Kenya Consultative Group Meeting 2003

Joint Donor Statement on Private Sector Development

Introduction

The development of a flourishing private sector and of private, entrepreneurial initiative is generally considered as the engine of economic recovery and growth. The Economic Recovery Strategy for Wealth and Employment Creation (ERS) recognizes and builds on this understanding. It follows therefore, that government policy should and will be pro-business and will aim to support a rapid development of the private sector. This comment tests this understanding.

On the whole, some positive developments imply that the **new government intends to be more pro-business** – it will encourage investment, encourage trade liberalization, and reduce protection. However, some key policy decisions already made imply that **any paradigm shifts should not be expected** in the short run – government does not intend to let the private sector invest in certain areas just yet – eg. government still proposes to revive the moribund Kenya Meat Commission, the Agricultural Finance Corporation and the Kenya Industrial Estates when the market is perfectly capable of making these investments. In addition, government intends to revert to provision of housing in urban areas, as well as the maintenance of roads. Finally, there's a clear indication that divestiture/privatization, especially in state banks and the telecommunications sector, will not happen in a hurry.

The challenge for GOK therefore, is to **"create an enabling environment for investment in Kenya"** and to "remove the various impediments that hamper private sector development". Although this implies a broad array of issues ranging from functioning labour, capital, and input markets; through to an efficient and effective customs administration process, GOK has to start somewhere. The key is to show real progress, building on key successes in markets where the private sector already has incentives to invest (financial sector as well as the dairy, horticulture and tea sub-sectors).

However, development partners welcome Kenya's commitment to providing an enabling environment, and are ready to support the government in related policy, regulatory and institutional reforms.

Recent developments affecting the private sector

Challenge: - Kenya is currently in serious economic decline. Per capita income has fallen below the 1990 level (shs4,200=) to about shs3,800 in 2002; poverty has increased to 56% in 2002 from 48% in 1990 (with a Gini coefficient of 0.42 in 1997); Both domestic and foreign (less than 1% of GDP compared to Vietnam which is at least 5% of GDP) investment in Kenya have seriously declined in the past decade. Gross domestic investment has fallen from 20% in the early 1990s to about 13% in 2002, and gross public sector gross capital formation has fallen from 10% to 5% over the same period. More directly, businesses have to cope with uncompetitively high transaction costs, some of which are due to inefficiencies in industry (over 20% excess capacity) but most related to high input tariffs eg for water, energy, telecommunications, transport, etc. Kenya for example, has one of the highest energy tariffs in the world (currently standing at $0.11/KwH compared to China at 0.10 and Eritrea and Mozambique both at $0.7). On a more general level, Kenyans have been overwhelmingly concerned about poor governance, poor access to justice, insecurity, unemployment, poor infrastructure in roads, energy, and telecommunication, and insecurity of land tenure, issues, which are also key impediments to private sector development.

Policy reforms: To provide an enabling environment, GOK will have to make investments in **improving efficiency in the delivery of services to the private sector** such as finance, water, energy, transport and warehousing, customs facilitation, tax administration, etc. In addition, GOK will have to invest in information generation and dissemination regarding local/regional and export market demands and business opportunities in the productive and service sectors. GOK will, however have to consider carefully the division of labour between government and the private sector, and establish clear criteria for government direct involvement in service provision. Public Private Partnerships are seen as a key service delivery strategy.

GOK requires an integrated, systematic approach to addressing **systemic weaknesses** and private sector needs, focusing on removing obstacles to private sector initiatives. This will not, however, guarantee investments. GOK will require a range of very clear incentives for private investments, as well as a conducive environment for business support programmes to emerge. For example, increased and successful entrepreneurial initiative at formal and informal levels, product diversification and upgrading relevant in the domestic context as well as in the global context will require much more than simply removing regulatory impediments to investments. It will require careful analysis of competition law and attendant institutional framework to promote competition in markets under liberalized trade regimes; business services which allow businesses to invest in export oriented enterprises, etc.

The NARC government has acknowledged and articulated these long-standing deficiencies in the ERS. The Action Plans and Implementation Matrix, as well as the Investment Programme define intended actions and investments for a way forward, but **coherence between these documents remains problematic**. For example, it is not yet clear that the sector strategies (where they exist, and when robust) necessarily contribute towards the ERS on specific indicators

We welcome GOK's announcement that it wishes, and will take steps to **strengthen partnership with the private sector** (on the ERS, sector interventions, as well as on trade issues). This partnership is already ongoing. The private sector has become an important part of GOK's consultation process. More recently, the Private Sector Alliance has accompanied the President on state visits to South Africa, America and London. Extensive dialogue is currently encourage at sector level in developing policies and strategies where so far missing (e.g. tourism, manufacturing sector/Industrial Master Plan, MSE Strategy; the National Export Development Strategy; banking sector reform; etc). The private sector, although not yet completely coherent, is taking steps to participate in debates and action to accelerate the enactment of pending bills (eg the Privatization Bill, the Micro-finance Bill, etc).

In addition, other positive developments include:

a) The completion and launch of the ERS in June, with clear signals from government that the private sector will be expected to deliver projected growth and employment.

b) The Investment Conference scheduled for November to launch the GOK and PS Investment Programme for jump-starting the economic recovery process. The Private Sector Alliance have been asked to partner government in making this a reality.

c) The PPP Conference held in Nairobi in July with the help of the World Bank/PPIAF.

d) The proposed Energy Conference in November aimed at informing what are likely to be far reaching reforms in the Energy sector.

e) The Pending Bills Committee report, with the support of DFID, which is ready and has been submitted to Cabinet for consideration.

f) The Kenya Roads Board is working and allocating resources appropriately.

g) The identification of the third mobile phone provider is likely to bring the cost of telecommunications down, although there still needs to be broad based liberalization of the sector. In addition, VSSAT licensing and issuing of ISP licenses has been accelerated.

h) The EAC Customs Union to be signed during the last quarter of the year. However, doubts about the speed of implementation of related infrastructure to facilitate regional and continental trade.

i) Kenya's leading role on regional trade integration and its interaction with COMESA, which has an active and focused secretariat.

j) More visible participation in the WTO at Cancun, although outcomes are not positive immediately for future growth.

k) The effort to revive the tourism sector with EU support.

l) The Micro-finance Bill tabled in parliament.

However there is concern that key issues (such as inefficiencies in the economy brought about by state delivery of key services including transport, telecommunications, energy, etc) in Kenya so far have not been sufficiently addressed.

Key challenges facing the private sector

In a period characterized by systemic, political and economic transformation, processes in which 'old' and 'new' approaches and attitudes tend to compete can slow down progress. In Kenya, the public is already disillusioned by what seems to be disjointed implementation of key reforms. The **speed of reforms is also worrying**.

As a result:

- Public debate is preoccupied with political issues rather than economic issues and as a result, business and investor confidence has not increased notably.
- Inadequate attention has been given to the current lack of capacity in the government ministries and departments.
- Failure to provide an enabling environment for private initiative as a consequence of unresolved government debates concerning policy approaches (eg interventionist vs enabling environment approach with limited focus on sectoral/line ministry responsibility).
- The roles of Government and the private sector are still not yet clearly defined and are sometimes conflicting. For example, as mentioned earlier, whilst there are opportunities for private sector investments in key sectors, government has just announced intentions to make significant investments (KMC, AFC, KIE, HCDA, etc).
- Government expenditure is not prioritised, hence, efforts to revive parastatals such as the Kenya Meat Commission and the Kenya Industrial Estates are de-linked from a comprehensive private sector development vision and may become costly in the medium to long run.

Priority actions

The challenges for providing an enabling environment for private sector development are multi-faceted, multi-sectoral and inter-linked. They often require simultaneous government action that is well coordinated between line ministries to avoid conflicting and/or duplicate results. Clearly, the impact of some interventions may be only fully felt in the medium to long term (e.g. full rehabilitation of key roads infrastructure). However, some may have an immediate effect (eg. reforms restoring confidence in commercial justice; harmonization of legislation and tax/customs procedures; bringing down costs of electricity consumption, telecommunication etc). Prioritization, sequencing and harmonization are therefore key principles in deciding priority actions, which include:

- A **sector-wide approach** to private sector development and a vision of integrated, concerted government action under the leadership of a lead ministry with prioritized, phased and costed activities. A **private sector development strategy** is critical for moving the process forward.
- **In addition, improved planning and targeting** of resources for private sector development, particularly focussing on providing an enabling environment for investment is essential. It is necessary and urgent to carry out a robust analysis of constraints including those related to implementation.
- Addressing the **capacity gaps** in line ministries with clear roles and structures, including clear linkages with other related, impacting ministries and agencies. For example, if Kenya is to achieve export led growth, agriculture, industry, trade and environment are key ingredients for a successful outcome. A multi-ministerial process would provide the appropriate framework for achieving Kenya's export objectives.
- **Cost-benefit analysis** is critical as a basis for possible incentive schemes and systematic reduction in the cost of doing business.
- **Completion and implementation of the MSE strategy** is urgent and crucial for economic recovery. Integrating the MSE sector in the rest of the economy in a pro-active strategy aimed at achieving competitiveness and efficiency in the economy as well as job creation. Benign neglect and/or marginalisation of the sector will no longer suffice as strategies in the future, and neither will the sector be expected to serve the sole purpose of absorbing excess, residual labour in the economy. In this regard, MSE development should focus on providing an enabling environment for private initiative, leaving its quality and performance assessment to market responses.
- Further, **pro-active enhancement of the role of private sector consultations** and its involvement in policy development/advise and monitoring of reform implementation against tangible outcome targets, e.g. through the establishment of institutionalized consultation frameworks such as the proposed NESC and JEC. It is absolutely key that these structures should be institutionalised, with clear grassroots infrastructure to project the voices of micro enterprises that would otherwise not be specifically included.
- Establish a specific mechanism (matrix/evaluation grid) for **monitoring the performance of private sector** related actions in a sector-wide context.
- Address some of the **immediate, pragmatic concerns of the private sector** in the enabling environment as mentioned earlier – license a second landline provider, concession the railways, rationalise the customs administration process, reduce the cost of finance, energy, water, etc. The private sector is desperate for some real quick wins which impact on the bottom line.

Donor Harmonization

The Private Sector **donor co-ordination group (list of current active members attached) was established** only very recently (May 2003). Under a 6-monthly rotating chair it meets on a regular, basis, to share information and discuss and harmonize ongoing and future initiatives in a sector-wide context. It is envisaged that the Financial Sector and the Trade development sub-sectors of the group will hold in-depth discussions to compliment the generic discussions in the main group. The Business Services Development Group holds regular meetings on operational issues.

The group has **jointly commented on the draft MSE Sessional Paper** to be finalised by the Ministry of Labour this quarter. The group is committed to engaging in regular dialogue with each other, and also with government and the private sector on the challenges and planning for the provision of an enabling environment for private sector's development. Clearly, a lot still needs to be done to harmonize collective actions which could undermine the main thrust of these intentions. Towards this, a **'mapping' exercise** is proposed to establish a) the extent to which donors are collectively supporting GOK's effort to provide an enabling environment for business; and b) the gaps, if any, in this support vis a vis what needs to be done (to report at next DCG). The group is conscious, however, that specific operational realities facing all interested donors will determine how this is taken forward.