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# Kenya Economic Development and Urbanization Policy

(In Two Volumes) Volume I: Executive Summary

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Water Supply and Urban Development Division

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## CURRENCY EQUIVALENTS

Currency Unit	=	Kenya Shilling (KSh)	<u>1/</u>
KSh 1.00	=	US\$ 0.07	<u>2/</u>
US\$ 1.00	=	KSh 13.9	<u>—</u>

## ABBREVIATIONS AND ACRONYMS

CBS	Central Bureau of Statistics
CDC	Commonwealth Development Corporation
COL	Commissioner of Lands
DDC	District Development Committee
EABS	East African Building Society
GPT	Graduated Personal Tax
GRF	General Rate Fund
HABITAT	United Nations Center for Human Settlements
HDD	Housing Development Department
HFCK	Housing Finance Corporation of Kenya
HRDU	Housing Research and Development Unit
ILO	International Labor Office
JCC	Joint Consultative Committee
KIE	Kenya Industrial Estates
LGLA	Local Government Loans Authority
MFP	Ministry of Finance and Planning
MLG	Ministry of Local Government
MLS	Ministry of Lands and Settlement
MTC	Ministry of Transport and Communications
MWD	Ministry of Water Development
MWHPP	Ministry of Works, Housing and Physical Planning
NCC	Nairobi City Council
NCCo	National Construction Corporation
NHC	National Housing Corporation
NSSF	National Social Security Fund
PPD	Physical Planning Department
RIDC	Rural Industrial Development Center
SLK	Savings and Loan Kenya Ltd.
UNDP	United Nations Development Program
USAID	United States Agency for International Development

## FISCAL YEAR

Central Government and Local Authorities - July 1 to June 30

1/ The official unit of currency in Kenya is the Kenya shilling (KSh). However, in accordance with the practice of the Kenya Government, revenues and expenditures of the central Government and the local authorities are expressed in Kenya pounds (K£) at the rate of K£ = 20 KSh.

2/ The dollar-shilling conversion factor given here is based on the approximate exchange rate in effect in mid-1984.

KENYA

ECONOMIC DEVELOPMENT AND URBANIZATION POLICY

VOL. I: EXECUTIVE SUMMARY

Introduction

1.01 Kenya stands on the threshold of a substantial increase in urbanization. At the same time, the country is undergoing a series of macroeconomic adjustments of serious magnitude. The circumstances which fueled Kenya's impressive economic growth since independence have by-and-large run their course, and the economy is having to adjust to a new and much harsher international climate. Kenya's balance of payments, agricultural output, and industrial productivity are all areas of concern to economic planners, and the Government is having to institute policy changes to improve medium-term economic growth at a time when short-term economic conditions limit the available options. In a situation such as this, the urgency of immediate economic problems is bound to divert attention from longer-term development issues such as urbanization. Nevertheless, ample evidence confirms that urban and rural development are intimately linked in Kenya, and that the macroeconomic policies being introduced in Kenya will have important implications for the pace and direction of urbanization. It is the purpose of this report to sketch out the prospects for urbanization in Kenya and to suggest policies consistent with Kenya's macroeconomic strategy which will sustain the contribution that urban areas can make to Kenya's economic development.

1.02 Kenya belongs to one of the last regions of the world to enter the urban revolution. Where less than one person in six lives in urban areas in Kenya at the present time, this ratio will change to one in three or four by the end of the century. Kenya's population growth rate, currently in excess of 4% p.a., means that the country as a whole must prepare for a doubling of its population in the next twenty years, and that urban areas can expect to grow by at least six million additional inhabitants. In addition, Kenya's urban structure is changing from a single dominant capital in the midst of a primarily agricultural economy to a spatially extensive urban pattern with close linkages to Kenya's agricultural resource base. The institutional and financial base for urbanization in Kenya is also changing rapidly in complexity and is undergoing significant strains in adapting to its evolving environment. There is an urgent need for the Government to provide suitable mechanisms to guide this multi-polar, multiple-actor urban economy.

1.03 Kenya's prospects for adapting to the requirements of urbanization rests on a foundation with many positive attributes. The Government has made significant strides over the past decade in articulating and implementing an urban policy framework which is consistent with Kenya's level of economic development and emphasis on the basic needs of its population. The system of local urban authorities in Kenya, while currently undergoing serious strain in its financial relationships with the central Government, has remained one of the stronger systems of local

government in sub-Saharan Africa. As a result, urban areas in Kenya are generally better serviced and better maintained than many other cities in Eastern Africa. This should not distract attention from the fact that there are a large number of urban residents in Kenya living in over-crowded and unsanitary conditions. However, in the face of current economic constraints, it is difficult to argue that urban areas should have priority for a larger share of investment funds. At the same time, the progress which has been made so far does justify sustained and reasonable support for urban areas as part of Kenya's long-term development efforts.

#### The Current Pattern of Urbanization

1.04 Population and Urbanization. During the most recent intercensal period (1969-1979), Kenya's urban population increased at an average annual rate of 7.9% and the number of urban centers (defined as towns with a population of more than 2,000 inhabitants) virtually doubled from 47 to 90. As compared to the earlier period surrounding independence, the decade of the 70s also represented a significant shift in the pattern of urban growth, with the population share of the secondary towns growing from 7% to 31% of the urban population, while the share of Nairobi and Mombasa fell from 70% to 51%.<sup>1/</sup> This pattern of urban growth differs from the experience in many African countries and other parts of the world, where the capital city often achieves overwhelming primacy. While the reasons for the change in Kenya's pattern of urban growth have not been fully explained, some contributory factors can be cited. One element is the development of an efficient inter-city transportation network, which has improved the mobility of persons and goods and thereby lessened incentives to relocate to the capital. Another important factor has been the relatively neutral policies Kenya has pursued with respect to the distribution of income between urban and rural areas (an important exception is industrial protection policy, which is discussed below). Kenya has refrained from subsidizing food, housing, and transportation costs in urban areas, policies which have encouraged migration to the capital city in other countries. In addition, the Government has taken various measures such as periodically restricting wage increases to 75% of the growth in the cost of living, which have moderated rural-urban income differentials. As a result, the implicit spatial incentives in Kenya's economy have favored the growth of a diversified urban structure which is complimentary to the distribution of economic activity in the country.

1.05 Spatial Distribution of Urban Production and Employment. Urban areas account for more than 30% of GDP in Kenya, as compared to a population share of approximately 15%. The reason for this disparity is the concentration of modern private sector activities in urban areas, as compared to the low earnings in agriculture from which the majority of Kenyans earn their living. Even within urban areas, modern sector activities are concentrated in a comparatively small number of towns, with six towns (Nairobi, Mombasa, Nakuru, Kisumu, Thika, and Eldoret) accounting

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<sup>1/</sup> Secondary towns are defined here as urban areas with a population in the range of 20,000 to 100,000 inhabitants or more and an economic base with strong linkages to the regional economy.

for 87% of total urban wage employment and 91% of wage earnings in 1982. The rate of growth in urban wage employment has exceeded the rate of population growth in only a few towns, implying that many urban centers are becoming increasingly dependent on small-scale and informal sector employment activities. Given that the number of workers in urban areas is expected to grow more than three-fold by the end of the century, the magnitude of the urban employment problem is sobering.

1.06 Urban Income Distribution. On an absolute basis, poverty is predominantly a rural phenomenon in Kenya, concentrated particularly among the landless and the smallholder sectors of the economy. Urban areas are not the primary refuge of the poor, although a significant number of poor people do live in urban areas. Indeed, an important function of rural-urban interactions in Kenya is the flow of remittances back to rural areas, which recent reports have estimated to be as high as 21% of the urban wage bill, constituting a major source of financing for smallholder innovations. If the definition of poverty is broadened to include environmental conditions, however, poverty does constitute a major problem in urban areas of Kenya. Surveys have found that various urban areas have from 18% to 40% of their population living in unplanned and over-crowded slum settlements, most of which lack even basic services. The effects of these conditions on health, productivity, and social discontent are well-documented. Demonstration projects in Kenya have shown that with imaginative effort, urban services can be provided in these low-income areas at an affordable price with no subsidies. The failure of urban institutions to extend such services on a scale adequate to ameliorate the worst of these conditions represents a serious challenge to current urban policy.

1.07 Kenya's Macroeconomic Strategy. The macroeconomic policies being introduced in Kenya as part of the Government's economic recovery program will have a profound effect on the development of urban areas. Among these policies, adjustments in trade and industrial protection policies will have the most direct impact on the future pattern of urbanization. The impressive increase in Kenya's manufactured output, which grew at an annual rate of 10.8% during the 1970s, was stimulated by increasingly high levels of protection and an emphasis on import-substitution oriented to a domestic rather than an external market. This had several effects on the structure of Kenya's manufacturing industry, including: (1) a cost-permissive atmosphere contributing to a rise in the prices of domestically manufactured goods relative to other prices; (2) an anomalous size distribution of firms bearing more resemblance to a high-wage capital-rich country than to a low-wage labor-intensive economy; and (3) a concentration of industry in major entrepots such as Nairobi and Mombasa which offer access to imported materials, skilled labor, and capital markets. The trade barriers erected to maintain the effective protection of the import-substitution industries also led to an overvalued exchange rate which tends to underprice all tradeable goods, including agricultural products. As a result, urban incomes in the modern private sector have tended to be higher and agricultural incomes to be lower than might have been the case with a less protective trade policy.

1.08 As part of its economic recovery program, the Government has begun to rationalize the system of tariffs and quantitative trade restrictions and to adjust the exchange rate as needed to maintain incentives for agriculture. The effect of these policies, if consistently followed, will be to turn the terms of trade in favor of rural areas, while making the manufacturing industry more export-oriented and subject to international competitive pressures. These policies will also affect the size distribution of firms, causing a shift to smaller firms with higher labor-absorption factors and closer ties to Kenya's agricultural resource base. This will affect the spatial distribution of employment, as experience from other countries has shown that such firms are more likely to locate closer to areas of primary resource availability. Therefore, Kenya's macroeconomic policies will reinforce patterns of urban growth which are already occurring, producing a spatially dispersed pattern of economic activities which will strengthen linkages such as rural-urban migration patterns and urban remittances from off-farm employment.

1.09 In conclusion, urban development in Kenya is occurring in a spatial pattern complementary to the Government's efforts to improve economic growth. Urbanization will have two major roles to play in Kenya's development during the next two decades. First, urban areas will have to absorb a large share of the expected population increase, and to the extent that Government policies designed to increase the labor-absorption of agriculture may not be fully realized, urban areas will have to accept even more migrants. Secondly, urban areas will have to service the growth and diversification of economic activity throughout Kenya. To do this, Kenya will have to develop a strong system of urban institutions capable of managing a complex pattern of urban growth. In addition, as the resources available to the central Government will be limited and constrained by other priorities, urban institutions will need to look toward local sources of resource generation and innovative efforts to improve the cost-efficiency of urban programs if they are to cope with the demands on them. The remainder of this report examines the prospects for achieving these goals.

#### The Urban Policy Framework

1.10 Kenya's urban policy framework as stated in the various National Development Plans contains the following three major elements:

- (a) Urban Spatial Policy -- to encourage the decentralization of urban growth throughout the country and avoid excessive population concentration in Nairobi and Mombasa;
- (b) Urban Employment Policy -- to encourage the growth of urban employment in the modern and informal sectors; and
- (c) Urban Investment Policy -- urban investment programs should emphasize the basic needs of the population.

These objectives are basically sound, and the Government has been generally consistent in holding to these principles in its urban program. In this section, we provide a brief evaluation of the Government's achievements so

far and the priorities for Kenya's urban policy in the face of changing economic circumstances.

1.11 Urban Spatial Policy. The Government's urban spatial objectives are partly a reaction to the perception that Nairobi is growing too fast and at the expense of the secondary towns, a conclusion which is based on the urban migration patterns observed in the 1969 census. In fact, Nairobi's growth rate of 5% during the 1969-79 period, while relatively high by international standards, has been moderate in comparison to the growth of the secondary towns. The spatial policy set forward in the latest National Development Plan does not advocate a high degree of selectivity among urban areas, and the major policy instrument identified to promote the Government's objective is to encourage ministries to take spatial priorities into account in the allocation of funds for social and economic infrastructure. Examination of the Government's allocations of funds for basic urban infrastructure (water, sewerage, housing, roads, and related investments) during recent years reveals that the allocation of funds has generally matched the population share of different urban areas, with no indication of either a "pro" or "anti" Nairobi bias. In cases where the funding allocation has been skewed to the larger urban areas, it is generally for investments such as airports and provincial hospitals which have regional or national significance rather than a purely local impact.

1.12 Ample evidence from a number of other countries has shown that inter-urban locational advantages are much more dependent on overall economic policies, rather than on marginal differences in urban infrastructure. The role of urban infrastructure investments should therefore be to support growth in areas where it is already occurring, rather than trying to lead growth in a pattern which is not consistent with macroeconomic incentives. On this basis, the Government's performance in allocating investment funds in relation to population share is a reasonable approach, particularly in the face of limitations on overall funding. As urban growth is already occurring on a widely decentralized basis in Kenya, there appears to be little justification in trying to bias the allocation of funds to favor particular "magnet" cities, just as it would be wrong to overemphasize the priority of Nairobi in the allocation of investment funds. The main value of the Government's urban spatial strategy is the recognition of the importance of secondary towns on a generalized basis. The actual allocation of funds between urban areas should depend on the economic rates of return of proposed investments and the capacities of the proposed implementing agencies, rather than trying to program the distribution of funds on the basis of spatial criteria.

1.13 Urban Employment Policy. Beyond the macroeconomic policies discussed above, the Government has also pursued direct policies to stimulate the growth of urban employment. One of the more important programs is the industrial estates program administered through Kenya Industrial Estates (KIE). In addition, several of the larger local authorities are carrying out programs to provide serviced land for workshops, often as an adjunct to low-income housing projects. In general, however, employment planning considerations have not been consistently applied in urban development projects, and a stronger advocacy role within the Government could be usefully considered.

1.14 Urban Investments. Urban investment policy has followed a basic needs strategy emphasizing investments in water supply, sanitation, low-cost shelter, primary education, and basic health care. Kenya has made good progress in carrying out this policy. Safe water supply has been provided to the majority of urban residents. Free primary education has been extended through the middle grades and basic health care has been improved. Kenya has also promoted a basic needs approach to urban shelter, emphasizing site and service type developments and programs of urban upgrading. Despite these innovative efforts, the scale of urban services remains inadequate, with many urban residents living in unserviced and poorly planned housing developments.

1.15 In general, the Government has been more successful in defining new policy directions in the physical aspects of urban investments, and less successful in implementing sound financial policies which could sustain the investments on a replicable basis. In water supply, a few jurisdictions have adopted policies approximating long-run marginal cost pricing, primarily as a response to pressure from international lending agencies, but the sector as a whole has not instituted pricing policies which will sustain an adequate long-term level of revenue generation. In education, a Government grant to cover the cost of teachers' salaries was introduced in 1978 as compensation for a municipal income tax which the Government abolished earlier. The effect of this transfer of funding responsibility was to remove incentives for revenue generation and cost control by the municipalities, which has contributed to the growth of recurrent expenditures for primary education in the Government budget. Even in site and service projects, where Nairobi City Council achieved a reasonable record of cost recovery in the past, financial policies in such areas as interest rates have not kept pace with the rest of the economy, with the result that significant subsidy elements have crept into a sector where the Government has advocated full cost recovery.

1.16 One area of urban investments where the Government has not developed a consistent policy framework is urban transportation. Responsibility for transportation planning is fragmented in urban areas, with local authorities having responsibility for physical investments, while responsibility for overall policy guidance is divided between various ministries. The private transit operators, both buses and "matatus", generally provide efficient service with adequate profitability, but financial policies in the sector are unclear and the legal framework governing transit operations has a number of deficiencies. In addition, road investments in urban areas have been constrained for a number of years, and the state of road maintenance has deteriorated sharply in most localities. While the situation in urban transportation has not reached a crisis condition, continued neglect will eventually constrain the economic efficiency of urban areas in the movement of goods and passengers.

1.17 Two major conclusions can be drawn on the basis of this review of the Government's urban policy framework. The first is that priority should be given to the consolidation of the institutional and financial framework which supports urban development. The Government defined new directions in

urban policy during the past decade, at a time when urban institutions were facing rapid growth in demand for services and increasing financial pressures. The thrust now should be to ensure that the institutions have adequate incentives for cost-efficiency and resource generation, so that the sector can develop a financial base capable of sustaining its operations on a replicable basis. Given the long list of alternative claims on the resources of the central Government, the financial policies of the urban sector itself will have to be the basis for ensuring that Kenya can meet the requirements of increasing urbanization.

1.18 The second conclusion is that the urban sector is expanding in complexity and scale far beyond the management capacity of the central Government. The only reasonable alternative is the continued development of local capabilities, local initiatives, and local resources, with the advice and encouragement of the central Government. Kenya has maintained a tradition of semi-autonomous local authorities, and the basis for the further development of local capabilities is one of the best in Africa. At the same time, Government actions in such areas as local revenues, budgetary responsibilities, and central/local relationships have often been detrimental to the local authorities and inadequately thought-out in execution. The changing partnership between the central Government and the local authorities in urban development needs redefinition, with a clear designation of responsibilities and the identification of the resources necessary to carry them out.

#### The Role of Local Authorities in Urban Development

1.19 Local authorities in Kenya are modeled on the U.K. tradition, with prescribed rights and obligations as put forward in the Local Government Act of the Laws of Kenya. The seven oldest municipalities (Nairobi, Mombasa, Kisumu, Nakuru, Thika, Eldoret, and Kitale) have responsibility for a broad range of urban services, including primary education, health services, road construction and maintenance, water supply distribution, sewerage, public housing, solid waste management, drainage, markets, and social services. Beyond the larger municipalities are a number of smaller municipal, town, urban, and county councils, each with varying responsibilities and financial autonomy depending on their level of development. The majority of public investments in urban areas are financed through debt obligations on the local authorities, although central Government ministries can assume financial and legal responsibility in areas where the local authorities are unable to manage efficiently. Even within the larger councils, the needs, resources, and staff skills vary considerably, with Nairobi dominating all the others in the size of its budget and its political visibility.

1.20 The period since independence has marked a steady trend of increasing control by the central Government over local authority expenditures and their revenue base. During the 1960s, local authorities had virtually complete responsibility for their recurrent revenues and their capital resources. However, local authorities have now become dependent on Government grants for part of their recurrent expenditures, and virtually all local authority capital investments are financed through the central Government development budget. While this change partly

reflects a valid concern by the Government to consolidate its fiscal base and expand and improve the coverage and minimum quality of basic need services, it has caused a deterioration in local incentives to maintain financial control and has resulted in a growing imbalance between the obligations on local authorities and the resources available to finance them.

1.21 Local Authority Expenditures. During the period 1972-81, the gross expenditures of local authorities grew at an average rate of 15% per annum. While significant, this percentage increase approximated the average rate of inflation during this period and provided little margin to expand services for the large influx of urban population experienced over the period. As a result, real expenditures per capita by local authorities have declined sharply over the past decade. Compared to the central Government, expenditures by local authorities dropped from 25% to 8% of the size of the central Government budget between 1969 and 1979. The share of local authorities in gross capital formation in the public sector fell from 15% to 5% over the same period.

1.22 Local Authority Revenues. Local authorities rely on three main sources of revenue to cover their recurrent expenditures; general revenues based primarily on the property tax, specific fees and charges such as water tariffs and license fees, and Government grants. A major problem with the local revenue sources is their inelasticity, which has severely constrained the ability of local authorities to cope financially during an inflationary period. The property tax in Kenya is based on unimproved site values for urban land, which are revalued no more often than every five years, and the only buoyancy between revaluations comes from relatively minor additions to the rolls and politically difficult changes in the annual percentage tax levy. Changes in specific fees and charges have also proved to be difficult, both because of intense political opposition and the reluctance of central ministries to approve increases which they deem to be inflationary. Despite these problems, the seven largest municipalities increased their yield from general and specific revenues by 13% p.a. during the period 1972-83. At the same time, however, the Government constrained the growth of cost-reimbursement grants for centrally-mandated services, and in fact eliminated several of the grants in 1984 as part of a realignment of revenue sources. Finally, the loans raised by municipalities to cover capital expenditures grew at a rate of 13% p.a. between 1972 and 1981, which is below the level required to compensate for inflation.

1.23 Overall Financial Position of Municipalities. In the face of the financial pressures described above, most local authorities have abandoned any pretense of separate fund management, which is the basic organizing principle of local authority accounting. During 1981, only three out of the seven largest municipalities budgeted for a surplus in their General Rate Fund, which is the largest fund for most municipalities and covers all general revenues and expenditures. The remaining municipalities relied on transfers from other funds (primarily their water and housing funds) to cover operating deficits. This practice, because it reduces the cash generation of the various capital funds and obliges the central Government to finance expansion and renovation of the capital stock out of loan funds,

precludes the possibility of sustaining urban investments on a self-replicating basis. As a result of this financial practice, the consolidated funds position of most local authorities has deteriorated sharply over the past few years. Combined with other local authority accounting practices, such as failing to budget for adequate working capital balances or to write off uncollectable debts, the liquidity position of several local authorities has become extremely precarious.

1.24 Many actions of the central Government have increased the obligations of the local authorities without providing adequate matching revenues, but the central Government itself is suffering from substantial budget deficits and is finding it necessary to cut back on its operations. For its part, the central Government has failed to establish an equitable basis for the sharing of centrally-mandated services, with a satisfactory designation of adequate revenue sources to carry them out. The local authorities, on the other hand, have often been reluctant to increase taxes and fees on an annual basis, and many of them have neglected to maintain adequate financial controls, trusting that the central Government would ultimately bail them out. In the absence of clear and consistent policies on local authority finances, the local authorities have had few incentives to find imaginative solutions to their financial problems. What has become clear is that the reforms and changes which have been introduced up until now have not been adequate to provide local authorities with the means to fulfill their designated role in providing for urbanization in Kenya.

1.25 Possibilities for Reform. While there are a number of options for increasing the revenue yield of existing local taxes, the lack of a political consensus has precluded any progress on this problem. However, unless improvements are introduced into the system of the local authority financing, this problem will ultimately rebound on the central Government. Urban areas are the centers for wealth and economic activity, and they should be allowed to raise more of their own revenues as part of any economic recovery program for Kenya. Unfortunately, neither the central Government nor the local authorities have a comprehensive plan of action for dealing with the situation. The basic data and analysis necessary to justify reforms in the financial system of the local authorities have not been compiled. It would be worthwhile to update the 1976 IMF study at this point, with particular focus on improving the elasticity of local authority revenues and establishing norms for evaluating local authority services and revenue generating capacity. A study cannot substitute for the most critical ingredient, however, which is a commitment to resolve the problem and a willingness to implement the results of a study when it is completed.

1.26 In addition to reforms in the recurrent revenue position of local authorities, the capital financing mechanisms for local authority investments also need review. The primary source of loans for urban development is the Local Government Loans Authority (LGLA), which was originally established as a central pool for local authority funds which could be relent for other purposes until they were required. With the widespread practice of using surplus capital funds to cover recurrent deficits, few local authorities have funds to deposit with LGLA, and a number are having difficulty in maintaining their debt service

repayments. At the current time, the LGLA functions primarily as a conduit for funds from the Government's development budget to the local authorities. Eventually, the LGLA could be upgraded to perform many of the functions of a municipal development bank within the context of its existing legislation. Even without expanding the LGLA's sources of funding, however, there is an extremely important role which can be introduced through this agency. At the present time, there is no systematic analysis of the impact of proposed urban investments on the overall financial position of the implementing local authority. Investments are reviewed on a case-by-case basis, generally with primary emphasis on their technical merit, and funding is determined by the overall availability of funds to LGLA. In this situation, there is no incentive for the local authorities to demonstrate financial discipline or to limit capital expenditures within their debt-carrying capacity. Because LGLA is vested with the authority to grant or deny loan sanctions, it would be the logical place to improve the systematic review of urban investments in relation to the overall financial position of the local authorities.

#### The Role of Central Government Agencies in Urban Development

1.27 A recent Government report on public expenditures has emphasized the need to improve the coordination between urban development planning and the budget procedures of the local authorities and the central Government.<sup>2/</sup> In addition, the Government has recently introduced a "District Focus" to planning in order to improve the local coordination of investment projects and encourage the development of economic activity throughout Kenya. These events indicate the importance that the Government attaches to the improvement of development planning, including the activities of the local authorities. On this basis, the role of the central Government in urban development can be defined as the following:

- (a) provide a coordinating function for the review of urban investments within the District Focus and the Government's Forward Budget process;
- (b) provide a forum for the coordination of inter-sectoral investments in urban areas and ensure that the sequencing of urban investments is internally consistent;
- (c) provide policy guidance to local authorities and facilitate the adoption of "best practices" and the dissemination of new techniques; and
- (d) encourage the development of local capabilities and initiatives and assist the local authorities in assuming greater control of their affairs.

Based on these objectives a structure for coordinating urban development planning can be defined, along with the corresponding functions and responsibilities of each implementing agency.

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<sup>2/</sup> "Report and Recommendations of the Working Party on Government Expenditures," Government of Kenya, June, 1982.

1.28 The main point of departure for the coordination of urban development should recognize the local authorities as the "prime clients," with the role of the central Government agencies being to facilitate and oversee the flow of investment funds to the local authorities and provide assistance in areas where the local authorities do not have an internal capability. This report advocates the type of flexible and overlapping sharing of responsibilities which many central Government agencies have already adopted with respect to the local authorities, where functions can be delegated between local authorities and the central agencies as individual circumstances warrant. Improvements in urban development planning and budgeting procedures should also include strengthening of the monitoring and evaluation of existing investment programs, a task which is being assigned increasing importance by the Ministry of Finance and Planning in its efforts to speed up the pace of development projects.

1.29 Because of the number of different agencies involved in the planning process, a fuller discussion of this topic is reserved for the main text. However, two clarifying points are worth raising. The first is that central Government agencies are also strapped for manpower and funds; it is unrealistic to argue that strengthening of urban development planning procedures should require a large expansion of staff and responsibilities. It will be necessary for the various ministries involved in the process to identify areas in which they have a comparative advantage in facilitating urban development and make these skills available to the planning process. For example, the Ministry of local Government and the Ministry of Works, Housing and Physical Planning should share the tasks of monitoring and evaluating various urban investment proposals, while LGLA should strengthen its screening value on the financial viability of proposed investments. The second point concerning the proposed planning process is that institutional structures are no more than enabling mechanisms and depend wholly on the staff comprising them. While many of the larger local authorities can and do take full control of their development programs, shortages of qualified staff at both local and the central levels are a recurring problem in Kenya. For smaller local authorities, this problem is especially acute, and most will have little choice but to seek extensive assistance from central Government agencies in planning and implementing their development programs. The central agencies should operate under the assumption that a major goal of urban development is the improvement of local capabilities to assume greater control. This will require both external training programs as well as in-service training of local authority staff, an effort which may ultimately have the most important impact on facilitating the urbanization process in Kenya.

#### Servicing Urban Land: Institutions and Finance

1.30 In order to absorb an additional six million urban inhabitants over the next twenty years, the cities of Kenya will have to expand and make provision for the extension of urban services to large areas of new land. The timing and quantity with which land is converted to urban use will be a major factor affecting the standard of living and the productive efficiency of Kenya's urban population. Moreover, it is a difficult area in which to intervene effectively, being restricted by legal and administrative procedures, involving cooperation or coordination between

the public and private sectors, and requiring an adequate flow of finance for the construction of infrastructure and the development of residential and commercial facilities. The fact that Kenya, like most developing countries, has not been able to maintain an adequate system of providing serviced land for urban growth is demonstrated by the growing slum settlements surrounding all urban areas, containing an estimated 18-40% of the urban population in various towns.

1.31 Kenya has actively developed policies over the past decade to provide serviced land to low-income urban dwellers through site and service projects and slum upgrading efforts. Some of these projects have been quite successful, with the Bank-financed Dandora project implemented by Nairobi City Council having achieved virtually all of its objectives. Nevertheless, many public sector projects have experienced a familiar sequence of delays in land acquisition, disputes on physical design, cost overruns, and slow start-up of housing construction. During recent years, the public sector managed an annual growth rate in housing provision of less than 2%, during a time when the private sector housing stock (including unplanned housing developments) grew at 10% per year. Because of various constraints in the housing sector, the public and formal private sectors are expected to produce only one-quarter of the new residential plots which are required for urban growth over the next five years, with the remainder of urban households relying on the informal sector for their shelter provision.

1.32 The failure of Kenya's public housing program to achieve an adequate level of performance requires a frank reappraisal of the assumptions underlying the policies. In particular:

- (a) the Government has emphasized public sector interventions, even though 80% of the urban housing stock is privately-owned and the amount of publicly-available land is rapidly dwindling in many urban areas;
- (b) the Government's housing policy has been based on the premise of home ownership, even though three-quarters of urban households are tenants and experience with existing site and service projects demonstrates that the projects are quickly converted into rental accommodations; and
- (c) despite efforts to lower the cost of site and service projects, inflation in building costs has made projects unaffordable to the original intended beneficiaries and a substantial drag on the Government's limited investment funds.

Technical modifications to existing policies are unlikely to be sufficient to bridge the difference between desired and actual performance in the sector. It has been suggested that relaxation of building by-laws and formal planning procedures would encourage more private developers to install adequate infrastructure services. The Kenya Low-Cost Housing By-Laws Study recommended a number of modifications to existing regulations which would go a long way in making building standards in Kenya more compatible with current conditions in the sector. Nevertheless, given the

lack of suitable housing finance geared to develop land at a standard which is affordable to low-income residents, technical revisions to building regulations are unlikely to stop the continuing spread of unplanned housing developments. Given these considerations, it is clear that priority in the allocation of urban investment funds should go to projects with shorter gestation periods, faster recovery of costs, and possibilities for mobilizing private resources as much as possible.

1.33        Servicing of Private Land. Given that public investment funds for urban areas are unlikely to increase by a significant amount in the near future, the only feasible method of providing for urban growth, other than the continuing spread of slum settlements, is for the Government and the local authorities to distribute the available funds as broadly as possible. In particular, it is recommended that the public sector should service privately-held land at minimum standards and on a massive scale. There are several advantages to servicing privately owned land without going through the acquisition process. Public funds do not have to be expended on expensive programs of land acquisition. As part of the development agreement, the private land owner can be required to surrender free of charge the land needed to install roads and services, often amounting to 20% of the total land area. The mobilization of private funds for providing additional shelter is maximized, as the private owner is responsible for housing construction using his own funds or financing secured on the private market. Finally, quicker methods of recovering public investment costs can be utilized, such as frontage charges for road construction. Other investment costs may have to be recovered through more indirect means, such as water tariffs and increased property taxes arising from changes in land use classification. However, since better procedures and safeguards exist for collecting water fees and taxes than for the plot charges used in site and service projects, the lower administrative costs and better collection performance may more than compensate for any loss in revenue as compared to plot charges.

1.34        By undertaking to work in cooperation with private land owners, the Government would be ensuring that basic needs services are extended to the large population of urban renters, who are largely ignored in current housing policy. Compelling as this argument is on social and financial grounds, there are a number of impediments to its implementation. First of all, the local authorities will have to enter into voluntary agreements with private land owners, a process which is complicated by time-consuming procedures and the difficulties of obtaining a consensus agreement. In addition, the local authorities would forego politically attractive policies such as allocation of land to individual plot holders, control of rentals at less than economic levels, and various restrictions on the quality of building construction. Finally, the lack of a clear linkage between financial and physical considerations in the planning process makes acceptance of reduced physical standards difficult. Nevertheless, given the economic conditions expected to prevail in Kenya over the next decade and the restricted outlook for growth in investment funds, the only choices available for the bulk of the urban population may inevitably be between minimal standards and no standards.

1.35 The Role of Public Agencies. The local authorities will play an important role in the identification and implementation of potential projects. In doing so, they will need the support and encouragement of central Government agencies, of which one of the most important is the National Housing Corporation (NHC). NHC controls the allocation of funds to local authorities for low-income shelter projects and manages the implementation of projects for many of the smaller councils. Despite the emphasis given in the National Development Plans on site and service projects, NHC has concentrated the bulk of its activity on fully-constructed housing for the middle income group and has shown little imagination in the implementation of its low-income shelter program. On this basis, there is little justification for maintaining NHC in a monopoly position on the allocation of public housing funds. These funds could be made available through other institutions, such as the LGLA and the commercial housing finance companies, on the basis of the competitive merit of various proposals to service the target income group, rather than relying solely on NHC to provide this initiative. As for NHC's housing development activities, it needs to define a position in the shelter market which would justify its continuing involvement. One possibility is the planning and implementation of urban servicing and shelter projects on a contract basis for the smaller local authorities, and another possibility is innovative site and service type developments for the lower income group in partnership with commercial housing finance institutions. The Government should consider providing technical assistance to NHC for a limited period to allow it to establish a suitable position in the shelter market, after which NHC would be responsible for obtaining development funds on a competitive basis rather than through the Government budget.

1.36 Commercial Housing Finance. Several studies of the housing sector in Kenya have determined that the major constraint on the development of middle and upper income housing is the lack of suitable housing finance, rather than a lack of experienced private developers. There is a broad gap in the availability of housing finance between commercial sources and the public sector site and service programs, covering housing units in the range of KSh 40,000 - 150,000, which are affordable to households in the middle income range. As a result, middle income households are largely frustrated in their desire to improve their housing, causing demand pressure on lower-income projects and inhibiting the motivation for increased savings. The Government should support innovative programs to extend the coverage of commercial housing finance to lower and middle income households. These might include special programs involving private developers and housing finance companies in providing low-cost housing using reduced building standards, as well as site and service type programs combining housing finance companies with the local authorities or NHC in promoting self-help development. Such programs are underway in Zimbabwe and Malawi, as well as efforts in Kenya, and these concepts need to be developed and extended to provide a full range of housing options for urban households in Kenya.

Summary of Recommendations

1.37 The major findings of this report are the following:

- (a) Role of Local Authorities: Urban local authorities provide the basis for the development of local capabilities, initiatives, and resources, all of which are necessary to provide for urban growth in Kenya. The changing partnership of the local and central agencies in urban development needs redefinition, with a clear designation of responsibilities and identification of the financial and human resources necessary to carry them out.
- (b) Local Authority Finances: The deteriorating state of local authority finances is the major constraint on the continued growth of urban services. The structure of recurrent revenues needs improvement, with particular emphasis being given to improving the buoyancy of general revenue sources. The system of central Government grants-in-aid to local authorities requires careful scrutiny, with a more consistent basis established between the obligations on the local authority to extend services and the revenues available to support them. Finally, capital financing decisions for local authority investments need to pay greater attention to the financial ability of the local authority to maintain the investment and cover the debt-service obligation within its revenue structure.
- (c) Urban Investment Planning: The planning of urban investments should focus on the local authorities as the "prime client" for urban development. The role of the central Government agencies should be to assist in the screening of urban investments within the District Focus on development, provide technical assistance and training to local authorities in developing their own capabilities, and assume an advocacy role for urban development through the identification of resources and cost-efficient programs to provide for urban growth.
- (d) Spatial Investment Criteria: Urban investments should be chosen according to their individual rates of return and the capacity of the implementing agencies, rather than to influence a particular spatial pattern of urban growth. This implies a policy of "evenhandedness" in choosing urban investments which would primarily support growth in areas where it is already occurring. The secondary towns are expected to be major centers of urban growth and will therefore require access to a greater share of investment funds.
- (e) Servicing Urban Land: Major priority should be given to the extension of urban services on a widespread basis, such as through the servicing of privately-held land. To reduce costs and mobilize private resources as much as possible, consideration should be given to the phased introduction of basic infrastructure, voluntary agreements with private landowners to obtain land rather than public acquisition of

land, faster approval procedures by local authorities, greater willingness to compromise on adoptive standards, and minimum controls consistent with public health objectives.

1.38 In support of these findings, the following actions are proposed:

- (a) Strengthening of local authority finances, with emphasis on measures to increase the elasticity of local authority revenues, improvements in revenue collection procedures, methods of measuring the productivity and demand for local authority services, and clearer designation of the responsibility for funding centrally-mandated services;
- (b) Establishment of an inter-ministerial urban development planning framework, which would facilitate the screening of urban investments in the Forward Budget process, provide a forum for ensuring inter-project consistency, and undertake monitoring and evaluation of urban investments to improve the speed of implementation;
- (c) Improvement of the financial review procedures of LGLA, with emphasis on the analysis of the impact of proposed investments on the overall financial position of the local authorities;
- (d) Development of criteria for pricing urban services, such as water, housing, and trading undertakings, which would cover recurrent costs and provide adequate funds for capital replacement and expansion;
- (e) Adoption of the Kenya Low-Cost Housing By-laws Study;
- (f) Establishment of NHC on a self-financing basis, with public housing funds being redirected through other financial agencies; and
- (g) Innovative programs to extend coverage of commercial housing finance to lower and middle income households through joint projects with local authorities, NHC, and/or private developers.

1.39 In addition, the following actions are recommended for serious consideration:

- (a) Clarification of the policy framework for urban transportation, including support for urban road maintenance, allocation of a reasonable amount of investment funds for road expansion and traffic engineering improvements, and clarification of ministerial responsibilities for public transport policy;
- (b) Adoption of a uniform pricing policy for water supply;

- (c) Adoption of a graduated system of land-use zoning with varying degrees of control on physical development;
- (d) More attention to employment concerns in urban development planning; and
- (e) Review of training requirements for local authorities and other personnel involved in urban development.

### Conclusion

1.40 Urbanization in Kenya has neither top priority in the Government's list of current problems nor any special claim over other sectors to increased development resources. On the other hand, urbanization is too important as a long-term issue to neglect the institutional and financial framework required to support this transition in Kenya's development. Given the heavy demands on the central Government, local authorities will bear the major responsibility of providing for urbanization, both through the development of local resources and by the identification of innovative and cost-efficient ways of extending urban services. However, local authorities cannot do it on their own. The central Government must provide financial legislation and urban planning procedures which support the local authorities. This report has presented a number of recommendations for improving the cost incentives and financial discipline of urban development programs. As many of the recommendations would require changes in current methods of operation, it is not expected that they will be accepted without additional study and careful consideration by the Government. It is intended that the analysis presented here should provide a framework for a continuing dialogue on the role of urbanization during the difficult economic times being experienced in Kenya. This is an important task in preparing for the adjustments in Kenya's economy which will be required during this decade.