Report No. 37688-KE

Kenya
Unleashing the Potential for Trade and Growth

February 2007

Poverty Reduction and Economic Management 2
Country Department for Kenya
Africa Region

Document of the World Bank

Currency Equivalents
(Exchange Rate Effective)

Currency unit = Kenyan shilling
US$1.00 = Ksh71.1 (November 2006)

Fiscal Year
July 1 – June 30

ABBREVIATIONS AND ACRONYMS

AGOA	American Growth and Opportunities Act
ATC	Agreement on Textiles and Clothing
ATI	African Trade Insurance Agency
CAFTA	Central American Free Trade Agreement
CET	Common External Tariff
CGE	Computational General Equilibrium
COMESA	Common Market for Eastern and Southern Africa
CRM	Customs Reform and Modernization Programme
DfID	Department of International Development
DOT	Direction of Trade
DTIS	Diagnostic Trade Integration Study
EAC	East African Community
EPA	Economic Partnership Agreement
EPC	Export Promotion Council
EPZ	Export Processing Zone
EPZA	Export Processing Zone Authority
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement/Area
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GTZ	Gesellschaft fuer Technische Zusammenarbeit (German Development Agency)
GOK	Government of Kenya
HDI	Human Development Index
ICO	International Coffee Organization
ICT	Information and Communication Technology
IMF	International Monetary Fund
IP-ERS	Investment Programme—Economic Recovery Strategy
ITA	Information Technology Agreement
KIPPRA	Kenya Institute for Public Policy Research and Analysis
KPA	Kenya Port Authority
KRA	Kenya Revenue Authority

KEBS	Kenya Bureau of Standards
KEPHIS	Kenya Plant Health Inspectorate Service
KIHBS	Kenya Integrated Household Budget Survey
LDC	Least Developed Country
MFA	Multi-Fiber Agreement
MFI	Micro-Finance Institution
MFN	Most Favored Nation
MSME	Micro, Small and Medium Enterprise
NCBP	National Cereals Produce Board
NEPAD	New Partnership for Africa
NES	National Export Strategy
NGO	Non-Governmental Organization
OECD	Organization for Economic Cooperation and Development
PSDS	Private Sector Development Strategy
RTA	Regional Trade Agreement/Area
SACCO	Savings and Credit Cooperative Societies
SACU	Southern African Customs Union
SADC	Southern African Development Community
SPS	Sanitary and Phytosanitary
SME	Small and Medium Enterprises
TBT	Technical Barriers to Trade Agreements
TREO	Tax Remission for Export Office
TRS	Time Release Study
UK	United Kingdom
US	Unites States
USAID	United States Agency for International Development
VAT	Value Added Tax
WTO	World Trade Organization

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The team visited Kenya over a period between July 2004 and November 2005 when a discussion workshop of the report was held. PS Nalo and former PS N'geno from the Ministry of Trade and Industry advised the team. The report benefited from comments by its peer reviewers Vyjayanti Desai (AFTPS), Bernard Kagira (Keplotrade), Richard Newfarmer (PRMTR) and from Andrea Nicolaj (EU Commission). The report was desk topped by Marjorie Kingston (AFTP2). Colin Bruce (Country Director, Kenya), Kathie Krumm (Sector Manager, AFTP2), John Panzer (Sector Manager, PRMTR) and Praveen Kumar (AFTP2) provided guidance. Financial assistance from the EU for the preparation of the report and from the Bank Netherlands Partnership Program for the Discussion Workshop is gratefully acknowledged.

FOREWORD AND SUMMARY

OBJECTIVE AND ROADMAP OF THE REPORT

The report "Unleashing Kenya's Potential for Trade and Growth" assesses Kenya's trade performance, and identifies key domestic constraints to its further integration into the global economy. Furthermore, the report advances a set of recommendations to tackle these constraints, with a focus on how trade can contribute to growth and poverty reduction in the country. Specifically, the report aims to support the Government of Kenya (GOK) to: realize its Investment Programme for the Economic Recovery Strategy for Wealth and Employment Creation 2003-2007 (IP-ERS), to implement its National Export Strategy (NES); to implement its Private Sector Development strategy and formulate a trade-policy strategy.

The IP-ERS, released in 2003, marked an attempt to reverse declines that had occurred in the economy over the previous two decades: GDP growth and standards of living deteriorated significantly, and the incidence of poverty increased. During the 1990s, on account of worsening investment climate and physical infrastructure, business confidence declined, and with it private investment flows, both domestic and external. The ERS objective is to revive growth by focusing on promoting investment and improving competitiveness through a revitalized role for the private sector, improved delivery of infrastructure services and enhanced security. In the IP-ERS, further trade integration and export promotion falls under pillar 1, "Strengthening Economic Growth." For specific action on stimulating exports, the IP-ERS refers to the National Export Strategy (NES); for strategy on trade-policy matters it will refer to the pending trade-policy strategy.

The focus on trade as an engine of growth is premised on the fact that trade significantly contributes to growth in a variety of ways. Domestic factors of production tend to be more efficient when engaged in export-oriented industries. There are also gains to be realized from technological spillover and learning, and knowledge is sometimes transferred in the form of traded goods, particularly capital goods. Research has established a positive relationship among trade openness, income growth and poverty reduction.[1] Furthermore, trade between countries has grown far more dynamically over the past decade than have individual economies.[2] Therefore, promoting Kenya's further integration into the global economy is expected to yield positive results in terms of economic growth. If, as a result of rational choices on regulation, policy and investment Kenya's exports grow at the average rate of

[1] See World Bank 2001.

[2] In Africa, trade has grown by 2.7 percent from 1977-87 and by 5.4 percent from 1987-97; per capita GDP, on the other hand, declined in the 1980s by 1.1 percent and by 0.2 percent in the 1990s; for all developing countries, the difference becomes even more significant: trade grew by 4.8 percent from 1977-1987 and by 11.3 percent from 1987-1997 while per capita GDP only rose by 0.7 percent in the 1980s and 1.7 percent in the 1990s (source: World Bank 2004).

world trade growth over the past decade, the country will progress considerably towards its vision of high growth rates.

The World Bank's Country Assistance Strategy [A More Equitable, Prosperous and Competitive Kenya Country Assistance Strategy (CAS) 2004-2007] is closely aligned with the IP-ERS. It organizes support for Kenya in four areas, trade falling under the second: "Reducing the cost of doing business and improving the investment climate." On trade issues, the CAS focuses on identifying barriers to trade, which GOK can then address in furtherance of increasing trade and tourism. The World Bank also supports Kenya's trade and export promotion agenda through a regional trade and transport-facilitation project, an initiative to improve the Northern Corridor, and technical assistance for EAC customs union implementation, and trade policy formulation.

This report aims to support GOK's implementation of the NES and the Private-Sector Development Strategy and formulation of trade-policy strategy by providing analysis of a number of issues where gaps were identified. The report is organized as follows: An executive summary highlights the main messages contained in the report followed by a matrix of priority actions that have been validated during a workshop held on the report in November 2005. The main body of the report contains six chapters: The first chapter provides background on Kenya's economic performance and structure, the second chapter reviews Kenya's trade performance. This is followed by an evaluation of Kenya's so-called behind-the-border constraints to trade in the third chapter. The fourth chapter offers an analysis of Kenya's trade regime, trade policies and the institutional set-up for trade policy. The fifth chapter addresses issues in Kenya's key trade and export sectors. A final chapter brings together main conclusions and recommendations developed over the course of the report.

The analysis in this report complements recent studies done on the legal and administrative costs of doing business in Kenya, and on skills constraints to productivity. An Investment Climate Assessment for Kenya and a FIAS report on the commercial legal framework and administrative and regulatory barriers to investment are also relevant. The report also builds on the 2003 Country Economic Memorandum for Kenya, which laid out a Policy Agenda to Restore Growth; ongoing research into Kenya's labor market and on drivers of growth will complement this study and related work. The report's focus is on merchandise trade; analysis of trade in services is needed to complete the diagnostic of trade integration for Kenya, but this was not feasible at the time of the report because the necessary data was unavailable for Kenya.

The report advances a number of recommendations for the GOK that will facilitate tackling constraints and taking advantage of opportunities for further trade integration and export development; these measures were discussed with Kenyan stakeholders at a workshop in November 2005. Priority actions have been organized in an Action Plan (ANNEX: Kenya Trade Report - Action Plan) based on which the trade and export-promotion agenda can be advanced.

Between the time analytical work was undertaken for the report and its publication, some of the findings and recommendations have had a significant and positive impact on programs, strategic documents, sectoral dialogue and projects. Specifically,

- The Time Release Study produced for this report significantly shaped the customs part of the Kenya Revenue Authority Reform Programme (which is supported by several donors). The TRS served to identify the weakest parts of the customs chain, and as a benchmark for the outcome matrix of reforms. Since the completion of the TRS, a number of reforms steps have been undertaken, such as installation of a fully automated customs system (SIMBA), and automatization of port processes.
- The trade report's sections on behind the border issues impacted Kenya's Private Sector Development Strategy, the flagship document of the MOTI that was recently finalized. After the workshop in November 2005, the trade report team was invited to present to the PSD Strategy team, and afterwards invited to comment.
- On the sugar sector, the impact has not been the report itself, but rather the dialogue which was started with the visit by the expert, and the messages he communicated to the policy makers. This work was followed up in March 2006, when the expert traveled to Kenya again to broaden the dialogue by adding poverty and social issues.
- The work on trade facilitation and transport provided input and background to the World Bank's East Africa Trade and Transport Facilitation project.

An important dimension of this report is its knowledge management. The report and its background papers, as well as studies and references cited and additional material can be found on the Kenya Trade Report website (under www.worldbank/kenya) which is a resource for policy makers, donors and researchers interested in trade integration and export development in Kenya.

EXECUTIVE SUMMARY

Export performance and potential

1. There is tremendous potential for trade to play a key role in driving and sustaining growth and poverty reduction in Kenya. Whilst Kenya has assumed an important role in multilateral trade institutions and in advancing regional integration, domestically, economic growth in Kenya has been largely unimpressive till recently. The ratio of trade to GDP has fallen sharply from 71 percent in 1995 to the current level of around 56 percent. Kenya's share of world trade has steadily declined and is now less than half of mid-1980s levels. Kenya has lagged faster- growing countries in terms of the pace of its integration into the global economy, both in terms of trade and attracting FDI. Thus, there is significant potential for greater participation in international markets to support growth and poverty reduction.

2. Kenya has had some notable achievements: in cut flowers and fresh vegetables the country has built a competitive supply chain based on its comparative advantage as an off-season producer; in the textiles and clothing sector Kenyan exporters have been able to take advantage of AGOA preferences. Tourism is the most important of Kenya's services exports, and the industry has been booming since the US and UK travel bans were lifted. At the same time Kenya has experienced diminished competitiveness in many of its exports, coffee being a notable example.

3. While Kenya has expanded its non-traditional natural resource-based exports, a significant share of exports are still agricultural commodities (mainly coffee and tea), for which prices have declined over the past decade, a trend expected to continue in the medium term. Yet natural resource-based exports, in which Kenya has a comparative advantage, are expected to continue to be the mainstay of its trade for quite some time.

4. The government should continue to focus on providing an enabling environment to recover, maintain or improve its competitive position in traditional sectors, and non-traditional, natural resource-based industries in which there is potential for growth and poverty reduction.

5. In the medium to long term, the government is rightly encouraging export development and diversification into labor-intensive manufacturing and processing industries through its National Export Strategy (NES). One option that has not yet been properly explored is further integration into ***international production sharing***, which is fast growing internationally against the backdrop of declining transport costs. South Africa is emerging as a key player on the continent. Some of Kenya's trade with South Africa is already in components. Production sharing may also hold potential for regional trade.

6. Traditionally, Kenya's main export market has been the EU. Given the sluggish economic growth there in the past decade and the contrastingly dynamic performance of South and East Asian economies, Kenya would do well to secure access to the latter's markets as well. South and East Asia's populations are likely to maintain strong demand for food items such as coffee, tea, nuts and horticulture, which is perhaps the sub-sector in which Kenya has the greatest competitive edge. However, Kenyan exports still face relatively high tariffs to enter these markets.

7. Kenya is deepening regional trade integration within the EAC, and with COMESA. There is some potential for growth in regional trade for commodities such as maize, dairy, processed food, and cotton and cotton products following the expiry of AGOA's provision allowing the use of third-country fabrics; regional trade in finished products, however, holds less growth potential because of low complementarity among regional partners.

8. The most important obstacles to export expansion and diversification are Kenya's commercial and investment climate, i.e. the cost of doing business, the weakness of the legal framework, licensing, complex rules and regulations for exports, and the poor quality and high cost of business services in Kenya. The GOK is addressing many of these issues in its PSD Strategy and the Investment Climate Action Plan; the priority now is to swiftly implement these initiatives. Also, issues related to infrastructure and utility services hamper exports, in particular high prices for telecommunications services, costly and unreliable power, the high cost of transport, low quality of trade logistics, and insufficient capacity for standards compliance. For MSMEs lack of access to export finance is a barrier to exportation. For trade to play a key role in driving and sustaining growth, reforms and investment need to be put in place to address these behind-the-border issues. The role of trade policy should be to complement this agenda.

The behind-the-border reform agenda (trade facilitation)

9. A key hurdle for exports is the poor quality of ***transport and trade logistics***, namely the quality of roads and delays in administrative procedures along the Northern Corridor, which drive up transport costs. Sector studies in Kenya reveal that 37 percent of the cost of sugar cane production goes on transport; for coffee, transport costs are a staggering 69 percent of total costs. Coffee and sugar production are region specific; improving roads and other transport infrastructure in these areas should be a priority. These problems have been thoroughly analyzed and action plans to address the problems are satisfactory. However, ***implementation*** will require: the political will to eliminate rent-seeking activities and vested interests; the capacity to implement, coordinate and supervise the action plans; and the resources to undertake the necessary investment. The first priority should be to increase efficiency at the Port of Mombasa through the automation of container tracking, which offers potential productivity gains (as can be seen at the Port of Dar es Salaam) but which has so far has been resisted by vested interests. A second priority is to use the recently completed Customs Time Release Study to benchmark reforms and progress. Private-sector participation in these reforms is critical; as the main potential beneficiary the private sector can be expected to drive the process forward; close consultation with the private sector will also ensure that new hardware and software is compatible with the industry's technology

standard. Apart from improving poor road quality, harmonization of axle-load regulations within the EAC and COMESA, and improvement of weighbridges will be vital to reduce transport costs. Phasing in weigh-in-motion bridges and adding mobile bridges to detect overloaded trucks should be a priority.

10. Compliance with ***food safety and agricultural health standards*** has been an important factor driving Kenya's diversification into such non-traditional exports as horticulture, cut flowers and to a lesser extent, fish. Public-private partnerships in these sectors, encompassing a suitable regulatory framework and the broad adoption of good agricultural and manufacturing practices, should serve as an example to other industries. The development of such systems is crucial if Kenya's industries are to meet the evolving challenges associated with competing in developed markets. Three broad priorities are: raising awareness on good agricultural practices; improvement of pest risk assessment and management capacities; and improving landing sites and environmental management in Lake Victoria.

11. In other sectors, ***quality, standards and conformity-assessment systems*** should follow a medium-term strategy of diversification into new regional and global export markets. With this goal in mind, it is important that standard-setting and conformity assessment institutions are re-oriented toward facilitation. This will necessitate increased private-sector participation in the regulatory debate and private-sector provision of services (mainly testing, conformity assessment and consultancy), whenever possible. Regionally, GOK should lead efforts to develop joint SPS-management capacity and share selected resources. The use of Kenya's pending accreditation system as a regional platform is an obvious starting point. Other promising areas for regional cooperation are: cross-border management of pests and diseases (a clear public international/regional good); food safety, hygiene services and training in the tourism industry; and establishing "regional centers of excellence" in instances where capacity is lacking in neighboring countries and regional markets.

12. For MSMEs, ***access to finance*** is a key constraint to export development. The problem is not access to specific export financing products, but rather one of access to financing or insurance for the amounts necessary in export transactions. MSMEs have to rely on non-banking MFIs, because the Kenyan banking sector does not, in general, provide financing to MSMEs. MFIs, however, cannot finance the amounts of working capital necessary for export transactions. To improve access to finance, GOK should create a regulatory framework to increase the flow of funds between various MFIs so that they can provide larger loans. Furthermore, GOK should develop a credit registry to enable at least some MSMEs to access banking and insurance services.

13. Kenya's ***telecommunications*** services had been expensive compared with those of other Sub-Saharan African countries and even more so in comparison with those of East and South Asia. High telecommunications costs hamper economic growth and exports in particular, as long distance telephone charges are particularly burdensome for the export industry. The reason for Kenya's expensive telecommunications services was a delay in the reform agenda set out in the ERS; according to preliminary estimates based on cross-country

regressions, this delay may have resulted in US$180 million in lost customer savings and increased and an additional US$87 million in forgone revenue. The priority for GOK is to continue pursuing reforms in the telecommunications sector with urgency to promote open competition in all segments of the telecommunications sector.

14. ***Access to, reliability, and the cost of power*** emerged as a major obstacle to manufacturing firms in the Investment Climate Assessment for Kenya completed in 2004. The poor performance of the power sector costs firms on average almost 10percent of annual sales in terms of lost production; 70percent of firms were forced to invest in their own generators to bridge blackouts. Power is of particular importance for the key export sectors of textiles and coffee.

Trade Policy and Institutions

15. Trade policy can be used to advance Kenya's trade and export development agenda in a number of ways:

16. In implementing the EAC Common External Tariff, Kenya significantly reduced its trade barriers. In general, the three-band CET is relatively simple and transparent. However, it preserves significant ***tariff dispersion***, and ***escalation***; the latter could be particularly detrimental to production sharing. Furthermore, the CET has an extensive exceptions regime. Reducing tariff dispersion and escalation, and the number of exceptions should be a priority for the 2009 CET review.

17. Regional integration will bolster Kenya's efforts to address the behind-the-border agenda, in particular in terms of trade logistics. Kenya should push for speedy implementation of the EAC customs-harmonization agenda.

18. At the multilateral level, Kenya's key interests would be advanced by using the Doha Round to negotiate improved market access to dynamic South and East Asian markets, in which Kenyan exports continue to face relatively high trade barriers. Furthermore, Kenya should use the ***GATS framework*** to consolidate domestic reforms, and reduce the cost of IT and business services for its economy.

19. Among Kenya's priorities during ***EPA negotiations*** with the EU should be to press for more liberal rules of origin, and to discuss with the EU relaxing restrictions on temporary migration of workers. When the EPA enters into force, GOK must take the necessary actions to avoid trade diversion, especially in the services sector. This may necessitate reduction of the tariff schedule and liberalization of the service sector on an MFN basis. Depending on the prevailing level of regional integration, Kenya may not be able to take such actions unilaterally. It may be necessary to begin negotiation on the reform agenda complementing well before full implementation, which is expected to take at least a decade.

20. Many constraints to export development and diversification in Kenya are beyond the reach of the Ministry of Trade and Industry (MoTI). Therefore, MOTI, as champion for trade and export expansion, must promote ***close coordination*** among the various ministries and

other public bodies. If the lack of inter ministerial coordination restricts export trade, addressing this should be a priority. It is equally important that the MOTI closely consults with exporters so as to remain informed about developments. To that end, the various public-private consultative bodies and committees on trade policy should be consolidated into one such body. Particular attention should be given to ensuring effective private sector participation in the consulting mechanisms.

21. There is a critical lack of reliable ***trade data*** on merchandise and services trade in Kenya that must be remedied urgently. Without solid statistical data, assessment of trade-policy is difficult, and recommendations based on inaccurate information are likely to result in misguided strategies. Three issues need to be addressed: inconsistent and variable processing of exports originating from EPZs, a decline in the accuracy of export statistics dating back to the 1980s, and a lack of coordination in efforts to collect data on service-sector trade.

Sector specific issues

22. The National Export Strategy Implementation Action Plan 2005 – 2008 identifies a list of priority areas for reform and investment to address key constraints for the sectors with the highest potential for export expansion and diversification. ***Successful implementation of the NES Action Plan*** should help trade to play a key role in driving and sustaining growth and poverty reduction in Kenya.

23. Recent reform of the coffee sector is expected to yield significant growth in output, exports and increases in coffee farmers' share of sales proceeds. The 2002 Coffee Act has recently been reformed to allow farmers to either sell their coffee through the central auction, or to sell directly to roasters abroad through a marketing agent. To enable small holders to benefit from this important change Government should take measures to publicize the new regulations widely to the coffee growing community.

24. Lessons from the successful development of the cut-flower, fresh- vegetable and tea sectors should serve to guide GOK's policy reform. As regards the horticulture industry, much of the success has been attributed to the "light" regulation and taxation by the Horticultural Crops Development Agency. Tea exports have benefited from the supervision of the Kenya Tea Development Agency which efficiently manages input provision and collection of green leaf tea, and from allowing smallholders to sell their produce directly to buyers.

25. For the horticulture sector, Government priorities should be to continue ***improving the enabling environment for the private sector*** such as upgrading security and transport infrastructure in the key horticulture growing regions. As regards Government intervention, the recommendation is to keep the private sector that has been successful in this sector in the driver's seat.

26. As far as the ***textile and clothing industry*** is concerned, the removal of the MFA has not led to relatively small declines in the Kenya's exports under the AGOA so far. However,

in order for the industry to grow at the rate desired by the government according to the IP-ERS, constraints in trade logistics need to be removed. For example, the Customs Department should reinstate the practice of allowing containers destined to EPZs to remain sealed until they arrive at the factory.

27. For the ***sugar sector,*** Kenya has evoked the COMESA safeguard clause which will expire in February 2008. To avoid a crisis for the sector after that date, the government needs to urgently put in place (i) reform measures such as linking sugar cane prices to domestic sugar prices, and privatizing state-owned factories, and (ii) measures to improve competitiveness of the industry such as improving transport infrastructure for the sector, and developing higher yielding and faster maturing sugar cane varieties; funds to pay for such investments can be raised through auctioning of the sugar import quotas. Furthermore, a study on the impacts of sugar sector reform for producers and workers should be undertaken to identify where adjustment may need to be supported by the government.

28. To stimulate further growth of the tourism sector GOK should continue to focus on ***improving the security situation both domestically and within the region*** through regional cooperation, and dialogue with governments in the major tourist-generating countries. Recommendations to address other constraints for tourist sector expansion, and attraction of FDI into the sector will be forthcoming from the currently ongoing World Bank tourism sector value chain analysis.

Table.1: KENYA TRADE REPORT – PRIORITY ACTION PLAN –UPDATED DECEMBER 2006*

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Performance Indicator	Donor activities	Update
Behind-the-border/trade-facilitation agenda						
Trade logistics						
Slow and cumbersome procedures at trade-facilitation agencies	Complete the ongoing waterfront system project by KPA, which will automate container terminal	2007	KPA	Total elimination of delays in identifying containers	Trade Facilitation Project (Common wealth Secretariat), World Bank	• The Waterfront Project implementation is in progress. Will be fully implemented by July 2007.
Inefficient and unreliable infrastructure	Complete Northern Corridor road rehabilitation	2006	MoRPW	***Reduction of vehicle operating costs by 50% and maintenance costs by 50%***	**World Bank, EU, SIDA**	• ***Rehabilitation of Miritini - Maji ya Chumvi (35km) and Maai Mahiu – Naivasha – Lanet (95km) sections ongoing.*** • ***Contract awarded for Sultan Hamud – Machakos Turnoff (55km), Machakos Turnoff - Athi River - Embakasi (33km), Lanet - Nakuru – Njoro Turnoff (14km) and Njoro Turnoff – Mau Summit - Timboroa (83km)***
	Complete upgrading investment program for KRC	2010	MoT RVR			• Upgrading programme in place. Rift Valley Railways will upgrade the rail network and rehabilitate locomotive engines. Rehabilitation of Mombasa-Malaba line to be completed by 2011 which should increase throughput by 75%.
	Finalize transformation of KPA to landlord	*2008*	KPA MOT	Improved capacity and handling at the port		
	Complete privatization of Telkom Kenya	***2008***	***MOF*** ***M of Information***			• ***Key transitional processes need to be carried out e.g. staff rationalization, addressing of legal issues, payoff of debts, etc. Sourcing of funds to address the***

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Performance Indicator	Donor activities	Update
			and Communication TKL			***reforms has been difficult. The process will be fast tracked in 2007 as important preliminaries have taken place or been agreed upon.***
Time-consuming weighbridges on the road and non-harmonization of regional axle-load regulations	Implement harmonized COMESA axle-load regulations	2007	MoT [MoRPW]	Harmonization and efficient regulation by 2007	World Bank	• Harmonized COMESA axle-load regulations implemented. 'Best Options' Study now completed and recommendations therein awaiting adoption by the Kenya Roads Board and the Ministry of Roads and Public Works. Need to negotiate with Tanzania which is not a member of COMESA • Reinforcing and increasing weighbridges. Six weigh-in-motion weighbridges acquired and single axle weighbridges.
	Improve management of weighbridges along Northern Corridor; move toward implementation of weigh-in-motion and mobile weighbridges	2007	MoT			
Standards and Conformity-Assessment Institutions and Capacities						
Kenya's standards architecture is over-stretched and support is needed through an adequate revenue structure	**Facilitate accreditation of the private sector to provide testing, consultancy and conformity-assessment services**	**2006**	**MoTI [KEBS, KEPHIS]**			• **KEPHIS: Not yet done since legal reforms still pending however KEPHIS aiming at accrediting private facilities on seed testing within the period of the Strategic Plan (2006-2010)** • ***KEBS: A national accreditation service, KENAS, has been set up (per legal notice no. 26 of March 2005) and is operational, and has legal authority to provide accreditation of private facilities. The***

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Performance Indicator	Donor activities	Update
						Chairman has been appointed and senior officers seconded from KEBS. • ***MoLFD occasionally uses other accredited laboratories such as KEMRI, ICIPE, ILRI, KARI and KETRI.***
Domestic Trade and Tariff policy						
Complicated exemptions regime is an administrative burden	Simplify, harmonize and eliminate exemptions Undertake study of adjustment costs and distribution	2010	MoEAC [MoTI, MoF]	All exemptions eliminated or harmonized	WB	• All exemptions on imports have been harmonized within EAC. Exemptions are not likely to be eliminated as this is a worldwide practice, but may be minimized.
Regional integration agenda						
Potential use of different rules of origin in EAC and COMESA that may impede regional and global trade	Review current rules of origin and their implementation with a view toward using the most simple, non-restrictive rules to promote trade	2008	MoTI MoEAC EAC	Simple, non-restrictive rules of origin in place		• Rules of origin issues currently being discussed at EAC and COMESA level.
EPA agenda						
EU currently has restrictive rules of origin	Develop and negotiate simple, non-restrictive development-friendly rules of origin	2008	MoTI [MoPND, KRA]	Non-restrictive development-friendly rules of origin for Kenya are identified	EU - KEPLOTRADE	• The ESA/EU EPA negotiations are in progress. A meeting to be held in Addis Ababa in January 2007 dedicated to rules of origin.
Sugar						
Reforms in the sugar industry may negatively affect farmers and workers	***Undertake a poverty and social impact assessment, including identifying crop alternatives***	***2006***	***MoA [MoTI, KSB & HCDA]***	***Completion of a report on social impact***	***DFID, WB***	• ***This is ongoing. MoA extension workers working with sugar companies are promoting growing of other crops along with sugarcane, to reduce over reliance.*** • ***A sugar industry strategic plan has been developed and a sugar policy is being drafted.*** • ***Government has negotiated resumption of***

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Performance Indicator	Donor activities	Update
						exports to the EU where Kenya has a sugar quota of 5000 metric tonnes.
Sugar cane prices are set too high which sends a wrong signal to producers	***Link sugar cane prices to domestic sugar prices*** ***Benchmark sugarcane prices with the world sugarcane prices***	***2006***	***MoA [KSB]***	***Harmonized producer and consumer prices***		• ***Ongoing. A cane pricing committee has been constituted under the umbrella of KSB. Members include MoA, factories' representatives, farmers' representatives and KSB. Various proposals have been put forward, including differentiating cane prices according to quality e.g. sucrose content.***

Responses from:

Ministry of Agriculture
KEPHIS
Min. of Labour & HR Devt.
Ministry of Trade and Industry
Kenya Power and Lighting Co. Ltd.
Ministry of Roads and Public Works
Kenya Ports Authority
Ministry of Transport
Ministry of Livestock & Fisheries Devt.
Ministry of Health
Central Bureau of Statistics
Kenya Revenue Authority
Ministry of Finance
Ministry of Foreign Affairs
Ministry of Information & Communication
Min. of Planning & Nat'l Devt.
Kenya Bureau of Standards
Kenya Railways
Export Processing Zones Authority

Actions in bold and italics: implemented in 2006
Actions in bold: planned for 2006 but not yet implemented

1. KENYA'S ECONOMIC PERFORMANCE AND RECENT DEVELOPMENTS

Economic Developments 1990 – 2001

1.1 Kenya's growth performance in the 1980 and 1990s was lackluster; between 1982 and 2001, average GDP growth never rose above five percent. Further, economic growth did not significantly exceed population growth, with the result that per-capita GNP remained stagnant.

1.2 In sector terms, services grew most significantly, contributing more than half of total GDP growth. Tourism was the largest contributor to the growth of services sector; finance and business services also grew in the 1990s, benefiting from trade and foreign-exchange liberalization. Agriculture and industry registered lower growth rates; the former remains dependent on climatic conditions. Poor growth in Kenya's industrial sector, especially manufacturing, reflects the country's deteriorating business climate (see Table 1.1)

Table 1.1: GDP Growth and Sectoral Contributions to Growth 1982 –2001

	82-86	87-91	92-95*	97-01	82-01
GDP growth rate	3.6%	4.3%	2.1%	2.3%	3.1%
Agriculture growth rate	2.9%	3.1%	0.3%	4.2%	2.8%
Industry growth rate	2.8%	4.8%	1.4%	-0.2%	2.3%
Manufacturing growth rate	4.3%	5.3%	2.2%	-0.7%	2.8%
Services growth rate	4.4%	4.8%	3.5%	2.2%	3.7%
Population growth rate	3.6%	3.1%	2.7%	2.5%	3.0%
GNP per capita (Atlas method) growth rate	1.4%	1.5%	-5.0%	1.9%	0.2%
Contribution to growth					
Agriculture	1.0%	1.0%	0.1%	1.3%	0.9%
Industry	0.6%	1.0%	0.3%	0.0%	0.5%
Manufacturing	0.5%	0.7%	0.3%	-0.1%	0.4%
Services	2.1%	2.4%	1.8%	1.2%	1.9%

Source: World Bank Live Data Base

*This period only covers four years because GDP calculations from 1996 are based on a new system

Recent Economic Development

1.3 During the past three years, Kenya's growth has accelerated. From less than one percent in 2002, it reached an average in 2003 at 3 percent and has since remained higher, at 4.9 percent in 2004 and 5.8 percent in 2005, driven mainly by continued strong growth in

services. The outlook remains positive beyond 2005 with expected growth rates above five percent. While growth has recently been more dynamic than before, it is still below the level necessary for sustainable poverty reduction, given the high population-growth rate (see Table 1.2).

Table 1.2: Recent GDP Growth and Sectoral Contributions 2002–2005

	2002	2003	2004	2005
GDP growth rate	0.6	3.0	4.9	5.8
Agriculture growth rate	-3.0	4.0	0.8	8.0
Industry growth rate	2.4	6.1	4.1	4.6
Manufacturing growth rate	0.1	6.0	4.5	5.0
Services growth rate	2.4	2.5	5.0	4.8
Population growth rate	2.0	1.8	1.7	1.9
GNP per capita (Atlas method) growth rate	-1.4	1.3	2.2	3.3
Contribution to growth				
Agriculture	-1.1	0.7	0.5	2.0
Industry	0.4	1.1	0.7	0.8
Services	1.3	1.3	2.7	2.5

Source: World Bank Live Data Base

1.4 Trade and exports can be an engine for growth—between 1982 and 2001, world trade increased 3.4 fold, which corresponds to an annual growth rate of 6.4 percent. However, since Kenya's exports have grown only slightly faster than the rate of GDP growth over this period (see Table 1.3), the country has not properly benefited from dynamic growth in international trade flows.

Table 1.3: Trade as a Share of GDP and Growth of Trade 1982–2004

	82-86	87-91	92-95	97-01	82-01	2002	2003	2004
Exports (goods and services) as a percentage of GDP	25.5	24.0	34.1	21.6	25.9	24.2	23.8	26.2
Export growth rate	1.7	3.7	7.8	-0.2	3.0	7.3	12.3	17.5
Imports (goods and services) as a percentage of GDP	27.0	29.1	24.0	28.0	29.3	28.2	28.2	32.0
Import growth rate	-3.3	5.0	12.8	3.2	3.7	-5.5	13.8	21.4

Source: World Bank Live Data Base

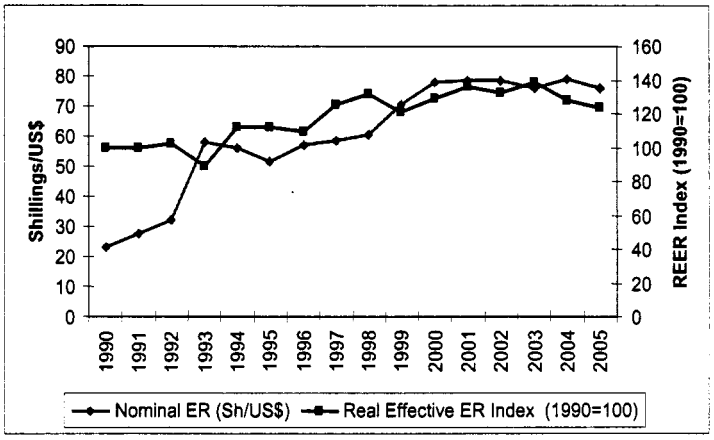
1.5 The macroeconomic environment in Kenya is favorable to more dynamic export growth. Domestic price levels are stable—after periods of high inflation, in particular in the early to mid 1990s; inflation has since been maintained at single-digit levels. In 2004 prices increased more rapidly—partly because of a relatively loose monetary policy—but the outlook is for inflation to return to low single-digit levels over the next few years (see Table 1.4).

Table 1.4: Consumer Price Index Changes 1982–2005

	82-86	87-91	92-95	97-01	82-01	2002	2003	2004	2005
CPI (average) change	-0.6%	5.7%	25.9%	8.0%	8.92%	2.0%	9.8%	11.6%	10.3%

Source: World Bank Live Data Base

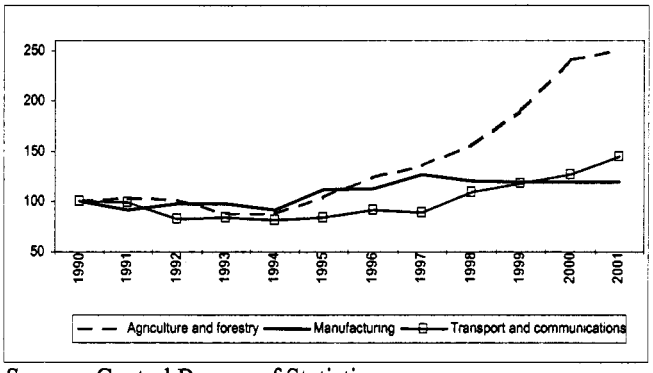
Figure 1.1: Kenya Nominal Exchange Rate and Real Effective Exchange Rate Index 1980-2005



1.6 Kenya's real exchange rate (REER) slowly depreciated over most of the 1990s but since 2003 the trend has been reversed (see Figure 1.1). However, this need not necessarily mean a loss of competitiveness for all of Kenya's exports. Kenya's main exports to the United States—textiles under the American Growth and Opportunity Act—are produced using mainly imported inputs, so appreciation of the real exchange rate is unlikely to have a significant effect. Kenya's regional exports are dominated by petroleum re-exports; again exchange-rate developments do not play a major role. At the same time cut flower exporters are losing their competitiveness to some extent.

1.7 In the short term, domestic factors may push the REER higher due to expected further nominal appreciation and further declines in inflation. A sustained appreciation of the REER may result in reduced competitiveness for exports produced using predominantly domestic inputs, or exported to countries the currencies of which have lost ground against the Kenya shilling.

Figure 1.2: Unit Labor Costs by Sector Index (1990=100)

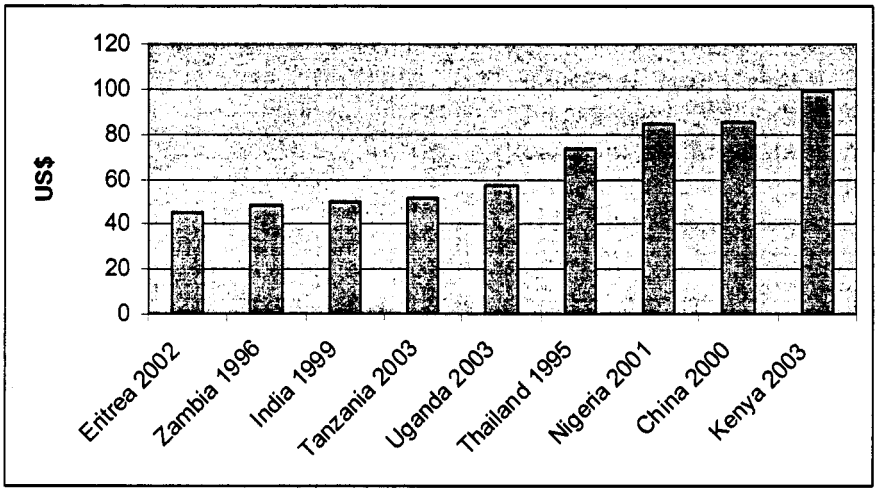


Source: Central Bureau of Statistics

1.8 Another aspect of export competitiveness affected by macro-economic conditions are unit labor costs. In Kenya, unit labor costs have increased since the mid 1990s (see Figure 1.2). Unit labor costs increased by 20 percent for the manufacturing sector, by 150 percent in the agri-cultural sector, and by 45 percent for transport and communications, between 1990 and 2001. This trend may also cause diminished competitiveness for some exports, in particular agricultural exports.

1.9 Evidence from manufacturing surveys (Regional Program on Enterprise Development (RPED) and Investment Climate Assessments (ICA) in Kenya and in comparator countries shows that Kenya's estimated monthly earnings for unskilled production workers are relatively high (see Figure 1.3), which hinders competitiveness in sectors that rely on unskilled labor.

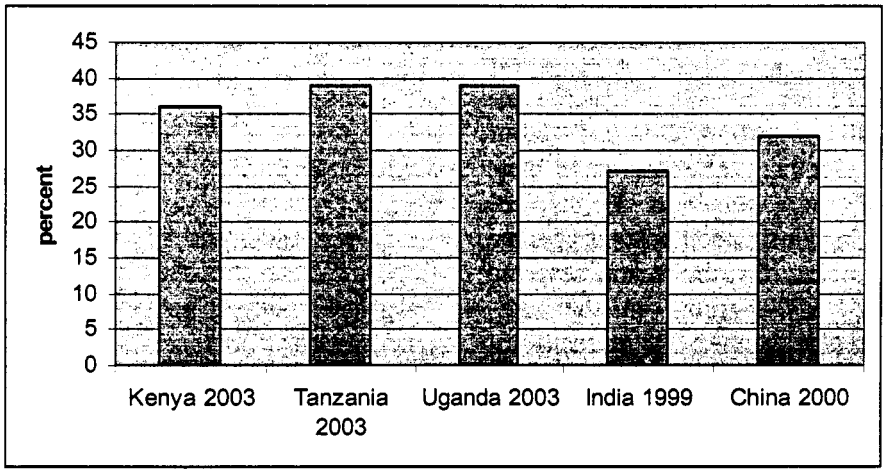
Figure 1.3: Estimate of Monthly Earnings of Unskilled Production Workers



Source: Kenya ICA (2005)

1.10 One finding of the 2004 ICA "Kenya: Enhancing the Competitiveness of Kenya's Manufacturing Sector; The Role of the Investment Climate" is that Kenya's wage levels are not matched by labor productivity on a par with those of Asia, although it is competitive within East Africa. A comparison of the ratio of wages to Manufacturing Value Added (see Figure 1.4) shows that Kenya's wage bill is 36 percent, similar to those of Uganda and Tanzania, but higher than India's and China's.

Figure 1.4: Ratio of Total Wages to MVA in Median Firms (Kenya and Comparators)



Source: Kenya ICA (2005)

1.11 A World Bank labor market study is currently under way which should shed some light on the effects of labor market developments on Kenya's competitiveness.

Poverty in Kenya

1.12 It is difficult to establish poverty measures and trends in Kenya over the past decades because of a lack of comprehensive and comparable data. The most recent household data were collected in 1997; a new household survey (the Kenya Income and Household Budget Survey, KIHBS) will be completed in 2006. Based on existing information, it is estimated that has poverty increased in the last ten years, from 48.8 percent in 1990 to about 55.4 percent in 2001. Since then, although there is no newer data, it is generally believed that poverty levels have held steady or even increased slightly. Poor education, misdirected funding of development by the government, the large population, and a lack of ready markets for goods in more remote areas are among the causes of poverty in Kenya.

1.13 There is evidence that inequality of poverty has also been on the rise. A recent World Bank and Ministry of Planning report shows substantial variability in poverty levels among constituencies and provinces. It appears that poverty levels are influenced by the education levels of heads of household. Homes headed by people with a secondary-school education or better are less likely to be below the poverty line than those headed by people with only primary-level schooling. The latter in turn are better off than those headed by people with no formal education. There is also a gender bias in the distribution of poverty, since female-headed households are more likely to be poor than those headed by men. There is considerable geographical variation in the distribution of poverty within each province and district. Nyanza, with has a poverty level of 65 percent, is the poorest province, followed by North Eastern, with 64 percent. Western has 61 percent; Eastern, 58 percent, Coast, 57.6 percent; Rift Valley, 48 percent; Nairobi, 44 percent; and Central, just 31 percent.

Trade and Poverty

1.14 That trade liberalization and export development have the potential to powerfully catalyze growth and poverty reduction is not in question. However, there is debate on the short-term effects of trade liberalization on the poor.

1.15 Cross-country studies and single-country analyses over time find that trade liberalization has an overall positive impact on growth and poverty reduction.[3] This linkage is, in fact, the main reason for much trade-policy reform. However, many studies find that benefits are distributed unevenly across the population; the economic environment within which trade reform takes place and the specific characteristics of the poor (e.g. their location, livelihood) are important determinants of the effects of trade reform. Furthermore, to assess the effects of trade-policy reform on poor Kenyans, empirical analyses are necessary.

1.16 Data collected as part of the KIHBS undertaken in 2005 will be useful to assess the impact of trade-policy changes at the individual (consumer, worker) level. In a background

[3] See Winters, McCulloch and McKay (2004) for a review of the empirical evidence on how trade liberalization affects poverty.

study to this report (under www.worldbank/kenya), we provide an example of a trade-poverty study using local surveys in Lake Victoria fishing communities.

1.17 Sectoral studies have revealed a direct link between increased exports and poverty reduction. A recent study[4] showed that horticulture exports represent an opportunity to reduce poverty through income generation among smallholders, rural farm laborers, and unskilled or semi-skilled processing factory workers. Information was compiled from pack-house workers and non-pack-house workers living in the same sections of Nairobi, workers on exporter-owned farms, workers on large commercial farms, smallholders engaged in horticulture, and non-horticulture smallholders farming in the same region (see Table 1.5). There is little doubt that horticultural production is significantly more profitable for a smallholder than the traditional intercropping of maize and beans commonly used by subsistence farmers. Findings allow the drawing of conclusions about the extent to which the poor participate in horticulture, as well as about the impact such participation may have.

Table 1.5: Income and Poverty Levels for Horticulture and Non-horticulture Households

	Pack-house worker	Non-pack house worker	Worker (exporter-owned farm)	Worker (large farm)	Hort. Small-holder	Non-hort. Smallholder
Household income						
- mean (Ksh)	55,490	59, 294	29,886	18,767	55,528	12,902
- median (Ksh)	46,853	28,747	21,330	17,144	32,431	5,658
% in poverty						
- food poverty (%)	15.0	31.7	30.8	40.0	25.0	73.2
- total poverty (%)	42.5	63.4	41.0	55.0	27.8	80.3

Source: McCulloch and Ota. (2002).

1.18 The above figures indicate that horticulture smallholders are much better off than non-horticulture smallholders, with an average (mean) income four times as large. Even workers on exporter-owned farms or independent commercial farms do significantly better than non-horticulture smallholders. Significant proportions remain below the poverty line; however, almost 75 percent of horticulture-growing smallholders are above the poverty line.

1.19 Analysis of the impact on poverty of increased textile exports from Kenya to the United States under AGOA (African Growth and Opportunities Act) reveals that expansion of the sector had two broad results: creation of new jobs—more than 33,000 new jobs were created between 1999 and 2003—and an increase in average monthly wages of 66 percent between 1999 and 2004 (see Table 1.6).

[4] McCulloch, Neil and Masako, Ota. 2002. "Export Horticulture and Poverty in Kenya." IDS Working Papers 174. Sussex, UK.

Table 1.6: Textile Exports, Employees and Wages 1999 and 2003/04

	1999	2003	2004
Export sales (US$ million)	43	182	
Number of employees	5077	38199	
% women	59.7	77.6	
% men	40.3	22.4	
Mean garment-sector wage (Ksh per month)	3543		5897

Source: Labor Force Survey 1999 and Kenya EPZ Authority

1.20 There is a gap between the average earnings of men and those of women in the textile sector; women earn substantially less than men. However, a study of the causes of the gender wage gap concluded that there are disparities in the skill levels of men and women; men and women at the same skill level earn equal wages. Thus, to address the gender wage gap which would ensure that women increasingly benefit from the wage premium paid to skilled workers[5] will require ensuring better access to schooling and training for women.

1.21 The region bordering Lake Victoria (Nyanza) is characterized by economic and social underdevelopment despite significant development of the Nile-perch export sector over the past decade.

1.22 Aggregate income to Lake Victoria fishers has increased significantly since the early 1980s as a result of the Nile-perch export industry. It is estimated that the total economic benefit for the fishers at the end of the 1990s was around US$92.5 million. Sector developments have also created employment opportunities: an estimated 299,000 people were directly or indirectly employed in 2004. However, income opportunities from fishing and fish exports have drawn many people to the area, so that income increases have been spread across a larger population. Further, recent declines in fish landings have negatively affected income levels.

1.23 A comparison of two landing beaches for Nile perch.[6] found that fishermen on the beach that was better integrated into the export supply chain have fared better in terms of income levels and poverty reduction. The disparity between the welfare of artisanal processors/traders on the two beaches is less pronounced.

1.24 Thus, while growth and trade integration in Kenya had declined over the 1990s, this trend has been reversed over the past several years. With a stable macro-framework in place, Kenya is now poised for continued further trade integration.

[5] In 2004, the premium paid to skilled over semi-skilled workers was Ksh623 per month, equivalent to 11 percent of the unskilled monthly wage.

[6] This comparison was done in a background study to this report; see www.worldbank/kenya.

2. TRADE AND EXPORTS IN KENYA

SIGNIFICANT CHANGES IN KENYA'S EXPORTS AND DRIVERS OF THOSE CHANGES

2.1 Kenya's share of world trade declined in the past two decades, as its exports grew only moderately by comparison with the growth of world trade. Between 1980 and 1985, Kenya supplied 0.65 percent of world trade; since then, its share of trade has declined to less than half of that, although Kenya has maintained its share of the manufacturing market. The decline is not so much a Kenyan phenomenon as a Sub-Saharan African one (see Table 2.1). If Africa had maintained the share of trade it had in 1975, exports would have been worth more than twice the value in 2003 of US$108 billion.

Table 2.1: The Relative Importance to World Trade of Sub-Saharan Africa and Other Regions

	Total Exports (US$billion)				Share of World Trade (%)			
Group	**1975**	**1985**	**1995**	**2003**	**1975**	**1985**	**1995**	**2003**
Australia/ New Zealand	14.1	28.3	66.6	87.1	1.8	1.5	1.3	1.2
East Asia[1]	39.5	194.2	896.6	1,517.4	5.2	10.5	17.8	20.2
Of which: ASEAN	22.0	72.5	322.8	481.9	2.9	3.9	6.4	6.4
European Union (15)	340.6	708.2	2,018.3	2,879.5	44.6	38.1	40.0	38.2
Other Western Europe	22.2	57.1	147.9	219.8	2.9	3.1	2.9	2.9
East Europe/Central Asia	24.2	115.9	205.4	404.8	3.2	6.2	4.1	5.4
Japan	55.7	177.2	443.0	473.9	7.3	9.5	8.8	6.3
Latin America	41.7	100.1	229.2	415.7	5.5	5.4	4.5	5.5
Middle East	45.7	99.1	152.1	285.4	6.0	5.3	3.0	3.8
NAFTA	144.6	326.0	853.2	1,160.1	19.0	17.6	16.9	15.4
North Africa	13.2	27.3	28.6	57.2	1.7	1.5	0.6	0.8
South Asia	6.5	13.6	46.0	85.8	0.9	0.7	0.9	1.1
Sub-Saharan Africa	**17.7**	**32.4**	**42.0**	**108.4**	**2.3**	**1.7**	**0.8**	**1.4**
WORLD EXPORTS	762.8	1,857.4	5,049.3	7,530.2	100.0	100.0	100.0	100.0

[1] East Asia is defined here as comprising: Brunei, Cambodia, China, Republic of Korea, Hong Kong, Indonesia, Lao PDR, Malaysia, Mongolia, Philippines, Singapore, Taiwan (China), Thailand, and Vietnam.
Source: International Monetary Fund Direction of Trade Statistics

2.2 The composition of Kenya's exports has changed significantly structural since 1964.[7] The export share of fruits and vegetables, textiles and mineral fuel have each increased by about ten percentage points. Coffee underwent the steepest decline in share of exports, with a loss of 25 percentage points; textile fibers export share fell by over 20 percentage points. The latter's losses were largely the result of substitutions of synthetic fibers for hard fibers like sisal (see Table 2.2).

[7] The choice of 1964 as the first year is because this is the year when the UN started its COMTRADE database.

Table 2.2: Value and Share of Kenya's Major Exports from 1964 to 2003

Kenya's major one and two-digit SITC product-group exports	1964 Exports		2003 Exports		1964-03 Share Change
	Value ($000)	Share (%)	Value ($000)	Share (%)	
Food and live animals (0)	110,163	56.1	937,326	41.3	-14.8
Fruits & vegetables (05)	6,166	3.1	307,892	13.6	10.4
Coffee, tea, & spices (07)	92,323	47.0	486,579	21.4	-25.6
Beverages and tobacco (1)	9	0.0	28,559	1.3	1.3
Crude materials (2)	67,626	34.5	402,691	17.8	-16.7
Textile fibers (26)	43,827	22.3	18,672	0.8	-21.5
Crude vegetable materials (29)	9,509	4.8	309,978	13.7	8.8
Mineral fuels and lubricants (3)	2,948	1.5	262,066	11.6	10.0
Petroleum & products (33)	2,880	1.5	260,358	11.5	10.0
Animal & vegetable oils (4)	82	0.0	12,334	0.5	0.5
Chemicals (5)	5,491	2.8	108,706	4.8	2.0
Manufactured goods (6)	4,021	2.0	172,751	7.6	5.6
Machinery & transport (7)	3,667	1.9	70,046	3.1	1.2
Misc. manufactures (8)	804	0.4	265,142	11.7	11.3
Clothing (84)	39	0.0	209,197	9.2	9.2
Other goods (9)	1,451	0.7	8,345	0.4	-0.3
All goods (0 to 9)	196,261	100.0	2,268,595	100.0	--

Source: UN COMTRADE

2.3 Kenya has built a successful industry of non-traditional, agriculture-based products (fresh fruit and vegetables, and cut flowers). The country is now Africa's biggest grower of cut flowers and one of the largest exporters of fresh horticultural produce.

2.4 In the last decade, output of fresh fruit and vegetables, and cut flowers has seen impressive growth, which continues to accelerate. Horticulture exports now comprise approximately 27 percent of Kenyan exports. Exports of cut flowers and fresh vegetables to the EU grew at annual rates close to 10 percent between 1995 and 2003, far faster than the corresponding rate for total exports, and generating trade gains of over US$100 million.

2.5 Kenya's traditional cash crops, coffee and tea have shown much less dynamic growth over the past decades, Coffee, while still an important export sector, has in fact experienced a steep export earnings decline since the mid 1990s. The tea sector has fared far better, with a steady growth of tea exports until 2000, and a slight decline over the past few years. However, while EU tea imports have remained flat, the value of Kenya's tea exports fell by almost US$20 million, owing to a loss in Kenya's EU market share.

2.6 Textile exports rose two hundred-fold between 1976 and 2003. Kenyan exporters have benefited from AGOA preferences: US exports grew by about US$160 million; the gains were achieved in relatively few product lines. In fact, net change in Kenya's other exports to the United States would be negative without apparel goods.

2.7 The increased share of energy-product exports is the result of increased domestic capacity to refine foreign-produced crude petroleum. Most of this is destined for Uganda and Tanzania.

2.8 The data show that the general erosion in Kenya's international competitive position was the cause of relatively Kenya's relatively modest export growth. Significant increases in exports, as occurred in such sectors as apparel and petroleum products, were unrelated to improved competitiveness or comparative advantage; however many significant declines were due to lost market share. Chapter 5 of this report looks at more detail at Kenya's key export sectors (tea, coffee, horticulture, textiles, and tourism).

Issues pertaining to the structure of merchandise exports

2.9 Kenya's exports are highly concentrated. Over the years, this has not changed, although the composition of exports has changed. In both 1976 and 2003 the ten most important products (two-digit SITC) accounted for approximately 80 percent of total export earnings. A slight diversification occurred between 1995 and 2003[8] (see Table 2.3). The combined share of the three largest export products to the EU fell from 63 percent to 56 percent, although the actual number of products exported has remained virtually unchanged since 1976. From 1995 to 2003, the combined share of the three largest products exported to the United States actually rose by 14 percentage points (to 83 percent), due largely to gains in the apparel sector. Similarly, over this period, the share of the three largest exports to Uganda almost doubled; this is almost entirely attributable to refined petroleum products.

2.10 The downside of concentration is over-dependence on traditional exports such as coffee. Kenya's traditional exports face unfavorable long-term global demand prospects due to their low income elasticities.[9] Demand for traditional products has grown very slowly, much more so than for other traded goods. There has been a long-term decline in real prices of tea, coffee, and hard fibers. Recent World Bank projections point to this trend continuing through the present decade. Another problem with traditional products is high price variability, which can lead to economic shocks.

[8] The first index is a count of the number of products exported, whereby a product had to account for a least one-half of one percent of total exports, to avoid including marginal exports; the level of aggregation is four-digit SITC; the second index is the share of a country's total exports accounted for by the largest four-digit SITC products. The higher the share of these products, the higher the level of export concentration; the third index is the "Hirschmann" index, defined in the notes to Table 2.3.

[9] For example, Ng and Yeats (2002) estimate that the global income elasticity of demand for Kenya's tropical beverage crops (tea and coffee) averaged about 0.70 during the last two decades. This means that import demand for these products grew at a rate 30 percent below that of world-income growth. Elasticity estimates for hides, leather, hard fibers, and other African raw-material exports were even lower.

Table 2.3: Concentration Indices for Kenya's Exports

Trading Partner	Number of Products Exported [a]			Share held by Top Three Products (%)			Export Concentration Index [b]		
	1976	1995	2003	1976	1995	2003	1976	1995	2003
High Income Countries									
European Union (15)	263	252	260	68.5	63.0	56.4	0.54	0.41	0.36
United States	84	123	133	88.1	69.1	83.4	0.61	0.43	0.61
Middle & Low Income									
Burundi [c]	118	107	151	35.0	35.1	28.1	0.24	0.25	0.21
Egypt, Arab Rep.	27	13	17	96.5	99.0	99.2	0.75	0.96	0.98
India	26	48	87	88.4	53.4	50.5	0.57	0.37	0.35
Pakistan	18	39	42	92.9	97.3	95.0	0.74	0.95	0.92
South Africa	..	146	196	..	83.8	33.3	..	0.63	0.23
Sudan [c]	221	39	100	51.8	85.6	90.6	0.32	0.71	0.87
Tanzania	402	358	424	21.7	40.4	40.8	0.18	0.29	0.33
Uganda [d]	389	468	495	47.6	31.4	59.6	0.30	0.21	0.51

Notes:
a: Number of products exported at SITC 4-digit level in Revision. 1
b: The concentration index (Hirschmann index) is defined as:

$$H_j = \sqrt{(\Sigma(x_i/X)^2}$$

where xi is the value of export products at SITC 4-digit level and X is the total exports in country's j. The value of the index ranges between 0 to 1, with lower values indicating less concentrated exports.
c: Due to the missing data, 2002 statistics are substituted for 2003.
d: Due to incomplete data, energy products are excluded from the 1995 statistics
Source: Computations based on partner import data from UN COMTRADE Statistics. South Africa failed to report trade statistics to the United Nations in 1976.

2.11 Kenya's export profile is evolving in a strikingly dissimilar manner to those of former commodity-exporting countries. Over the past 40 years many of these countries, such as Brazil, China, India, Malaysia, Mauritius, Pakistan and Thailand have made a successful transition to exporting manufactured goods, even as Kenya's exports continue to be predominantly commodities and raw materials. Put another way, Kenya's current export profile is quite different from those of its major non-African trading partners. This lack of complementarity is an obstacle to broader trade contacts (in terms of the number of products that can be traded with partners).

2.12 Analysis shows that Kenya has a relatively low level of intra-industry trade. Intra-industry trade, or production sharing, occurs when parts and components of a specific product move in one direction, as trade in the final product occurs in the reverse direction between two countries. World Bank studies indicate many developing countries have a comparative advantage in assembly operations that are relatively labor intensive. Kenya may have potential opportunities in several sectors, such as office machinery and electronics.

GEOGRAPHIC DESTINATIONS AND ORIGINS OF KENYA'S TRADE

2.13 East Africa and the European Union are the two most-important destinations for Kenya's goods; each absorbs about one-third of total exports. Kenya sources about 12 percent of its total imports from East African countries, and another 25 percent from East and South Asia; less than one quarter of its imports originate from the EU. The geographic direction of trade has been relatively stable from 1975 to 2003 (Table 2.4), with the exception of South Asia and NAFTA, for which share of trade with Kenya rose by four percentage points or more. Growing tea exports to Pakistan account for the increased trade with South Asia; the increase with NAFTA is largely the result of increased garment exports under AGOA preferences.[10] Kenya's exports to East Africa are dominated by refined petroleum products. Kenya's major exports to East and South Asia consist of: tea (54.8 percent); other inorganic chemicals (6.5 percent); raw hides and skins (6.0 percent); and fish (6.0 percent).

Table 2.4: Geographic Origin and Destination of Kenya's Trade from 1975 to 2003[11]

			Share of Exports Destined For (%)										
		Global		Of which:							Sub-	Of which:	Rest
Country	Year	Exports ($ mill.)	East Asia	China	ASEAN	Japan	EU (15)	NAFTA	Oceania	South Asia	Saharan Africa	East Africa	of World
Kenya	1975	601.7	3.6	0.6	1.9	2.0	31.5	6.0	0.7	2.7	34.7	33.8	12.7
	1985	957.5	1.4	0.4	0.9	0.8	47.7	5.8	0.3	7.1	22.0	21.3	7.9
	1995	1,826.0	2.5	0.1	1.1	0.7	35.6	3.4	0.3	7.1	41.9	41.5	0.9
	2003	2,535.7	3.2	0.3	1.4	0.9	32.6	10.0	0.5	8.8	32.1	31.2	1.6
			Share of Imports Coming From (%)										
		Global		Of which:							Sub-	Of which:	Rest
Country	Year	Imports ($ mill.)	East Asia	China	ASEAN	Japan	EU (15)	NAFTA	Oceania	South Asia	Saharan Africa	East Africa	of World
Kenya	1975	938.6	3.2	0.4	1.3	8.6	42.7	8.8	1.7	2.1	4.1	4.1	1.9
	1985	1,436.1	8.5	0.8	6.8	10.3	39.2	5.3	1.2	1.3	1.6	1.6	1.5
	1995	3,249.1	13.4	3.5	4.5	9.1	38.2	4.2	0.4	8.8	10.8	10.6	0.0
	2003	4,231.9	12.8	6.3	2.8	4.8	23.2	5.4	0.5	7.4	13.2	12.8	0.9

Source: IMF Direction of Trade Statistics.

2.14 East Africa increased its import share in Kenya's markets by about nine percentage points, while the EU experienced almost a 20-percentage-point decline in market share. In large part, East African trade gains were due to relatively few products like fish and fish preparations, which went from virtually nil in 1995 to a value of US$45 million in 2003.

[10] An examination of available COMTRADE statistics indicates the increase for South Asia was largely accounted for by growing tea exports to Pakistan (and to a lesser extent to India), while the increase for NAFTA is largely the result of increased garment exports under United States African Growth and Opportunity Act (AGOA) preferences.

[11] East Asia here denotes: Brunei, Cambodia, China, Hong Kong, Indonesia, Republic of Korea, Lao PDR, Macao, Malaysia, Mongolia, Myanmar, North Korea, Philippines, Singapore, Taiwan (China), Thailand and Vietnam; Sub-Saharan Africa denotes Angola, Botswana, Burundi, Comoros, Congo Democratic Republic, Congo Republic, Eritrea, Ethiopia, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Rwanda, Seychelles, Somalia, South Africa, Sudan, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe. The rest of the world comprises Europe (non-EU), the former members of the USSR, and "bunkers" or loadings of foreign flag vessels.

Coffee and tea combined was Kenya's second largest import from East Africa with a trade value of about US$22 million in 2003 (given the nature of available statistics, it cannot be determined whether these imports were for domestic consumption, further processing, or re-export).

2.15 Historically, Kenya's main export market has been the EU; however, economic growth there has been sluggish for the past decade. By contrast growth in South and East Asia has been much more dynamic, a trend that seems likely to continue. Surging income levels of large segments of South and East Asia's population will generate strong demand for food items such as coffee, tea, nuts and horticulture; the latter, in which Kenya has a competitive advantage, has the highest potential. Kenya would do well to focus on securing access to these markets, which still have high tariff barriers for many of its products.

Regional Trade

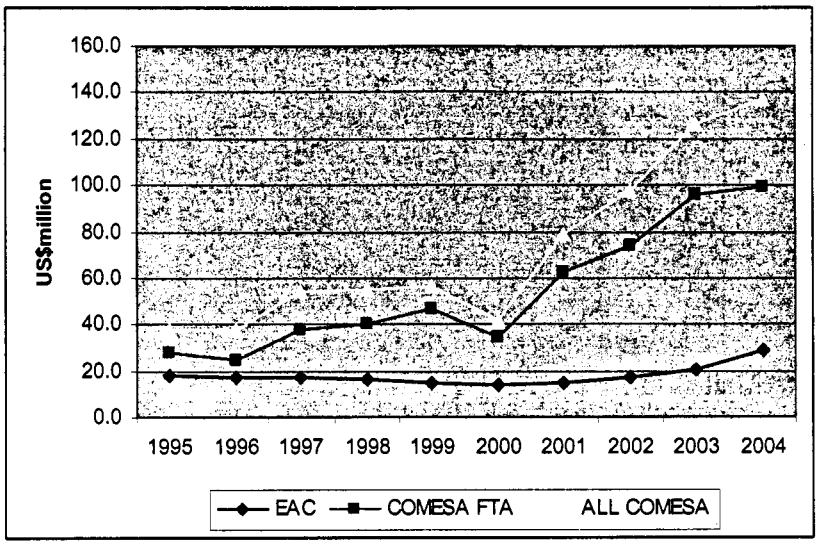
2.16 There is a general consensus that Kenya's regional trade is important, and becoming more important as regional trade integration within EAC and COMESA deepens. However, there is uncertainty over the exact magnitude and composition of Kenya's regional imports and exports. Regional trade flows are difficult to assess because of a lack of, or inconsistent, data, and informal trade. With this caveat, the following paragraphs assess the recent development of Kenya's regional trade flows using evidence from Kenyan customs data.[12]

2.17 Kenya's regional trade has intensified over the last decade, in particular since 2000. In 2004, Kenya sourced about 5 percent of its imports from EAC and COMESA (up from 1.4 percent in 1995), regional exports accounted for about 40 percent of Kenya's total exports in 2004, up from a low of 33 percent in 2001, though relatively unchanged compared with percentages in the late 1990s.

2.18 The three-year moving average[13] of regional imports into Kenya depicted in Figure 2.1 shows that COMESA countries are a more important source of imports into Kenya compared with the EAC. Imports from the EAC have been trending upwards since 2000 when the Treaty for the Establishment of the EAC entered into force, albeit slowly. COMESA imports have grown faster since 2000, whereby – somewhat surprisingly – imports from the COMESA free trade area (FTA)[14] that was established in 2000 did not grow more quickly than imports from COMESA as a whole.

[12] Data submitted to UN COMTRADE database, SITC-1 series; for this section the period of 1990 to 2004 was analyzed.
[13] Using the moving average representation smoothes data irregularities to a certain extent.
[14] COMESA FTA emerged from the COMESA PTA in 2000, and included the following countries: Djibouti, Egypt, Kenya, Madagascar, Malawi, Mauritius, Sudan, Zambia and Zimbabwe.

Figure 2.1: Kenya Regional Imports 1995-2004 (3 year moving average)



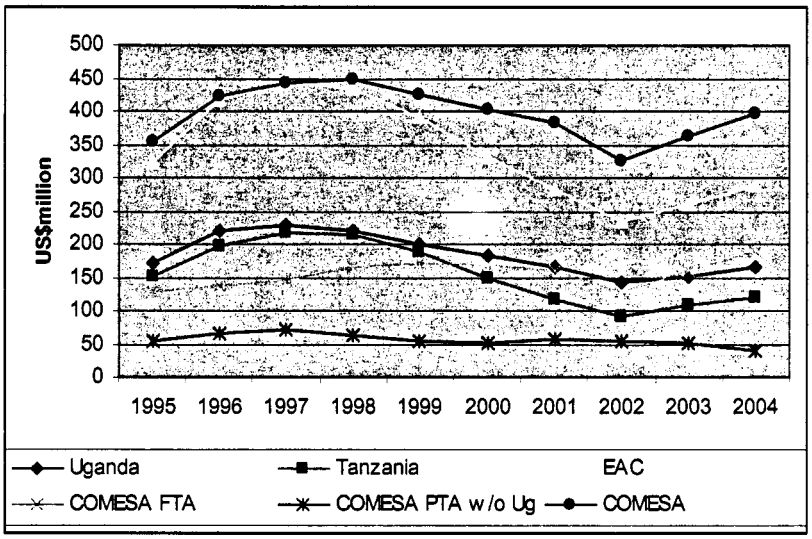
Source: Calculations based on UN COMTRADE database

2.19 Kenya's regional imports mainly consist of textile fiber/textile products, tobacco, beverages, and cereals from the EAC, and iron and steel, paper products, sugar, machinery/transport equipment and chemicals from COMESA. The main drivers of COMESA imports into Kenya are Egypt and Swaziland; in 2004, they accounted for 70 percent of COMESA imports into Kenya, up from 40 percent in 2000. Imports from Swaziland and Egypt are dominated by sugar and chemicals, other main imports from Egypt include cereals, paper and paper products, iron and steel, and machinery/transport equipment.

2.20 Kenya's regional exports first increased between 1993 and 1998, then declined somewhat until 2001, and have since been rising quickly. Regional exports are dominated by re-exports of petroleum and petroleum products into its hinterland (Uganda, Rwanda, and Burundi). Kenya's non-oil exports are mainly destined for the EAC. Figure 2.2 shows that Kenya exports almost as much into Uganda as it exports into the entire COMESA FTA; exports to Tanzania are not much lower; exports into the COMESA FTA are dominated by exports into Egypt, Sudan, Rwanda, Ethiopia and Burundi.[15]

[15] Rwanda and Burundi actually became members of the COMESA FTA in January 2004. However to keep the country groupings consistent, Rwanda's and Burundi's has been included in the COMESA FTA in Figure 2.2.

Figure 2.2: Kenya Regional Non-petroleum Exports 1995– 2004 (3 year moving average)



Source: Calculations based on UN COMTRADE database

2.21 Kenya's non-oil exports into the EAC are chemicals and other manufactured products, also mineral products into Tanzania, and cement and metal products into Uganda. Exports into COMESA feature tea (into Egypt and Sudan) apart from manufactures.

2.22 Kenya's top manufacturing exports into the region are articles of artificial plastic material, coated iron and steel plates, cement, medicaments, soaps and paper bags/paperboard boxes (in 2004, these 6 exports lines account for 40.6 percent of all regional manufacturing exports, and 14.6 percent of total regional exports). Except for medicaments, these are exports for which Kenya's comparative advantage is the short transport distance, i.e. heavy goods and goods with little value addition.[16] The situation may, however, be different for medicaments.

2.23 Kenya's trade with South Africa, Africa's largest economy is very one sided: in 2004, US$450 million imports from South Africa far outweighed US$21 million exports;[17] over the last decade, exports into South Africa declined from US$31 million in 1995 to a low of US$6 million in 1999; since then exports to South Africa have been rising steadily.

[16] Mirror data indicate that there are no major errors in these categories; products in second tier of 'top regional exports' (cleaning agents and powders; paper and paperboard; glass carboys, bottles, etc; rubber footwear soles and uppers; pens, pencils and fountain pens) are also mainly low value added and/or heavy.

[17] Figures quoted from COMTRADE database, using data reported from South Africa. The 2004 figure excludes a US$30 million aircraft export from Kenya to South Africa; this is likely a one-off deal involving a used airplane.

PROSPECTS FOR EXPORT EXPANSION AND DIVERSIFICATION

2.24 Natural resource-based goods, in which Kenya has a comparative advantage, will continue to be the mainstay of its exports for quite some time. Kenya can attain a comparative advantage in new sectors through further development of human capital; however such development is likely to occur over the long-term.

2.25 One way to gauge a country's growth prospects is to assess the outlook of a range of its exports. A growth-prospects index was calculated to establish a concordance [correlation] between the share of exports held by a product, and the recent world-trade growth rate for that product, assuming continuation of growth trends, and no changes in a country's competitive position.[18]

2.26 Kenya has an index of 0.55; thus its exports should expand at a rate just over one-half that for world trade. Kenya's index is close to the average for Sub-Saharan Africa, which is 0.58 (see Table 2.5). Within Sub-Saharan Africa, the southern cone comprising SACU, Madagascar and Mauritius have the best prospects for growth; Mauritius is the only country with an index above unity.[19]

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[18] The index is defined as follows: if s_{ij} is the current share of product i in country j's total exports, and R_i is the rate of growth of the product in world trade, the export prospects index (P_j) is

$$P_j = [\sum s_{ij} \times R_i]/R_w$$

where R_w is the rate of growth of world trade in all products. There are several caveats: First, use of this measure is justified by correlations showing longer-term growth rates for trade in most products are relatively stable. A basic assumption of the index is that past trends will continue. As an example, rank correlations of 1980-1989, and 1990-1999 export-growth rates for all four-digit SITC products were statistically significant at the 99 percent confidence level. Second, information provided by the index differs from a measure based on the growth rate of a country's total exports over a given period. The latter may be biased by changes in the relative importance of products during the interval. Third, the measure can provide information on the likely influence of a policy-induced change in the composition of exports on trade-growth rates, but it provides no information concerning the costs, or feasibility, of implementing trade changes. Such changes may take the form of government incentives to diversify exports into new product lines.

Countries with an index value above unity may be described as having above-average export-growth prospects, while the reverse is true for those with indices below unity. Furthermore, because the index is measured relative to the growth rate for world trade it shows how relatively favorable, or unfavorable, are a country's export prospects compared to world trade. For example, an index value of 0.50 suggests a country's exports should grow at one-half the rate of world trade. An index value of 1.50 indicates its exports should grow 50 percent faster.

[19] This observation is subject to qualifications. Mauritius' relatively high export-growth prospects index is due to the high share (53 percent in 2003) of clothing in total exports. In 2005, Multi-fiber Arrangement quotas on clothing exports are scheduled to be phased out and Mauritius' exports will be subject to increased competitive pressure from China, India, Bangladesh and Vietnam. This may cause the share of clothing in Mauritius' exports to decline, which, in turn, would lower the country's export-growth rate. Lesotho and Kenya are other African countries with relatively high shares of clothing in total exports.

Table 2.5: The Export Prospects Index for Sub-Saharan African Countries

Country	Growth Prospects Index	Country	Growth Prospects Index
Angola	0.62	Mauritius	1.18
Benin	0.47	Mauritania	0.56
Cameroon	0.46	Mozambique	0.57
Congo, Democratic Rep.	0.70	Nigeria	0.62
Congo, Republic	0.57	SACU	0.81
Cote d'Ivoire	0.46	Senegal	0.56
Ethiopia	0.40	Sudan	0.50
Gabon	0.46	Tanzania	0.57
Ghana	0.62	Uganda	0.42
Guinea	0.39	Zambia	0.64
KENYA	**0.55**	Zimbabwe	0.58
Liberia	0.50		
Madagascar	0.90	MEMO ITEM	
Malawi	0.74	Average	0.58
Mali	0.20	Range	0.20 to 1.18

Source: Ng and Yeats (2005)

Diversify

2.27 The above data reinforce the necessity of diversifying exports. Continued reliance on current exports will mean continued poor trade-growth rates and thus, continued global marginalization. This is confirmed by long-term price projections for Africa's traditional exports, most of which face: declining or relatively low growth in global demand; falling real prices; and high price volatility.

Potential Sectors for Export Diversification in Kenya

2.28 Efforts to foster export diversification for Kenya must first identify potential export sectors in which the country would have a comparative advantage. Economic theory posits that diversification should be into the manufacture of goods that demand relatively low-skilled labor intensiveness. What is increasingly clear is that countries like Kenya may have more options for export diversification than is generally recognized, and that the range of potential new exports extends well beyond footwear, textiles, and apparel products (see Box 2.1).

Box 2.1: Implications of Industry level Labor-intensive Indices

Specific proposals for product diversification should recognize that new export ventures should be highly intensive in a factor Kenya has in abundance, one of which is low cost relatively unskilled labor.

To assist countries like Kenya to evaluate prospects for potential new exports, the World Bank conducted a study aimed at identifying goods normally produced using labor-intensive manufacturing processes.

Among survey findings was that manufacturing processes in a relatively high number of industries were dependent on highly labor-intensive production methods and, therefore, suitable for manufacture in developing countries like Kenya. Textile and clothing products were often identified as highly labor intensive; the table below lists a few of the other products that also utilize high labor inputs.

The World Bank's analysis indicates the potential for developing countries to engage in these types of activities is fairly high. Further, many of these products have relatively high growth rates. Also, even though developing countries were increasing their shares in international markets for many of these products, there is still scope for further expansion.

INDUSTRIAL PRODUCTS REQUIRING LABOR-INTENSIVE MANUFACTURING PROCESSES

Industry (Labor Intensity Index)	Industry (Labor Intensity Index)	Industry (Labor Intensity Index)
Poultry and dressing plants (41.7)	Wood TV and radio cabinets (50.3)	Women's handbags (48.2)
Fresh and frozen fish (59.7)	Wood kitchen cabinets (67.5)	Leather glovers (43.0)
Curtains and draperies (42.5)	Wood office furniture (72.7)	Leather belts (60.5)
House furnishings (59.7)	Upholstered furniture (57.3)	Leather tanning (68.9)
Textile bags (50.5)	Bookbinding (53.2)	Luggage (62.7)
Canvas products (57.6)	Watches and clocks (66.7)	Earthenware food utensils (47.6)
Hardwood flooring (45.1)	Musical instruments (64.4)	Pottery (57.7)
Hardwood plywood (57.4)	Dolls (66.5)	Artificial flowers (59.6)
Softwood plywood (55.2)	Costume jewelry (64.7)	Buttons (57.5)
Nailed wood boxes (49.9)	Fabricated rubber products (83.3)	Woven carpets (62.0)
Folding paper boxes (72.8)	Rubber and plastic footwear (47.4)	Cordage and twine (63.7)
Envelopes (81.1)	Boot and shoe stock (52.7)	Wood household utensils (65.7)
Wood containers (45.2)	House slippers (46.2)	Handbags (67.2)
Wood household furniture (50.1)	Men's footwear (54.9)	Sewing machines (71.1)
Brooms and brushes (71.1)	Women's footwear (53.0)	Residential light fixtures (73.5)

Note: The lower the intensity index, the higher the labor intensity. An index value of 50.0 indicates a product that requires twice the average labor inputs as an average of all sectors of the economy

2.29 Africa is not exploiting these opportunities; Ng and Yeats (2005) show that labor intensive-manufacturing accounts for less than six percent of Sub-Saharan Africa's exports (excluding South Africa); this is slightly lower than the corresponding share in the mid-1990s. Also, textile and apparel production accounts for 80 percent of all labor-intensive manufactures exported from the region.

Dynamic Exports in Sub-Saharan Africa

2.30 Dynamic exports from Sub-Saharan Africa are exports for which world trade grew at above average rates and for which growth of exports from Africa exceeded global averages.[20] Forty-eight products fall in this category and these had a value of US$13billion in 2003. Seventy percent of these are manufactured goods. Passenger motor vehicles are the single

[20] Ng and Yeats (2005) compiled this list using a metric that enabled categorization of products according to growth in world-market demand and Africa's market share; see their publication for further details.

largest product on the list, with an export value in 2003 (primarily from South Africa) of over US$2billion. However, there is a relatively broad range of products for which world trade grew at above average rates, and in which African countries were able to maintain or improve their international competitive position.[21]

2.31 A noteworthy point about the African origins of exports in these 48 goods is that most originated in the southern cone of Africa. SACU accounted for 71 percent of all exports, followed by Mauritius (16 percent), and Madagascar and Zimbabwe (3 percent each). However, all Sub-Saharan African countries, with the exception of Reunion and Rwanda, produced some competitive-dynamic goods for export (see Table 2.6).

[21] Among goods for which trade expanded at above-average rates even as African countries were unable to maintain market share are several textile and apparel products, trade in which may have been strongly affected by AGOA. Other goods in this category are platinum, printing paper, miscellaneous base metals and toys and games. Goods for which trade expanded, but export growth in Africa actually shrank include palm oil, vegetable tanning extracts and safety glass.

Table 2.6: Fast Growing Exports, of which African Countries Increased their Share of World Markets

SITC	Export Product (Revision 2)	2003 Global Imports (US$ million)		2003 SSA Market Share (%)	Annual Import Growth 1990-03 (%)	
		From Africa	World		From Africa	World
072.2	Cocoa powder	122	1,287	9.5	46.7	12.8
034.3	Fish fillets	176	2,184	8.1	44.1	12.1
743.6	Filtering machinery	1,097	14,818	7.4	40.1	8.8
764.3	Radiotelephonic goods	76	78,562	0.1	36.9	20.3
781.0	Passenger motor cars	2,333	379,276	0.6	36.7	6.7
762.1	Radio receivers	38	8,735	0.4	34.3	5.8
341.3	Petroleum gases	1,445	47,920	3.0	31.4	7.8
776.3	Diodes and transistors	33	29,247	0.1	31.1	11.7
713.2	Combustion engines	104	38,788	0.3	29.8	7.7
893.2	Toilet articles	34	1,881	1.8	29.5	7.2
523.3	Salts of metallic acids	112	2,208	5.1	29.2	5.9
551.4	Air fresheners	55	9,320	0.6	28.7	10.7
511.1	Acyclic hydrocarbons	149	7,402	2.0	28.0	5.0
112.1	Wine of grapes	526	17,690	3.0	26.8	6.0
334.1	Motor spirits	1,807	152,489	1.2	25.7	15.3
122.2	Cigarettes	52	12,227	0.4	24.9	5.1
741.5	Air conditioning units	39	16,503	0.2	24.2	9.4
625.1	Pneumatic tires	100	15,415	0.6	24.0	6.4
553.0	Perfumery and cosmetics	107	30,313	0.4	22.8	10.3
112.4	Spirits and liqueurs	39	13,103	0.3	22.5	4.3
642.8	Articles of paper	44	13,411	0.3	21.0	7.8
277.2	Natural abrasives	44	710	6.2	20.8	-0.5
672.7	Iron or steel coils	643	21,568	3.0	20.6	5.3
821.1	Chairs and other seats	460	33,923	1.4	20.5	9.5
533.1	Other coloring matter	33	6,766	0.5	20.4	5.8
892.8	Printed matter.	38	11,574	0.3	20.3	5.2
282.0	Scrap metal	163	13,971	1.2	19.7	6.3
761.1	Television receivers	35	34,021	0.1	19.7	6.0
625.2	Tires	69	8,797	0.8	19.5	5.8
098.0	Edible preparations	156	21,560	0.7	19.2	8.8
773.1	Insulated wire	119	39,609	0.3	18.9	9.2
512.1	Acyclic alcohols	285	16,436	1.7	18.6	7.7
081.4	Flours of meat or fish	48	2,368	2.0	18.5	2.2
776.4	Electronic microcircuits	37	215,600	0.0	18.4	13.3
246.0	Pulpwood	384	2,657	14.4	18.0	2.2
872.0	Medical instruments	35	34,978	0.1	17.7	10.4
233.1	Synthetic rubber	34	8,434	0.4	17.6	4.5
782.1	Trucks	177	64,341	0.3	17.4	5.9
764.9	Parts of telecommunications	76	77,861	0.1	17.2	9.5

Table 2.6: Fast Growing Exports, of which African Countries Increased their Share of World Markets (continued)

SITC	Export Product (Revision 2)	2003 Global Imports (US$million)		2003 SSA Market Share (%)	Annual Import Growth 1990-03 (%)	
		From Africa	World		From Africa	World
598.9	Chemical products n.e.s.	145	45,784	0.3	16.6	7.5
843.9	Other outer garments	471	34,949	1.3	16.3	7.4
778.8	Other electrical machinery	79	54,801	0.1	16.2	8.8
541.9	Pharmaceutical goods	34	8,063	0.4	15.8	9.6
743.9	Parts of centrifuges	71	11,501	0.6	15.8	7.8
714.9	Parts of engines and motors	55	29,199	0.2	15.8	6.7
784.9	Other motor-car parts	497	170,260	0.3	15.7	6.9
778.3	Electrical motor equipment	43	17,919	0.2	15.6	7.2
845.9	Other knitted outer garments	319	23,639	1.4	15.4	8.1
	ALL ABOVE PRODUCTS	13,039	1,904,069	0.7	24.0	8.5
0 to 9	ALL GOODS	109,183	7,189,836	1.5	4.7	6.1

Note: The fastest-growing African products are those having exports with a value above US$30 million in 2003 and average annual growth rates of at least 15 percent from 1990 to 2003 (excluding armored vehicles)
Source: Computations based on world imports from UN COMTRADE Statistics.

2.32 One unexploited segment is international production sharing. Worldwide, production- sharing activities and the related component-and-finished-product trade have grown substantially in recent years, and are expected to continue to do so. African trade in components is limited to relatively few items. Over 50 percent of all component imports occur in just three product groups: telecommunications equipment, motor vehicles and switchgear.

2.33 It is difficult to determine what portion of African component imports are locally processed, and then re-exported. However, evidence from East Asia indicates that domestic assembly of imported components for re-export is of major importance. Trade in components will offer African countries an opportunity to export products that they otherwise would not be able to. One example is BMW motor cars, which are assembled in South Africa.

2.34 Over the past 15 years, Kenya has emerged as Africa's third-largest importer of components, with 2003 trade equivalent to US$250 million, or about ten percent of total trade; South Africa dominates African imports of components. Trade in parts and components between Kenya and South Africa has been developing rapidly (see Table 2.7).

2.35 Kenya imports crude petroleum from various sources, refines it, and then exports processed petroleum products to other East African countries. Given the importance of production sharing, further opportunities should be exploited for processing other primary commodities like foodstuffs, wood and paper products, or metal ores. Initiatives to encourage food processing for export or domestic consumption should be given a high priority.

Table 2.7: Changes in Selected African Countries' Trade in Parts and Components, 1990 to 2003

Trade Flow/Country	Component Trade Values ($000)			Share of Parts in Total Trade (%)		
	1990	1995	2003	1990	1995	2003
African Countries' Imports						
Angola	193,772	174,445	589,122	12.42	12.42	13.74
Burundi	21,568	18,626	9,475	13.21	13.21	7.49
Congo, Dem. Rep.	215,273	80,243	72,311	17.29	17.29	10.56
Congo, Rep.	74,904	101,766	133,069	12.08	12.08	13.28
Cote d'Ivoire	115,414	204,166	161,991	7.46	7.46	7.66
Ghana	116,417	227,045	244,958	10.39	10.39	8.50
Kenya	326,277	327,202	248,222	18.08	18.08	9.45
Madagascar	83,105	60,072	70,509	12.55	12.55	6.78
Mauritius	89,380	117,885	167,863	8.80	8.80	9.23
Nigeria	845,724	668,632	1,695,592	16.36	16.36	13.57
South Africa	2,918,284	4,684,771	5,104,523	23.70	23.70	18.46
Sudan	99,846	95,301	244,412	11.04	11.04	11.00
Tanzania	154,364	198,982	192,735	16.26	16.26	11.25
Uganda	57,056	57,911	84,722	11.37	11.37	8.06
Zambia	127,540	147,154	134,601	19.15	19.15	15.29
Zimbabwe	142,253	261,147	137,071	17.50	17.50	10.94

Source: Computations based UN COMTRADE database.

2.36 An analysis of available trade data reveals that Kenya's participation in production-sharing activities and export of finished goods produced from components are both relatively low. There is also no clear evidence that Kenya's integration into international production chains is increasing. Kenya exports and imports parts for manufactured products (engines, machinery, refrigerators, telecommunications, appliances). Exports of such parts and components increased by almost 60 percent between 2000 and 2003 (still account for less than one percent of Kenya's total exports though); imports of parts and components declined during the same period by 20 percent (see Table 2.8).

Table 2.8: Exports and imports of parts and components 2000 and 2003

	2000	**2003**	**% change**
Exports of parts and components (US$ million)	10.8	17.2	59
to OECD (US$ million)	7.0	7.9	13
to SSA (US$ million)	3.4	7.0	110
% of all exports	0.6	0.7	
% of worldwide trade in parts and components	0.0012	0.0018	47%
Imports of parts and components (US$ million)	316.1	252.8	-20
from OECD (US$ million)	239.0	195.0	-18
from SSA (US$ million)	9.6	12.3	29
% all imports	13.6	9.2	
% of worldwide trade in parts and components	0.035	0.026	-26%

Source: Computations based UN COMTRADE database.

2.37 Overall, Kenya's integration into global production chains decreased between 2000 and 2003 since the increase in parts and components exports has been offset by a decline in imports of same. Kenya's share of worldwide trade in parts and components was 0.018 percent in 2000 and has since declined by almost a quarter to 0.014 percent.

2.38 However, Kenya is integrating into emerging Sub-Saharan African production chains; imports and exports of parts and components from and to other African countries increased between 2000 and 2003, although levels remain moderate.

2.39 Table 2.9 shows that Kenya's exports of finished assembled products (machinery, transport equipment, and other manufacturing) are low, about two percent of total exports in 2003, but increasing; exports to both OECD and Sub-Saharan African countries increased, and the increase in exports to the former is more pronounced.[22]

Table 2.9: Exports of machinery, transport equipment and other manufactures, 2000 and 2003

	2000	2003	% change
Exports machinery etc. (US$ million)	24.9	44.6	79
to OECD (US$ million))	5.6	17.8	217
to SSA (US$ million)	17.6	24.5	39
% of all exports	1.4	1.9	

Source: Computations based UN COMTRADE database.

2.40 Table 2.10 compares production sharing exports' contribution to export growth in Kenya and comparator countries. Kenya lags behind countries in East and South Asia, Latin America, and South Africa. Contribution of production sharing exports to total export growth is further broken down in to contribution to export growth by (i) exports that *use* parts and components, and (ii) exports *of* parts and components. In Kenya, the latter is by far the more important contributor to export growth.

Table 2.10: Contribution of Production-Sharing Exports to Export Growth 1992 to 2000

Country	Contribution of production sharing to export growth (%)	Contribution of exports based on parts and components to export growth (%)	Contribution of exports of parts and components to export growth (%)
Kenya	0.14	0.01	0.13
South Africa	0.59	0.19	0.40
Malaysia	0.81	0.42	0.39
Thailand	0.69	0.31	0.30
Philippines	0.92	0.51	0.41
Indonesia	0.57	0.17	0.40
India	0.34	0.09	0.25
Sri Lanka	0.49	0.43	0.06
Brazil	0.37	0.10	0.27
Chile	0.46	0.14	0.32
Costa Rica	0.73	0.50	0.23
Turkey	0.48	0.36	0.12

Source: Computations based UN COMTRADE database.

2.41 Kenya has performed relatively well in exporting intermediate goods (compared with its export of goods for which it imported intermediate goods). Other countries that are increasingly engaged in intermediate manufacturing (as supposed to the final stage) are

[22] The significant increase in exports to the OECD is largely driven by a jump in "Electric sound and visual signaling apparatus" exports to the UK (such exports were worth US$0.05 million in 2000, but had jumped to US$10.4 million in 2003 before falling to US$0.7 million in 2004; thus the 2003 number may be inaccurate.

Brazil, Chile and South Africa. It may therefore be worthwhile for GOK to study conditions and developments in these countries.

2.42 There seems to be no particular reason for Kenya's diminished integration into global production chains other than a general erosion of business competitiveness relative to countries that compete with it in OECD markets. Studies of production-sharing in other countries show that the following conditions are critical for exporting economies matter: transport infrastructure; reasonable telecommunications costs and networks; access to finance; and minimal or no political risk and corruption. The next section of this report will more closely examine transport infrastructure, telecommunications and access to finance. However, it is clear that to achieve further integration into production-sharing networks, policy must not be sector specific but rather should address improving the broader business environment.

Potential of Regional Trade

2.43 Regional trade's potential for significant expansion and diversification appears limited for a number of reasons: Growth expectations for Kenya's existing regional exports is limited since Kenyan imports already zero tariffs in these markets, so there is no further trade liberalization round that could stimulate exports. Hence, any further demand for Kenyan exports would come from economic growth in the region. Also, the complementarity between the regional products is low: for Kenya's top exports in horticulture where the country has developed a competitive edge, its regional neighbors are competitors, rather than potential markets.

2.44 A caution should also be sounded at the possibility of regional exchange of relatively high cost manufacturing inputs and production equipment for which member countries do not have a comparative advantage in production, and trade is stimulated by trade preferences. For some of these products, competitors, in particular from Asia might soon be able to supply at lower cost. The same may also be true for some of Kenya's regional manufacturing exports that are competing with exports from Asia, as well as with production capacity elsewhere in the region, financed with FDI from Asia.[23]

2.45 As regards diversification, the historical record is not encouraging. Overall, concentration in Kenya's top five export products increased between 1976 and 2004, from 61 percent to 63 percent for exports to EAC, and from 56 percent to 59 percent for exports to COMESA (see Table 2.11). Petroleum and petroleum products were Kenya's major regional export to EAC and COMESA in 1976 and 2004; the share of this top export commodity increased for EAC by about 3 percent and for COMESA by about 4 percent over this period. Thus there is little evidence that regional trade facilitated an important expansion of exports in new product lines.

[23] See below, and in more detail World Bank (2006).

Table 2.11: The Largest Products in Kenya's Exports to EAC and COMESA 1976 and 2004

	Value of Imports (US$m)		Share of Total imports (%)	
	1976	**2004**	**1976**	**2004**
TOTAL EXPORTS TO EAC	155.0	465.8	100	100
EAC 5 largest exports 2004		291.4		**62.6**
Petroleum and petroleum products		201.9		43.4
Non-metallic mineral manufactures		26.2		5.6
Paper, paperboard and manufactures		21.6		4.6
Iron and steel		21.2		4.5
Medicinal and pharmaceutical products		20.6		4.4
EAC 5 largest exports 1976	94.7		**61.1**	
Petroleum and petroleum products	62.8		40.5	
Machinery, other than electric	10.5		6.8	
Manufactures of metal	8.3		5.4	
Chemical materials and products	6.7		4.3	
Transport equipment	6.4		4.1	
TOTAL EXPORTS TO COMESA			100	100
COMESA 5 largest exports 2004		358.6		**59.3**
Petroleum and petroleum products		223.4		36.9
Iron and steel		44.2		7.3
Coffee, tea, cocoa, spices		37.7		6.2
Non-metallic mineral manufactures		29.2		4.8
Paper, paperboard and manufactures		24.2		4.0
COMESA 5 largest exports 1976	121.2		**55.8**	
Petroleum and petroleum products	71.2		32.7	
Transport equipment	14.6		6.7	
Non-metallic mineral manufactures	13.5		6.2	
Machinery, other than electric	11.6		5.3	
Manufactures of metal	10.4		4.8	

Source: Kenya's exports as tabulated from the import statistics of Uganda and Tanzania for the EAC, and COMESA member states for COMESA. The choice of years in this table was necessitated by the fact that many EAC and COMESA countries did not report trade statistics to the United Nations from 1977 to the mid-1990s.

2.46 However, South Africa should become an increasingly important market for many of the raw materials and foodstuffs exported by Kenya. Differences in the level of industrialization and in labor costs between South Africa and Kenya may have positive implications for the development of regional production sharing in a manner similar to that in East Asia. One possible scenario is that South Africa will increasingly emerge as an exporter of parts and components for assembly in low-wage, less-industrialized, African countries.

Potential of AGOA

2.47 Kenya provides less than two percent of US imports under AGOA preferences. This is negligible, and the scope for increasing exports under AGOA is limited for several reasons:

- There are few sectors apart from apparel and clothing in which AGOA preferences provide significant advantage (due to the generally low level of MFN tariffs and existing preferences under the GSP program).
- It is unclear whether Kenya (and other clothing exporters in Africa such as Lesotho) can remain competitive exporters of apparel following removal of all multi-fiber restrictions. Thus far there has been little impact in the first six months since removal of restrictions.
- Kenya appears to be at a transport-cost disadvantage for exports to the US vis-à-vis other countries. Kenya's overall nominal transport costs are more than three percentage points higher than those of its global competitors.

Potential for Trade with Asia

2.48 A recent World Bank report[24] assessing the developments and opportunities of trade between Africa and Asia finds that the volume of African exports to Asia is accelerating. It grew by 15 percent between 1990 and 1995, it has grown by 20 percent during the last five years (2000-2005); this growth largely reflects a sharp upturn of their exports to China and India. However, despite this growth, Africa still remains relatively small from perspective of Asian economies. African exports to Asia account for only 1.6 percent of total global imports of Asian economies.

2.49 Furthermore, the report finds that Africa is increasingly well-positioned to competitively supply labor-intensive goods and services to today's Chinese and Indian firms and consumers. China and India are not just big potential markets for more diversified and higher valued-added goods and services from Africa, they are real opportunities, especially compared to Africa's traditional export markets in the North.

2.50 Petroleum is the leading African export, followed by ores, metals, and gold. But the rapidly growing exports to China and India are not limited to fuels and other mineral and metal products. Raw or semi-processed agricultural commodities that are used for further processing for industrial use (timber, cotton) or for food are also increasingly imported by China and India.

2.51 Asian exports to Africa are equally growing rapidly. During the last five years, they have grown by 18 percent, higher than any other region, including the EU. Asian exports to Africa are largely manufactured goods, which have surged into African markets. There are also sizable amount of imports of consumer non-durables from Asia which compete against Africa's domestically produced products. However, some of Asian exports to Africa are also intermediate inputs to manufacturing products assembled in Africa and shipped out to the third markets such as the EU and US, or providing capital goods (machinery and equipment) for the manufacturing sectors in Africa.

2.52 So far, Kenya's exports into China and India are minuscule – in 2004, Kenya exported goods worth US$11 million into China, and US$51 million into India – that is

[24] World Bank (2006).

comparable with exports into Malawi and Sudan respectively, and combined just slightly over 2 percent of Kenya's total exports. However, trade with these two countries has been growing rapidly. Since 2000, exports into China increased more than four fold, and exports into India more than doubled.

2.53 Hence, regional diversification into Asia is already under way, and a combination of the low export values to date, and the size and growth of the two markets, there is considerable potential for further regional diversification into Asia.

2.54 As far as product diversification is concerned, Kenya's top exports into China and Asia confirm Kenya's competitiveness in tea which features prominently in exports into both countries. Other important exports that do not feature in Kenya's top export list are nuts which is another important export into both countries and into China sisal, titanium and natural gums, and into India quartz, leather, soda ash and precious and semi-precious stones.

SUMMARY OF KEY MESSAGES THAT HAVE POLICY IMPLICATIONS

2.55 Kenya's sub-par export performance cannot be attributed entirely to the lack of access to developed-country markets. The average level of OECD tariffs for African exports is much lower than those faced by East Asian exporters at the start of their industrialization drive.

2.56 There have been some achievements, in such sectors as cut flowers and fresh vegetables, in which Kenya has established a competitive supply chain, and clothing in which Kenyan manufacturers have profited from AGOA preferences. At the same time many of Kenya's exports have become less competitive, the most salient being coffee.

2.57 Natural resource-based exports are likely to remain the mainstay of Kenya's exports for some time. Lessons from the successful development of cut flowers, fresh vegetables should serve to guide GOK's policy reform of other non-traditional natural resource-based sectors.

2.58 There is some growth potential in regional trade for commodities such as maize, dairy, and processed food. Regional trade in finished products however holds less potential because of low complementarity among regional partners.

2.59 Traditionally, Kenya's main export market has been the EU. Given the sluggish economic growth there in the past decade and the contrastingly dynamic performance of South and East Asian economies, Kenya would do well to secure access to the latter's markets. South and East Asia's populations are likely to maintain strong demand for food items such as coffee, tea, nuts and horticulture, which is perhaps the sub sector in which Kenya has the greatest competitive edge. However, Kenyan exports still face relatively high tariffs to enter these markets.

2.60 The government is right to encourage export development and diversification into labor-intensive manufacturing and processing industries. One sector that warrants close attention is international production sharing, which is fast growing in part because of

declining transport costs. South Africa and South and East Asian countries are potential partners. The need to improve competitiveness and create a commercial environment conducive to export diversification is key. The first step towards improving the commercial environment would be to identify the major domestic constraints to international business development. Clearly, the ability to attract foreign investment will be vital if Kenya is to diversify into new export lines.

3. DOMESTIC CONSTRAINTS TO TRADE

COMPETITIVENESS AND COMMERCIAL CLIMATE FOR TRADE IN KENYA

3.1 The major obstacles to export expansion and diversification are Kenya's commercial and investment climate (i.e. the cost of doing business), a weak legal framework, licensing issues, complex rules and regulations governing exports, and the poor quality and high cost of business services in Kenya. This is the conclusion of a number of recent analyses undertaken by the World Bank (see Box 3.1).[25] The GOK has acknowledged many of these issues in its PSD Strategy and Investment Climate Action Plan; the priority must now be to swiftly implement these initiatives.

Box 3.1: Kenya's Business Climate—Key Findings of Recent Analytical Work

The ICA's findings underscore how manufacturing competitiveness is undermined by high indirect costs pertaining to corruption, crime and infrastructure. Transport services are poor, power services are uncertain, and fixed-line telephone costs uneconomical. These weaknesses negate Kenya's inexpensive, relatively well-educated labor force, hamper productivity and discourage investment.

Flaws in the legal system include: cumbersome and expensive procedures to establish a business; outdated, complex and bureaucratic measures relating to key elements of commercial legislation; lengthy and costly insolvency procedures; a weak framework for secured transactions and difficulties associated with contract enforcement and commercial-dispute resolution due to inefficiencies in the court system. Investment in Kenya is further severely constrained by corruption and crime.

Lastly, a report on growth and competitiveness found that although literacy of the Kenyan workforce is relatively high compared to its Sub-Saharan African neighbors, the level and quality of skills development and technical training is inadequate.

3.2 In addition to the above constraints, for MSMEs there is also very limited access to export finance, which is a key barrier to exporting. For trade to play a key role in driving and sustaining growth, reforms and investment need to be put in place to address these behind-the-border issues.

TRANSPORT AND TRADE LOGISTICS [26]

3.3 Kenya's trade logistics are weak in critical aspects, but have some bright spots. Trade by sea and land routes (98 percent by volume) faces major hurdles and bottlenecks. Kenya's trade logistics chain—with the exception of air transport—lies along the so-called Northern Corridor which links the port of Mombasa with Nairobi and the hinterland (Uganda, Northern DRC, and Rwanda). Many cities and economic activities in Kenya and the interior

[25] World Bank (2003), Kenya—Growth and Competitiveness, report No. 31387-KE, Washington DC, USA; FIAS (2004), Kenya—Improving the Commercial Legal Framework and Removing Administrative and Regulatory Barriers to Investment, Washington DC, USA; World Bank (2004) Enhancing the Competitiveness of Kenya's Manufacturing Sector: The Role of the Investment Climate, Washington DC, USA.

[26] This is a summary of the main report in which can be found at www.worldbank/kenya.

are located on or close to the corridor. Assessing trade logistics in Kenya thus focuses on various procedural and physical impediments that occur along the corridor. The quality of much corridor infrastructure is sub-par because of very low levels of maintenance and investment over the past two decades.

3.4 The ensuing high cost of transport constitutes a variable burden for export industries varies—it is particularly high for sugar and for coffee. Coffee and sugar production concentrated in particular regions; therefore improving roads and other transport infrastructure in these areas should be a priority. Another sector where transport and trade logistics play a major role is the garments sector, for which turnaround times for production cycles are an important determinant of competitiveness.

3.5 A positive aspect of Kenya's transport and trade logistics is the existence of an effective private sector able to implement innovative solutions despite a poor investment climate. Very efficient air logistics services have been established to provide a first-class link between Kenya and global markets.

3.6 Kenya's poor trade-logistics performance is due to a backlog in investments and reforms. The condition of some sections of the main corridor highway is very poor. Kenya Railways has been essentially defunct as a provider of freight services since the 1980s. In addition, transport operators face overly onerous transit and border-crossing procedures that inhibit trade with Uganda and Rwanda.

3.7 As a result of dilapidated infrastructure and complicated procedures, especially at Mombasa port, trade facilitation indicators for Kenya are poor. Customs operations are still essentially manual and relatively complex. It takes an average of about two weeks to clear a container at port.[27] The port is congested, a consequence of mismanagement rather than a lack of physical capacity. Mombasa's performance is sub-par, compared with the port of Dar es Salaam, where container throughput has grown much faster (see Table 3.1). Transport logistics are also characterized by a high degree of unpredictability, due to poor information systems and physical bottlenecks at the port or en route. Uncertainty over delivery times is a considerable cost burden to operators and consignees, especially manufacturers, and is sometimes more damaging than delays. Kenya lags far behind other Sub-Saharan gateway countries in the design and implementation of core trade and transport facilitation measures (see Table 3.2).

Table 3.1: Container Throughput in TEU

Country	Port	1997	1998	1999	2000	2001	2002	2003	Change 1997-2003
Kenya	Mombasa	230,698	248,451	232,417	236,928	290,500	305,427	380,353	65%
Tanzania	Dar es Salaam	103,627	119,585	111,055	126,628	147,863	166,253	205,044	98%

Source: PMAESA, Liner Trades in Eastern and Southern Africa

[27] Information on the average dwell time was provided by freight forwarders, rather than by the port authority because KPA does not collect statistics on dwell times. Thus, in order to benchmark future efforts on improving port performance, it would be necessary to collect statistics on dwell times, broken down further if necessary.

Table 3.2: Benchmarking of Kenyan Reforms Against Those of Other Sub-Saharan African Countries

	Ports	Railways	Customs
Kenya	Lack of investment, lagging productivity; Grain operations have been privatized	Operations and infrastructure have been neglected; Concession awarded	Modernization launched, with implementation of GAINDE 2000 system
Cameroon	Container terminal modernized and privatized; Other port operations under rehabilitation	Very successful privatization, with operations now of high quality	Undergoing modernization since 2003; New IT system installed: Single window in Douala to be automated
Côte d'Ivoire	Good standard of operations; Most operations (containers, stevedoring, tugging) have been privatized	Very successful privatization; Operations compromised by the ongoing political situation	Partially modernized; Aging in-house automation system
Ghana	Very few services privatized; Of average quality but services are the least expensive in the sub-region	Limited to domestic coastal and mining traffic; Not privatized	Partially modernized; Successful automation program extended into a community system
Senegal	Good standard of operations; Most operations (containers, stevedoring) have been privatized	Privatization complete; concessionaire has begun operations	Customs successfully modernized; Locally developed IT system GAINDE 2000, now being implemented in Kenya
Tanzania	Very efficient container terminal operation following privatization; Other operations currently of average quality to be privatized	Very poor quality infrastructure; 25-year concession awarded in April 2006 to RITES Co. of India; Privatization planned for the rail link to Zambia	Modernization underway, including implementation of ASYCUDA ++

3.8 It is not surprising then that international logistics operators have a very negative perception of Kenya's logistical performance compared to that of other developing economies. Kenya was ranked as the least logistically friendly of 70 countries in the 2004 Logistics Perception Index, which also includes Nigeria, Ghana, South Africa and Zambia.[28]

3.9 In the last two years, modernization of trade logistics has accelerated. The current agenda addresses four main issues: improvement of road infrastructure backed by a consistent maintenance policy; a Customs Reform and Modernization (CRM); concessioning the operations of the Mombasa-Nairobi-Kampala railway line; and a modernization program for the port including investment in key equipment (gantry cranes) at the container terminal and automation of the waterfront information system. Implementation of this reform program is being pushed by a proactive private sector, strong cooperation among stakeholders, and considerable donor support for modernization.

[28] The Logistics Perception Index (LPI) measures perceptions of the logistics environment of countries. The data for the LPI is gathered from managerial-level personnel of international freight forwarding firms. worldwide. To date, LPI is the most comprehensive, albeit qualitative, logistical performance index. The index is compiled and published by the Turku School of Economics and Business Administration in Finland; the most recent index was released in 2004.

3.10 The modernization agenda must be implemented effectively to bring about the desired gains. These are likely to be very significant (see Box 3.2). However, successful implementation requires not only new equipment, but also implementation capacity at the level of the port, at the level of coordination, and at the supervisory level. Also needed is the political will and support from the highest level to eliminate rent-seeking activities that arise from the system's present inefficiency.[29] The ongoing involvement of the private sector is also vital, particularly in freight forwarding and transport, to ensure that public-sector modernization complements technologies already deployed by the private sector.

Box 3.2: Expected benefits of East Africa's Trade and Transport Facilitation Project

A recently approved World Bank project, the East Africa Trade and Transport Facilitation Project aims to expand regional trade in and from East Africa by providing more reliable and less-costly transport services in the region. The project's main activities are the implementation of community-based systems in Mombasa and Dar-es-Salaam; elimination of the escort transit system in Kenya and of weighbridge delays, and simplification of transit systems in Uganda and Rwanda.

Benefits have been estimated based on three parameters: namely expected travel/dwell time and uncertainty along transport corridors, value of consignees' time for storage and inventory, and value of time for transportation equipment. The estimation assumes that the project will achieve: a 25 percent reduction in dwell time at Mombasa and Dar-es-Salaam ports; a 25 percent reduction in transit times through Kenya; a 40 percent reduction in domestic transit times through Rwanda; and a 66 percent reduction in border-clearance times at Malaba. Improvements in Mombasa and along the Kenyan portion of the Northern corridor are expected to accrue the lion's share of benefits; consequently Kenya is set to benefit most substantially from the project.

	Benefits per measure		**Benefits per country**
Reduced dwell time Mombasa	US$56m	Kenya	US$46m
Transit simplification in Kenya	US$14m	Uganda	US$21m
Malaba border crossing	US$10m	Rwanda	US$22m
Transit simplification in Rwanda	$10m	Tanzania	$23m
Reduced dwell time at Dar es Salaam port	$22m	Tanzania	
Total	$112m		$112m

A further breakdown of cost savings reveals that 40 percent of savings ensuing from reduced dwell time at Mombasa can be attributed to a reduction in delays; 60 percent can be attributed to reduced uncertainty for shippers. Almost 90 percent of savings gained from simplified transit procedures in Kenya will accrue to transport companies because of reduced delays.

3.11 There must be sufficient capacity and resources to implement, monitor and evaluate the modernization program. Progress on customs-facilitation reforms can be effectively monitored using indicators developed in the Time Release Study (TRS) undertaken by the Kenya Revenue Authority and the World Customs Organization (WCO) (see Box 3.3).

[29] One important example is the intermediaries that help consignees or forwarders to track their containers; replacing the current manual system with a computerized tracking system would eliminate the business of such intermediaries and has thus been fiercely resisted.

Box 3.3: Time Release Study

Kenya Revenue Authority (KRA) and World Customs Organization (WCO) prepared a Time Release Study (TRS) to enable KRA to benchmark its reforms, and to monitor reform implementation and success against a baseline, as well as global benchmarks. The TRS provides information on the time needed for completion of various stages in the customs clearance process, from arrival of goods until their release, and identifies where improvements are needed.

The study finds that the time taken to clear goods has to be improved to meeting international standards. Goods at land border posts in Kenya take 20 hours to clear; at seaports clearance takes 10 days, 8 hours; and at the airport, 11.5 hours. Release times are shorter than in Tanzania (2 days, 20 hours at land border posts, 11 days, 9 hours at seaports and 7 days 20 hours at airports), but are very much longer than in the most efficient countries; in Sweden in 2001, land border crossings took an average of 11 minutes; at the seaport the release time was 1.4 hours. A TRS conducted at Port Klang, Malaysia, 11 years ago found an average release time of only 34.5 hours.

To reduce customs release times, the report recommends introduction of an electronic declaration system that will allow the introduction of a single window at which traders can lodge information with one agency, at the same time fulfilling all import- and export-related regulatory requirements. The electronic SIMBA system was introduced in July 2005, and is now fully functional and supporting a single window.

The report also recommends a range of improvements to avoid duplication and eliminate unnecessary procedures. The most important recommendations of these: introduction of a random quality-control provision on receipt of declaration; introduction of a single entry-identification number; improved coordination between customs authorities and other agency controls; introduction of enhanced risk-analysis techniques by all agencies involved; and introduction of post-clearance audits to ensure compliance.

Lastly, the report recommends augmenting cooperation between customs authorities and the private sector to improve procedures, and to explore the introduction of an authorized trade scheme that would permit "frequent traders" to use simplified procedures.

3.12 Implementation of the reform agenda is expected to yield significant reductions in transport costs. This report estimates that improvements made along the Northern Corridor and at the port could reduce facilitation times for the garment sector by between 22 percent and 32 percent, and reduce the total textile-production cycle by 4 percent-5 percent. Recent productivity improvements and corresponding reductions in dwell time at Dar es Salaam port following its privatization in 2000 illustrate the benefits of upgrading port infrastructure (see Table 3.3).

Table 3.3: Performance Indicators at Dar es Salaam Container Terminal 2000–2003

	1999	2000	2001	2002	2003	% improvement
Service time (days/ship)	1.09	1.1	1.1	0.69	0.76	30%
Crane productivity (moves/crane/hour)	14	15	19	20	21	50%
Dwell time (days/container)	37.7	25.9	16.7	16.7	17	55%

Source: PMAESA, Liner Trades in Eastern and Southern Africa

3.13 Kenya's very efficient air logistics are illustrative of the benefits of allowing the private sector to take the lead in pushing development. Air transport in Kenya effectively links Kenya and its global markets flower and horticulture markets and sustains the thriving tourist industry. Kenya has become a leader in these industries because private entrepreneurs—both Kenyan and foreign—have developed a very efficient supply chain, leveraging the advantages of Jomo Kenyatta International Airport (JKIA). Transport cycles from the field to markets in Europe can take as little as 24 hours. Volume of exports is over 100,000 tons per annum with shipment costs to Europe about 50 percent less than cargo rates

elsewhere in Africa. GOK provided the institutional conditions by privatizing the airline and the airport and eliminating conflicts of interest by separating regulatory functions from those of service providers.

3.14 JKIA airport has emerged as the dominant hub in East Africa for passenger transport; almost 90 percent of regional passengers originating in or destined for Nairobi, and more than 80 percent of flights from Europe and 75 percent of flights to Asia going through Nairobi.

3.15 Kenya's road transport and forwarding industries are among the best-organized in Africa. Quality of service and operating costs are close to levels in Europe. Once again, the private sector has been key in instigating and pushing the modernization agenda.

3.16 In addition to the current modernization agenda, this trade report has identified three key issues: development of a roadmap for electronic data interchange (EDI) that encompasses transit activities (such as cargo tracking);[30] phase out of the current convoy trucking system and replacement with a less inflexible and expensive alternative; and overhaul of weighbridge regulations and operations to eliminate delays and regional inconsistency.

3.17 Kenya has not experienced the emergence of regional third-party logistics services for importers and exporters in East Africa. Logistics in the region are still very much organized along the corridors, reflecting the segmentation of markets. However, there is potential to add value beyond mere point-to-point transportation on the Northern Corridor (e.g. regional hubs for distribution of products in several countries). The highly professional and competitive operators based in Kenya are certainly well positioned to provide these services on a regional basis in the future.

3.18 The widespread perception that Kenya suffers from high inland cost transportation, and that the lack of rural roads is a key constraint for farmers could not be substantiated by the study. Transport infrastructure and logistics were not found to be major constraints for long-distance transport nor for bringing produce from farms to processing plants or collection centers. Findings from a field study (see Box 3.4) show that rural transportation costs are only a small fraction of total production cost.

[30] This is likely to be resolved by the World Bank EAC Trade and Transport Facilitation Project, which is being negotiated at the time of writing of this report.

Box 3.4: Issues in Trade Logistics in Kisumu and Nyandarua

A case study undertaken for this report analyzed rural logistics chain in two districts (Kisumu and Nyandarua). Through extensive interviews and surveys, the study examined how subsistence and cash crops reach markets, and provided cost estimates for the logistics chains. It appears that the typical logistics chain involves a series of intermediary means of transportation as well as middle men or brokers who typically have access to motorized means of transportation. Transportation costs are not particularly high, consistent with observations made along the Northern Corridor, and accounts for about 10 percent to 20 percent of the disparity between farm gate and consumer prices, depending on the distance. More significant is that farmers have little market information or bargaining power, and the lion's share of margins is captured by a series of middlemen, a problem correlated with distance from markets. Large commercial organizations that deal directly with farmers offer more favorable conditions, but their reach is limited to the areas close to Nairobi where most are based. Other problems along the supply chain that limit farmers' market power or their ability to access export markets are a lack of cold-storage facilities for horticulture and milk products, and the increased stringency of standards for horticulture exports.

Oversight for transport logistics is distributed across various ministries (see Table 3.4).

Table 3.4: Distribution of Government oversight for transport and logistics

Agency	Responsibility
Ministry of Transport and Communication	Overall responsibility for transport policy
Motor Vehicle Inspection Unit	Determine roadworthiness of public service vehicles
Transport Licensing Board	License public-service vehicles and assign them routes; Regulate operation timetables for all passenger-carrying vehicles
Parastatals	Report to the Ministry of Transport
Kenya Port Authority	Own and operate port facilities; Oversee shipping
Kenya Airports Authority	
Civil Aviation Authority	
Kenya Railways Corporation	
Ministry of Roads and Public Works	Develop, standardize and maintain roads
Roads Department	Manage national road network, (including the enforcement of axle-load regulations)
Kenya Roads Board	Maintain national road network; Manage Fuel Levy Fund; Oversee District Roads Boards;
District Roads Boards	Manage minor roads
Ministry of Finances	
Registrar of Motor Vehicles	Register and license all motor vehicles and drivers, and keep records thereof; Determine and fix passenger and luggage capacity for all categories of vehicles
Customs and Excise Department of Kenya Revenue Authority	Enforce transit procedures; Collect taxes due on importation of motor vehicles
Others	
Traffic Police Department	Enforce Traffic regulations
Local Authorities	Maintain roads in jurisdiction
Kenya Wildlife Service	Maintain roads in game reserves and national parks

RECOMMENDATIONS

3.19 Effective implementation of the current modernization programs is of paramount importance. The reform agenda must receive continuous high-level political support. The first priority is automation of container tracking at the port. A second priority is the development of a set of logistics indicators to benchmark reforms and progress. It is critical that the private sector occupy an important role in driving forward reform, as well as in some advisory capacity.

3.20 The study recommends that technological solutions for sealing or cargo tracking not be considered until a basic information system on goods in transit is in place. The system should rely on just two components: a carnet system (road manifest attached to the truck) and real-time reconciliation of transit information between port of entry and port of exit. Ensuring consistency among regional regulations is vital. Divergence from COMESA/EAC recommendations on weighbridges is highly undesirable and should be addressed by the relevant regional bodies.

3.21 Donors have been active in this area for a relatively long time in Kenya; however, GOK should manage donor support going forward to ensure coordination of priority actions.

3.22 There are currently no problems in the air-transport sector, and it is very important that this continues, given the importance of air traffic for Kenya's key export sectors.

STANDARDS AND CONFORMITY -ASSESSMENT INSTITUTIONS AND CAPACITIES[31]

Standards for Export Diversification: Horticulture, Flower and Fish

3.23 Kenya's expansion and diversification into horticulture has increased the attention given to meeting standards.[32] These were of little importance in the past; traditional agricultural commodities' competitiveness is driven more by price and quality concerns than by standards-related measures. Yet, the "success story" of Kenya's fresh produce industry, and the government's and industry's response to the challenges posed by meeting food safety standards in international markets, illustrate how these can catalyze trade and redefine comparative advantage.

3.24 Attaining a strong market position has come at a cost. Significant industry consolidation and private investment has been required, supplemented by GOK facilitation measures. Major fresh-produce exporters and the Government of Kenya have embraced a strategy emphasizing output of value-added products for sale to markets that place high value on well-designed and documented systems of food safety and quality management.

[31] This is a summary of the main report that can be found under www.worldbank/kenya.

[32] The term standard, unless otherwise specified, is used in a broad sense, covering technical regulations, i.e. mandatory standards settled by governments, and private-driven standards.

3.25 The public-private partnerships established in these sectors, encompassing a suitable regulatory framework and the broad adoption of good agricultural and manufacturing practices, should serve as a model to other industries. The system has been crucial in permitting Kenyan industry to meet the challenges of competing in developed markets.

Standards in other Sectors and the Role of Institutions

3.26 For other sectors, in which standards compliance is less advanced, quality, standards and conformity-assessment systems should be strengthened over the medium term, with the aim of facilitating diversification into new regional and global export markets. At the same time, standard-setting and conformity-assessment institutions should be reoriented to play a facilitating role. This will necessitate greater private-sector participation in the regulatory debate and in provision of testing, conformity-assessment and consultancy services, whenever possible.

Standards in the Regional Arena

3.27 The emergence of a customs union initiative in Eastern Africa throws up new challenges and opportunities. To achieve free trade within the customs union, harmonization and mutual recognition must advance and be given a legal and institutional framework. So far, regional cooperation in the field of standards is very limited, because of the difficulties of delegating competence; the disparate capacities of countries involved; the need to streamline national regulations and institutions; and inadequate private-sector participation and political determination.

3.28 At the regional level, GOK should lead efforts to develop shared and joint SPS management capacities, and the development of a strategy to share selected resources. In that context, Kenya's future accreditation system can be used as a regional platform in a pilot regional standards initiative. Other promising areas for regional collaboration might include: (i) cross border management of pests and diseases (a clear public international-regional good); (ii) cooperating in food safety, hygiene services and training to the tourism industry; (iii) sharing resources following the concept of "regional centers of excellence" in areas where capacities are lacking in neighboring countries and markets are seen as regional by the industry (like pesticide regulation, registration, research and awareness).

RECOMMENDATIONS

3.29 Priorities for improving the capacity in standards and conformity assessment institutions are

- Awareness raising on good agricultural practices
- Improvement in pest risk assessment and management capacities
- Improvements of landing sites and environmental management in Lake Victoria

3.30 For a roll-out of the quality standards and conformity assessment system beyond the horticultural sector, GOK should ensure that the standard-setting and conformity assessment

institutions focus on facilitating private sector delivery of the services (testing, conformity assessment, consultancy, etc).

3.31 GOK should lead the development of joint SPS-management capacity and share resources. Using Kenya's pending accreditation system as a regional platform would be a good starting point.

TRADE FINANCE

3.32 Access to finance remains a major obstacle to export development for micro, small and medium enterprises (MSMEs) and farmers. A crucial element of Kenya's export growth and diversification strategy must be to increase participation by smaller enterprises and smallholder farmers in international trade. Small firms and smallholders face immense difficulties in obtaining credit, in accessing export-credit insurance and in securing letters of credit. This is a particularly significant impediment to export diversification away from existing markets such as the EU and US, toward potential new markets in Asia or the Middle East, where links with new buyers must be established and where risks may be higher than in traditional markets.

3.33 Relative to other countries in Africa, Kenya has a well-developed financial sector, and the cost of capital is falling. High levels of credit are channeled into the Kenyan private sector relative to other Sub-Saharan African countries.[33] A recent survey[34] of manufacturing firms showed that access and cost of finance "does not currently appear to be a general and severe constraint to business."

3.34 However, the situation is quite different for MSMEs.[35] Only 1.5 percent of credit to MSMEs in Kenya is provided by banks, and about 90 percent of MSMEs have no access to credit. This is because of the high cost for banks of evaluating and monitoring credit to small producers; the difficulty of assessing risk of an MSME operation in the absence of rating agencies; and deficiencies in the legal system that make enforcement of debt contracts difficult and push collaterals too high for small firms. Many MSMEs lack the capacity on to process relatively complicated bank paperwork.

3.35 As a result, MSMEs, the importance of which has increased significantly over the past decade[36] for the economy, are forced to rely on micro-finance institutions (MFIs) and Savings and Credit Cooperatives (SACCOs) for financial services. However, although there are a large number of providers of MSME credit, the market is segmented and disconnected,

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[33] Beck and Fuchs (2004), Structural Issues in the Kenyan Financial System: Improving Competition and Access, World Bank Research Working Paper 3363.

[34] ICA survey.

[35] The ICA survey finds that access to finance is an "acute problem for a subset of firms, usually smaller ones."

[36] Between 1993 and 1999, the contribution of the MSME sector to GDP increased to 18.4 percent from 13.8 percent. A new MSME survey is currently under preparation. Based on other surveys the importance of the MSME sector relative to GDP is expected to have grown further (see Central Bureau of Statistics, International Center for Economic Growth, and K-Rep Holdings, National Micro and Small Enterprises Baseline Survey 1999, and Central Bureau of Statistics, Ministry of Planning and National Development, Economic Survey 2003).

which impedes the smooth and rapid flow of funds across and through institutions, sectors and regions. This results in gaps in access to finance, in particular for growing firms and those needing higher levels of financing for international trade transactions.

3.36 MSMEs and farmers seeking financing for export transactions will increasingly need to resort to commercial banks for export financing. Most banks in Kenya offer trade and export-finance products; however, transaction-size requirements disqualify most MSMEs.

3.37 Still, most banks active in Kenya do provide some services to MSMEs, typically the larger ones.[37] That said, MSMEs encounter the following general problems when attempting to raise funds for international transactions:

- High interest rates and collateral. Banks cover the additional work and risk involved in dealing with a small firm or farmer by increasing the spread, which reduces exporters' profit margins, and increases collateral requirements.
- Limited regional coverage for Letter of Credit (LoC) financing. Banks avoid financing LoC—which is the type of transaction financing preferred by MSMEs—from countries that they perceive as high risk (e.g., DRC, Sudan, Afghanistan).
- Non-availability of structured finance for trade/export financing. Ideally, MSMEs need trade/export financing to be structured in such a way that repayment coincides with export-transaction payment terms and schedule; however, this rarely occurs. Developing a structure specifically for a MSME transaction would be prohibitively expensive.

MSMEs in the export sector encounter the following industry-specific problems:

- In general, banks are averse to financing agricultural exports because of the perishable nature of the product, the high risk of non-compliance with standards, and price volatility.
- Tea exporters ship to Pakistan, Egypt, Afghanistan, Yemen and Sudan, which are considered high risk for banks, and where insurance is often hard to acquire.
- Small horticulture businesses are often run by one family and have informal business structures unlikely to clear banks' due diligence, especially when start up financing is required.
- Banks are reluctant to finance the coffee sector because of past poor performance and the complicated nature of warehousing agreements that are part of many transactions.
- Businesses in the textile sector usually handle relatively large orders and therefore have large financing requirements even as there is a relatively high risk of order rejection; banks are thus often reluctant to provide the full amount required.

3.38 **MSMEs and small farmers also lack the capacity to exercise effective demand** because they lack knowledge of relevant and available products for export financing and

[37] Banks dealing with medium-sized firms for trade and export financing often specialize in specific sectors (e.g. Barclays Bank of Kenya finances the majority of handicraft exporters, Stanbic is the main financier of the tea market, Dubai Bank finances Muslim-owned MSMEs, which have specific requirements as to deal structure); in this way banks develop specific knowledge on the business and performance risk in the relevant sectors, or type of MSMEs.

guarantee, and need assistance in preparing funding proposals and in understanding risk and financial-management concepts. Banks might be more responsive to MSMEs if the latter utilized better financial-management systems, or if they collaborated to increase the size of a transaction and spread the risk. The lack of a well-functioning credit registry means that banks have limited access to information on potential borrowers, which results in higher credit risk and loan loss provisions. [38].

3.39 An additional count against MSMEs is that they have limited access to the insurance market. Purchase of insurance against performance, diversion and/or political mishap could significantly reduce the spread and collateral required for a loan, but since MSMEs usually have as little access to insurance as to financing, they are trapped in a vicious circle.

3.40 Political risk can effectively scupper a transaction if the perceived risk is too high, as may be the case in the Middle East, Pakistan, Afghanistan or Sudan.

3.41 However, insurance against political risk is available through a World Bank-financed project, although to date only for large transaction amounts (see Box 3.5). The volume of transactions usually undertaken by MSMEs is too low to be covered by this scheme, although there is no explicit lower limit for transactions, and MSMEs would in principle then be eligible for ATI insurance.

Box 3.5: World Bank Regional Trade Facilitation Project

To address the lack of access to political-risk insurance for productive transactions and cross-border trade in EAC countries, the World Bank developed a project to cover political risk for short-term trade transactions in seven countries, mainly members of COMESA (Burundi, Kenya, Malawi, Rwanda, Tanzania, Uganda and Zambia). The project is implemented by the African Trade Insurance Agency (ATI). ATI will use a number of insurance structures. Eligible transactions will include: exports from one participating country to another; exports from participating countries to third countries; and imports of goods or capital from anywhere to a participating country, as long as the import is related to a productive activity. The facility covers a wide variety of trade transactions, including sale of goods on credit terms, LoC confirmation, financial or operational lease, loans by foreign or domestic lenders, services, and a wide range of political/non-commercial risk including embargo, war or civil disturbance, seizure of goods, expropriation, imposition of exchange controls, imposition or increase of import or export taxes.

RECOMMENDATIONS

3.42 To address MSMEs' lack of access to finance in general, GOK should develop a coherent national policy and strategy for micro- and small-business finance. Of particular importance would be the achievement of better coordination among regulators and the development of a common legislative and regulatory framework for different finance providers, which would simplify the flow of funds between them, and MSMEs.

3.43 Secondly, there is urgent need to establish a well-functioning credit registry to improve the flow of information on borrowers. The institutions covered should include commercial banks as well as microfinance institutions and SACCOs, to allow small borrowers to graduate from micro and local finance to bank finance as their business grows.

[38] See Beck and Fuchs (2004).

3.44 To improve competitiveness, GOK's priority should be to strengthen the enabling environment for the private sector, the legal and regulatory framework, and the general business climate. These issues are covered by the Private Sector Strategy Action Plan.

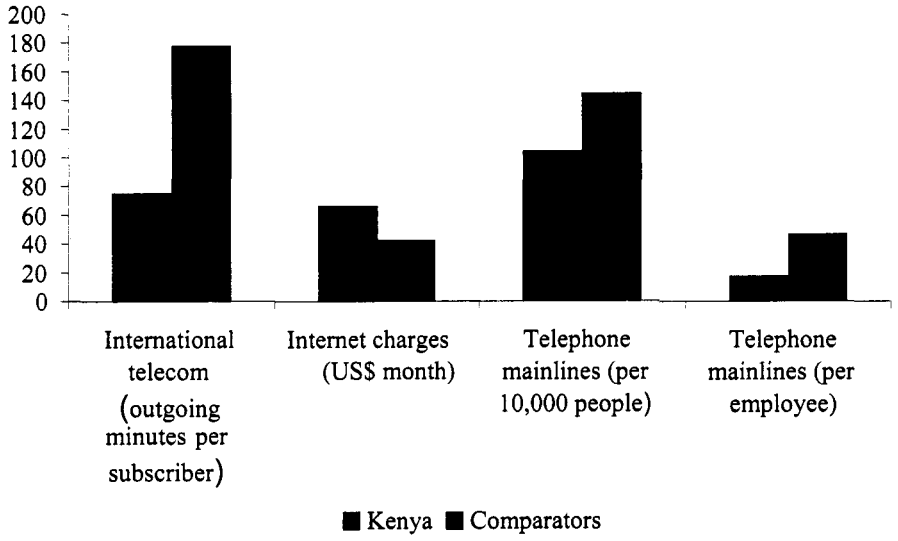
TELECOMMUNICATIONS SERVICES AND POWER

3.45 Kenya's telecommunications services are expensive compared with those of other Sub-Saharan African countries and still more so in comparison with those of East and South Asia (see Figure 3.1).

3.46 Furthermore, between 1999 and 2002 telecommunications costs in Kenya did not fall, as they did virtually everywhere else; it is likely that prices have come down since 2002, but as they probably have elsewhere it is unclear whether Kenya remains at a cost disadvantage.

3.47 Penetration of services is low given Kenya's per capita income, and lags many Sub-Saharan African countries. In the last few years, the number of mobile phones increased from close to zero in 1999 to approximately a nine-percent mobile teledensity in 2004; penetration of fixed lines is about 1.5 percent.[39] While the improved teledensity has spurred private-sector competition, and significantly improved access, the country is still sub-par in providing services across a range of areas. Table 3.5 shows that compared to its nearest income comparators,[40] Kenya has fewer fixed lines per capita, less than half the level of international calls per subscriber, and higher Internet charges. Behind these statistics lies considerably lower efficiency in service provision.

Figure 3.1: Telecommunications Indicators for Kenya and Comparator Countries



[39] Mobile coverage extends far further than that of the fixed network, and prepaid cards and time-reselling makes mobile telephony available to those without credit or their own phones. As a result, it is mobile service that extends telecommunications access to the poor and to rural areas in Kenya.

[40] Bangladesh, Benin, Haiti, Mauritania, Nigeria, Pakistan, Sao Tome and Principe, Sudan, Vietnam, Zambia.

Table 3.5: Key Telecommunications Cost and Penetration Indicators for Kenya and Comparator Countries

	Kenya			Tanzania			Uganda			Rwanda		
in US dollars unless otherwise stated	1999	2002	% change	1999	2002	% change	1999	2002	% change	1999	2002	% change
Mobile connection charge	127.97	31.75	-75%	53.55	18.13	-66%	30.93	25.03	-19%	..	5.26	
Mobile monthly subscription	7.11	9.52	34%	26.77	..		23.92	0.00	-100%	..	18.93	
3-minute mobile call	0.40	0.57	44%	0.91	0.54	-40%	0.41	0.61	47%	..	1.24	
Business-phone connection charge	29.86	29.21	-2%	48.34	41.38	-14%	116.85	61.19	-48%	62.89	31.13	-50%
Business-phone monthly subscription	3.63	6.35	75%	4.12	3.62	-12%	6.87	5.56	-19%	1.50	2.10	40%
Mobile subscribers per 100	0.08	3.77		0.16	2.21		0.25	1.59		0.15	1.36	
Total phone subscribers per 100	1.09	4.79		0.63	2.68		0.51	1.81		0.33	1.64	
Internet users per 100	0.12	1.27		0.08	0.23		0.11	0.40		0.07	0.31	

	SA			Mauritius			Lesotho			Madagascar			Swaziland		
	1999	2002	% change	1999	2002	% change	1999	2002	% change	1999	2002	% change	1999	2002	% change
Mobile connection charge	15.55	9.20	-41%	19.85	16.69	-16%	16.37	8.54	-48%	23.87	12.44	-48%	15.71	9.01	-43%
Mobile monthly subscription	27.82	12.81	-54%	7.94	4.17	-47%	16.37	11.39	-30%	13.14	0.00	-100%	28.48	9.01	-68%
3-minute mobile call	0.74	0.48	-34%	0.12	0.10	-16%	0.62	..		0.82	0.53	-35%	0.76	0.49	-36%
Business-phone connection charge	34.00	22.68	-33%	119.09	66.76	-44%	71.19	29.89	-58%	39.53	30.30	-23%	60.56	32.50	-46%
Business-phone monthly subscription	11.89	8.54	-28%	3.97	7.01	77%	4.91	2.85	-42%	9.55	3.74	-61%	3.98	2.49	-37%
Mobile subscribers per 100	12.05	30.14		8.70	28.76		0.57	4.47		0.24	1.02		1.43	6.59	
Total phone subscribers per 100	24.81	40.80		30.59	55.79		1.59	5.79		0.59	1.40		4.63	9.99	
Internet users per 100	4.23	6.82		4.68	10.33		0.05	0.97		0.17	0.35		0.51	1.94	

Table 3.5: Key Telecommunications Cost and Penetration Indicators for Kenya and Comparator Countries (continued)

	India			China			Pakistan			Sri Lanka			Bangladesh		
	1999	2002	% change	1999	2002	% change	1999	2002	% change	1999	2002	% change	1999	2002	% change
Mobile connection charge	27.87	10.29	-63%	60.39	6.04	-90%	..	16.73		71.02	10.45	-85%	30.56	9.93	-67%
Mobile monthly subscription	..	3.09		6.04	11.84	96%	12.19	0.00	-100%	7.10	0.00	-100%	10.19	0.00	-100%
3-minute mobile call	0.42	0.12	-71%	..	0.22		0.30	0.29	-4%	0.45	0.22	-52%	0.32	0.31	-3%
Business-phone connection charge	18.58	16.46	-11%	..	..		89.37	30.98	-65%	184.66	156.81	-15%	374.82		-53%
Business-phone monthly subscription	5.81	5.14	-11%	3.99	..		4.15	4.37	5%	4.26	4.70	10%	3.06	2.59	-15%
Mobile subscribers per 100	0.19	1.22		3.42	16.09		0.21	0.85		1.41	4.92		0.12	0.81	
Total phone subscribers per 100	2.85	5.19		12.00	32.78		2.41	3.35		5.10	9.58		0.46	1.26	
Internet users per 100	0.28	1.59		0.70	4.60		0.06	1.03		0.36	1.06		0.04	0.15	

3.48 In a series of investment-climate surveys worldwide, the World Bank asked companies to rate the seriousness of various barriers to doing business. The global average for the percentage of firms that named telecommunications was 9.8 percent. For Kenya, the corresponding figure was 44 percent. Long-distance telephone charges are burdensome for exporters.

3.49 Kenya's telecommunications services are costly because of delays in implementing the reform agenda laid out in the ERS. The benefits of completing the reform are: an estimated 500,000 additional telephone subscribers; a more than doubling of international call volumes; and over 100,000 more Internet subscribers. This would translate into about US$180 million in customer savings and increased revenue and an additional US$87 million in forgone revenue.

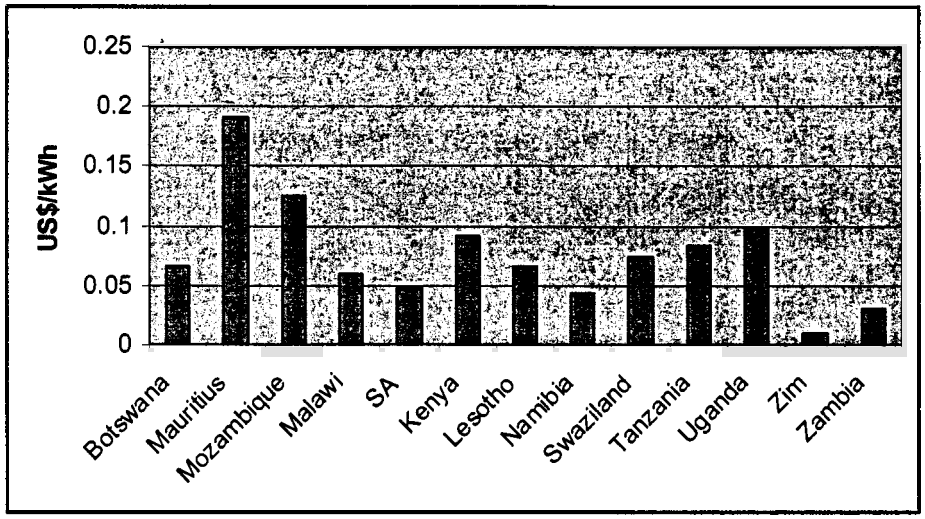
3.50 Access, reliability and the cost of power was named as a major constraint for manufacturing businesses in the recently completed ICA for Kenya. The poor and erratic performance of the power sector costs firms on average almost 10 percent of annual sales in terms of lost production; 70 percent of firm were forced to invest in their own generators to bridge blackouts. Power is of particular importance for textiles/garments and coffee. Power accounts for 35 percent of the costs of garment production at the fabric-dyeing stage, 28 percent of costs at the fabric cutting/layering stage, 22 percent at the sewing/assembly stage and 20 percent at the finishing stage. The cost of electricity for drying coffee beans accounted for more than 25 percent of total costs at the primary processing stage.

3.51 From an analysis of comparative data for electricity prices and performance in 13 southern and East African countries,[41] Kenyan prices are among the highest in the region for domestic consumers, general business and small and large industries. This is a reflection also of taxes, levies and surcharges on energy in Kenya (VAT of 18 percent plus an electrification levy of 5 percent and a 3c/kWh surcharge), which were the highest in the region in 2003. The sector's technical performance, as measured by transmission losses is worse than that of many African competitors, and financial performance is also very poor: KPLC (Kenya Power and Lighting Company Ltd.) in 2003 was the only utility company among the 12 comparator countries that registered a loss.

3.52 For general business, i.e. low voltage commercial users that consume about 2500 kWh per month, 2003 prices in Kenya were fourth highest, on a par with those of Tanzania and Uganda, but much higher than corresponding prices in South Africa, Botswana, Malawi or Namibia (see Figure 3.2).

[41] The source of this information is SAD-ELEC (2003). The 12 comparator countries are: Botswana, Mauritius, Mozambique, South Africa, Malawi, Lesotho, Namibia, Swaziland, Tanzania, Uganda, Zimbabwe and Zambia.

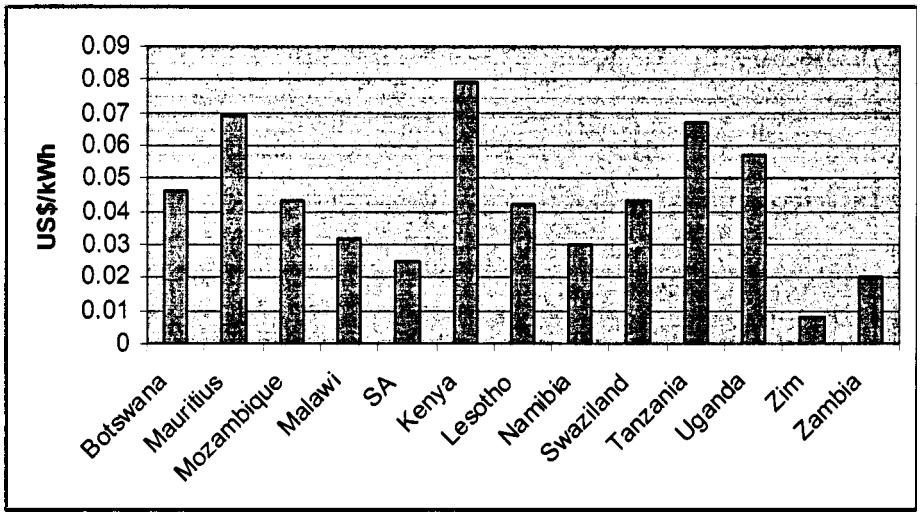
Figure 3.2: Energy Prices for General Business (low voltage



Source: SAD-ELEC (2003).

3.53 For small and large industrial consumers,[42] 2003 energy prices in Kenya were significantly higher than elsewhere in the region (see Figure 3.3); East African neighbors Tanzania and Uganda were also close to the top of the list. Industrial consumers in higher per capita income economies such as Botswana, South Africa, Namibia, and Swaziland all face significantly lower energy prices (see Figure 3.4).

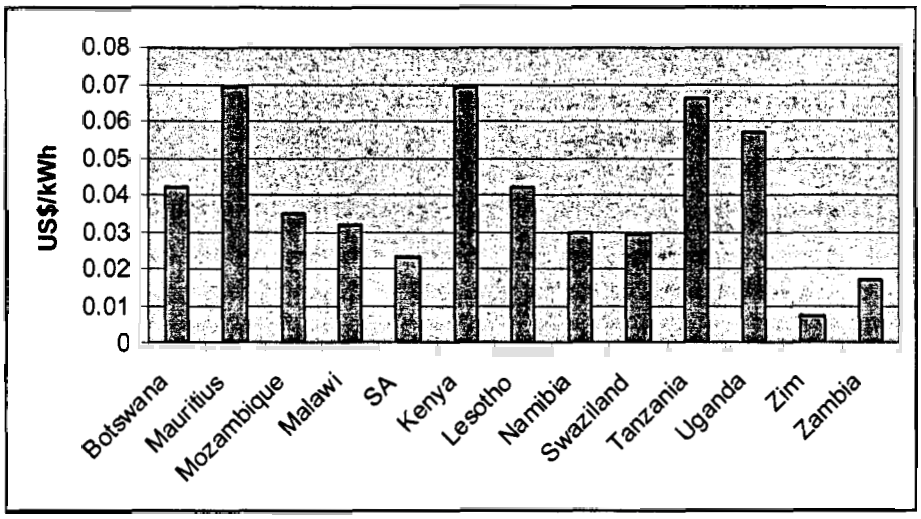
Figure 3.3: Energy Prices for Small Industrial Consumers



Source: SAD-ELEC (2003).

[42] Small industrial consumers denote those with a peak demand of KVA100 and a load factor of 80 percent; large industrial consumers denotes those with a peak demand of KVA2500 and a load factor of 80 percent.

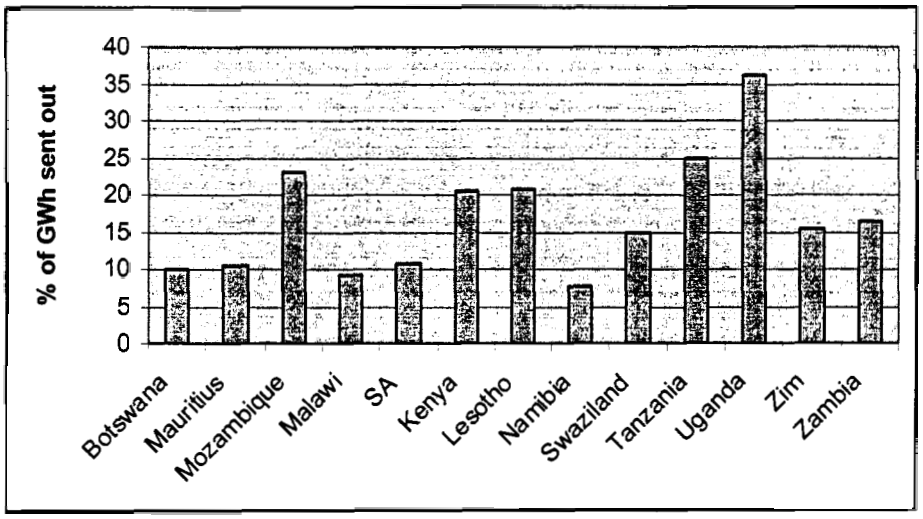
Figure 3.4: Energy Prices for Large Industrial Consumers



Source: SAD-ELEC (2003).

3.54 Clearly power costs in Kenya are a major inhibitor of the business climate, especially for energy-intensive exports such as textiles and garments, and some agricultural products. There is no information on relative performance as relates to brown outs and black outs, but data on relative transmission losses, may be used as an indicator. Kenya's transmission losses are lower than those of Uganda, Tanzania and Mozambique, but much higher than those of Mauritius, Namibia, South Africa, Botswana and Malawi (see Figure 3.5).

Figure 3.5: Total Transmission Lossos (% of GWh sent out)



Source: SAD-ELEC (2003).

4. TRADE POLICY AND INSTITUTIONS

4.1 Effective trade policies complement and enhance actions taken to eliminate behind-the-border barriers to trade. Domestic trade policies influence the incentive framework for producers and thus the potential returns from engaging in tradable activities. Policies implemented in overseas markets influence the ability of Kenyan producers to exploit their comparative and competitive advantages in global markets. Successful pursuit of international integration must unite three inter-linked policy domains—unilateral, multilateral and regional policies—into a coherent trade strategy. This study has identified five areas in which Kenya could more effectively use trade policy to advance its growth and development agenda: national trade policy, regional integration, multilateral negotiations, the Economic Partnership Agreement with the EU, and trade-policy institutions.

KENYA'S TRADE POLICIES

Tariff Regime

4.2 Kenya has significantly liberalized its trade regime in recent decades. Since the mid-1980s, Kenya shifted away from an import-substitution strategy towards a more outward-oriented growth policy. Prior to 1993, Kenya used administrative controls—mainly import licensing—to manage its balance of payments and protect local industries. In 1993, the GOK abolished import licensing and foreign-exchange controls, and import tariffs became Kenya's central trade policy instrument, in line with GATT principles. The tariff schedule was gradually simplified from 24 bands in 1988 to 8 in 1994, and the maximum rate was reduced from 170 percent in 1988 to 60 percent in 1994. By 1999, Kenya had reduced the number of bands to five and lowered the maximum rate to 25 percent. Following formation of the EAC Customs Union and the introduction of the Common External Tariff (CET) in 2005, Kenya now oversees tariff rates in conjunction with Tanzania and Uganda.

4.3 Adoption of the CET led to a further reduction in the average applied tariff rate—from 16.8 percent in 2004 to 13.2 percent—a 21 percent downward adjustment on tariffs facing extra-regional imports. Tariffs declined across most sectors, with the exception of products of animal origin, precious and semi-precious stones, and miscellaneous manufacturing and works of art. The highest tariff reductions are those for industrial goods, such as chemical products, ships and boats, mineral fuel and oils, and electrical machinery and equipment. Given that these items are primarily used as inputs for other products this could potentially provide a broad boost to output across the economy. However the tariff regime can be further simplified and rationalized.

4.4 Implementation of the CET began in 2005 and many problems have already been resolved. However, the current EAC-exemptions regime is complicated. The CET exemptions schedule applies to a large number of products (56), and 8 different rates are

applicable, ranging from 35 percent to 100 percent.[43] The top rate of 100 percent applies to most varieties of sugar; high rates also apply to rice (75 percent), wheat (60 percent), milk and various milk products (60 percent) and maize (50 percent).

4.5 Adoption of the CET has increased tariff dispersion. In other words, the variation of tariff rates has increased—from one product to another, across products within sectors, and across stages of production. At the sectoral level, tariff dispersion increased in 16 of 21 sectors, and rose to levels above 100 percent in five of these sectors.[44] Tariff dispersion creates two general problems. A highly dispersed tariff schedule creates incentives to misallocate resources—investment and workers flow to industries with the greatest government protection and away from where productivity is highest. Tariff dispersal imposes a heavier economic burden on society than a uniform tariff schedule with the same average tariff rates. In addition, setting different tariff rates on similar products provides an incentive for companies to misclassify imports and facilitates corruption.

4.6 The CET preserves another form of tariff dispersion, escalation of tariff rates, depending on the stage of processing. Final goods typically face higher tariffs than intermediate inputs and raw materials. Many countries adopted escalating tariffs to promote industrialization through import substitution and through the development of vertically integrated industries. Tariff escalation magnifies the protection of the final stage of value addition, insulating producers from global pressure to innovate and increase productivity at the expense of producers of raw materials and intermediate goods. However, policies designed to promote vertical integration no longer make sense in a world economy increasingly characterized by fragmented production or global supply chains, in which firms in different countries specialize in different stages of the production process. Setting tariff rates more uniformly across stages of production facilitates integration of the internal chain of production sharing.

4.7 EAC countries have scheduled a CET Review for 2009/10, which in addition to reducing the top rate to 20 percent as agreed, will offer an opportunity to review the exemptions regime, and to reduce tariff variation and escalation. Efforts should focus on reducing the maximum tariff rate across all products, and on additional reductions in apparel, manufacturing, and other sectors with higher-than-average tariffs. Tariff reductions could be replaced by more broadly based taxes that do not discriminate between imports and locally produced items. For example, replacing the high customs duties on tobacco and cigarettes with a trade-neutral excise tax would allow EAC members to rationalize the tariff schedule while continuing to pursue fiscal and social policy objectives.[45]

4.8 **EAC member states have bound tariffs for different products and at different rates.** Following the Uruguay Round, Kenya, Tanzania and Uganda each bound some of their tariff lines; these tariff bindings currently cover 3 percent (Uganda), 13 percent (Tanzania) and 14 percent (Kenya) of all tariff lines. Kenya and Tanzania bound tariffs on all agricultural products at ceiling rates of 100 percent and 120 percent respectively. Uganda

[43] The rates used are 35, 40, 45, 50, 55, 60, 75, and 100 percent.
[44] Dispersion is measured as a coefficient of variation.
[45] See Castro et. al (2004) for more details on Kenya, Tanzania and Uganda's potential to raise revenue.

bound 60 agricultural goods at rates between 40 percent and 70 percent. Kenya bound tariffs on seven non-agricultural products, Tanzania on six, and Uganda on about eighty (see Table 4.1).

Table 4.1: Binding Overhang in Kenya, Tanzania and Uganda

	Product (HS heading or code)	WTO Bound Rate	Applied MFN Rates (2005)
Kenya	Agricultural products (various)*	100	0–25
	Fresh fish (0302)	62	25
	Frozen fish (0303)	62	25
	Medicaments (3003)	35	0
	Pharmaceutical goods (3006)	18	0–25
	Fertilizers (3105)	31	0
	Primary ethylene polymers (3109)	31	0
	Tractors (8701.90)	62	0
Tanzania	Agricultural products (various)*	120	0-25
	Silk fabrics (5007.20	120	25
	Woven fabrics of coarse animal hair (5113.10)	120	25
	Hydraulic water turbines (8410.13)	120	0
	Diesel electric locomotives (8602.10)	120	0
	Dummies and other lay figures (9610.00)	120	25
	Antiques (>100 years) (9706.00)	120	25
Uganda	Agricultural products (60, various)*	40-70	0-25
	Various non-agricultural goods (about 80)	40-50	0-25

Notes: Applied rates are the range of CET rates at the tariff line level (8-digit) for the particular product category bound during the Uruguay Round.
* The CET provides for a number of exemptions from the top tariff rate for selected sensitive agricultural products.
Sources: Kenya's Uruguay Round goods schedule; EAC Common External Tariff

4.9 Given that the three countries have formed a customs union, there is a need to consolidate tariff bindings to avoid confusion for potential investors and suppliers as to which tariff lines are bound at which rates. Furthermore, while the wide margin between bound and applied rates and the fact that only few rates are bound at all, offers flexibility to increase tariff rates without the risk of retaliation from other WTO members, the political benefits of this flexibility must be weighed against the economic costs. Potential foreign investors and suppliers are likely to be deterred by the prospect that EAC countries can raise customs duties on almost any product. To minimize this problem, and to encourage trade partners to do the same, the EAC could bind all tariff lines within the framework of Doha Round negotiations, and bind all but politically sensitive tariffs at levels much closer to their applied rates. Doing so would have no impact on applied rates or customs revenues. Furthermore, in the event of a sudden surge in imports that might hurt domestic producers, WTO rules provide flexibility for members to invoke safeguard measures.

INCENTIVE SCHEMES FOR EXPORTERS

4.10 Incentive schemes for exporters—duty drawback, manufacturing under bond, VAT refunds and export-processing zones—are used to offset the anti-export bias in the tariff system. Thus, implementing a lower and more uniform tariff schedule will reduce the need for complex administrative measures to compensate for anti-export biases introduced by tariffs. However, none of these programs can ever fully eliminate disincentives to export. Both the public and private sectors allocate financial resources and skilled labor that could be used more productively elsewhere in the economy.

4.11 Among incentive schemes for exporters, the VAT refund is least effective and requires the most attention. The administrative burden on both the government and exporters increased when VAT and customs-duty refunds were separated into two different programs. According to the private sector, VAT refunds can take anywhere from six to nine months, with predictable effects on firms' cash flow. News reports estimate the value of arrears to be in excess of Ksh2 billion.[46] A delay in refunding VAT paid on imports effectively constitutes a tax on exports, reducing Kenyan exporters' ability to compete in world markets.

4.12 The EPZ program, which formerly worked well, has begun to experience problems at the border. Significant operational problems influence the handling of EPZ products by customs authorities, and this is influencing clearance times. This threatens the competitiveness of products, particularly in the textile and clothing sector, and compounds difficulties arising from phase-out of the MFA. The GOK should reintroduce fast tracking of EPZ products by the Customs Department, which was discontinued some months ago.

4.13 Small businesses have difficulty gaining access to these schemes. The duty-drawback and manufacturing-under-bond systems reportedly work reasonably well. Exporters receive duty drawbacks more expeditiously than VAT refunds in part because the Kenya Revenue Authority (KRA) has streamlined and fast-tracked the process, but not that for the VAT refund. Small businesses find it difficult to use either program, however. The Export Promotion Council (EPC) reports that small exporters frequently lack the administrative resources to understand the duty-drawback program and fulfill the reporting requirements. The manufacturing-under-bond scheme has explicit eligibility requirements that disqualify many small and medium enterprises.[47] This scheme has largely been marginalized by export processing zones.

[46] See, for example, Kaburu Mugambi, "Manufacturers want KRA to pay interest on Sh2.3bn tax refunds, " *The Nation* (July 12, 2005), and Benson Kathuri, "VAT refund backlog hits Sh2.2bn mark," *The Standard* (February 28, 2005).

[47] Participating firms must export $440,000 per year or employ more than 50 persons.

RECOMMENDATIONS

4.14 Kenya and the EAC should prioritize full implementation of the EAC Customs Union. Furthermore scheduled CET reviews should be used to simplify the exemptions regime by reducing the number of exemptions and the rates applied. Furthermore, EAC countries should use the 2009/10 CET Review to reduce tariff dispersion and escalation, in addition to reducing the top rate to 20 percent as planned.

4.15 The EAC countries should also: consolidate tariff bindings within the framework of the WTO; and bring bound rates closer to the applied rate.

4.16 A third priority should be to expedite processing of VAT refunds for exporters, and to reinstate fast-track treatment for EPZ containers. One option could be to implement an accelerated clearance process for exporters with good records of compliance. To eliminate the VAT backlog, the Treasury will need to grant more authority to KRA to pay claims.

4.17 An assessment of the EPZ program would be useful to determine the aspects that are most cost effective as well as to discern features that could be extended to the rest of the country. There are currently 37 gazetted export processing zones in Kenya. The program offers a wide range of both fiscal incentives and non-fiscal incentives (e.g., on-site customs inspections, more liberal employment of foreign technicians). Participation in the EPZ program expanded sharply following passage of AGOA. Still, Surveys conducted in other countries have found that a streamlined operating environment, pro-private sector policies, reduced corruption, and quality infrastructure and public services are far more important to investors than tax holidays and most fiscal incentives.

4.18 Donor support should take the form of provision of resources for studies on EPZs, and on the impact of further trade liberalization on the economy.

KENYA'S ROLE IN EFFECTIVE REGIONAL INTEGRATION

4.19 A large, open and flexible regional market can foster growth and stimulate local and international investment. Regional integration will increase the size of relevant markets and thus expand opportunities for Kenyan firms, workers, and consumers. Effective integration enables local firms to better integrate into global production chains if goods move freely among regional partner states. Effective integration also makes Kenya more attractive to multinational firms as a destination for FDI. The available data suggest that Regional Trade Agreements (RTAs) can have a significant effect on FDI inflows, especially to regions with low inflation, strong institutions, and pro free-trade policies. Within this broad policy spectrum, short- and medium-term priorities should be to create an integrated regional transportation and trade facilitation system, eliminate internal economic borders, and promote measures towards a common market (see Box 4.1).

Box 4.1: The Need for Consistency Between EAC and COMESA

In addition to the EAC, Kenya is also a member of The Community of East and Central Africa (COMESA). Progress in achieving intra-COMESA integration has been slow because of the body's large size. However, Kenya will benefit considerably from finalization of the FTA and the ensuing access to COMESA markets. Other COMESA initiatives (regional transport insurance, the COMESA bond-guarantee scheme) are also very much in Kenya's interest. As COMESA moves toward its ultimate aim of customs union, The EAC should seek to ensure that obligations under one such union do not contravene those of the other. One option could be for the EAC CU to become part of COMESA CU, provided that the CET and all other provisions—including rules of origin—are consistent. However, Tanzania must first rejoin COMESA and withdraw from the SADC (Southern African Development Cooperation). The principle to which Kenya—as well as its partners—should adhere is that it can only one set of common trade policies can be implemented, which calls for consistency among various groups, or the decision to leave one in favor of another.

4.20 Regional cooperation on transportation and logistics would yield the greatest gains for Kenya and the EAC. As countries seek to diversify their trade into more sophisticated agricultural and manufactured products, logistics requirements become more important—and more costly. Competing in international markets and functioning within global production chains necessitates not only low transport costs and efficient ports, but also short transit times, reliable delivery schedules, appropriate storage facilities, and security. Trade liberalization is unlikely to yield the expected economic benefits as long as transport costs remain very high, and logistical services weak.

4.21 The EAC offers a forum for discussion and definition of norms and harmonized rules. Private-sector involvement in these discussions is a prerequisite for effective action. In the medium term, it may also be useful to include additional regional partners—Burundi and Rwanda—which have a vital interest in improving transport logistics along the Northern and Central Corridors.

4.22 Implementing nonrestrictive rules of origin would enable firms to buy inputs at the lowest cost and would spur regional integration. In principle, customs union obviates the need for rules of origin on intra-regional trade. However, the EAC-CU is being phased in with temporary barriers to trade against selected imports from Kenya until 2010, and thus rules of origin are needed both for extra and intra-regional trade.

4.23 The EAC has largely adopted COMESA's Rules of Origin (ROO), albeit with a number of exceptions for which SADC product-specific rules are used. On paper the COMESA's ROO are fairly simple and liberal. By allowing firms different criteria to satisfy origin, they provide the flexibility for effective sourcing of inputs. Goods that are not wholly produced in one country can satisfy origin if: inputs imported from non-members do not exceed 60 percent of the costs of all materials used in production; or domestic value-added exceeds 35 percent of the price of the product as it leaves the factory; or imported inputs are placed in a different tariff category than that of the product produced. However, in practice, many COMESA members apply only the value-added requirement, and do so without consistency across members (Uganda, for example, imposes a 45 percent value-added requirement). In order to ensure consistency between COMESA and EAC, the latter should adopt COMESA rules without exception; furthermore, it is important that ROO are

implemented in their entirety across COMESA to give firms—especially small firms—the flexibility necessary to effectively source inputs and engage in regional trade.

4.24 Greater integration of regional services markets, particularly for services that facilitate international trade, would be of benefit to Kenya. Regional integration can lower costs of services inputs through lower transaction costs, greater competition, and creating economies of scale. Extending EAC countries' GATS commitments (see WTO section below) is one way to expand services trade. However, to generate real demand for Kenyan services, its neighbors would need to back up GATS commitments with regulatory reforms aimed at harmonizing national regulations. Although harmonization at the level of COMESA would be preferable, chances for real progress are probably better in the smaller EAC, which is more dynamic in its progress toward integration.

4.25 Customs reform and harmonization would also facilitate deeper integration. Many bottlenecks that raise trade costs such as queuing at the border do not generate revenues but simply waste economic resources and constrain productivity. The removal of these requires policy coordination and ultimately harmonization of customs administration, standards and conformity assessment, transport regulations and competition policy.[48]

4.26 The EAC is expected to achieve its common market by 2007, and monetary union by 2010. A fully integrated regional market will require harmonization of, among other things: tax policy, export incentives (duty/VAT remission schemes, manufacturing under bond, export processing zones), standards, transportation rules, modalities for revenue sharing, competition policy, and mutual recognition of educational degrees. Though the degree and mode of harmonization may vary depending on specific policy areas, the greater the degree of harmonization, the lower the transaction costs of intra-regional trade and more competitive EAC countries will be in regional and global markets. This is a long-term agenda that will require attention from numerous government ministries. EAC governments already have formed a number of committees and working groups to drive forward harmonization is areas such as capital markets development. Typically, more developed partners in a regional grouping often play the crucial role in pushing and supporting integration. Thus, within the EAC Kenya can be expected to spearhead the integration process.

[48] Currently, and for the first phase of EAC-CU, internal barriers will remain for a number of reasons, among these because Tanzania and Uganda are still levying temporary tariffs on selected Kenyan imports. However, when the first phase of CU implementation is completed in five years, these tariffs will be phased out. At that point, internal trade borders will be removed if customs reform and harmonization has been completed.

RECOMMENDATIONS

4.27 Consistency between the EAC and COMESA rules and their implementation, particularly with respect to Rules of Origin, is vital. Kenya, as the EAC's most-developed economy, should take the lead in implementing regional integration through liberalization of regional services markets, and strengthening EAC-wide customs and trade logistics reforms and harmonization.

4.28 Donor support for regional integration can be in the form of institution and capacity building at the regional and national levels.

INTERESTS IN MULTILATERAL NEGOTIATIONS

4.29 Kenya's membership in the WTO offers different avenues to advance its trade agenda. Not least of these are the ongoing Doha Development Agenda negotiations, which potentially grant Kenya better access to foreign markets, particularly in fast-growing—but heavily protected—Asian markets, but also provide a forum to push for reductions in developed countries' agricultural subsidies. In addition, WTO negotiations can be used to reinforce Kenyan reforms and improve the domestic commercial climate. Finally, for Kenya, participation between rounds in the TBT and SPS Enquiry Point would be important.

4.30 Following establishment of EAC-CU, all WTO trade-policy negotiations should be coordinated among the three East African countries; As establishment of a common market is not too far away, coordinated negotiations are even more necessary.

4.31 **Market access for exports to Asia can be improved through multilateral negotiations.** East Asia's share of Kenyan exports has more than doubled since 1985 from 1.4 to 3.2 percent; the share of exports going to South Asia has also increased, albeit more slowly, from 7.1 to 8.8 percent. The key feature of access to Asia's markets is that it is granted on an MFN basis, thus negotiations offer the best path. Asian markets are very large, but key Kenyan products face high tariff barriers (see Table 4.2).

Table 4.2: Selected tariffs on Kenyan Goods: Asian and Other Markets

		Coffee	Tea	Vegetables	Fruit	Fruit Juice	Cut Flowers
	Applied Rate	31.6	45.3	28.2	39.1	44.1	20.1
China	Bound Rate	14.3	15	10.6	18.5	19.2	16.5
	Applied Rate	100	100	30	30	30	60
India	Bound Rate	133.3	150	105.4	96.8	75	150
	Applied Rate	4	5	4.9	5	5	20
Indonesia	Bound Rate	44.5	52.5	46.7	47.7	54.3	55
	Applied Rate	40	45	58.8	56.1	45	60
Thailand	Bound Rate	90	90	46.5	39.3	37	48
South	Applied Rate	2.9	400c/kg	10.6	7.6	19.4	15.6
Africa	Bound Rate	119	170	34.3	21.1	49.5	
U.S.	Applied Rate	0	0	4.8	3.4	7.4	4.85
EU	Applied Rate	0	0	13	8.1	23.3	9.8

Sources: Calculations using tariff schedules submitted to WTO and UNCTAD. Indian tariff data are from the Indian Central Board of Excise and Customs (www.cbec.gov.in). U.S. and EU tariffs are generally bound at their applied levels.

4.32 For Kenya to achieve greater market access in Asia and elsewhere, WTO negotiations must include all countries and all goods. As developing countries' average bound rates on agriculture imports are often twice as high as their applied rates, Kenya, its EAC partners and other WTO members will enjoy few, if any, economic benefits from liberalization unless they bound tariff rates receive sizeable cuts.[49] In industrial countries, protectionism is sometimes concealed by tariff-rate quotas,[50] which some countries have tried to keep off the table during the current negotiations. Kenya and other developing countries would benefit from a liberalization formula that simultaneously relaxes quotas and reduces the tariff rate on out-of-quota shipments.

4.33 One of the more promising aspects of the Doha Development Agenda for Kenya is trade-facilitation negotiations, which at the time of writing, are moving forward even as other talks are stalled. Negotiators have submitted proposals to: streamline and harmonize port information requirements; employ a "single window" for all border-clearance and revenue collection; reduce the number of documents needed to import goods; and mandate advance rules. These are highly technical and complex issues, and negotiators will require guidance and advice not readily available in Geneva. Kenya can benefit from these negotiations by identifying border-clearance bottlenecks in its export markets and pushing proposals to address those bottlenecks. Negotiations can also serve to reinforce Kenya's own customs-modernization agenda. Effective participation in talks will require close communication among KRA, TRA (Tanzania Revenue Authority), URA (Uganda Revenue Authority) and trade negotiators in Geneva on the one hand, and between these revenue authorities and the wider East African business community on the other.

[49] Kym Anderson and Will Martin, "Agricultural Trade Reform and the Doha Development Agenda," Policy Research Working Paper No. 3607, Washington, World Bank, May 2005.

[50] The tariff-quota system introduced during the Uruguay Round has lower tariff rates for specified quantities, and higher (sometimes much higher) rates for quantities that exceed the quota.

4.34 The potential for developing countries to use GATS to pursue market access in other countries remains poorly understood. Kenya would benefit from industrial countries' opening their borders to the temporary movement of unskilled service providers. The remittances sent by such overseas workers are good for the Kenyan economy in the short term, and the acquisition of skills will be of long-term use. As a provider of services to regional markets, Kenya could benefit from neighboring countries' commitments in sectors such as insurance and other financial services, transportation, technical services (e.g., for the provision of testing and conformity assessment services to firms in neighboring countries), and other business support services—more important forums to push for those, are, however, regional (EAC, COMESA) as mentioned above. Identifying offensive interests for services liberalization is one area where Kenyan trade negotiators would benefit from research and collaboration with current and potential Kenyan services exporters. A couple of priorities are mentioned in the next section.

4.35 Kenya and its EAC partners would do well to strengthen the development of their ICT sectors by joining the optional WTO Information Technology Agreement (ITA). To join is to agree to eliminate customs duties on major information technology products (see Box 4.2). Joining would reduce the cost of ICT inputs and encourage new investment in Kenya and broaden access to IT inputs to include smaller businesses. Given that imports of many IT products are already subject to exemptions the impact on revenues is unlikely to be significant and it would allow the dismantling of the exemption scheme with its administrative costs.

Box 4.2: The WTO Information Technology Agreement

The ITA is a tariff-cutting mechanism with three basic principles:

- all products listed in the Declaration must be covered;
- all must be reduced to a zero-tariff level; and
- all other duties and charges (ODCs) must be bound at zero.

There are no exceptions to product coverage; however for sensitive items, it is possible to have an extended implementation period. Commitments undertaken under the ITA are on an MFN basis, and therefore market access is extended equally to all WTO members. The agreement covers the main categories of IT products: computers, telecommunications equipment, semiconductors, semiconductor manufacturing equipment, software, and scientific instruments. ITA has 63 members, among them such developing countries as China, Egypt, El Salvador, India, Mauritius, Moldova and Morocco. There are no LDC members.

Source: WTO website

4.36 Liberalization of services trade allows local producers access to service inputs at the lowest possible cost.[51] In particular, participation in global production networks demands access to efficient services, especially transport, logistics, telecommunications and financial services. At the conclusion of the Uruguay Round, Kenya made commitments pertaining to the banking, tourism, telecommunications, and transportation sectors. GOK promised in most cases to impose no restrictions on cross-border trade in these services although it did place

[51] Liberalization of the telecoms and banking sector could add as much as 1.5 percent to overall economic growth according to a recent study (World Bank (2004), Global Economic Prospects, Washington DC.

limits on foreign ownership of locally established service providers and refused to commit on regulations affecting FDI in services.[52]

4.37 In view of the EAC's plans to create a common market, its members need to align their GATS commitments. Box 4.3 is a summary of Kenya's GATS commitments in the telecoms and banking sector.

4.38 Secondly, GOK—in consultation and cooperation with its EAC partners—should consider making a number of additional commitments in the current trade round, among these: commitments in the business-services sector would encourage foreign investment in management consulting, accounting, engineering, marketing, technical testing, and so on. Low-cost access to these services would boost productivity across many sectors. Another option would be to impose no restrictions on foreign commercial investment in transportation. Imposing no restrictions on foreign commercial investment in computer services and IT-related telecommunications services would complement joining the ITA and bolster Kenya's aims of becoming a regional ICT leader.[53]

Box 4.3: Kenya's Existing GATS Commitments in Telecoms and Banking

International trade agreements such as the GATS can be useful mechanisms to enhance the credibility of domestic policy reforms. Options that may face strong domestic opposition from special interest groups are strengthened by connection to an international commitment mechanism. In the telecoms arena, Kenya has already made some of the most difficult policy decisions by establishing an independent regulator, and taking steps to introduce greater competition in the fixed-line sector.

Kenya's GATS commitments pave the way for foreign competition in fixed-line telecommunications if and when the network is adequate. Key among these commitments are the obligations outlined in the Reference Paper on Basic Telecommunications, which focus on pro-competitive regulation, interconnection disciplines and dispute settlement.

International competition in the mobile sector is already close to a reality, following the licensing of Kenya's third mobile operator. The increased use of VSATs (very small aperture terminals) would be integral to plans to expand the benefits of mobile telecoms to rural and low-density areas; the licensing of a new VSAT operator would be a step in the right direction but enhancing competitiveness in the provision of VSAT services should be explored further.

Regulatory policy in Kenya's banking sector has relaxed restrictions on foreign entry. At present, both foreign commercial presence and cross border trade are permitted. However although regulatory policy currently does not discriminate between foreign and domestic banks, and as Kenyan authorities move toward greater openness, there are no commitments on national treatment (i.e. to not discriminate against foreign-owned financial institutions) in Kenya's GATS schedule. Unless there is a clear policy-based reason for not guaranteeing national treatment, Kenya should amend its GATS schedule to amend this.

[52] Kenya's commitments are published in WTO documents WT/SC/47 (April 15, 1994), WT/SC/47/Suppl.1 (February 26, 1998), and WT/SC/47/Suppl.2 (November 18, 1999).

[53] Kent Bressie, Michael Kende, and Howard Williams, "Telecommunications Trade Liberalization and the WTO," paper presented at the 15th ITS Biennial Conference, Berlin, September 5–7, 2004 presents data suggesting that, after accounting for income level and geography, countries that have included the telecoms sector in their GATS commitments enjoy greater fixed-line penetration and telecoms-sector revenues than those that have not; They attribute this to the greater credibility accorded governments committed to maintaining open and competitive telecoms sectors.

4.39 Much of the important work of the WTO is conducted outside of negotiating rounds. Given the limited capacity of the Geneva based staff, Kenya should participate in committees and working groups most relevant to its economic interests.[54]

4.40 TBT and SPS agreements require Kenya to report its new standards and technical regulations to other WTO members. This contributes little to Kenya's economy. However there are economic benefits associated with using the notifications submitted by others more effectively—distributing them to the Kenyan business community, identifying measures that constitute technical barriers to trade and submitting counter-notifications. Additional benefits will derive from using the enquiry point mechanism to disseminate information about Kenyan standards to Kenyan companies. Using the mechanism in this manner will require shifting the mandates of Kenya's TBT and SPS enquiry points to provision of services to the business community.[55] In the long run, EAC members might choose to conserve resources by managing the enquiry point function at the regional level.

RECOMMENDATIONS

4.41 Kenya and its EAC partners can use their participation in the WTO to better integrate into the world economy. Specific steps would be to focus on negotiating better access to dynamic Asian markets, and to identify offensive interests for the GATS negotiations. Furthermore, Kenya should join the ITA and expand its GATS commitments in terms of IT-related services, business services, wholesale trade and other sectors critical to export competitiveness. Lastly, Kenya's SPS and TBT enquiry points should be used to enable Kenyan and EAC firms to overcome standards-related trade constraints.

4.42 Donor assistance should take the form of provision of resources for a thorough study of trade in services, including the determination of negotiation priorities for the Doha Round, and for the regional service sector liberalization agenda. Donor assistance would be helpful also in establishing standards enquiry points.

POTENTIAL BENEFITS AND RISKS OF AN EPA WITH THE EU

4.43 Implementing an Economic Partnership Agreement with the European Union would boost Kenya's integration into the world economy. The EPA would replace the existing unilateral preference regime in effect since the 1970s with a reciprocal free trade agreement that would offer Kenya a degree of access to the European market little different to that enjoyed by LDCs under the Everything But Arms (EBA) initiative. The EPA negotiations present several opportunities to advance Kenya's trade agenda, as well as some pitfalls to avoid. The most important aspects of the EPA for Kenya are rules of origin and standards recognition, aid for trade, trade diversion, and worker migration.

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[54] For example, the mission in Geneva is listed as participating in a number of accession working parties for countries that are not commercially important to Kenya (e.g., Belarus, Montenegro, and Serbia).

[55] Kenya operates three enquiry points for the SPS agreement. The enquiry point for the TBT agreement is the Kenya Bureau of Standards.

4.44 For Kenya to profit from expanded access to EU markets, the EPA must incorporate more liberal rules of origin than exist under current preference schemes. The expansion of African garment exports to the U.S. under AGOA demonstrates the potential benefits of liberal rules of origin:[56] Kenya has been able to dramatically expand employment and exports. The EU is leaning toward rules of origin that rely primarily on a value-added requirement. Kenya should negotiate for the EPA to allow firms a choice of a change-of-tariff-heading rule or a uniform value-added rule of 15-20 percent.

4.45 The EPA should also address mutual recognition in standards and conformity assessment. These agreements provide a useful framework for addressing the need to avoid rules of origin in Mutual Recognition Agreements. A conformity-assessment certificate issued in Kenya by an EU-recognized body should be accepted regardless of the good's origin. As KEBS has been recognized by the EU, there should be no need for a conformity assessment in the EU for a product carrying a KEBS certificate.

4.46 The EPA should make provision for increased aid to address supply side constraints for trade expansion. Improving logistics, standards compliance and other behind-the-border aspects of trade is costly. The EPA should feature some of "aid for trade" if it is to be more successful than past preference schemes. To the extent that the EPA introduces commitments that require extensive regulatory, institutional, or administrative reforms, while at the same time significantly curtailing revenue,[57] it would only be appropriate to seek additional aid from the EU to implement such reforms.

4.47 **An EPA, however, also would introduce the risk of trade diversion.** Depending on the size of preference margins, market competitiveness, and the efficiency of EU suppliers, the EPA may simply spur a change in the supplier rather than a reduction in domestic prices. This is known as trade diversion. Trade diversion would transfer money from the Kenyan treasury (in forgone customs duties on imports from Europe) to European exporters. Consumers fail to gain since prices do not fall. A KIPPRA study estimated that trade diversion would exceed trade creation. To reduce trade diversion, Kenya should seek a reduction in CET before the EPA is fully phased in, which is likely to be between 12 and 20 years after negotiations are concluded. Kenya could also develop a strategy for negotiations that would link domestic reforms and regional integration to EPA commitments, in particular with respect to merchandise services trade liberalization. For merchandise trade, a phased and variable geometry of tariff reductions can be achieved by: eliminating internal barriers to trade within the East and Southern Africa group to promote regional trade; reducing MFN

[56] Rules of origin are the criteria used to define where a product was made. They are an essential part of trade rules because quotas and preferential tariffs discriminate between exporting countries. Determining a product's origin is complicated by the fact that increasingly, products are processed in several countries before being sold as a finished product. The purpose of rules of origin is to prevent trade deflection or simple transshipment, whereby products from non-preferred countries are redirected through a free-trade partner with lower external tariffs so as to avoid payment of customs duties.

[57] Eliminating duties on imports from the EU will affect government revenue, given the volume of such imports. A recent KIPPRA study projected that the elimination of all duties on EU imports would reduce Kenyan customs revenue by around Ksh9 billion annually (KIPPRA, "The assessment of the potential Impact from the Economic Partnership Agreement (EPAs) on Kenyan Economy" on Behalf of Ministry of Trade and Industry, March 2005).

top rates; and cutting MFN average rates before enacting EU preferences. For services trade, one strategy could be to implement a phased, region-specific program of services sector liberalization to promote wider access to lower cost trade-related services (e.g. telecommunications, electricity and transport); this should be undertaken on an MFN basis to avoid entrenching high cost monopolies.

4.48 For similar reasons, GOK should ensure that services markets open to European firms as a result of the EPA are also open to firms from other regions, especially in service sub sectors where EU providers are not competitive. A sector-by-sector analysis needs to be undertaken before full implementation of the EPA.

4.49 The EPA negotiations offer a forum to broach European restrictions on temporary migration.

RECOMMENDATIONS

4.50 Priorities include advocating for more liberal rules of origin, mutual recognition of standards and conformity assessment and to initiate dialogue on temporary migration of workers. Once the EPA enters into force, GOK should take action to avoid trade diversion, especially in the services sector. This may necessitate reduction of the tariff schedule and liberalization of the service sector on an MFN basis.

4.51 GOK should undertake a cost assessment of the EPA for use in negotiations with the EU. Kenya should push for assistance to finance implementation of EPA measures.

INSTITUTIONAL FRAMEWORK FOR TRADE POLICY

4.52 Kenya's institutional framework for trade policy has some significant flaws. Firstly, policymaking for trade is divided among various ministries. Secondly, there is no comprehensive consultative body covering trade policy with input from the various stakeholders. Trade data with which to undertake trade policy analysis is scarce, and there is also a shortage of analytical capacity necessary to evaluate the impact of various trade policies and to determine the positions of the Ministry of Trade and Industry during negotiation.

4.53 Under the current institutional structure, the Ministry of Planning and National Development nominally takes the lead in formulating trade policy; the Ministry of Trade and Industry oversees implementation. In practice, these roles are not so clear-cut, and as many as 12 ministries are actually involved in developing trade policies and programs. Clearly there should be a mechanism to facilitate communication and coordination among the wide range of actors involved in trade policy.

4.54 Weaknesses in transportation infrastructure, customs procedures, and the domestic business climate should all be addressed in trade strategy. The trade ministry, through its interactions with the business community, is well placed to monitor the implementation and success of measures outlined in the trade strategy.

4.55 Trade consultative bodies in Kenya are fragmented. For specific trade policy areas—notably WTO and EPA negotiations—consultative bodies exist, and these have private-sector and civil-society representation. Private sector participation in particular is seen as crucial because exporters are the main force driving integration into the global economy. However, there is insufficient dialogue between the government and the private sector and this must change.[58]

4.56 Compartmentalization in the Department of External Trade inhibits the effective formulation of trade policy and trade negotiation. The department is divided into three divisions: the WTO Division, the Regional Division, and the Bilateral Division. The latter two are further subdivided by agreement. This approach does not facilitate using trade negotiations to advance a country's trade strategy. Most modern trade agreements—whether multilateral, regional, or bilateral—address the same issues, such as: market access for goods and services; intellectual property rights; standards; subsidies; trade remedies; and dispute resolution. It would be advantageous to organize staff according to these functional specializations. This would allow GOK to identify which negotiating forum would be the most appropriate venue for a particular issue.

4.57 There are serious gaps in availability of trade data on Kenya (see Box 4.4). In terms of merchandise trade data, this trade report identified two key issues: inconsistent treatment of exports originating from EPZs and a decline in the accuracy of export statistics extending back to the 1980s. The situation is much worse with service-trade data; there was insufficient information to undertake even a preliminary analysis. Trade-policy evaluation is virtually impossible without reliable and abundant data, and recommendations based on inaccurate information may give rise to misguided strategies. Priorities should include improved collection of data from EPZs on exports and improved reporting on intra-African trade. Demand for services trade data could be championed by the working group on trade in services chaired by the MOTI.

Box 4.4: Trade Data Issues in Kenya

Merchandise Trade Data

Any analysis of Kenya's export performance must confront some very serious data problems. The export and import statistics submitted to the United Nations COMTRADE database provide a poor basis for empirical analyses, or for policy formulation. Kenya did not include information on shipments from its export processing zones (EPZs) in its official trade data. Secondly, there are major discrepancies in Kenya's trade data for other reasons and statistics frequently understate actual trade. International Monetary Fund Direction of Trade (DOT) data indicate Kenya's 2001 and 2002 trade statistics undervalued the worth of exports by as much as US$1.5billion. Problems relating to the accuracy of Kenya's export statistics are not new. Statistical comparisons indicate there has been deterioration in data quality that dates back to the early or mid-1980s. Thus, partner country import statistics must be used, where possible, for analyses of Kenya's export performance. This works relatively well for trade between Kenya and OECD countries, which compile accurate data. However, given the nonreliability of African countries' statistics in general, considerable caution must be applied when assessing regional trade flows.

[58] See World Bank (2004) *Kenya Growth and Competitiveness*, World Bank (2004) *Enhancing the Competitiveness of Kenya's Manufacturing Sector: The Role of the Investment Climate;* and Morara. (2004) *Institutional Framework for Promoting Links between Ministries Involved in Trade Issues and Poverty Reduction Strategy Process.*

Services Trade Data

Opening up trade in services is—under the right circumstances—expected to bring lower priced, higher quality and more diverse services to consumers in recipient countries. Given the importance of infrastructure services such as telecommunications and banking in supporting and facilitating wider economic activity, improving service provision will likely can be expected to produce economic gains.

This report set out to analyze the effects of services trade liberalization in Kenya using a set of questionnaires to identify and track: key changes in policies outlining the extent and type of foreign entry allowed; changes in market structure and concentration, and the role of foreign firms in services markets, over time; and changes in performance indicators such as price and access over time.

However, after a three-week mission and several months of follow-up, the quality of data collected was still too poor for any meaningful analysis. The main reason for this is that ministries and regulators collect data based on expressed demand, and the information needed to assess the effect of services trade in Kenya (e.g. how much did it cost to make a three minute call to London in 1990?) was unavailable. As a result analysis based on even a very short historical time frame remained frustratingly out of reach.

In many other countries data collection on services trade is stuck in a vicious circle: reforms in the telecoms sector are relatively recent, and there has been little demand for data on them; the lack of data in turn means a lack of interest in addressing analytical questions surrounding services trade liberalization; lack of demand for data generates little incentive to collect data.

4.58 MOTI capacity will need to be upgraded to if the ministry is to manage concurrent implementation of the NES, trade strategy, regional and multilateral trade negotiation, the Private Sector Development Strategy, the Investment Climate Action Plan, and various other planned or ongoing initiatives. There must be adequate technical capacity to evaluate fiscal and economic impacts, both ex ante in the policy formulation process and ex post as part of monitoring and evaluation. The input of think tanks should be sought.

4.59 Kenya's Export Promotion Council has not yet been effectively integrated into the MOTI's structure in terms of coordination and division of labor (see Box 4.5). Currently the MOTI's Department of External Trade (DET) carries out a number of trade promotion activities that should be the responsibility of EPC. EPC involvement in the recently formulated NES Implementation Plan of NES was inexplicably limited. Also commercial attachés[59] in embassies are not being properly used. Currently, they are DET officers with multiple functions, and disconnected from the needs of Kenyan exporters. GOK would do well to review the role and responsibilities of these attachés with an eye toward creating stronger links between them and EPC.

[59] Kenya has commercial attachés in: eight African countries (DRC, Egypt, Ethiopia, South Africa, Tanzania, Uganda, Zambia and Zimbabwe); six OECD countries (Belgium, Germany, Switzerland, UK, US and Canada); and Pakistan and the Russian Federation.

Box 4.5: Export Promotion Council (EPC)

Kenya's EPC was established 1992 under the jurisdiction of MOTI, with the primary objective of promoting exports by assisting exporters and producers of export good to overcome bottlenecks in order to achieve higher levels of export performance and foreign earnings. Formerly, EPC's main activities were the provision of trade information, export-market development, product development and adaptation, and development of export skills. In the past EPC has not been effectively discharged its mandate due to: a limited budget and human resources; insufficient demand for services from exporters; a poor organizational structure and low incentives; duplication of mandate and responsibilities with other trade-related organizations, such as DET, HCDA, Tea Board; and lack of information on EPC among small and medium exporters.

In 2003 a new strategy was adopted to revive the institution, and the EPC is now expanding its activities accordingly, in an attempt to become the "premier institution in the development and promotion of export trade" and the "focal point for export development and promotion of activities in the country." In particular the organization's structure has been overhauled to make it more efficient and responsive to the needs of exporters, which will have to pay for some of its services.

RECOMMENDATIONS

4.60 Many constraints to export development and diversification in Kenya are beyond the reach of the Ministry of Trade and Industry. MOTI, as spearhead for trade and export expansion must promote close coordination among the various ministries and other public bodies. MOTI should also consult closely with the actual exporters to remain informed about constraints it may need to address.

4.61 Secondly, the various public-private consultative bodies/committees on trade policy should be consolidated into one such body. Particular attention should be given to ensuring effective private-sector participation in the consulting mechanism.

4.62 MOTI should also supervise the efforts of agencies (KRA, Ministry of Transport, Central Bank, Ministry of Finance, CCK, CBS) tasked to undertake data collection and administration to develop and implement a plan to upgrade data collection for trade in merchandise and services.

4.63 Donor support can be a catalyst for this, by providing technical assistance, and financing for resources, especially in the period when services trade data collection is jump-started.

4.64 Finally, the Department of External Trade should institute reorganization to more effectively analyze, formulate and implement trade policy and export development strategies. Reorganization should include: restructuring the department along functional lines; improving trade data quality by including information on EPZs and boosting accuracy in export data reporting; and upgrading capacity to evaluate fiscal and economic impacts of trade policy.

4.65 Donor assistance can be useful in implementing reorganization of the DET. Thus far, donors have extended their support for capacity building in an opportunistic way, with little coordination.

5. ISSUES IN KEY TRADE SECTORS

FIVE KEY EXPORT SECTORS AND ONE IMPORT SECTOR

5.1 In addition to the constraints for all business activities highlighted in Chapter 3, Kenya's key export sectors each face a set of sector specific constraints. The government and donors can assist key export sector by addressing these specific constraints that have been identified in a serious of reports and the 2004 National Export Strategy (NES), in addition to driving forward the behind the border agenda outlined above. In the NES, the GOK has identified key sectors for export development which include the traditional export commodities such as tea and coffee and non-traditional, but established export industries such as horticulture and textiles. From the services sectors, the NES' focus is on tourism which is well established and highly successful, and business services (financial services, telecommunications, transport services) which have high potential.

5.2 Below, we highlight the main constraints for key merchandise export sectors tea, coffee, horticulture, and textile exports. As far as services are concerned, the constraints are less well understood. However, this gap is currently being filled for the tourism sector for which the World Bank is undertaking work. Business services and the potential of services liberalization remains an area for further study which we sketch briefly. Finally, this chapter addresses key problems in the sugar sector which at present is still highly protected. However, as protection is due to be phased out, we outline the main constraints for the sector to perform well in the post liberalization environment in early 2008.

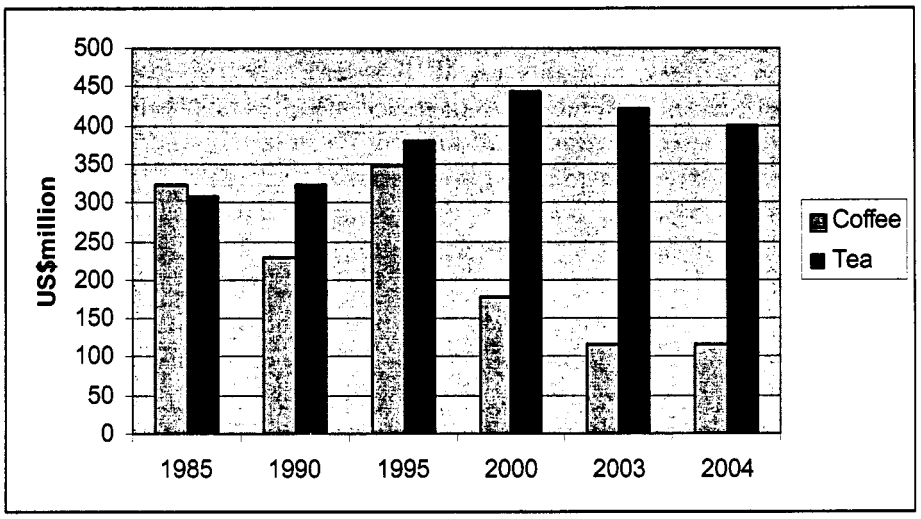
TRADITIONAL CASH CROPS

5.3 Kenya's traditional cash crops are coffee and tea, and these two sectors provide a livelihood for more than 750 thousand people, small growers, and plantation employees. Kenya has fared quite differently in its export performance in these two crops (see figure 5.1). Through a combination of commodity price decline, stiff competition from Latin America and Asia, and country specific conditions, Kenya's coffee exports have declined over the past two decades, while tea exports have expanded over most of this period. Kenya's competitive position in coffee exports has dropped from the 8th largest exporter in 1985 to the 16th largest exporter in 2004; within the Sub-Saharan African region, Kenya has fared somewhat better, keeping its position in the top four in 2004, after Ethiopia, Uganda and Coté d'Ivoire. As regards tea exports, Kenya has been second largest exporter in 2004 (after Sri Lanka), the same constellation that prevailed in 1985.

5.4 This reflects a collapse in coffee prices as well as declines in the global value of EU imports, which have fallen by over 50 percent, from US$8.5billion in 1995. However, Kenya's export losses in European markets were worsened by eroded market share, from 3.3

percent to 1.8 percent, a loss in value terms of about US$38 million.[60] Coffee production declined from a peak of 128,700 tons in 1987/88 to 51,700 tons in 2001/02. The cause of production declines are attributed to the policy environment, government interventions in coffee marketing, and the inefficiency of cooperatives (see Figure 5.1).

Figure 5.1: Kenya's Coffee and Tea Exports 1985-2004



Source: UNCOMTRADE Database

5.5 While international conditions (competitive pressures, demand development, and resulting commodity prices) are have been better for the tea sector, the tea sector has also been benefiting from are more advantageous regulatory environment in Kenya. Smallholders are under the supervision of the Kenya Tea Development Agency who manages input provision and collection of green leaf tea. Small holders are allowed to sell their produce through an auction, or directly to buyers. The situation has been different in the coffee sector, where market liberalization was incomplete. The Coffee Board of Kenya is responsible for regulatory and marketing functions, while service delivery is being performed by cooperatives structures which have lacked the capacity to perform these functions efficiently. Processing and marketing costs for coffee have been much higher than for tea, and have reduced the share of coffee prices received by farmers.

5.6 The tea and coffee sectors have been studied over the past years, and the constraints are well understood.[61] After the restructuring and liberalization of the tea sector, there are few sector specific constraints. However, the economy wide problems of poor infrastructure

[60] According to the International Coffee Organization (ICO), Vietnam increased its global exports of coffee more than threefold between 1995 and the early 2000s. Vietnam now produces more than 13 percent of world exports (as opposed to 5 percent in 1995). Partly as a result of new sources of supply, the ICO estimates the price paid to Kenyan coffee exporters fell from about 177 US cents per pound in January 1995 to about 60 cents per pound in December 2002. Preliminary estimates point to a continued decline; Kenyan coffee exporters received about 36 cents per pound in December 2003.

[61] See for example World Bank (2004, 2005), and specific sector analyses European Commission (2003), and Nyangito (2001).

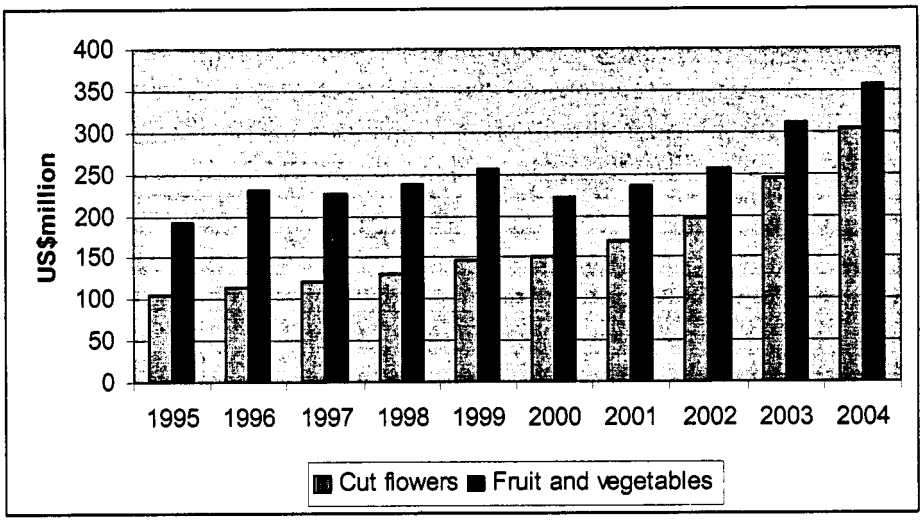
prevent an even better performance. The coffee sector, and in particular the small holders are still to benefit from the recently introduced reforms to the Coffee Act. While producers are now allowed to sell coffee outside the auction if they wish, this new opportunity is still to trickle down to producers.[62]

HORTICULTURE

5.7 As seen in the review of Kenya's export performance in Chapter 2, horticultural exports (cut flowers, and fruit and vegetables) are Kenya's second and third largest export commodity, after tea. Cut flowers are the fastest growing export sub-sector in agriculture, growing faster even than fruit and vegetable exports (see Figure 5.2 below). Kenya is world wide the third largest supplier of cut flowers (after Columbia and Ecuador), supplying 4.7 percent of world imports in 2004, mainly to Europe (Netherlands, France, Germany and Switzerland).

5.8 The expansion of horticulture export has contributed significantly to poverty reduction, even as product sourcing of many exports has evolved. Formerly, fresh fruit and vegetables, and cut-flower exports were typically sourced from small-scale farmers; now the majority of these products come from large estate farms that employ laborers.[63] Overall, horticultural exports have generated jobs that directly support half a million workers, small farmers and their families.

Figure 5.2: Horticultural Exports 1985-2004



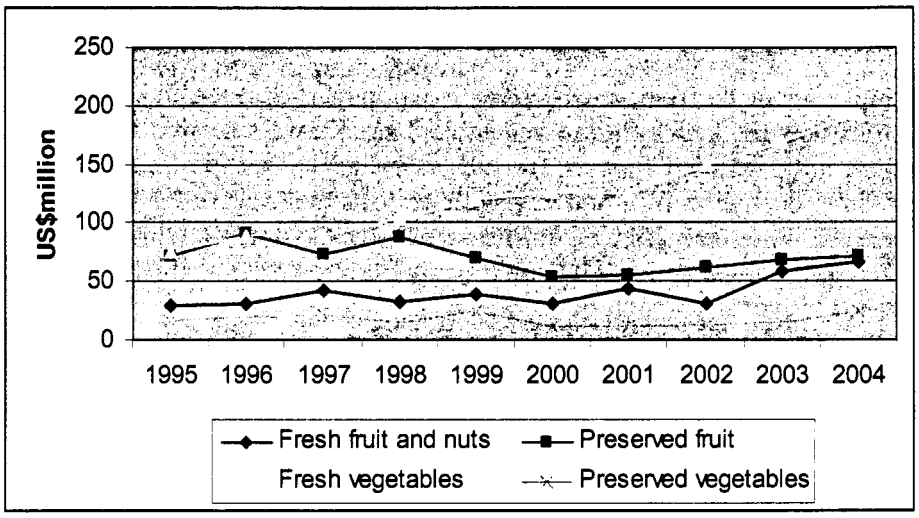
Source: UNCOMTRADE Database

5.9 Fruit and vegetable exports include four sub-categories, namely fresh fruit and nuts, preserved fruit, fresh vegetables and preserved vegetables. Figure 5.3 shows that the growth of fruit and vegetable exports is driven mainly by the export of fresh vegetables to Europe. Four of the fastest- growing exports to the EU trade were agricultural products in which

[62] Reuters, September 17, 2005.
[63] See English, Jaffee and Okello (2004).

Kenya has established a competitive supply chain based on its comparative advantage as an off-season producer.

Figure 5.3: Fruit and Vegetable Exports 1995 – 2004



Source: UNCOMTRADE Database

5.10 Horticultural export growth benefited from sound economic management and political stability during the first post-independence decade, but then had to overcome a deteriorating economic and business environment, and political instability. Today, much of the success of the horticulture industry can be attributed to "light" regulation and taxation by the Horticultural Crops Development Agency. The driver of horticultural exports in Kenya is the private sector which over the decades has learned to successfully navigate the diverse, risky and fast changing environment.

5.11 Exports of horticultural products critically depend on their ability to strictly adhere to the food safety requirements and environmental standards such as maximum residue levels which are constantly being tightened, in particularly in the EU, Kenya's major exports market for horticulture. The role of standards in Kenya's export industry has been discussed in the standards section of the Constraints to Trade chapter of this report.

5.12 The cut-flower sector faces competition from other African countries – Zimbabwe and South Africa rank among the top ten cut flower exporters; Ethiopia, a relative new comer, has registered high growth rates, and is well positioned owing to its climate, proximity to the major market, and relatively cheap cargo fees. Competition in the flower sector is putting pressure on prices and thus profit margins. In a more competitive environment, further expansion of the cut flower sector Kenya will be constraint by its relatively high transport and freight cost, and high cost of inputs, in particular sprays and fertilizers, and for security.[64]

[64] See World Bank (2005), and UNCTAD and ICC (2005).

5.13 As current supply, demand and price trends in international fruit and vegetable markets are likely to persist; demand for high-value agro-food is expected to grow, fueled by higher income demand elasticity for high-value food products, demand toward product differentiation, healthy eating and quality, and demand for year-round supplies. Thus, there will be opportunities for further export growth in this sector. Kenya has still only a small share of the EU market in vegetables and fruits, and the US market is almost unexplored, owing to the absence of direct flights from Kenya to the US.

5.14 At the same time, demand for semi-prepared, and/or ready-to-eat combinations has been progressively increasing, offering opportunities for countries like Kenya for adding value to its exports. Apart from Kenya's ability to keep up with standards requirements in key target markets, expansion in the value added sector will depend on strong ties with supermarket chains, and direct distributors in Europe, to satisfy processing, packaging and labeling according to the specifications. Constraints in the fruit and vegetable export sector are poor infrastructure, in particular transport and complicated bureaucracy.

5.15 The GOK can help the sector best by addressing specific constraints such as providing security in the regions where produce are being grown, improve the transport infrastructure, reduce the bureaucratic burden, and speed up VAT refunds. However, sector analyses caution against a more interventionist stance. The reason is that horticultural exports critically depend on the high performance of private sector actors that has been developed over decades in Kenya. The private sector benefits from the experience that has been gained over decades to adapt quickly to new conditions, and to strike partnerships within the country and with foreign importers.

TEXTILES AND CLOTHING

5.16 **The textile and clothing sector in Kenya can continue to thrive despite the MFA removal, if key behind the border issues are being addressed.** As seen in the performance section of this report, Kenya's textile and clothing exports have grown impressively over the past years. This growth has been driven by the preferences available under AGOA and the quotas that previously existed under the Agreement on Textiles and Clothing, (ATC). The preferences under AGOA have been fuelled by the third country fabric provision which is due to expire in September 2007. The growth of the clothing sector is likely to have contributed to poverty reduction and especially to have had positive gender effects.

5.17 However, there was widespread concern in Kenya as well as other countries who had successfully increased textile and clothing exports to the United States that with the removal of the last MFA quotas by the end of 2004, their exports would collapse because of more competitive producers in South and East Asia. A product specific study undertaken for this report, however, comes to a different assessment, and predicts a continuing success for Kenyan textile and clothing exports, at least until the phase out of the third country fabric provision.

5.18 Analyzing the impact of MFA quota removal on Kenya, the study finds that East and South Asian countries have a relatively smaller market share in the specific product categories that are exported by Kenya, compared with the overall sector. Kenya's textile and

clothing exports to the United States are concentrated in a few categories (cotton non-knitted items), and in these categories, imports entering under binding quotas have been in decline over the past few years, and the market share for quota facing countries has been declining too. The same is true for the categories that Kenyan exporters have started to export more recently, such as knitted sweaters. A final observation relates to the prices that Kenyan exporters have received for their products. Relative prices for Kenyan exports have increased (in particular for men's cotton and synthetic-fiber trousers), which indicates an improvement in quality and implies that Kenyan exporters should remain successful, especially in these categories after quota removal.

5.19 This assessment is confirmed by the post-MFA experience to date as can be seen in Table 5.1. The value of Kenya's textile and clothing exports to the United States between January and August 2005 is almost identical to the performance in the same period in 2004, despite the MFA quota removal, and an appreciating currency. The same is true for the other African AGOA exporters, apart from Mauritius; in Lesotho and Madagascar exports experienced a very slight decline; in Swaziland they even grew. The Caribbean Basin Initiative (CBI) countries,[65] another region where negative effects of the MFA removal were feared, exported January – August in 2005 the same value of textile and clothes to the United States as in 2004. Chinese exports have grown very significantly, as expected, though we note that exports from Macao and Honk Kong have declined, which indicates that before MFA removal some Chinese textile exports had been channeled through Hong Kong and Macao. The South Asian countries are doing very well with double digit export increases from India, Bangladesh, Sri Lanka and Pakistan. However, demand in the United States textile market is growing strongly, so while some changes in market share are occurring, Kenya's and most other African exports have not taken a hit.

Table 5.1 Textile and Clothing Exports to the United States 2004 and 2005

	Jan-Aug 2004	Jan-Aug 2005	Percentage change
Kenya	182	178	-2
Lesotho	189	169	-7
Madagascar	185	174	-6
Swaziland	110	112	2
Mauritius	149	118	-21
China	6795	11852	74
Macao	904	669	-26
Hong Kong	2354	1860	-21
CBI	6472	6472	-
India	1552	2102	35
Bangladesh	1187	1444	22
Sri Lanka	968	1096	13
Pakistan	736	808	10

Source: Customs Declarations Collected in US, published by ITC.

5.20 To diversify textiles and clothing exports, Kenyan exporters should also explore the opportunities for entering the EU market, in particular if Rules of Origin will become less restrictive. Kenyan exports are currently totally concentrated on the US market. Although the

[65] Honduras, Dominican Republic, Guatemala, El Salvador, Nicaragua, Costa Rica, Haiti, Jamaica.

nature of the EU market is less harmonized in terms of tastes than that of the US, there are still substantial opportunities in the EU market. The value of exports to the US is a multiple of 34 times greater than exports to the EU. At present, Kenya can export duty free to the EU (a margin of preference lower than the US, but still significant at around 12 per cent) but faces more restrictive rules of origin requiring production from yarn.[66] The EU is reviewing its rules of origin under the GSP, and for the EPA. AS mentioned in the last chapter, this is a priority for Kenya in its EPA discussions with the EU where it should contribute to the discussion pushing for more liberal rules of origin, and seeking their immediate extension to trade under the Cotonou agreement.

5.21 Furthermore, if Kenya could provide the quality and reliability of service demanded by EU buyers and the security and speed of transport and customs clearance that are required for high value fabrics, then local producers could attract the processing activities of EU firms.

5.22 **To effectively realize the opportunities available in the clothing sector will require progress in reducing the behind the barriers constraints to exports.** The main unit cost items for textile and clothing production is labor. Labor cost is relatively low in Kenya, compared to key competitors, and should thus not be a major constraint. Information on labor cost per shirt produced suggests that costs in Kenya (US$0.18) are below those of China (US$0.29) and comparable with those of India (US$0.17),[67] two countries who are thriving in the post MFA removal period. The main constraint for late deliveries, cancelled orders, and additional, unforeseen cost (such as having to ship an order by air, rather than by sea) are trade logistics, mainly at Customs and at Mombassa Port. The main problem is that Customs has discontinued the practice to allow import containers for EPZs to remain sealed until they arrive in the factory which we mentioned in the preceding chapter).

5.23 Furthermore, after September 2007, the third country fabric provision in the AGOA no longer apply, and Kenyan exporters will no longer be able to use fabrics imported from Asia, as is currently the practice. It should be noted that the third country fabric provision had already been extended once, so the chances for a further extension are slim. The message that the sector can survive without the preferences should be conducive to stimulate the growth of local fabric and yarn production, especially when coupled with improvements in the business climate and infrastructure.

TOURISM

5.24 Tourism is Kenya's main service export and thus an important source of foreign exchange earnings (estimated at US$340 million in 2004); it provides direct employment for some 212,000 employees, and for a further 278,000, employed in the informal sector supporting tourism. Tourism in Kenya is built on three pillars, namely safari tourism, beach

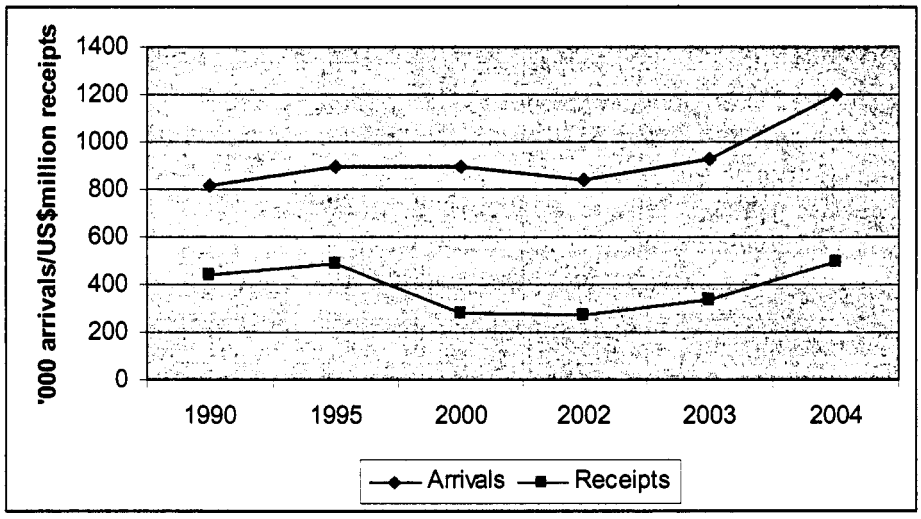
[66] These rules of origin are more restrictive for non-knitted than knitted products, which are more often produced in a single stage from yarn. This rule for non-knitted products requires a double transformation and the use of local fabric. Hence, at least initially there would appear to be an opportunity to build upon the initial expansion of knitted products observed under AGOA.

[67] These data come from Cadot and Nasir (2001) as reported in Eifert, Gelb and Ramachandran (2005).

tourism along the coast and on the islands, and conference tourism mainly in Nairobi and Mombasa.

5.25 In 2004, Kenya received 1.2 million visitors, and registered US$495 million in tourist receipts. Compared with 814 thousand visitors and US$443 million receipts in 1990. Figure 5.4 shows that receipts declined after 1995 to a low in 2002, after which they picked up again to reach a new record in 2004; tourist arrivals, on the other hand, remained relatively stable over the period, with a slight dip in 2002. These diverging trends in tourist arrivals and receipts in Kenya have two reasons: in the second half of the 1990s, prices for holidays in Kenya – in particular at the beaches – declined because of increased competition and crumbling infrastructure in Kenya which squeezed revenues; a further downturn in revenue was triggered by the terrorist attacks on the US Embassy in Nairobi, and on hotels and flights at Mombasa. Secondly, many of the tourists destined for elsewhere in East Africa arrived through Kenya because of low international air fares to Nairobi. This led to an increase in tourist arrivals, though many of them spend very little during transit in Kenya.

Figure 5.4: Tourist Arrivals and Receipts in Kenya 1990-2004



Source: World Tourism Organization, Tourism Market Trend, 2005 Edition – Annex

5.26 Compared with other countries in Sub-Saharan Africa including its regional neighbors Tanzania and Uganda, Kenya's tourism industry has grown well below average. Table 5.2 below shows average per annum growth rates in Kenya, Sub-Saharan Africa, and selected African countries. Table 5.2 shows that Kenya's tourism industry is not benefiting from the tourism boom since the 1990s; while in some countries tourism receipts grew more than twice as fast as tourist arrival, Kenya's tourism industry is stagnating, and thus falling back behind its competitors.[68]

[68] In 1990, Kenya was second only to South Africa in tourist receipts; its rank declined to 7 in 2002 and 2003; in 2004 it ranked fifth, behind South Africa, Mauritius, Tanzania, and Botswana (World Tourism Organisation, Tourism Market Trend, 2005 Edition - Annex).

Table 5.2: 1990 – 2004 Growth in Tourist Arrivals and Receipts (in %)

	Tourist arrivals	Tourist receipts
Sub-Saharan Africa	9%	9.2%
Kenya	3%	0.9%
Tanzania	7.9%	19%
Uganda	16.7%	28.7%
South Africa	15.7%	9.9%
Botswana	5%	12.6%
Namibia	12.4%	12.7%

Source: Calculated from World Tourism Organization,

5.27 Europe is the major source of visitors to Kenya, especially Germany and the United Kingdom, followed by North America and Africa. The Government aims at diversifying into new markets, with particular attention to the Far East (in particular China, Japan, and Korea). In 2004, Kenya Airways launched direct flights to from Nairobi to Hong Kong via Bangkok.

5.28 Data from the tourism module of the 2004 ICA and earlier sector studies[69] indicate some of the basic constraints faced by the industry: One of the main constraints is the regional and domestic security situation, and steps are already under way to address security issues by strengthening the Tourist Policy Unit, and cooperating with other countries on security-related issues. Other constraints are Kenya's poor road infrastructure, and the deterioration of the country's tourism infrastructure and other tourism-related services. Investment flows to address these issues are being hampered by a weak institutional and regulatory support framework. Finally, efforts in marketing and promotion of Kenya in key and emerging tourist markets are still considered insufficient.

5.29 Improved performance of the tourism sector in recent years has resulted in optimism within the industry and there is a sense that tourism to Kenya could be significantly expanded if some of the key constraints can be addressed and the Government and private sector work together to make product improvements and enhance competitive advantage. Furthermore, to participate in the growth of the tourism industry elsewhere in Africa, it is imperative for Kenya's tourist industry to move up the value chain, developing assets and facilities to attract more affluent, high-end tourists. This will necessitate targeted investments in supporting infrastructure, adjustments in the policy and regulatory framework, and a more integrated approach to tourism promotion. To address these issues, a new tourism policy and a tourism development plan are being formulated. The legislation and the regulatory framework affecting private investors are being reviewed to provide a more hospitable environment for investors.

5.30 A World Bank study on the tourism sector is currently under way. The objective of the study is to assist the GOK in developing a strategy to improve the business climate for the tourism sector to attract investment into the industry, and increases Kenya's share in tourism receipts. Secondly, the study will identify how Kenya can access new tourism markets and improve performance in existing markets through innovative marketing and product enhancement strategies.

[69] Ikiara (2001), Kenya Tourism Federation (2003).

THE POTENTIAL OF BUSINESS SERVICES (AN AREA FOR FURTHER STUDY)

5.31 Services play an integral role in economic advancement and inefficient provision of key services, such as finance, telecommunications and transport, limits economic growth. Inefficient domestic production of services behind trade and investment barriers acts as a tax on the production of goods. Indeed, the liberalization of services may be necessary for industrial sectors to be able to fully benefit from the direct opportunities that are made available by the removal of trade barriers and to effectively access global markets. In addition, participation in global production networks requires access to efficient services, especially transport and logistics, telecommunications and financial services.

5.32 Both regional and global trade strategies for services are important elements in providing an environment for improved efficiency in services. However, trade policy making is severely constrained by lack of information and analysis on the particular sectors in which Kenya has an advantage, the main barriers to trade in those sectors and the implications of trade restrictions in services on the capacity of other goods and services sectors to compete in regional and global markets. This lack of information makes it difficult for Kenya to formulate effective offers in international negotiations and to pursue effective opening of overseas markets that can support the growth of Kenyan services providers. There is therefore a need for a number of careful studies of the main services sectors in Kenya, the opportunities for trade and the current constraints. A focus on services is also important since efficiency of services is a key factor affecting the scope for expansion of new sectors and services often are an important source of new employment to assist adjustment away from declining sectors.

SUGAR

5.33 **Reform of the sugar sector is essential if the sector is to survive.** Sugar is a key sector, being the largest industry in Western Kenya and providing incomes to about 100,000 smallholder sugar cane growers, a large number of casual workers and cane cutters, and about 8,600 wage employees of the sugar companies. However, the industry's cost structure is relatively high, and is therefore not able to compete with lower cost producers in COMESA countries. In response the Government negotiated a safeguard provision with COMESA in 2003 to limit duty-free imports to 200,000 tons per year until February 28, 2008.

5.34 **A renewed commitment by the Government and the industry to reforms is needed in order to avoid a crisis in 2008.** The sugar industry needs to quickly undertake major reforms to reduce sugar production costs in order to compete with imports during the period of opportunity whilst the safeguard provision is in place. Past efforts to reform the sugar industry have been largely unsuccessful, and the industry has been plagued by mismanagement and corruption. Sugar production costs can be reduced substantially if the Government and the industry address the major problems. In addition, value can be added to the industry by cogeneration of electricity, but that addition will not be sufficient to offset high production costs.

5.35 Kenya's sugar production costs are about double those of the world's lowest-cost exporters, and ex-factory prices are more than 50 percent higher than imports prices from COMESA's most competitive exporter (see Table 5.3). Without major reforms, the industry will not be able to compete with duty-free and quota-free imports after the COMESA safeguards expire in 2008.

Table 5.3: Comparison of Sugar Prices in the COMESA Common Market, 2003.

	Cane Price		Ex-Factory Price		Wholesale Price		Retail Price	
	LC per Ton	US$ per Ton	LC per Ton	US$ per Ton	LC per kg.	US ¢ per lb.	LC per kg.	US ¢ per lb.
Kenya	1,800	23.70	40,460	532.82	41,960	25.1	46,090	27.5
Egypt	105	17.64			1.4	10.3	1.6 [1]	11.8
Malawi						19.1		
Sudan			113,076	462.89		21.0		

Note: Conversion from Local Currency (LC) to U.S. dollars was at the official exchange rate reported in the IMF's International Financial Statistics

Sources: Kenyan data is from Kenya Sugar Board Yearbook 2003, Table K.

Egyptian data is from USDA/FAS Sugar Annual 2003 and 2004. South African data is from USDA/FAS Sugar Annual 2004. Sudan's data is from Kenana sugar company.

[1] The retail price of LE1.6 per kg. in Egypt is for government outlets while prices in private shops are between LE 1.8 and 2.3 per kg.

5.36 If major reforms are successfully undertaken, the large private sector factory, Mumias, which accounts for more than half of Kenyan production, will be internationally competitive. The four Government-owned factories and a smaller private sector factory will face a difficult challenge to compete even with successful reforms, and have almost no chance to compete without reforms.

5.37 Preparing the Kenyan sugar industry to compete with imports from COMESA requires three major reforms and a number of supporting actions. First, sugar cane prices must be reduced to internationally competitive levels and linked to domestic sugar prices. Cane prices are currently one-third higher than can be justified by international prices due to large increases during the early 1990s when the Government controlled all sugar prices. These increases were motivated by the change from a single party system to a multi-party democracy and were not justified by market conditions.

5.38 Lower cane prices will be difficult for sugar cane farmers to accept and this leads to the second major reform which is to improve the roads and invest more in research to raise cane yields. This will allow cane price declines to be partially offset by higher yields and lower costs. Cane transport costs currently account for 37 percent of cane production costs and poor roads contribute to these costs by slowing the movement of cane hauling equipment and contributing to more frequent breakdowns and equipment deterioration. Faster maturing and higher yielding cane varieties are needed to increase grower incomes and raise the cane supplies to overcome the frequent factory problem of cane shortages.

5.39 Thirdly, Government-owned factories should be privatized to improve performance and reduce future Government budget exposure. The private sector factories operate about 80 percent of the available time while the Government-owned factories operate only 60 percent of the time. This difference, plus the more than 20 percent higher sugar extraction per ton of cane of Mumias compared to the Government-owned factories, contributes to lower private sector factory costs.

5.40 Funding for these reforms can come from three sources. First, the Government should provide for road repairs in exchange for the 18 percent VAT collected from domestic sugar sales and imports. Roads have not been adequately maintained and poor roads add to the cost of cane transport. Secondly, the Sugar Development Levy can be directed to the most urgent needs of the industry which is research on better cane varieties instead of being loaned to loss making sugar factories and poorly managed outgrower companies. Thirdly, the sugar import quotas should be auctioned in a transparent system to raise revenue to revitalize the sugar industry rather than being allocated to favored firms for their own gain. The debts of the Government-owned factories should be partially recovered during the privatization of the factories and the remainder should be absorbed by the Government rather than carried to accumulate interest with little chance of repayment.

5.41 The Kenyan sugar industry may benefit from both higher international prices and added value from cogeneration of power which would make the reforms easier. However, neither of these developments can be counted on to offset the needs for reforms. International sugar prices have been extremely depressed in recent years because of the large increase in exports from Brazil. This situation is moderating as ethanol production increases in response to high petroleum prices and increased number of ethanol powered cars in Brazil. Despite this, Brazil has substantial capacity to expand production of sugar cane for both ethanol and sugar production and sugar prices may remain depressed. Policy reform in the EU and US may also contribute to higher sugar prices in the medium-term by reducing support to domestic producers and lowering barriers to imports. However, such reforms are uncertain and may not occur by the time the COMESA safeguard provision expires in 2008. Adding value by co-generating electricity for sale to the national power company is attractive in Kenya because of the high prices of electricity. However, the immediate impact will be small and substantial investment is required in order to produce enough power to significantly add to sugar company revenues. Thus, it appears unlikely that Kenya will have any alternative except to reform its sugar industry to compete with imports from COMESA Common Market countries or abandon its obligation to free-trade within COMESA.

5.42 In addition to the need for reforms in order to compete in COMESA, there is concern within the industry that illegal imports are entering the country and that some legal imports may be cross subsidized by higher priced domestic sales. These concerns should be carefully evaluated and action taken, if warranted, to protect domestic producers from unfair trade practices and illegal imports. However, investigating unfair trade practices and illegal imports should not substitute for the difficult cost cutting reforms which must be undertaken in order to avert a crisis in 2008.

RECOMMENDATIONS

Cash Crops

5.43 The 2002 Coffee Act has recently been reformed to allow farmers to either sell their coffee through the central auction, or to sell directly to roasters abroad through a marketing agent. To enable small holders to benefit from this important change Government should take measures to publicize the new regulations widely to the coffee growing community.

Horticulture

5.44 For the horticulture sector, Government priorities should be to continue improving the enabling environment for the private sector such as improving security and transport infrastructure in the key out grower regions. As regards Government intervention, the recommendation is to keep the private sector that has been successful in this sector in the driver's seat.

Textiles and clothing

5.45 For the textile and garment sector, immediate priorities are to:

- Extend working hours for Customs Officers both in the EPZs and at the Port which should help factories meeting tight production schedules.
- Relax the fee requirement for EPZ bound containers at Mombassa port, and allow export bound containers to arrive closer to the actual departure date of their ship.

5.46 In the medium term, Kenyan exporters need to be able to source fabrics from Africa which requires capital and lead time set up knitted-cloth and woven-cloth production. To attract the relevant investment, the GOK needs to drive forward its larger agenda of improving the investment climate. If there are indications that specific obstacles for investments into the cotton to fabric segment of the value chain exist, there may be need for further analysis.

Sugar

5.47 There are a number of specific actions that need to be taken to prepare the sector for market liberalization in 2008. To drive forward these necessary reforms, GOKs need to express clearly its commitment to liberalization and the reform agenda. This will require better knowledge on the precise effects that can be expected from liberalization. Thus, the first step is to:

- *Undertake an analysis of the impact of liberalization and reforms on the industry structure*, and of mitigating actions (policy and institutional reforms, investments) to mitigate potentially negative impacts. The study should cover the value chain, starting from the sugar factory level down to the farmers to identify likely poverty and social consequences of reform and liberalization in the sugar sector.

Important steps to reform the industry towards liberalization in 2008 are:

- *Link sugar cane prices to domestic sugar prices.* Cane prices should be linked to domestic sugar prices, which would currently cause prices to decline by about one-third, but it would also allow future price increases to benefit producers.
- *Improve roads to reduce cane transport costs.* Cane transport accounts for an estimated 37 percent of cane production costs, and poor roads contribute to these costs.
- *Invest more in sugar cane research.* Higher yielding and faster maturing sugar cane varieties would partially offset the decline in sugar cane prices which is necessary for the industry to compete.
- *Privatize the Government-owned factories to increase efficiency.* The private factories perform better than Government-owned factories which should be privatized and the proceeds from factory sales used to reduce the factory debt.
- The Sugar Development Levy collects 7 percent from domestic sugar sales and imports to support industry development. *The effectiveness of this Levy needs to be evaluated* and the Levy reduced if it is not found to be effective.
- *Auction import quotas and invest the revenues in cost-cutting activities.* The current quota allocation system allows importers to benefit from the price difference between imports and domestic sugar prices. According to Kenya Sugar Board's data, the price differential is 60 percent and has a value of US$30 million per year.

Tourism

5.48 The Government should continue to focus on improving the security situation both domestically and within the region through regional cooperation, and dialogue with governments in the major tourist-generating countries. Recommendations to address other constraints for tourist sector expansion, and attraction of FDI into the sector will be forthcoming from the currently ongoing World Bank tourism sector value chain analysis.

Business Services

5.49 To guide government policy on regional and international services integration, studies should be undertaken for the various service sub-sectors.

6. CONCLUSIONS AND RECOMMENDATIONS

Trade Performance

6.1 Growth and trade integration in Kenya had declined over the 1990s. Over the past several years, this trend has been reversed. With a stable macro-framework in place, Kenya is now poised for continued further trade integration.

6.2 Natural resource-based exports are likely to remain the mainstay of Kenya's exports for some time. Lessons from the successful development of cut flowers, fresh vegetables should serve to guide GOK's policy reform of other non-traditional natural resource-based sectors. As regards the horticulture industry, much of the success has been attributed to the "light" regulation and taxation by the Horticultural Crops Development Agency. Tea exports have benefited from the supervision of the Kenya Tea Development Agency which efficiently manages input provision and collection of green leaf tea, and from allowing smallholders to sell their produce directly to buyers.

6.3 There is some growth potential in regional trade for commodities such as maize, dairy, and processed food. Regional trade in finished products however holds less potential because of low complementarity among regional partners.

6.4 Traditionally, Kenya's main export market has been the EU. Given the sluggish economic growth there in the past decade and the contrastingly dynamic performance of South and East Asian economies, Kenya would do well to secure access to the latter's markets. South and East Asia's populations are likely to maintain strong demand for food items such as coffee, tea, nuts and horticulture, which is perhaps the sub sector in which Kenya has the greatest competitive edge. However, Kenyan exports still face relatively high tariffs to enter these markets.

6.5 As regards further trade diversification, attention should be paid to production sharing, which is fast growing in part because of declining transport costs. South Africa and South and East Asian countries are potential partners. The need to improve competitiveness and create a commercial environment conducive to export diversification is key.

Domestic Constraints

6.6 In the area of transport and trade facilitation, the first priority is to effectively implement the Customs Modernization Programme, which will require continued high-level political support. Particular attention should be given to the automation of container tracking at the port, and to the development of a set of logistics indicators to benchmark reforms and progress. It is critical that the private sector occupy an important role in driving forward reform, as well as in some advisory capacity.

6.7 Technological solutions for sealing or cargo tracking should not be considered until the recently implemented information system on goods in transit (SIMBA) is working well. Sealing/cargo tracking can then rely on just two components: a carnet system (road manifest attached to the truck) and real-time reconciliation of transit information between port of entry and port of exit.

6.8 Furthermore, ensuring consistency among regional regulations is vital. Divergence from COMESA/EAC recommendations on weighbridges is highly undesirable and should be addressed by the relevant regional bodies.

6.9 Donors have been active in the transport trade facilitation area for a relatively long time in Kenya; however, GOK should manage donor support going forward to ensure coordination of priority actions.

6.10 There are currently no problems in the air-transport sector, and it is very important that this continues, given the importance of air traffic for Kenya's key export sectors.

6.11 Priorities for improving the capacity in standards and conformity assessment institutions are:

a. Awareness raising on good agricultural practices;
b. Improvement in pest risk assessment and management capacities; and
c. Improvements of landing sites and environmental management in Lake Victoria.

6.12 For a roll-out of the quality standards and conformity assessment system beyond the horticultural sector, GOK should ensure that the standard-setting and conformity assessment institutions focus on facilitating private sector delivery of the services (testing, conformity assessment, consultancy, etc).

6.13 At the regional (EAC) level, GOK should lead the development of joint SPS-management capacity and share resources, such as using Kenya's pending accreditation system as a regional platform.

6.14 Access to finance is a key problem for Kenyan exporters, in particular for micro, small and medium firms trying to export.

6.15 To address MSMEs' lack of access to finance in general, GOK should develop a coherent national policy and strategy for micro- and small-business finance. Of particular importance would be the achievement of better coordination among regulators and the development of a common legislative and regulatory framework for different finance providers, which would simplify the flow of funds between them, and MSMEs.

6.16 Secondly, there is urgent need to establish a well-functioning credit registry to improve the flow of information on borrowers. The institutions covered should include commercial banks as well as microfinance institutions and SACCOs, to allow small borrowers to graduate from micro and local finance to bank finance as their business grows.

Trade Policy and Institutions

6.17 Kenya and the EAC should focus in implementing in full the EAC Customs Union. The CET review scheduled for 2009 should be used to simplify the CET exemptions regime, reduce tariff dispersion and escalation, in addition to reducing the top rate to 20 percent as planned.

6.18 As EAC trade integration is deepened, the member states should consolidate tariff bindings within the WTO framework, and bring bound rates closer to applied rates.

6.19 Kenya and its EAC partners can use their participation in the WTO to better integrate into the world economy. Specific steps would be to focus on negotiating better access to dynamic Asian markets, and to identify offensive interests for the GATS negotiations.

6.20 Furthermore, Kenya should join the ITA and expand its GATS commitments in terms of IT-related services, business services, wholesale trade and other sectors critical to export competitiveness. Lastly, Kenya's SPS and TBT enquiry points should be used to enable Kenyan and EAC firms to overcome standards-related trade constraints.

6.21 Consistency between the EAC and COMESA rules and their implementation, particularly with respect to Rules of Origin, is vital. Kenya, as the EAC's most-developed economy, should take the lead in implementing regional integration through liberalization of regional services markets, and strengthening EAC-wide customs and trade logistics reforms and harmonization.

6.22 A third priority should be to expedite processing of VAT refunds for exporters, and to reinstate fast-track treatment for EPZ containers. One option could be to implement an accelerated clearance process for exporters with good records of compliance. To eliminate the VAT backlog, the Treasury will need to grant more authority to KRA to pay claims.

6.23 An assessment of the EPZ program would be useful to determine the aspects that are most cost effective as well as to discern features that could be extended to the rest of the country. This could be done using donor support for studies in the area of trade and export promotion.

6.24 As regards the EPA Kenya is currently negotiating with the EU as part of the ESA negotiating group, the negotiating priorities include advocating for more liberal rules of origin, mutual recognition of standards and conformity assessment and to initiate dialogue on temporary migration of workers. Once the EPA enters into force, GOK should take action to avoid trade diversion, especially in the services sector. This may necessitate reduction of the tariff schedule and liberalization of the service sector on an MFN basis.

Issues in Key Trade Sectors

6.25 As regards **coffee**, the 2002 Coffee Act has recently been reformed to allow farmers to either sell their coffee through the central auction, or to sell directly to roasters abroad through a marketing agent. To enable small holders to benefit from this important change

Government should take measures to publicize the new regulations widely to the coffee growing community.

6.26 For the **horticulture sector**, Government priorities should be to continue improving the enabling environment for the private sector such as addressing security and transport infrastructure in the key out grower regions.

6.27 For the **textile and garment sector**, immediate priorities are to:

- extend working hours for Customs Officers both in the EPZs and at the Port which should help factories meeting tight production schedules; and
- relax the fee requirement for EPZ bound containers at Mombassa port, and allow export bound containers to arrive closer to the actual departure date of their ship.

6.28 There are a number of specific actions that need to be taken to prepare the **sugar sector** for market liberalization in 2008. To drive forward these necessary reforms, GOKs need to express clearly its commitment to liberalization and the reform agenda. This will require better knowledge on the precise effects that can be expected from liberalization. Thus, the first step is to:

- *Undertake an analysis of the impact of liberalization and reforms on the industry structure*, and of mitigating actions.

6.29 Important steps to reform the sugar industry towards liberalization in 2008 are:

- Link sugar cane prices to domestic sugar prices.
- Improve roads to reduce cane transport costs.
- Invest more in sugar cane research.
- Privatize the Government-owned factories to increase efficiency.
- The effectiveness of the Sugar Levy needs to be evaluated and the Levy reduced if it is not found to be effective.
- Auction import quotas and invest the revenues in cost-cutting activities.

6.30 To facilitate growth of the **tourism sector**, GOK should continue to focus on improving the security situation both domestically and within the region through regional cooperation, and dialogue with governments in the major tourist-generating countries. Recommendations to address other constraints for tourist sector expansion, and attraction of FDI into the sector will be forthcoming from the currently ongoing World Bank tourism sector value chain analysis.

6.31 To guide government policy on regional and international **business services integration**, studies should be undertaken for the various service sub-sectors.

ANNEX: KENYA TRADE REPORT - ACTION PLAN

(updated December 2006*)

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
1.0 Behind-the-border/trade-facilitation Agenda						
1.1. Trade logistics						
Slow and cumbersome procedures at trade-facilitation agencies	Complete the ongoing waterfront system project by KPA, which will automate container terminal	2007	KPA	Total elimination of delays in identifying containers	Trade Facilitation Project (Common wealth Secretariat), World Bank	• The Waterfront Project implementation is in progress. Will be fully implemented by July 2007.
	Fully implement SIMBA customs system	***2006***	***KRA***	***Reduction in the number of procedures***		• ***Implemented***
	Introduce post-clearance audit and risk-management techniques	***2006***	***KRA***	***Elimination of inspection of all containers; all containers under green channel will receive fast-track treatment***		• ***Implemented***
	Promote pre-lodgement of declarations	***2006***	***KRA***	***50% increase in the number of pre-lodged declarations***		• ***Implemented. Both manifest & entries are lodged before arrival of the vessels.***
	Implement the CBS involving all stakeholders	2008	MoTI [KRA, KPA]	All agencies interconnected, and paperless port		• The CBS implementation is in progress. The first phase is expected to be implemented by end of 2007.

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
				by 2008		
Long delays and burdensome procedures at land-border posts	Introduce one-stop system at all major border posts • ***Complete Phase I (Malaba Railways)*** Finalize other Phases (Malaba roads, Busia, Namanga)	2008 ***2006*** 2008	MoT [KRA, MoTI, MoRPW] ***MoT [KRA/KRC]*** [MoRPW]	Joint inspection and documentation; crossing time reduced to 2 hours ***Building in place*** All border posts to have buildings	World Bank, ECA Trade Hub, ADB	• Piloting being done at the Malaba Border, where Immigration and Customs services for Kenya and Uganda are housed in one building. Joint inspection taking place. • To be replicated in the other border stations. • ***Implemented in March 2006, in which there was improvement and refurbishment of Malaba Railway Station.*** • **Phase 2 will improve infrastructure and will be completed by 2008.** • Designs for the Malaba Bridge and other Border facilities are being undertaken in – house. Preliminary designs created for 6 border posts between Uganda and Tanzania including Malaba, Busia, Lunga Lunga, Taita Taveta and Isebania.
Poor facilities and equipment at trade- facilitation agencies	Upgrade: - KEBS laboratories - KRC locomotives - KEPHIS laboratories	2010	KRA KPA KEBS KEPHIS Port Health KIFWA MoLFD	50% reduction of release time		• KRA has made a lot of progress by SIMBA, is in the process of planning a Post SIMBA Time Release Study. • KPA last year received full complement of new ship-to-shore, rubber-tyred and rail mounted gantry cranes for container terminal operations. This has reduced time taken to load and discharge vessels at the terminal which is the busiest part of the port. The conventional cargo area has also received complement of new equipment to facilitate cargo handling operations • KEBS: New equipment acquired at Nairobi

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
						headquarters. Labs have been upgraded. Radiation labs will soon be operational. In Mombasa, lab facilities have been expanded enabling them to carry out more tests e.g. chemical, microbiological and food analyses. Amount of testing has generally decreased due to the Pre-export Verification of Conformity (PVoC) programme which covers 75% of the goods imported. • KEPHIS: Proposals being developed and shared with potential donors. • MoLFD is upgrading its laboratories. • Port Health Office: Radioactive tests done at PHO's facilities and other samples sent to the Government Chemist for analysis.
Inefficient and unreliable infrastructure	***Design and implement a sector wide road development and maintenance policy and strategy*** Complete Northern Corridor road rehabilitation	***2006***	***MoRPW***	***Reduction of vehicle operating costs by 50% and maintenance costs by 50%***	**World Bank, EU, SIDA**	• ***Rehabilitation of Miritini - Maji ya Chumvi (35km) and Maai Mahiu – Naivasha – Lanet (95km) sections ongoing.*** • ***Contract awarded for Sultan Hamud – Machakos Turnoff (55km), Machakos Turnoff - Athi River - Embakasi (33km), Lanet - Nakuru – Njoro Turnoff (14km) and Njoro Turnoff – Mau Summit - Timboroa (83km)***
	Set up residual company for asset management and a regulatory body for KRC	2010	MoRPW		***IFC, KFW-Germany***	• ***Implemented. Residual company, Kenya Railways Corporation, manages the assets and the concession. Contract signed in September 2006.***
		2006	***MoT***			• ***National railway network concessioned to***

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
			[KRC]			***private sector operator in November 2006.*** • ***KRC acting as the regulator.***
	Complete upgrading investment program for KRC					• Upgrading programme in place. Rift Valley Railways will upgrade the rail network and rehabilitate locomotive engines. Rehabilitation of Mombasa-Malaba line to be completed by 2011 which should increase of throughput by 75%
	Finalize transformation of KPA to landlord	2010	MoT RVR			• Process on course as per the Port Master Plan. Will be carried out in phases. Awaiting Parliament endorsement of the Privatisation Bill.
	Complete privatization of Telkom Kenya	**2006**	KPA [MoT]			• **Key transitional processes need to be carried out e.g. staff rationalization, addressing of legal issues, payoff of debts, etc. Sourcing of funds to address the reforms has been difficult. The process will be fast tracked in 2007 as important preliminaries have taken place or been agreed upon.**
	Increase generation and supply capacity of energy; and reduce unit costs	2008 2009	MoIC KENGEN IPPs KPLC	Eliminate power rationing, 50% reduction in unit costs		• Generation: KenGen and the IPPs (Independent Power Producers) working to increase their capacity. Additional 434 MW to be generated by mid-2008. • Transmission and distribution: Through the Energy Sector Recovery Project, the World Bank and other donors are providing USD 153 million to upgrade the distribution system. Tenders are being evaluated. • Financing being sought for a 220 KV line between Olkaria and Lessos

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
						• Developing a line between Arusha and Nairobi. Commercial negotiations already concluded, the contractor has been appointed and finance will be provided by a Dutch organization. • Feasibility study for a line between Kenya and Ethiopia to be done by end of 2007 with financing from African Development Bank. The line is to be completed by late 2009. • Feasibility study on Nairobi –Mombasa line almost complete, funded by French development agency who is also interested in financing the project.
Absence of mechanism to monitor and evaluate trade-facilitation performance indicators	***Introduce benchmarks of trade facilitation indicators for KRA, KPA, KEBS, KEPHIS, KRC***	***2006***	***KRA [KPA KEBS KEPHIS Port Health KIFWA]***	***All trade-facilitation agencies to report performance targets by 2006***		• ***KRA has performance contracts and pegs performance on these.*** • ***KPA has developed a Customer Service Charter which will be useful in ensuring that they meet customers' expectation in service delivery.*** • ***KEPHIS: Service contract signed between KEPHIS and the government; performance contracts signed by staff and performance targets submitted. KEPHIS has also published a Service Charter which will soon be distributed. The activities to improve efficiency and competitiveness, outlined in the Strategic Plan 2006-2010 are on course. KEPHIS offices in Mombasa have moved to a central location together with other trade facilitation agencies to enhance service delivery.*** • ***KEBS: Performance contracts have been signed between KEBS and the government, and all senior management have signed performance contracts as well. KEBS achievements include PVoC programme; harmonizing with KRA and KPA e.g. joint***

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
						verification during the scanning process; KEBS to be incorporated into SIMBA system, CBS and KPA Waterfront System • ***Port Health Office: Senior officials at the Ministry have signed performance contracts.***
Cumbersome and costly transit procedures	***Implement cargo-tracking system for goods in transit*** ***Connect Northern Corridor customs administrations***	***2006*** ***2006***	***KRA*** ***KRA***	***Elimination of escort convoys by 2006***	***World Bank***	• ***The procurement process for the cargo tracking system has been started.*** • ***The process to interconnect the SIMBA and ASYCUDA ++ has been started.***
Time-consuming weighbridges on the road and non-harmonization of regional axle-load regulations	Implement harmonized COMESA axle-load regulations Harmonize axle-load regulations within EAC ***Implement one-weighing policy, at first weighbridge*** Improve management of weighbridges along Northern Corridor; move toward implementation of weigh in motion and mobile	2007 2007 ***2006*** 2007	MoT [MoRPW] MoT ***MoT*** MoT MoRPW	Harmonization and efficient regulation by 2006	World Bank	• Harmonized COMESA axle-load regulations implemented. 'Best Options' Study now completed and recommendations therein awaiting adoption by the Kenya Roads Board and the Ministry of Roads and Public Works. • Axle load regulations harmonized within COMESA, of which Kenya and Uganda are members. Need to negotiate with Tanzania which is not a member of COMESA. • ***Implemented. Land identified near KPA, one weighbridge located here. After weighing, the goods are sealed and the truck can continue up to Malaba without having to be weighed again.*** • Reinforcing and increasing weighbridges. Six weigh-in-motion weighbridges acquired and single axle weighbridges.

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
	weighbridges					
Unnecessary delays in processing of documentation at the agencies	***Invest in continuous training of staff*** ***Professionalize clearing and forwarding services***	***Ongoing***	***KRA*** ***KIFWA***	***50% reduction in release time***		• ***Training of staff is an ongoing exercise.***
1.2 Standards and Conformity-Assessment Institutions and Capacities						
Poor awareness of SPS-management requirements	Establish information center on international standards requirements ***Raise awareness of the importance of SPS management, good agricultural practices and involvement of the private sector, especially in the smallholder production base***	2007 ***Ongoing***	MoTI, ***MoTI [MoA, KEBS, KEPHIS, DVS, NEMA]***	Information center up and running by 2007 ***50% improvement in standards compliance by 2008***		• KEBS is the WTO technical barriers to trade (TBT) national enquiry point where a department is dedicated to handle WTO TBT issues. There is also a resource centre providing information on a large number of international standards. • ***HCDA greatly involved in awareness creation on standards, working with the Department of Horticulture in MoA.*** • ***KEPHIS: Awareness creation on-going through road shows, radio, shows and exhibitions and features in the print media. KEPHIS intends to establish programmes to create standards awareness as well as promote its activities in the rural areas.*** • ***The MoLFD, working with the Public Health Dept. in MoH, handles sanitary issues and is involved in a series of campaigns. MoLFD exploring possibility of exporting beef and is already in high level consultations with countries in the Middle East and Egypt.*** • ***DVS is involved in creating awareness on standards through extension officers (divisional livestock officers and divisional veterinary officers) who interact with farmers***

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
						frequently. There are also "Farmers days" used for sensitization of farmers. Sensitization programmes are also carried out when there is a quarantine due to disease outbreak, these include having meetings to advise on treatment, etc. DVS is also involved in quality control, disease control • ***MoTI involved in creating awareness in GAP especially in horticulture, in conjunction with MoA.*** • ***KEBS: Information on standards is posted on the KEBS website; PVoC partners have all the information on Kenyan standards and can provide advice; KEBS marketing department undertakes publicity campaigns on quality marks, standards, etc.***
Kenya's standards architecture is over-stretched and support is needed through an adequate revenue structure	***Reorganize key public-sector functions with a focus on training and accreditation***	***2006***	***MoTI [KEBS]***	***Existence of functioning private-sector laboratories and testing agencies recognized by KEBS***		• ***Ongoing. KEPHIS is recognized by the EU on food and vegetable standards. KEPHIS are under a monitoring period after which Japanese and US are looking to accept its certification.***
	Facilitate accreditation of the private sector to provide testing, consultancy and conformity-assessment services	**2006**	**MoTI [KEBS, KEPHIS]**			• **KEPHIS: Not yet done since legal reforms still pending however KEPHIS aiming at accrediting private facilities on seed testing within the period of the Strategic Plan (2006-2010)** • **KEBS: A national accreditation service, KENAS, has been set up and is operational, and has legal authority to provide accreditation of private facilities. The Chairman has been appointed and senior officers seconded from KEBS.**

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
						• **MoLFD occasionally uses other accredited laboratories such as KEMRI, ICIPE, ILRI, KARI and KETRI.**
	Reform legal framework to address accreditation	***2006***	***MoTI, [MoH, MoA, MoLFD]***			• ***A legal notice no. 26 of March 2005 established KENAS.*** • ***MoLFD: The legal and policy framework is being addressed e.g. drug policy, meat inspection laws, disease free zones policies, the veterinary policies are being revised.*** • ***MoH: Government Chemist currently providing satisfactory services, no plans to accredit private facilities.***
	Strengthen and operationalize Kenya's National Accreditation Service (KENAS)	***2006***	***MoTI [KEBS]***			• ***KENAS is already operational. An interim accreditation committee is in place awaiting strengthening of the legal framework. Capacity building training of assessors is being carried out in areas of assessing facilities, gauging competence of facilities, infrastructure and personnel to deliver services. Assessors have also been trained in ISO 17025.***
Sub-optimal implementation of regional standards related services and regulations that facilitate trade both regionally and internationally	***Enhance implementation of regional standards*** Create awareness of regional standards	***2006*** 2007	***-KEBS*** ***-KEPHIS***	Obtain mutual recognition in 2 years		• ***KEPHIS is involved in the harmonization of standards within East Africa and COMESA. The standardization of standards within EA is nearly complete and includes Kenya, Uganda, Tanzania and Rwanda. This is being done under the umbrella of the EAC and chaired by the respective umbrella ministries.*** • **KEBS: Harmonized 602 standards within EA region, over 200 harmonized within COMESA region. A protocol is in place for EAC but is yet to be signed.** • The PVoC programme recognizes international systems e.g. ISO quality management systems,

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
						quality marks, etc. • KEBS recognizes quality marks by Uganda and Tanzania.
	Undertake regional pest mapping and collaborate to control and manage pests and diseases	2007				• Funding for mapping etc lacking
	Advance toward a regional accreditation system based on the Kenyan model	2007				• Fostering KENAS to be the regional accreditation system.
	Share resources in the form of "regional centers of excellence" for pesticide regulation, registration and awareness	2008				• KEPHIS is on course to be a regional centre of excellence
	Advance regional mutual recognition of conformity assessment, combined with less-ambitious standards harmonization	2008				• Ongoing.
Low level of testing infrastructure	***Stocktaking analysis of infrastructure, audit of testing competences, to rationalize systems***	***2006***	***MoTI [KEBS, KEPHIS]***	***Reduce testing time to 1 day***		• ***KEPHIS-A proposal has been prepared for EU funding for laboratory equipment, pest diagnosis, etc., aimed at increasing efficiency therefore reducing testing time. (The 1 day benchmark may not be possible for all tests as some involve incubation e.g. testing for diseases, mycotoxins).*** • ***KEPHIS has spent over Kshs 20m on equipment recently. KEPHIS was accredited by SANAS of South Africa in May 2006 (ISO 17025) and evaluated by International Plant***

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
						Protection Convention (IPPC). • ***KEBS: New equipment acquired at Nairobi headquarters which has reduced turnaround time by more than 60%, i.e. from around 14 days to 4-5 days.*** • ***KEBS laboratories are accredited by United Kingdom Accreditation Services (UKAS) and were last audited in March 2006.***
1.3 Trade Finance						
Lack of access to export finance by MSMEs	***Launch forum for commercial banks and insurance companies to discuss and develop ways to increase export finance and insurance for MSMEs*** ***Accelerate current efforts to establish an export credit guarantee scheme that accepts confirmed orders as a basis for credit rather than solely LC (Letter of Credit)***	***2006*** ***2006***	***MoTI*** ***MoF***	***50% of banks and insurance companies develop and offer products for MSMEs***	***EU, ATI***	• ***Joint Loans Board is a scheme under the Department of Internal Trade, MoTI, that provides loans to small business from a revolving fund. It is administered at district level and receives grants from the government and local authorities. This scheme is being restructured*** • • ***MoF: Forum not launched however, a sensitization workshop was held in 2006 to discuss issue of pre-shipment finance which included the banking industry and MoF. In a liberalized economy, it is difficult to make the banks and insurance companies to lend to small businesses.*** • ***Microfinance bill is in parliament and will provide a regulatory framework for lending to small businesses.***
2.0 Trade Policy and Institutions						
2.1 Domestic Trade and Tariff policy						
CET dispersion and escalation discourages	Review CET to reduce dispersion and escalation and reconsider sensitive products	2010	MoEAC, [MoTI]	Reduce top tariff rate; minimize dispersion and	WB, GTZ, EU	• Talks on CET ongoing in Arusha. Review of sensitive products and CET rates on individual products e.g. rice, second hand clothes. A

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
Kenya's integration into international production sharing				escalation		review is done every year, with a shift in band happening before the budget for a few individual items; generally sensitive items are shifting to lower bands. Some products may shift upwards for various reasons e.g. protecting local industries.
Complicated exemptions regime is an administrative burden	Simplify, harmonize and eliminate exemptions Undertake study of adjustment costs and distribution	2010	MoEAC [MoTI, MoF]	All exemptions eliminated or harmonized	WB	• All exemptions on imports have been harmonized within EAC. Exemptions are not likely to be eliminated as this is a worldwide practice, but may be minimized.
EAC countries have different tariff schedule bindings at WTO	***Consolidate tariff bindings and bring them closer to applied rates and apply to more product lines*** ***Undertake study on maximum CET***	***Ongoing***	***MoTI [MoF]***	***Consolidated tariff bindings***	WB	• ***Negotiations ongoing at WTO level. Uganda and Tanzania are considered Least Developed Countries while Kenya is not, thus different tariff bindings.*** • ***A study was carried out before CET was implemented***
VAT refund system entails long delays	***Accelerate and improve VAT refunds to exporters***	***2006***	***MoF [KRA]***	***Exporter to be paid within 3 months; after that pay is with interest***	***DFID***	• ***MoF has increased monthly refund allocation for VAT and allocated money to clear the backlog at KRA.*** • ***If the exporter meets the requirements, the refund is processed within 3 months.*** • ***Payment with interest would require policy direction.***
No assessment of EPZs' most attractive features, which should be scaled up to attract investment for exports	***Undertake a diagnostic on which aspects of EPZ are most cost-effective and how these can be extended to the rest of the country***	***2006***	***MoTI [EPZA]***	***Complete diagnostic studies and programs***	***WB***	• ***EPZA does a self-assessment annually, looking into issues such as the environment in which EPZs are operating, constraints, etc. Policy recommendations are then made to MoTI.*** • ***Looking into possibility of creating incubation centres in EPZs for MSMEs, also to help diversify from the dominating textile industry.***
Weak linkages	Set up database to enhance	2007	MoTI	Database in place	WB	• A draft policy has been prepared on the

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
between EPZ-based companies and domestic producers	linkages		[EPZA]			transformation of EPZs into economic zones. This will enhance linkages between local companies and EPZ companies e.g. sourcing of raw materials from local industries. • A database on EPZ companies exists.
2.2 Regional integration agenda						
Potential use of different rules of origin in EAC and COMESA that may impede regional and global trade	Review current rules of origin and their implementation with a view toward using the most simple, non-restrictive rules to promote trade	2008	MoTI MoEAC EAC	Simple, non-restrictive rules of origin in place		• Rules of origin issues currently being discussed at EAC and COMESA level.
EAC and COMESA regional-services markets not yet integrated	Negotiate regional liberalization of EAC and COMESA services markets	2007	MoTI CBK MoEAC MoT MoIC	Initiated negotiations on Trade in Services	WB, EU	• Communications recognized as important for regional integration. Meeting to be held in January 2007 to address issues of policy as EAC has not had a clear position on communications, integration, connectivity, etc
2.3 WTO agenda						
High tariff barriers to products of export interest to Kenya as well as other developing countries	***Push for reduction of the relevant tariff rates and border barriers*** ***Consider implementation of enhanced integrated framework (IF) facility*** ***Secure access to ACP facilities in Geneva***	***Ongoing*** ***2006*** ***2006***	***MoTI***	***Kenya perceived as strongly favouring reductions in barriers***		• ***Negotiations are ongoing at the WTO level.*** • ***This is for LDCs not including Kenya. Kenya benefited from the Joint Integrated Technical Assistance Programme (JITAP).*** • ***ACP facilities accessible to all member states.***
High cost of IT products and services in Kenya	***Assess advantages of ITA membership, and expand liberalization under GATS related to IT services*** ***Conduct a review on services***	***2006***	**MoTI [MoIC]**	***IT product prices reduced by 50%***		• ***IT products are zero rated in Kenya.*** • ***There's a moratorium on taxation of internet services until the next WTO ministerial meeting in 2007.*** • ***Kenya signed a preliminary contract after***

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
	regulatory framework with a view to enhancing commitment under GATS ***Work with WB and other donors within the regional framework***					***negotiations to join The East African Marine System (TEAMS) which connects a number of East African countries. This should lower communication costs and enhance capacity.*** • ***Terrestrial links being established using fiber optic cables between Nairobi-Mombasa, Nairobi-Malaba, plan to set up Nairobi-Garissa.*** • ***Lake Victoria Basin Development project based in Kisumu aims to link communications between the EA countries.***
2.4 EPA agenda						
EU currently has restrictive rules of origin	Develop and negotiate simple, non-restrictive development-friendly rules of origin	2008	MoTI [MoPND, KRA]	Non-restrictive development-friendly rules of origin for Kenya are identified	EU - KEPLOTRADE	• The ESA/EU EPA negotiations are in progress. A meeting to be held in Addis Ababa in January 2007 dedicated to rules of origin.
Risk that EPAs could undermine regional and global economic integration through hub and spokes trade diversion	Cooperate with ESA and COMESA partners to leverage EPA negotiations to promote regional and global integration through reduction in intra-regional and MFN barriers to trade in goods and services Formulate an enhanced road map for regional economic integration to be incorporated into the EPA	2008	MoTI [MoEAC, MoPND]	Roadmap for regional economic integration a component of EPA	EU/ KEPLOTRADE	• The Lagos Plan proposes that the different blocs within Africa eventually integrate into one economic bloc. EPA negotiations should not negate African economic integration being pursued by the African Union. • Council of Ministers to discuss possibility of ESA negotiations being carried out under COMESA.
2.5 Trade Policy Institutions						

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Insufficient inter-ministerial policy formulation and coordination delays implementation of export facilitation programs	***Establish a high-level trade and investment policy steering forum***	***2006***	***MoTI, [MoA MoT KRA, MoPND, MoF, MoE, MoPW]***	***Steering forum in place***	***DFID***	**A number of high level forums have been established** **-Kenya Trade and Poverty Programme (KTPP)** **- National Council on World Trade Organization (NCWTO)** **-National Export Strategy** **-KEPLOTrade** **-Business licenses review** **-Investment Climate Assessment Programme (ICAP)** **-Trade Facilitation Project** **-Community Based System** **-Northern Corridor forum** **-Seamless Transport forum** **-EA Investment Forum** **-MSMEs Promotion** **-Forum on Africa China Cooperation**
Limited capacity within MoTI to promote Kenyan trade interests in international markets	***Dedicate appropriate human and financial resources***	***Ongoing***	***MoTI EPC, MoFA, Investment Authority, MoF***	***Increased resources for trade promotion***		• ***Ongoing efforts to increase capacity but limited resources hindering efforts. MoTI needs to request the funds from MoF.*** • ***MoFA promotes Kenyan trade interests through*** - ***foreign policy e.g. diplomatic contacts at bilateral or multilateral level open new frontiers for trade and economic development*** - ***international legal framework such as WTO where issues of trade are discussed at a global level e.g. trying to get export quotas increased, scout for new markets, etc.*** - ***enhancing Kenyan missions in areas where Kenya has comparative advantage and potential for further exports e.g. Middle East.***
Poor quality and outdated data	Build capacity to improve quality of trade data in	2007	MoPND, [CBS, KRA,	Data consistent with national	DFID, EU, WB IMF	• There is a Special Committee chaired by CBS that deals with improving quality of Trade

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limits scope for effective trade-policy analysis	partnership with regional countries Set up a taskforce to improve quality of trade statistics EPC to start producing quarterly periodicals on quarterly data		EPC, MoTI]	standards		Statistics. • Technical working group member under Macro sub-committee in EAC • Hosted roundtable Trade reconciliation exercise between Kenya, Uganda and Burundi under stewardship of COMESA (30th Oct- 3rd Nov. 2006) • Coordinates quarterly sub-committee meeting on International Trade, Transport Statistics and ICT • CBS, through STATCAP project is promoting build-up of sustainable statistical capacity in the country and enhancing the comparative advantage of each of the participating institution and minimize duplication of efforts. • Planning user/producers of statistics workshop for early 2007. • Training done in trade related statistics, poverty mapping, etc.
2.6 Improve Kenyan and African access to US markets via AGOA						
Possibility that third-country fabric provision will expire and not be renewed in 2007, limiting Kenya's and Africa's market access	***Propose early and permanent renewal of third-country fabric provisions for duration of AGOA***	***2006***	***MoTI***	***Third-country fabric rule extended beyond 2007***		• ***Efforts are ongoing between AGOA eligible African countries to persuade US to extend.***
AGOA excludes products that are of interest to Kenya and other African countries	***Propose extending AGOA product coverage***	***2006***	***MoTI***	***Extension of AGOA coverage***		• ***Consultations on product coverage ongoing. Technical Barriers to Trade (TBT) issues need to be sorted out as US regulatory authorities have stringent requirements.***

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
3.0 Sector Plans						
3.1 Textiles and Clothing						
Mombasa Port regulations increase transaction cost for EPZ containers	**Relax fee requirement for EPZ containers at the port, and allow containers to arrive at the port a day before ship departure**	**2006**	**KPA [EPZA, MoTI]**	**Reduction in transaction costs**		• **Presentations from the EPZ companies on the matter yet to be received for discussions and incorporation in the new proposed KPA tariff to be rolled out by April 2007.**
High Kenya Ports Authority charges	**Reduce port charges for fully sealed EPZ containers in line with sealed transit containers**	**2006**	**KPA [EPZA, MOTI, KRA]**	**Reduction in transaction costs**		• **Same as above.**
Kenya Ports Authority does not allow containers to reach the port 1 day before a ship sails	***Grant permission for export containers to reach the port up to one day before sailing***	***2006***	***KPA [EPZA, MoTI, KRA]***	***Reduction in costs***		• ***This is purely an operational issue. Ships are planned in advance and exports nominated for an exporting vessel are allowed into the port up to 2 days prior to the vessel sailing date.***
Customs regulations increase transaction costs for textile and clothing exports to the US	***Extend working hours for customs officers at EPZs and the port; propose staggered working hours for customs officers and in the mid term, consider working in shifts***	***2006***	***KRA [EPZA,EPC , MoTI]***	***24 hour/7 day work schedule***		• ***At the moment, the work load in the EPZs does not warrant Customs Officers operating 24hrs/7 days a week. However in case an EPZ requires an Officer to work outside the normal working hours, all they have to do is request.***
Absence of labour officer at the EPZA to address labour disputes	***Station labour officer at the EPZA premises to facilitate negotiations between workers and employers***	***2007***	***MoLHRD [MoTI, EPZA, Unions]***	***Cordial labour relations***		• ***There is an officer at the Ministry headquarters who handles EPZ issues. Discussions are underway with EPZA to provide office space in order for the officer to be stationed there. There is already a labour office in Machakos however this is not convenient.***
Lack of sharing of industrial	***EPZA should provide data on EPZ firms on a***	***2006***	***EPZA [KRA,***	***Timely, accurate and dependable***		• ***EPZA collects data on EPZ firms quarterly which is available on request.***

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
production & Export Statistical Data by both the EPZA and KRA	***monthly/annual basis; The EPZA and KRA should expand the target audience for this data***		***MoTI, CBS]***	***statistical data on EPZ firms***		• ***EPZA is now a member of quarterly sub-committee meeting on International Trade, Transport Statistics and ICT.***
3.3 Leather and Leather Products						
3.4 Fish and Fish Products						
Declining fish catch, increased wastage at land beaches and poor fishing methods	***Develop full-service landing beaches (already identified) with ice plants and auction hall***	***Ongoing***	***MoLFD***	***Better landing beaches constructed***	***EU UNIDO***	• ***Twenty percent of the landing beaches have been electrified or have generators, and cooling systems have been installed. Funding lacking for the auction hall. Government considering public-private partnership to establish ultra modern auction centre in Kisumu.***
	Educate fishermen on fishing and handling techniques	***Ongoing***	***MoLFD***	***Reduce the losses of catches by 50%***		• ***This exercise is ongoing under extension services (fish officers on the ground). There are also beach managers elected by fishers who conduct training on new fishing techniques, marketing, alternative sources of income, etc***
	Enforce use of ice by fishermen	***Ongoing***	***MoLFD***	***Reduced catch losses***		• ***Training on use of ice being done by beach managers.***
	Conduct stock assessment of and sustainability in Lake Victoria	***2006***	***MoLFD***	***Assessment report***		• ***Government carries out studies of the fish stock periodically through a regional project assisted by EU under LVEMP. Recent studies show increase in fish stocks.***
		Mid 2007	MoLFD	Lake Turkana		

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
	Conduct study of Lake Turkana to determine extent of parasite problems ***Improve fisher's access to finance to buy equipment***	***Ongoing***	***MoF [MoLFD]***	viability established ***Finance window opened***		• Study to be conducted by the government to establish the capacity of L. Turkana and the extent of the parasite problem. • ***Weak cooperative societies and lack of control of the market by the fishers make financing difficult. However, the proposed Microfinance bill provides enabling legislation to help small business obtain loans.***
3.5 Horticulture						
A multiplicity of taxes and levies, high freight costs, deteriorating infrastructure and insecurity	Develop a common strategy and vision to encourage coordination among stakeholders ***Re-establish VAT refunds*** ***Eliminate additional taxes and levies*** ***Introduce 24 hour/7-day customs clearance*** ***Introduce paper-based customs control of EPZ factories*** ***Amend EPZ legislation to include 100% of export-***	2006 ***2006*** ***2006*** ***2006*** ***2006*** ***2006***	MoA [HCDA, FPEAK] ***MoF [MoA, HCDA]*** ***MoF [MoLG, HCDA]*** ***KRA*** ***KRA [EPZA, HCDA]*** ***EPZA [HCDA]***	Common strategy ***Prompt VAT refund*** ***Number of taxes reduced*** ***24-hour/7-day clearance*** ***Paper-based customs control*** ***Amended EPZ legislation***	USAID	• Task force on horticulture was established in 2005 to develop horticulture. • A policy draft on horticulture is being developed. • ***Implemented.*** • ***Business regulatory reform unit formed under MoF reviewing licences, fees charges.*** • ***Review of levies by MoLG ongoing.*** • ***Implemented.*** • ***EPZ companies are using the electronic Simba customs systems.***

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
	oriented farms					
	Adopt legislation to require industry compliance with KenyaGAP	***2006***	***MoA [HCDA, FPEAK]***	***Legislation adopted***		• ***Recommendations have been made to MoTI on this issue under a bill on transforming EPZs to economic zones.*** • ***A task force on agriculture is looking at the modalities of enhancing HCDA mandate to ensure compliance with good agricultural practices.*** • ***MoA is reviewing with a view to consolidate all legislation affecting agriculture (over 100 legislations).***
	Rehabilitate access roads to growing areas	***2006***	***MoRPW***	***Roads rehabilitated***		• ***Development partners assisting Kenya in the maintenance of rural roads in 37districts using Roads 2000 strategy***[70]
	Improve security especially in Lake Naivasha area	***2006***	***OP [MoA, HCDA, FPEAK]***	***Improved security***		
3.7 Services Sector						
Insufficient information on services- export performance and potential	***Undertake studies in the various service sub sectors***	***2006***	***MoTI, [MoIC]***	***Availability of service sector performance data***		• ***Studies are ongoing in areas where Kenya is hoping to make commitments at WTO level e.g. health, education, telecommunications, building construction.*** • ***MoIC conducting studies in the ICT sub-sector e.g. digitization of records, etc.***
Lack of government	Develop policy on export of services	2007	MoTI [MoLHRD,	Policy document in place		• There's a sub-committee on services in the National Council for WTO (NCWTO) under

[70] *The Roads 2000 Programme is a strategy for the maintenance of the Kenya public road network to an economic level of serviceability using local resources and labour methods wherever these are cost effective.*

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
policy on export of services			Immigration]			MoTI which is addressing issues of trade in services. • A draft Sessional Paper on Employment Policy and Strategies for Kenya has been prepared for discussion in Parliament. It addresses among other things, issues of foreign employment of Kenyans, both skilled and unskilled.
3.8 Sugar						
Reforms in the sugar industry may negatively affect farmers and workers	***Undertake a poverty and social impact assessment, including identifying crop alternatives***	***2006***	***MoA [MoTI, KSB & HCDA]***	***Completion of a report on social impact***	***DFID, WB***	• ***This is ongoing. MoA extension workers working with sugar companies are promoting growing of other crops along with sugarcane, to reduce overreliance.*** • ***A sugar industry strategic plan has been developed and a sugar policy is being drafted.*** • ***Government has negotiated resumption of exports to the EU where Kenya has a sugar quota of 5000 metric tonnes.***
Sugar cane prices are set too high which sends a wrong signal to producers	***Link sugar cane prices to domestic sugar prices*** ***Benchmark sugarcane prices with the world sugarcane prices***	***2006***	***MoA [KSB]***	***Harmonized producer and consumer prices***		• ***Ongoing. A cane pricing committee has been constituted under the umbrella of KSB. Members include MoA, factories' representatives, farmers' representatives and KSB. Various proposals have been put forward, including differentiating cane prices according to quality e.g. sucrose content.***
Sugar cane producers face high transport cost	Improve road quality between farming areas and sugar-cane factories Use CDF/LATF /Road Maintenance Levy Funds	2008	MoRPW [CDF,KRB/ LATF]	Lower transportation costs and better roads (37%)		• RMLF increased during the 2006/7 budget • Most sugar producing districts covered under R2000 programme • CDF/LATF being used
Sugar cane varieties available in Kenya have	Invest in sugar cane research	2008	MoA [KSB, KARI]	Cane yield increased by 50%		• Kenya Sugar Research Foundation is conducting research on sugar cane in Kibos. Mumias Sugar Co. also has a research

Constraint	Recommended Actions/Measures	Proposed Time frame	Responsible Bodies	Indicative target	Donor activities	Update
low yields and are slow maturing						department that is carrying out field trials of certain sugar cane varieties.
A 7% development levy increases domestic sugar (retail) prices	***Evaluate the effectiveness of the levy***	***2006***	***MoA [KSB]***	***Reduced costs of sugar production***	***WB***	• ***Ongoing. Efficiency at farm and factory level is being promoted. Factories are expanding their capacities and diversifying their activities. This is in preparation for the lifting of COMESA Safeguard measures in February 2008 which have allowed the government to control sugar imports.***
4.0 Implementation of National Export Strategy (NES)						
Lack of implementation of National Export Strategy Action Plan (Livestock, Fish, Horticulture and Food and Beverages)	***Re-activate the office of the Co-ordinator***	***2007***	***MoTI***	***Quarterly Progress Reports prepared by the Consultant***	***EU, WB, GTZ***	• ***The NES is currently being harmonized with the Private Sector Development Strategy, under which it will be implemented. The PSDS can only be implemented in cooperation with other ministries and should be included in their budgets. The PSDS team is already in place and the strategy should be launched early 2007.***
Lack of Action Plan for 5 sectors under National Export Strategy	***Prepare Action Plan for 5 priority sectors under National Export Strategy (Tea, Commercial Crafts, ICT, Tourism and Transport)***	***2006***	***MoTI [MoIC, MoT, KTB]***	***Published Action Plan***	***WB Institute, EU***	• ***Same as above.***
Lack of harmony between the National Export Strategy and The Tourism Master Plan and Strategies	**Hold Consultative Workshops**	**2006**	**KTB**	**Summary Messages**		**Date not yet determined.**

Responses from:

Ministry of Agriculture	Ministry of Roads and Public Works	Central Bureau of Statistics	Min. of Planning & Nat'l Devt.
KEPHIS	Kenya Ports Authority	Kenya Revenue Authority	Kenya Bureau of Standards
Min. of Labour & HR Devt.	Ministry of Transport	Ministry of Finance	Kenya Railways

Ministry of Trade and Industry Ministry of Livestock & Fisheries Devt. Ministry of Foreign Affairs Export Processing Zones Authority
Kenya Power and Lighting Co. Ltd. Ministry of Health Ministry of Information & Communication

Actions in bold and italics: implemented in 2006
Actions in bold: planned for 2006 but not yet implemented

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