rate of 16 per cent applies to most goods and services, and a reduced rate of 14 per cent to certain services, in particular hotels and restaurants. In 2008, the rate on electricity was reduced to 12 per cent under the fifth Schedule (Section 8) of the VAT. A zero rate applies to exported goods and services, imports and purchases by designated persons or organizations (e.g. the President, armed forces, commonwealth and other Governments, diplomatic and aid agencies), all goods and taxable services destined for the export processing zones (EPZs), and many essential goods such as certain milk products, sugar, maize and medicines.

The base for the VAT, in case of local supplies, is the sale price. For imports, the taxable value is the customs value plus the amount of customs duties, whether or not a remission of the duty has been granted. As part of the on-going reform efforts, KRA has embarked on an extensive audit of VAT taxpayers.

Following the recommendation of the IPR to increase the clarity of transfer pricing rules, the Government introduced in 2006 a system called the Income Tax (Transfer Pricing) Rules. As recommended in the IPR, these rules provide for the adoption of the methods of the Organization for Economic Cooperation and Development (OECD) (in effect a codification of methods used by transnational corporations (TNCs) in the absence of specific regulations) for determining transfer pricing. Rule 4 allows the taxpayer to choose from six methods of arm's length pricing: (1) comparable uncontrolled price method; (2) resale price method; (3) cost price method; (4) profit split method; (5) transactional net margin method; or (6) such other method as the Commissioner for Domestic Taxes may prescribe.

With regards to duty waiver, the fifth schedule of the East Africa Community Customs Management Act (EACCMA) provides the list of goods exempted from duties, when imported to Kenya. It includes goods imported or purchased before clearance through the customs, by or on behalf of public bodies, and privileged persons and institutions. The Eighth Schedule of the EACCMA is the main legal basis for export prohibitions and restrictions. In 2010, through a gazette notice, the EAC Council of Ministers restricted the exports of used automobile batteries, lead scrap, crude and refined lead, and all other forms of scrap metals to support the region's demand for metals.

In the interest of the national economy, the Minister of Finance may waive import duties and value added tax by order in the *Kenya Gazette.* Remissions, rebates and refunds of import duties are also available, under export incentive schemes, on raw materials, capital equipment, machinery and other components used in the manufacture and packing of goods destined for export. Goods in transit are exempt from customs duties. Kenya does not grant any export subsidy. However, three incentives schemes are available to Kenyan companies to encourage export-oriented activities: the EPZ Scheme, the Manufacturing under Bond Scheme and the Duty Remission Scheme. Moreover, as mentioned above, exports are zero-rated for VAT refund purposes.

According to authorities, EPZs in Kenya are in the process of being transformed into Special Economic Zones. The SEZ programme would cover a wider scope and provide diverse incentives to various eligible schemes which will include EPZs.

Competition

The IPR found that, although the Restrictive Trade Practices, Monopolies and Price Control Act, 1989, (RTPT Act) had a measure of success, the RTPT Act had numerous shortcomings, inter alia, that the process for enforcement was convoluted; no clear abuse of dominance provisions; merger thresholds and time frames were not provided; there was no separation of the three functions of competition regulation; and practices of bodies created by an Act of parliament that had express provisions that were anticompetitive in nature, were exempt from the Act, notably electricity and telecommunications. Prior to the enactment of the Competition Act 2009, Kenya's Restrictive Trade Practices Act specifically exempted from its scope commercial activities associated with exclusive trading privileges recognized by law, such as parastatals. Under the new Competition framework, State Corporations are governed by the Competition Act 2009, insofar as they engage in trade.

Taking into account the need to modernize the competition regime as advocated by the IPR, in August 2011, a new Competition Act replaced the 1989 Law. The new Act puts in place a new competition framework which aims to foster a well-functioning competitive environment, provide consumer protection, and establish and define the role of the Competition Authority and the Competition Tribunal. Following good practice, the new framework introduces a separation between policymaking and enforcement, which is now the responsibility of a Board within the Ministry of Finance. The final approval of mergers and acquisitions (M&A) rests with the Competition Authority, which also has the power to set the relevant thresholds.

Within its mandate to harmonize competition policy across different sectors, the Authority can investigate previously exempt sectors such as insurance, energy and banking. This should address the confusion caused by the overlapping mandate of sector regulators in the area.

Under the new process, the Director General analyses proposed M&As and provides the analysis reports to the Board (comprising of a non-executive chairperson, five independent members, three institutional representatives and Director General, who is an ex official member of the Board but with no right to vote at any Board meeting), which makes the final determination. Investors who are dissatisfied with the rulings can appeal to the Competition Tribunal. If the investor is still dissatisfied, then the case can be sent to the High Court. Deadlines have been introduced at each stage of the process to ensure that cases are heard in a timely manner.

The Act prioritizes enforcement in sectors that have a high impact on vulnerable members of society such as food, energy and infrastructure development.

To complement the changes introduced with the new law, the Competition Authority is also drafting additional regulations and guidelines, including exemptions such as for the cooperative efforts of small and medium-sized enterprises (SME) to enter certain markets. It is also developing a model for intellectual property rights and relevant subsidiary legislation.

The Kenya Competition Authority is one of the success stories of the past years. Much of the success is due to competition regulation being firmly established in the economic development agenda. Furthermore, Kenya is leading the way in competition policy in the EAC, being the only member, with the United Republic of Tanzania, that has a competition authority. With respect to regional initiatives, the EAC Competition Act (2006), as yet not in force, is under revision to take into account the addition of Burundi and Rwanda. On the other hand, COMESA, of which Kenya is also a member, is working on a toolkit to help members operationalize their competition law in line with harmonization efforts.

Business legislation

The IPR found the Companies Acts to be outdated, as it fails to take into account modern business practices. For example, it imposes strict rules regarding company seal and procedures for company meetings. The IPR recommended that the act be replaced with more modern legislation. In line with this recommendation, a new Companies Bill is now awaiting parliamentary approval.

The draft Companies Bill, which embraces the use of new technologies and EAC integration, will simplify company formation. Under the proposed amendments, one person can form a company, whereas in the current Act, at least two members are required (50 members for a public company). Another amendment would simplify the memorandum of association and provide model articles of association, which can be adopted wholly or with amendments. The new Bill also allows for information to be disseminated electronically and through websites, thus replacing paper distribution.

In the area of business licensing, which has constituted a major issue for investors for some time, due to the proliferation of licences largely aimed at generating revenue, the IPR recommended to eliminate licences that are not indispensable for health protection, protection of consumers' and workers' interests, the protection of the environment and safety. This would be paired with an initiative to simplify the remaining licences and ensure there is a clear rationale for their continuance.

The Government adhered to these recommendations and began the process of licensing reform in 2005 by creating a Working Committee on Business Licences. The Committee conducted a comprehensive review of the licensing scheme in Kenya and identified 1,325 licences.[3] Headway has been made in this regard through the Licensing Laws (Repeals and Amendments) Act, 2006, which repealed the Trade Licensing Act. Other positive legislative change came through Licensing Laws (Repeals and Amendments) Bill, 2007, which provided for further elimination of licences. The Business Regulatory Reform Unit was also created in 2006, under the Ministry of Finance, to carry out the recommendations of the Committee. As a consequence, the Government has eliminated 315 business licences, simplified 379 and retained 294. Effectively, 24 per cent of licences have been eliminated.

The IPR also advocated for the need to publish clear guidelines on obtaining licences as well as to enhance communication and coordination between licensing agencies. Substantial progress was made on the former but none on the latter. One of the key activities of the

Business Regulatory Reform Unit is the development of an online repository of all business licences in Kenya. The intent of the online system is to put all information regarding licensing and registration necessary for investors in one location. Ultimately, a Business Regulations Act, which is before parliament, will deem any licence not listed on the e-Registry as illegal and unenforceable.

In the area of controls and inspections, the IPR recommended to establish random and targeted inspections. There is evidence that inspections are being carried out, but it is not clear whether they are targeted or systematic. In addition, a recurrent complaint of investors is the continual, overlapping visits by Government agencies, costing investors an inordinate amount of time.

Land

Historically, land access has posed a challenge to foreign investors interested in locating in Kenya. With over 100 land laws regarding ownership, authority and regulation, it is extremely difficult territory to navigate. The IPR recommended replacing the Government Lands Act, the Land Control Act and related laws in order to simplify and bring clarity to land access.

In line with the IPR recommendations, a 2009 Land Policy, which called for repealing certain land laws and harmonizing others, was passed by parliament. In February 2012, a new Land Bill was put before parliament and has been approved. The primary purpose of the new Land Act is to provide one reference document for land. The new Bill has given way to the creation of a National Land Commission, which will manage public land on behalf of national and county authorities. It will evaluate all parcels of public land for capability and classify them by potential use. The Commission will also be mandated with developing guidelines for public land management by all public agencies and will be responsible for allocating land. The regulations detailing allocation criteria, however, have not yet been published.

Following an IPR recommendation, the Commission is charged with setting aside land for investment, which will benefit local communities and their economies.[4] If land is not already set aside for investment, then the process can take a minimum of one month (a 30-day notice to county governor and interested parties and a three-week period for gazetting).

One aspect of land commented on in the IPR was the poor state of land records, the absence of computerization and, consequently, title insecurity. As part of the overhaul of land management, an initiative is underway to digitize all land registration.

There is also progress in other areas. Currently, the Land Ministry is working on the Integrated Land Rent Information System (ILRIS). Approximately 25 per cent of national and 90 per cent of Nairobi land rents have been computerized. The ILRIS system was developed in-house and designed with the new Commission in mind. This important project and the upcoming initiative for land registration are however facing challenges such as poor record storage, a shortage of skilled ICT personnel and continued funding needs.

Labour and foreign work permits

Although the IPR considered the labour laws to be sound, it encouraged the Government to pass new legislation that would introduce modern mechanisms for the resolution of labour disputes and suggested that minimum wages would be better set on the basis of broad sectoral activities rather than under a nearly exhaustive list of occupations.

Kenya has since worked to adopt the principles of the ILO Declaration of Rights and Principles at Work. After an extensive review, the six laws governing labour were repealed and replaced by five new Acts: (1) the Employment Act, 2007; (2) the Labour Relations Act, 2007; (3) the Occupational Safety and Health Act, 2007; (4) the Work Injury Benefits Act, 2007; and (5) the Labour Institutions Act, 2007.[5]

The new legislation created a Labour Board, an organization comprised of employer representatives, worker representatives, Government representatives and independent members nominated by the Minister for Labour with the Labour Commissioner acting as the Secretary of the Board. The role of the Board is to advise the Minister on a wide range of issues related to employment and labour, including among others legislation, labour relations and inspection issues. The new legislation also provides a more open environment for unions and improved minimum terms and conditions for workers (e.g. 21 days of annual leave and three months maternity leave). An effort is also under way to harmonize EAC labour laws and further integrate the role of the labour market within the context of *Vision 2030*.

In terms of reducing the complexity in the minimum wages regime, the recommendation of the IPR has not yet been taken on board and over 75 different minimum wages are set for individual professions and functions.

The IPR also stressed that foreign work permits were particularly problematic to obtain for investors wishing to access skills not available locally. The Investment Promotion Act, 2004, currently provides an allowance for six key personnel but the Minister of Immigration is required to sign each permit approval and there are no published procedures and criteria for approval. Overlapping and inconsistent regulations contribute to making the process cumbersome. For example, foreigners are not allowed to open a bank account without a work permit but they are allowed to get a work permit without a bank account. As a result, over 50 per cent of investor facilitation revolves around foreign work permits.

The IPR recommended implementing a sliding scale for foreign work permits whereby the greater the investment the more key positions would be allowed. Next, the IPR recommended moving away from the labour-market test approach and adopting a more selective approach to facilitate employment of foreign talents. This included fast-tracking foreign work permits for key positions, introducing a predesignated set of positions open for foreign hire without labour market testing and reviewing measures to attract highly skilled overseas Kenyans. Lastly, the IPR recommended that requiring investors to spend some minimum amount proportional to turnover on training of employees would have proved a more effective skills development policy than the rigid understudy programme in place.

In meeting some of the above IPR recommendations, the Government of Kenya has established the Kenya Citizens and Foreign Nationals and Management Service, a State Corporation established under an Act of Parliament of 2011 to take over the core functions of the Ministry of State for Immigration and Registration of Persons. The Kenya Citizenship and Immigration regulation 2012 is now operational. Under the new Act and regulations, the Minister will no longer be required to sign each permit which should be issued within one to two business days.

The Management Service brings under its ambit all services undertaken by Department of Immigration, National Registration Bureau, Civil Registration Department, Department of Refugee Affairs and the Department of Integrated Population Registration Services.

The functions and mandate of the Service include the development of policies and laws on matters relating to citizenship, border control, foreign nationals, immigration, registration of births and deaths, the identification and registration of persons and the creation and maintenance of a comprehensive national population register.

Privatization

The IPR strongly recommended that the Government enact the Privatization Bill and accompanying regulations with particular attention to assets in infrastructure and banking. The urgency expressed in the IPR was the result of slow progress in an area with high potential to attract FDI that would deliver development benefits to the country.

Under the Economic Recovery Strategy for Wealth and Employment Creation (ERSWEC) 2003–2007, the Government successfully completed the privatization of the following companies: Kenya Electricity Generating Company (KenGen) in 2006 (initial public offering for 30 per cent of the company); a concession of the Kenya Railways operations; Mumias Sugar Company; Kenya Reinsurance Corporation (51 per cent); Telkom Kenya (49 per cent); and the recently completed Safaricom initial public offering. This privatization round brought in just under $100 million (Kenya Privatization Commission, 2012).

The Privatization Act was adopted in 2005 and finally put into practice in January 2008. For 2008–2009, the newly established Privatization Commission identified 26 assets to be privatized and created detailed proposals for 16 of them. The proposals are still awaiting parliamentary approval. These include among others the Development Bank of Kenya, the National Bank of Kenya, the Consolidated Bank of Kenya, the Agro-Chemical and Food Company, Kenya Pipeline, New Kenya Cooperative Creameries, Kenya Electricity Generating Company and the ports. The port initiative has been put on hold as a result of stiff opposition from the Dock Workers Union. The Privatization Commission stopped its activities in 2010 for a year and a half due to legislative backlog in enacting the new Constitution. The Commission has recently been reinstated and is now operational. Due diligence and restructuring plans are ready for several parastatals so that privatization can move forward quickly.

The Privatization Commission is mandated to formulate, manage and implement the country's privatization programme. A number of legal and institutional structures established under the Act constitute a major reform in the governance of the country's privatization programme.

Mining

The IPR found that outdated legislation is at the top of the list of challenges for investors in the mining sector. Companies are operating under a law dating back to the 1940s. Although the Mining Act Chapter 306 has been revised on two occasions –1972 and 1987 – it fails to reflect current circumstances. In particular, the law's lack of clarity around mineral rights has led to conflict and clogged courts with disputes; vague royalty regulations have created fertile ground for corruption; and non-transferable licences have made exploration challenging. Change was therefore in order. To this end, the IPR recommended to adopt new mining legislation.

In line with this recommendation, in December 2011 the Government, working with the Kenya Chamber of Mines, drafted and put before Parliament a new Mining and Minerals Bill with expectations that it would be passed and operational by the end of 2012. The Act would establish four agencies to oversee the regulation of the mining industry and provide guidelines on how royalties from the industry would be distributed. The royalties would be managed through a fixed policy where fees and royalties are calculated using a formula differentiated by mineral. The Act would also allow four-year, transferable prospecting licences with seven-year renewal.

Although the legislation is still pending, there have been some recent investments in the mining sector. In November 2011, Tata Chemicals Magadi (TCML), Kenya's largest export manufacturing facility and top producer of soda ash[6], opened a new $100 million plant. A recent $250 million investment by Base Titanium is expected to employ 350 Kenyans, once the mine is operational in mid-2013, and 1,000 people in the construction of a related dam and dam facilities.[7] The recent discovery of oil in Kenya by the United Kingdom-based Tullow Oil is also expected to generate investor interest in the sector.

4. GOVERNANCE AND INSTITUTIONS

In parallel with improving and modernizing the legal investment framework, the IPR highlighted the lack of consistency in implementing official plans and programmes. It thus recommended to increase monitoring and accountability for all agencies of the public administration. The IPR also called to improve public governance by following the three guidelines of transparency, efficiency and predictability.

4.1. Policy implementation and coordination

The IPR recommended that the National Investment Council draw up a shortlist of priority policy actions. Furthermore, it recommended that the role of the Kenya Investment Authority (KenInvest) to coordinate and monitor the priorities be significantly expanded and strengthened. No noticeable progress has been achieved in these areas.

The Government has launched across several Government agencies the Rapid Results Initiative (RRI), which aims to increase the pace of implementation of the new Constitution and *Vision 2030*. Headed by the Public Service Transformation Department, under the Office of the Prime Minister, the RRI provides high visibility for an agency's success or failure. An agency is given 100 days to adopt clear and measurable goals. KenInvest has recently launched its RRI with the following goals:

- Improvement of the investment climate;
- Creation of awareness on investment opportunities in Kenya;
- Modernization of handling of enquiries and registry system;
- Implementation of the Digital One-Stop Shop.

These goals are in line with IPR recommendations.

4.2. Transparency, efficiency and predictability

When the IPR was drafted, many of the laws granted significant discretionary powers to their administrators, which created some uncertainty among investors in their dealings with Government agencies. Recognizing the time-consuming process of revising laws, the IPR recommended that the Government agencies publish guidelines and decision-making criteria on current policies and regulations. The adoption of IPR recommendations in this area is mixed. For example, no guidelines for land acquisition have been published while on the other hand the tax system is now online and key issues such as transfer pricing and delayed VAT withholding refunds have been addressed. Foreign work permit processing continues to be in disarray with overlapping and sometimes contradictory regulations, while the adoption of performance contracts across all Government agencies has exceeded the IPR recommendation.

Performance contracts

The IPR recommended that the country establish and enforce clear performance contracts. The contracts should include international benchmarking and short- and medium-term targets for public sector companies, such as airports, ports, railways and utilities.

Performance contracts were first introduced in 1991 but it was in 2004, as part of the economic recovery strategy (ERSWEC) 2003–2007 initiative, that they started to be fully integrated into the public sector. The Kenyan Performance Contract System is somewhat unique. Unlike in most developing countries, the Kenyan system applies to all Government departments and agencies, as well as municipalities and not only to State-owned enterprises (SOEs).[8]

The system is also distinguished by the amount of political support it receives. When the first results became available in 2006, President Kibaki announced publicly the top and worst performers, which has played a big role in the system's success. Lastly, evaluation is performed by independent reviewers comprised of ex-permanent secretaries, academicians, ex-senior executives of SOEs and other private sector experts. Objectivity and neutrality are the final elements which have made performance contracts and the subsequent scores a respected performance assessment tool. In this regard, the implementation of the IPR recommendation surpassed expectations.

Corruption

Article 79 of the new Constitution addresses corruption directly. The Ethics and Corruption Act of 2011 operationalizes the Article and creates the Ethics and Anti-Corruption Commission (EACC). The EACC focuses on enforcement and public education. Prosecution has been made independent from the directorate and occurs under the Office of Public Prosecution. An Efficiency Monitoring Unit was also created in the Office of the President to advise the Government on actions to be taken to further improve the system. In addition, the role of the Attorney General, formerly the Deputy Public Prosecutor, has been redefined so that the office only handles civil matters. Lastly, a Committee on Administrative Justice has been formed which handles complaints against public officers and has quasi-judicial powers.

Other legislation includes the Crime and Money Laundering Act of 2007, which creates a legal framework to combat money laundering and for managing recovered proceeds; and the Public Procurement and Disposal Act, introduced in 2011, which reduces the scope for discrepancy and provides for various checks and balances to ensure transparency in the procurement process.

Commercial justice

Kenya has worked to improve its justice system over the last few years. In an attempt to reduce the caseload on courts, several special courts have been created. The Industrial Courts Act (2011) created a division of the high court to deal with commercial matters only. Land and environment also have separate courts to deal with the respective cases. Furthermore, the Judicature Amendment Bill (2011) proposed to increase the number of judges of the Court of Appeal from 12 to 30 and the number of judges of the High Court from 70 to 150, with the majority of the positions located in commercial justice. Another effort to reduce court loads is the alternative dispute resolution process, which has been put in place but is not being used to its full extent. There remain some reservations about using the process and the ability to have a case resolved satisfactorily.

Finally, a training programme, developed in cooperation with the World Bank and the Kenya School of Law, has been put in place for all judges. Due to the recent introduction of these initiatives, their impact has yet to be captured by international rankings on commercial justice.

5. HUMAN CAPITAL AND INFRASTRUCTURE

5.1. Education

Kenya is known among investors for the high quality of its human capital. The IPR recognized this comparative advantage and recommended sustained dialogue with the private sector to ensure that the education system continued to produce workers with the skill sets that are in high demand.

In this regard, the Government, in conjunction with a national manpower survey, is in the process of formulating a national employment programme that will focus on skills transfer and youth employment. Another effort under way is the improvement of the Technology Development Centre, formerly the Vocational Training Centre. The Ministry of Labour is also ramping up exchange programmes between FDI and local firms. Dialogue also occurs through quarterly round tables chaired by the Prime Minister and gathering representatives from the private sector and related Government agencies.

5.2. Infrastructure

The IPR focused on four aspects of rebuilding infrastructure: (1) benchmarking services against South Africa, (2) surveying investors on pressing needs, (3) establishing targets against South Africa benchmarks and investor priorities, and (4) where there is a competitive environment, involving private sector. The IPR also made a number of specific recommendations in the areas of ports, airports, energy and ICT.

Regarding service and cost levels, no benchmarking has been completed against South Africa per se. It is well known, however, that the costs of services in Kenya are high compared to countries in the region and to South Africa and reports have been compiled to that effect. As recommended by the IPR, there have also been several surveys of investors, all of which indicate that infrastructure (roads and rails) and investments in energy sector are a top priority if the Kenyan economy has to achieve sustained growth. The social welfare of the people, being a key pillar under *Vision 2030*, should also be supported by increased investments in infrastructure, health, recreation and educational services. Investments in the expansion of ports services and trade facilitation measures, i.e. customs clearance and the elimination of trade restrictive factors such as non-tariff barriers, are a priority. For the most part, there has been limited involvement of the private sector in the development of infrastructure. Substantial involvement in rebuilding infrastructure is being impeded by the lack of a PPP policy and by the temporary suspension of the privatization process mentioned earlier.

Ports. Port congestion in Kenya is a top concern for some investors, in particular tea growers and investors in manufacturing. The port is overburdened in part because of trade and economic growth in the region and also because of diversions from the Dar es Salaam port in the United Republic of Tanzania, which is suffering from congestion as well. The Mombasa port is designed to accept 600,000 twenty-foot equivalent units (TEUs) but it is handling nearly 800,000 TEUs. Power surges and outages affecting computers and equipment contribute to slowing down operations. The Ports Authority estimates that six hours per day are lost to power fluctuations.

In order to respond to these concerns, the IPR recommended fostering a more competitive environment to enhance the quality and cost of services of the Kenya Ports Authority (KPA) by allowing greater private sector participation. Following the IPR, the Government should turn the KPA into a landlord port authority with user services to be provided by private operators in a competitive environment. Up to the writing of this report, the legislative and regulatory aspect of Kenya’s ports has been neglected. However, efforts to improve port operations are under way. They include increasing the depth, width and capacity of the Mombasa Port and upgrading the port power supply by early 2013.

Furthermore, the Government has embarked on new projects. The Lamu Port – South Sudan – Ethiopia Transport Corridor Project (LAPSSET) was commissioned in March 2012. Crucial for the Kenya *Vision 2030* flagship project, LAPSSET forms Kenya’s second Transport and Economic development corridor that is much wider than the Port and is expected to transform regional economies through increased trade, integration and interconnectivity spanning South Sudan and Ethiopia with a first time land bridge across the middle of Africa from Lamu, all the way to Doula, Cameroon on the coast of the Atlantic Ocean.

The Government has formed a Central Coordinating Committee, based at the Office of the Prime Minister, to plan and manage the LAPSSET project implementation modalities. To kick off the grand project, the construction of the initial three berths of the planned thirty-two berths at the modern port of Lamu has recently been launched. The port will be three times the size of the current Mombasa port at the more sheltered Manda Bay that is also large and deep enough to accommodate “Post Panamax” vessels. The three berths are designed to handle 30,000 Dead Weight Tonnage (DWT) and 100,000 DWT for general and bulk and container cargo respectively. The development of the berths is crucial for the importation of building materials for the other project components.

Airports. The Jomo Kenyatta International Airport (JKIA) in Nairobi was built in the 1960s and had undergone little modernization since. In 2006, a $141 million airport expansion project was launched to add a new terminal and separate arrivals and departures (a primary security concern blocking certification by the United States Federal Aviation Authority). As of March 2012, construction was still under way.

The upgrading of the current facilities and the construction of the new Unit 4 at JKIA is on track and expected to be completed on schedule in 2013.The upgrade of the current JKIA facilities is part of the mandate of Kenya Airports Authority to modernize and expand both JKIA and Moi International Airports as a key *Vision 2030* delivery. The upgrade is expected to boost Nairobi’s position as the communication and financial hub of East and Central Africa region. Once the project is complete, it will enhance the airport’s capacity to handle the growing volume of passengers who use the airport each year. It will handle both domestic and international flights and allow JKIA to handle nine million passengers, up from the current six million passengers. In line with the IPR recommendation, the Government has also asked for an FAA certification that would enable the establishment of direct flights between Kenya and the United States of America.

Roads. Although many trunk roads are considered in fairly good condition, primary and secondary highways as well as rural roads are largely not paved. This is particularly problematic for agri-businesses such as tea growers and horticulturalists. In 2007, a Roads Bill was passed which created several authorities to coordinate the rehabilitation and maintenance of the road network. An Annual Public Roads Programme (APRP) was also introduced to bring roads planning in line with the *Vision 2030*. According to the 2011/2012 Annual Report, nearly $8 billion are required for development, rehabilitation and reconstruction over the course of the 2010–2014 Road Sector Investment Plan. The APRP estimates that, during the 2011/2012 fiscal period, the Board will be able to mobilize $1.2 billion through transit tolls, road maintenance levies and Government budget allocation.

Energy. Energy has been the other primary infrastructure problem in Kenya and the energy sector's high tariffs continue to challenge investors, particularly in the manufacturing sectors. The IPR recommended that the Government move forward with separating the transmission and distribution activities. In addition, it recommended allowing more transparent accounting of revenue and expenses and segregated performance benchmarking.

While there has been no separation of transmission and distribution, performance contracts have been introduced and generation capacity has increased steadily. The goal is to receive 20 per cent of energy from independent producers. Much of the infrastructure needed to achieve the goal would be completed through public–private partnerships (PPPs).

Kenya is also increasingly turning to alternatives to coal. Nearly half of the new capacity expected to come on line over the next five years will be alternative: geothermal (32 per cent), wind (12 per cent) or hydropower (3 per cent).[9] The push for alternative energy sources has attracted several foreign companies. For instance, the Ubbink/Centrotherm Group is the first producer of high-quality solar panels in East and Central Africa.[10]

And finally, the Lake Turkana Wind Power Project, an initiative started in 2006 by Anset International, is expected to make a sizable impact in the energy sector. This joint venture aims at providing 300 MW to the Kenya national grid by 2012.[11] The project will also contribute to national revenues (around $700 million over the project life) and to employment (approximately 2,500 people during construction and 200 full-time positions).[12]

ICT. The IPR specifically called for the Government to focus on establishing high-quality ICT services in one of the EPZs and to actively promote a cluster of service providers in a single zone to achieve economies of scale. In this respect, the Government has exceeded the recommendations by creating special economic zones (SEZs). A new SEZ Bill was drafted in 2010, which specifically addresses the development of technology parks and the aim of SEZs to attract high-end technology companies.

Furthermore, the authorities have set aside 2,000 hectares (5,000 acres) to create a Technology City in Konza. Konza is located 60 km outside of Nairobi on the main route towards Mombasa (500 km). The entire project is expected to cost $12 billion over the course of 20 years. The vision for the technology city is one where there is a central business district, with a science park to the south and a university campus to the north. There are also plans for 35,000 new homes for workers in the city. Schools, parks, and sports and entertainment facilities are also envisaged. A fibre optic cable running along the Mombasa–Nairobi corridor provides reliable telecommunication services for the park.

6. THE STRATEGIC AGENDA FOR FDI ATTRACTION AND PROMOTION

The IPR provided Kenyan policymakers with a strategic agenda to attract and benefit from investment in potentially attractive sectors of the economy. The strategy, to be implemented with the support of tailored and professional FDI promotion, was structured around four pillars: (1) basic manufacturing, (2) regional services, (3) agro-business and (4) EPZ diversification. Much has happened in Kenya in the seven years since the IPR was conducted. As the country's priorities focused on restructuring the institutional architecture and renewing its democratic identity, FDI policy and promotion were neglected. While broad priority sectors for promotion were identified in the IPR, an overarching attraction policy is still missing. As a consequence, among the four pillars of the strategic agenda for FDI attraction proposed in the IPR, only one has been fully implemented.

Pillar I: Pursue regional opportunities in manufacturing

In an effort to attract investment to Kenya's manufacturing sector, EPZs were put in place in the 1990s. However, it was not until the United States' African Growth and Opportunity Act (AGOA), introduced in 2000, that manufacturing received a boost and an injection of FDI. The IPR found that many of the new investors were export-oriented garment manufacturers from China, India and Sri Lanka that were "quota hopping".[13] Their activities were characterized by poor logistics and quality assurance resulting from low investment in technology and training.

The IPR also pointed to Kenya's progressive loss of market share in the supply of manufactured goods to the region (namely to the seven key neighbours: the Democratic Republic of the Congo, Ethiopia, Rwanda, Sudan, the United Republic of Tanzania and Uganda), attributable in good part to increased competition from within and outside the area, particularly from South Africa, China and India.

To counter this trend, the first pillar of the strategic plan for FDI attraction and promotion proposed in the IPR recommended to exploit market access under regional trade agreements to regain a footing in the regional market, reduce the tax rate on foreign income source of Kenyan companies, and introduce the concept of world-class manufacturing (or lean production) based on flexible forms of production organization, such as production-pulling, total quality control or cellular layouts.

With respect to regional market access, important progress is being achieved within the EAC. The operationalization of the EAC Common Market has been progressing since July 2010. The Common Market Protocol covers issues such as the free movement of people and workers, goods, services and capital, trade facilitation, standards and measures, the removal of non-tariff barriers and trade capacity-building assistance. The process is complex and progress to date varies depending on the area considered. As anticipated by the IPR, however, a positive aspect of the Common Market has been an increase in intraregional trade and cross-border investments, particularly from Kenya to the region. In this regard and according to the authorities, Kenya registered a rise in exports to the EAC for 2010 and 2011 of over 13 per cent. Kenya has over the years experienced trade surpluses in its trading with EAC countries, and the volumes continue growing as per EAC trade reports.[14]

The Government has also been working to align the industrial sector policy with the Constitution's emphasis on renewed commitment to economic performance. Carried across the various Government ministries, it has resulted in a new industrial policy piloted by the Ministry of Industry. One of its key objectives is to enhance the sector's competitiveness through infrastructure improvements and reduced operating costs.

The World Class Manufacturing concept was proposed because modern management and production processes had not been adopted in Kenya. The significant gains that could be achieved by adopting these methods are more appealing because they are largely low-cost improvements. It should be noted that although these methodologies have not been introduced, in EPZs there is a push for the adoption of ISO standards and high quality production methods as a result of the requirements of export markets (e.g. the European Union and the United States).

Pillar 2: Kenya as a regional services hub

The IPR made several recommendations to improve Kenya's competitiveness in services, including in the areas of taxation, regional market access, human resources and minimum capital requirements, as described above.

A precondition for creating a successful services sector is to address human resource needs. The IPR thus called for the free movement of people in the region and recommended the mutual recognition of the qualification of professionals, more accommodating EAC immigration and labour market regulation, and removing licensing requirements for services.

The milestone EAC Common Market protocol signed in 2010 requires opening up sections of the services sector like education and management, the mutual recognition of academic qualifications and the elimination of fees for work permits. Mutual recognition agreements (MRA) have already been signed in accounting and architectural services, and additional MRAs are expected in other sectors, including engineering. With respect to the movement of professionals and workers, however, only Kenya and Rwanda have made visible progress by eliminating work permits for workers from EAC member States. There is some frustration on the part of Kenyans at the lack of reciprocity in other EAC countries. Implementation of the EAC Common Market protocol is progressive, up to 2015, and full reciprocity and compliance by partner states on various annexes implementing the protocol is then anticipated.

In the area of licensing, Kenya has made progress towards their reduction, as detailed earlier.

Pillar 3: Reinforcing the agri-business success

It is well known that agriculture plays a large role in the Kenyan economy. The Government would like to increase value added processing to its agricultural exports and grow the agri-business sector through FDI. To this end, the IPR made several recommendations focusing on infrastructure, land access (section 2.2) and diversification of the sector.

Much of the current road improvement projects are focused around Nairobi and highways connecting EPZs and manufacturers to ports and airports. There is one project, the Nairobi–Thika highway, which will provide some relief to the growing regions. The highway heads northwest out of Nairobi, towards Mount Kenya, a top coffee and tea production region. Whereas it does not extend to the heart of the growing region, the highway will at least ease congestion by providing an eight lane highway for 45 km of the approximately 150 km distance to the growing region.

TNCs in the agricultural sector in Kenya provide training to local growers and suppliers without the benefit of tax incentives. At one time, training was provided by the Ministry of Agriculture but its lack of capacity ultimately led to firms providing training at their expense. The training offered includes international standards compliance and good manufacturing practices. In an effort to improve this training, the Tea Board introduced a training curriculum for several university agriculture programmes which specifically address tea.

Responsible for approximately a quarter of all foreign exchange earnings, tea is a top priority sector for Kenya. In 2009, a Tea Act was introduced and a policy put in place for tea production. The Government has also worked to align market regulations with international standards, an effort that has been rewarded by Mombasa becoming the second largest tea auction in the world behind Colombo in Sri Lanka. Currently, 85 per cent of tea is sold in bulk with the remainder comprised of instant and bagged tea. The Government would like to increase the amount of domestic processing and has commissioned a study on the subject. Coffee, representing 10 per cent of agriculture earnings, is also important to the economy. An auction is held in Nairobi for 45 weeks of the year. Branding initiatives are underway for both tea and coffee. Logos and marks of origin have been developed for both. Guidelines and criteria have also been published and products meeting those standards will be allowed to use the marks and logos for marketing.

The IPR recommended diversification through active Government involvement and investor targeting in fruit processing. Up to today, there has not been a push in this direction.

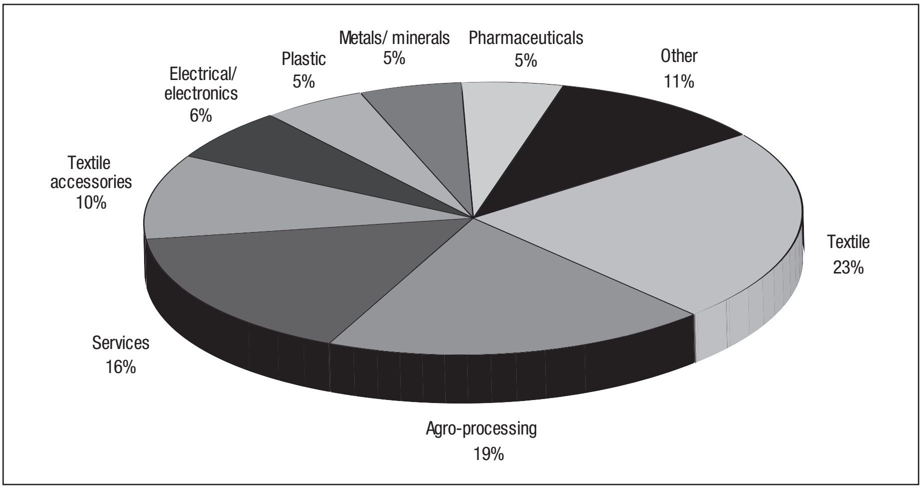
The primary focus is on the top foreign exchange earners: tea, sugar, flowers, coffee and pyrethrum.

Pillar 4: Diversification of FDI in EPZs

The IPR recommended that Kenya diversify its EPZs to move away from garment assembly and take measures to diversify FDI in manufacturing and attract efficiency-seeking FDI in services, such as call centre operators and international gateways.

The EPZs have worked diligently and successfully to diversify the profile of companies in the zones. Fifty-seven per cent of investment is foreign, 24 per cent joint venture and 19 per cent domestic, which is spread across 15 sectors (see figure 3). Textile, which used to represent the majority, is now just under a quarter of all enterprises.

Figure 3. Sectoral distribution of EPZ enterprises, 2011
(Percentage, based on the number of firms in each sector)



Source: Kenya Export Processing Zones Authority.

The IPR also recommended that the EPZ Authority (EPZA) establish a linkages programme, promote pioneering activities and use EPZs as a policy testing ground, particularly for the ICT sector. The facilitation of linkages is a part of the EPZ Client Service Charter. In an effort to deliver this service, it has set up a linkages programme for SMEs in the EPZ.

The introduction of Special Economic Zones (SEZs) constitutes the main contribution to diversifying zones' FDI. SEZs base their attractiveness to investors on the quality of the infrastructure and service offering, rather than on incentives for exports. Regional trade integration has made EPZs unattractive because their 80 per cent export requirement cannot be met if the destination is an EAC country. As a result, Kenya is focusing on SEZs, beginning with the Dongo Kundu project. Dongo Kundu will include an ICT park, free port, industrial park, and science and technology parks. The city plan includes world-class infrastructure and a pool of SMEs to support the bigger industries.[15]

Investment promotion

The IPR recommended that the advocacy role of KenInvest be strengthened. KenInvest has since created a policy advocacy section, which has been active in promoting the changes needed for private sector development and advocating for investor concerns. The section also plays an advisory role to the Government on the changes needed to improve the investment environment. KenInvest participates in a round table with investors, the Prime Minister and cabinet ministers every quarter. The agency brings a comprehensive matrix of issues to review at the meeting.

Furthermore, KenInvest has been placed under the Ministry of Finance to give it greater visibility and access to policymakers.

The primary challenge facing KenInvest in its policy advocacy efforts is feasibility. Multiple changes in leadership and organizational restructuring have created a rudderless organization and disrupted operations. However, KenInvest has also been hindered by competing efforts at investment promotion from agencies including the Manufacturers Association, Brand Kenya (under the Ministry of ICT) and EPZA.

The IPR also focused on aftercare services by highlighting the need for both KenInvest and the EPZA to make a significant effort in this area. KenInvest makes approximately 200 visits to investors each year. The agency seems to be hampered by a lack of information. While it has information on investors that come through the agency, there is no information on foreign firms which forego its services. There does not seem to be a similar programme through the EPZA. However, KenInvest is working on institutionalizing both a physical one-stop shop and a digital one-stop for the purposes of easing investor facilitation processes.

A linkages programme facilitated by KenInvest was also envisaged in the IPR. With the help of and funding from the United Nations Industrial Development Organization, KenInvest is in the process of launching an initiative to create a joint-venture programme, which will promote local businesses in the vertical and horizontal supply chains of foreign investors. A Subcontracting and Partnership Exchange (SPX) programme supported by UNIDO is currently hosted at KenInvest. The programme aims to contribute towards making Kenya the investment destination of choice by improving the capacity of local companies, including SMEs, to meet the supply requirements of large corporations (both locals and TNCs).

In addition to improving specific FDI promotion functions, the IPR recognized the need to foster the domestic private sector with a view to increasing the country's attractiveness. It recommended putting in place an enterprise Kenya programme to help domestic companies enhance their competitiveness. Whereas such a specific programme was not implemented, the Government launched the Private Sector Development Strategy in January 2007 with a 2007–2012 implementation schedule. The five goals highlighted in the Strategy are to (1) improve the business environment, (2) accelerate institutional transformation, (3) achieve economic growth through trade expansion, (4) improve productivity and competitiveness, and (5) support entrepreneurship and SME development.[16]

This report has provided a brief account of the Government's progress in achieving some of the above goals, with a particular focus on improving the business environment, most directly related to the implementation of IPR recommendations. Several efforts, however, have been made to achieve the other goals. In the area of SME development and entrepreneurship, for instance, a Women and Youth Enterprise fund was established. Through this fund, the Government can accept a portion of the loan risk in order to increase access to credit for women and youth. One shortfall of the programme is the focus placed on loan recovery rather than on improving the skills required to ensure the success of the companies. Incubation centres are proposed in the Ministry of Trade 2007 SME Support Policy. In the same line, the Ministry of Industrialization is leading the process of establishing SME parks in all 47 counties to give impetus to investment growth by supporting SME incubation programmes.

7. CONCLUSIONS AND RECOMMENDATIONS

Kenya's performance in legislative and regulatory reform has been impressive, as summarized in table 3. Nearly all areas which touch on the investment framework have experienced solid progress. Highlights include the new competition framework, modernization of tax administration (i.e. online filing), simplification of business licences and introduction of performance contracts. FDI has been increasing as a result, but the volume of inflows is still lower than in comparator countries. The adoption of a new Constitution and the consolidation of both political and economic stability will eventually provide renewed opportunities to put Kenya high on the FDI map.

However, more needs to be done. Indeed, according to the World Bank's 2012 report on the ease of doing business, Kenya ranks 109 (106 in 2011) out of 183 economies. Going forward, it will be important that the Government tackles areas where it has lagged in legislative and regulatory reforms (see below), so as to promote FDI in the areas of high potential and derive benefits for the local economy. With the establishment of 47 counties as per the requirements of the new Constitution, equitable allocation of the scarce resources for development projects remains a major challenge. Also, from looking at past experience, the upcoming political transition in 2013 remains unpredictable. Depending on how the leadership manages it, cases of unrest and political volatility remain a possibility.

Address foreign work permit issues

An important area which has been neglected is that of facilitating foreign work permits to fill the local skills gap. Of the six recommendations related to work permits, none was adopted. The facilitation of work permits consumes a larger percentage of KenInvest's facilitation activities and is a major complaint of investors. The Government should move quickly to implement the recommendations surrounding work permits provided by the IPR. Several of the recommendations were specifically designed to work under the current system and could be adopted fairly easily. These include:

- Publishing the procedures and criteria for obtaining foreign work permits;
- Implementing a sliding scale for foreign work permits;
- Fast-tracking foreign work permits in key positions;
- Opening positions for foreign hire based on a predetermined list of skills shortages.

Move forward with privatization

Another bottleneck to FDI, which has been in process for quite some time, is privatization and the development of a PPP policy. These are central to the country's infrastructure development, the attraction of FDI and economic development. The Privatization Commission needs to be fully operational and the PPP policy adopted and published.

One area of particularly slow progress relates to the FDI attraction recommendations. The review process revealed that this is likely the result, among others, of a weak investment promotion agency. Although well-funded and staffed by experienced, capable personnel, KenInvest's frequent changes in leadership and inherent lack of a focused investment strategy have impeded the country's ability to effectively attract FDI in priority sectors.

Develop an investment policy and implement the FDI strategy

- The lack of a whole encompassing investment policy to guide the attraction and promotion of both FDI and DDI remains a hurdle. A newly designed investment policy should also take advantage of the enlarging trading and investment space created by regional integration groupings such as the EAC and COMESA to promote cross-border trade and investment flows.
- An FDI strategy for key target sectors was set out in the IPR. Thus far, implementation of the FDI strategy has been inadequate consequently resulting in limited investment attraction. The strategy should be reviewed and an implementation plan developed. Progress in implementing the strategy should be closely monitored as part of KenInvest's performance contract goals.
- Both the policy and the strategy should be promoted and disseminated throughout the Government.

Create an "advocacy network"

Once KenInvest is on firm ground from an organizational standpoint and poised to more aggressively take up the reins of FDI promotion and related activities, it should consider launching a more concerted advocacy effort on behalf of investors, by creating and spearheading an advocacy coalition. Although KenInvest has a Policy Advocacy section, the agency is being overshadowed by the Kenya Private Sector Alliance (KEPSA), the Kenya Manufacturers' Association (KMA) and the EPZA, among others. With KenInvest's direct access to the Minister of Finance, top priorities could be coherently proposed at a level of

Government likely to garner results. KenInvest could draw on the resources of the other members of the advocacy network, such as KEPSA, KMA and EPZA to help conduct surveys, produce reports and formulate coherent strategies to address investors' issues.

Introduce project management methods

The scope of activities and implementation fall short of best practices. This is likely a symptom of leadership changes, although this only highlights the need for a mechanism which will allow business to proceed as usual regardless of personnel changes. In that vein, a project management system should be put in place. There are many examples in the private sector which could serve as templates.

Enhance collaboration on business registration

Data collection has become a problem since the elimination of investor registration with KenInvest. The latter only has information on companies that voluntarily register with them. The information on companies which have not registered with KenInvest is available in the Business Registration Office, where all companies must register. Not having the information on foreign firms in the country hinders any efforts at aftercare and promoting expansion activities. In order to ease access to the data and create a positive working relationship, a programme should be put in place for operational collaboration for enhanced information sharing on FDI between the various agencies.

Foster regional integration

To fully tap the potential of its regional market and increase its role as a base for regional sourcing in manufacturing and services, Kenya needs to continue to play a prominent role in moving forward the EAC agenda, with a view to accelerating integration in the region and fully implementing the EAC Common Market protocols.

To conclude, the prospects for Kenya's economic performance remain promising. However, Kenya's economic performance may also be undermined by its vulnerability to climatic conditions. Furthermore, any sociopolitical unrest would certainly undermine the performance of Kenya's most dynamic sectors, including tourism and agriculture. Notwithstanding these risks, a combination of some designated factors could contribute to consolidate the positive outlook of Kenya's economy in the short to medium term. The set of reforms undertaken in all economic sectors by the Government since the adoption of a new constitution are expected to strengthen investors' confidence and create a more conducive business environment. Similarly, continued investment in infrastructure by the Government is to reduce the costs of doing business. Efforts to deepen regional integration at the EAC level, by harmonizing trade and investment policies and practices as well as removing all trade barriers, will create a larger market for the private sector. In addition, business-friendly macroeconomic management will keep inflation and interest rates low to expand production activities. In a favourable scenario, Kenya's economy is forecast to grow by an average rate of nearly 6 per cent between 2012 and 2014.

Table 3. Summary of implementation achievements

IPR recommendations	Results	Comments
1. Regulatory framework for investment		
Amend the Investment Promotion Act to lower minimum capital requirement	★★	Amendments adopted
Negotiating and ratifying BITs with key FDI source countries	★	Six new BITs signed, one in force
Extend network of DTTs	★★	Two new DTTs
Provide unilateral foreign tax credit if no DTT is in place	–	No change
Lower tax rate on foreign source income	–	No change
Lower withholding tax on service fees in regional DTTs	–	No change
Extend investment deduction on fixed assets to services	–	No change
Reduce 5 per cent withholding tax on agency fees to 1–2 per cent of invoice value	+	Chose to increase withholding tax to 10 per cent to address tax evasion problem
Publish guidelines on transfer pricing	★★	New regulation adopted OECD guidelines for transfer pricing
Establish performance benchmarks for KRA	★★★	Introduces as part of overall performance contract programme
Modernize the competition regime, strengthen independence and functions of competition agency	★★★	Introduced modern Competition Act and Authority
Introduce new and modern Companies Act	★	Modern companies bill drafted, awaiting parliamentary approval
Reduce and simplify business licences	★★★	Eliminated 70 per cent of licences and simplified remaining ones
Enhance communication and coordination between licensing agencies	–	No change
Publish clear guidelines on obtaining licences	★★★	Detailed website with criteria and the agencies, sophisticated interface allowing search based on business type to see all licences required.
Establish targeted and random inspections to ensure compliance	–	No change
Review and consolidate land legislation and clarify land access	★	Consolidated Land Act drafted, awaiting parliamentary approval
Mandate the Land Commission to set aside land for investment	★	Reflected in the new Land Act

IPR recommendations	Results	Comments
Digitalize land records	★	Several initiatives, including ILRIS, partially implemented due to lack of funding or approvals
Revise labour legislation on resolution of labour disputes	★★	Modern labour relations Act introduced
Reduce complexity of minimum wages regime	–	No change
Publish procedures and criteria for obtaining foreign work permits	–	No change
Implement sliding scale for foreign work permits	–	No change
Replace labour market testing with a selective approach to facilitate employment of foreign talents	–	No change
Replace understudy programme with employers' contribution to training	–	No change
Enact privatization bill and accompanying regulations	★	Bill awaiting parliamentary approval (expected by 2012)
Introduce modern mining legislation	★	New law drafted (expected by 2012)
Governance and institutions		
Draw up a shortlist of priority policy actions to be implemented in the short term	+	Rapid Response Initiative introduced instead
Establish and enforce performance contracts in the public administration	★★★	Implemented the Kenyan Performance Contract System with high-level support
Improve transparency	★★	Introduced the Ethics and Corruption Act of 2011 and the anticorruption authority (EACC). Introduced the Crime and Money Laundering Act of 2011
Strengthen commercial justice	★★★	Created special courts for commercial matters, land and environment. Training of judges is ongoing
Human capital and infrastructure		
Sustain dialogue with private sector on skills required	★★★	Carried out manpower survey; organized exchange programmes TNCs/local firms and introduced quarterly advocacy roundtables with Prime Minister

IPR recommendations	**Results**	**Comments**
Benchmark infrastructure services against South Africa (quality and cost)	★	Data available but a specific benchmark report not undertaken
Survey investors on pressing needs	★★	Completed investor survey
Establish targets against benchmarks and investor priorities	+	Targets for infrastructure introduced in Vision 2030
Involve private sector in energy infrastructure development and unbundle the sector	★	Partial involvement by IPPs. No unbundling, delays with Privatization Act and PPP policy holding back further involvement
Involve private sector in provision of ports services and review role of the Kenyan Ports Authority	–	No change
Work to establish direct flights between Kenya and United States	★	FAA certification requested
Improve roads connection growing areas and airports	★★	The Nairobi–Thika highway done
Involve private sector in ICT infrastructure development	★★	Opened sector to FDI, resulting in new fibre optic cabling and investment opportunities in ICT city development
Strategic agenda for FDI attraction and promotion		
Pillar 1: Pursuing regional opportunities in manufacturing		
Exploit market access under regional trade agreements including EAC and the expansion of the COMESA free trade area	★	New initiatives on trade facilitation, investment , commercial dialogue, and removal of non-tariff barriers, operation of one stop border posts and standardization, but limited to the EAC
Reduce the tax rate on foreign source income of Kenyan companies	–	No change
Promote the diffusion of World Class Manufacturing (lean production)	–	No change
Introduce Government-funded regional benchmarking initiatives	–	No change
Provide fiscal incentives to firms promoting cooperation and training within the value chain	–	No change
Pillar 2: Kenya as a regional services hub		
The recommendations on the Investment Promotion Act, on taxation and on the entry of foreign skills summarized above are particularly relevant for the development of the services sector. In addition:		
Foster mutual recognition of qualification of professionals in EAC countries	★	Progress in accounting and architectural services, other services in discussion.

IPR recommendations	Results	Comments
Promote more accommodating EAC immigration and labour market regulation	★	Kenya among the first countries providing work permits to EAC members' citizens
Remove licensing requirements and regional barriers to trade in services	★	Some requirements removed or simplified
Pillar 3: Reinforcing the agri-business success		
The recommendations on infrastructure development and land access summarized above are particularly relevant for the development of agri-business. In addition:		
Exploit synergies between tourism and floriculture or horticulture	–	No change
Promote Kenya through major United States tour operators	–	No change
Diversify sector by promoting attraction of large fruit producer	–	No change
Brand Kenya tea and coffee	★★	Kenya logos and marks of origin have been developed. Working on increasing in-country processing
Pillar 4: Diversification of FDI in EPZs		
Promote FDI diversification away from textiles and garment assembly	★★	24 per cent of EPZs companies in manufacturing; 16 in services 16 and 19 in agro-processing
Establish EPZ linkages programme	★★	Linkages programme in place
Provide access to Kenyan market for pioneering activities and promote a cluster of service providers	★★	Introduced Policy on Special Economic Zones based on world-class infrastructure and proximity to SME clusters
Investment promotion		
Strengthen advocacy role of KenInvest	★★	New advocacy section and quarterly roundtables established. Agency placed under Ministry of Finance for increased visibility and access to policymakers
Increase aftercare efforts of KenInvest and EPZA	★★	Regular visits to investors by KenInvest and new aftercare programme by EPZA
Start linkages programme in KenInvest	★	Programme in launching phase
Introduce Enterprise Kenya Programme in support of local competitiveness	+	Programme not implemented but Private Sector Development Strategy launched

Key to table:

★★★ surpassed expectations
★★ fully or largely accomplished
★ partially accomplished

– no change or reversal
+ different policy direction taken

NOTES

1 This report was prepared by the Investment Policy Review team of UNCTAD under the direction of Chantal Dupasquier. Overall guidance was provided by Joerg Weber and James Zhan. Substantive support and contributions by Milasoa Chérel-Robson, Alexandre de Crombrugghe, Paige Griffin and Massimo Meloni are acknowledged. Additional input and comments were made by Martin Mutuku and James Musau of the Kenya Investment Authority.

2 France Telecom's purchased of a 51 per cent stake in Telekom Kenya for $390 million and Helios Investment, a United Kingdom-based company, paid $165 million for 25 per cent in Kenya Equity Bank.

3 Agimba, Christine, Deputy Solicitor General. August 2007. "Institutionalizing drivers of reform how to ensure sustainability of reform without imposing rigidity and more bureaucracy? Kenya: The proposed Business Regulation Bill," FIAS Conference: Better Regulation for Growth.

4 Land will continue to be available under 99-year lease agreements.

5 Sections 11–27 were repealed by the new Industrial Court Act 2011. More detail on this Act is provided in section 3.2 on commercial justice.

6 Soda ash is important to manufacture glass and in the production of detergents and industrial chemicals. With Tata Chemicals Magadi's capacity expansion before 2015, the company will produce about two per cent of the world's natural soda ash.

7 100 hectare dam at Mukurumudzi River.

8 As of 2010/11, performance contracts were in place for 468 public institutions. Prime Minister's office Performance Evaluation Report FY 2010/11, 27 March 2012.

9 Capacity from KenGen projects. KenGen, 30 June 2011 Annual Report.

10 Leone, Steve. September 2011. "For Large Companies, Kenya Represents Fertile Ground." renewableenergyworld.com

11 Manufacturer of agrochemicals, industrial chemicals and pharmaceuticals.

12 Aldwich International 2012. Lake Turkana Wind Power. itwp.co.ke, retrieved 10 April 2012.

13 Quota hopping refers to the circumvention of trade quotas by registering business in a foreign country in order to benefit from its quota.

14 EAC facts and figures 2011. These figures relate to all categories of trade and not just manufacturing.

15 Ministry of Trade. March 2010. Draft SEZ Policy.

16 Kenya Private Sector Development Strategy Implementation Plan (PIP) 2007–2012, January 2007.