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ON

ECONOMIC MANAGEMENT

FOR

RENEWED GROWTH

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SESSIONAL PAPER NO. 1 OF 1986

ECONOMIC MANAGEMENT FOR RENEWED GROWTH

PREAMBLE

This Sessional Paper represents a departure from previous practice. In the past, changing economic conditions have required sessional papers on the economy to indicate adjustments in the ongoing development plans. The horizon of these mid-term sessional papers has been the same as the development plan itself.

The situation in 1986 makes it imperative that this Sessional Paper takes a more fundamental and long-term approach than previous mid-term reviews. Kenya has come through a series of economic crises: the oil price rises of the 1970s and the decline in Kenya's terms of trade, domestic inflation of the early 1980s, the world recession of the same period, and the devastating drought of 1984. Kenya has coped successfully with these crises, which can be counted as a major accomplishment. But the cost has been high: economic growth has slowed to the point where average incomes have barely risen the late 1970s. But because the short-term problems have been brought under control, while progress has been made on reorienting the economy, 1986 presents a ripe opportunity to look much farther ahead, towards the end of the century, to determine what kind of an economy Kenya is going to have then and how it is going to get there.

As the first chapter makes clear, this opportunity must be seized now, before the pressure of population growth overwhelms the economy's capacity to produce and provide for its people. The urgent need is to renew economic growth in ways that will provide jobs for the growing labour force, prosperity for the mass of people in the rural areas, an equitable and widespread sharing of the benefits of growth, and a continuing provision of basic needs for all. The task of this Sessional Paper is to propose a broad strategy and specific measures to accomplish these goals. The fundamental importance of this task, and the historical opportunity to concentrate on accomplishing it, justify both the exceptional length of this paper and its much longer time horizon than is customary for mid-term reviews. This Sessional Paper provides a blueprint for the next development plan and those to follow.

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CHAPTER 1: KENYA IN 2000

At the end of this century, Kenya will have a population of about 35 million people, 78% more than lived in Kenya in 1984. That population will include a work force of 14 million people, 6.5 million more than in 1984. These future workers have already been born. To accommodate that work force without a rise in the rate of unemployment, it will be necessary in the next 15 years almost to double the number of jobs in Kenya. Moreover, at current trends, the urban population will reach 9 to 10 million by 2000, over one-fourth the total population, compared to only 3 million (15%) in 1984. Unless new workers can be attracted in large numbers to jobs in smaller urban centres and on prosperous farms, it will be necessary to build at least six cities the size of present-day Nairobi, or to watch Mombasa and Nairobi expand into cities of two to four million each. And, unless those working on farms and in rural towns continue to raise their productivity, the rural population will be plagued by uneconomic subdivision of the land, migration into marginal areas, falling average incomes, and food shortages.

1.2. To accommodate Kenya's rising population, the country must enter a new phase of development and the provision of basic needs. The foundation for this new phase has to be renewed, rapid economic growth: a target average GDP growth rate of 5.6% a year is established for 1984 to 2000. Rapid economic growth will have to be generated by job creation sufficient to absorb the larger work force of the end of the century; increased productivity in agriculture to feed the nation, raise rural incomes, and provide export revenues; widespread rural non-farm activity to provide jobs and good living standards outside the central cities; a dynamic informal sector that creates jobs at low cost and caters to the needs of people at all income levels; and a restructured industry, capable of employing more workers at high productivity and of creating export markets for Kenya's manufactures.

1.3. Economic growth channelled in these directions will provide widespread benefits for Kenyans of all income levels, improving the distribution of income. Indeed, there is little conflict between growth and income distribution in Kenya, because growth can only be sustained by the rising productivity and incomes of farmers, herdsmen, and workers in the informal (i.e., very small-scale) sector--occupations that employ over 70% of the entire work force and include virtually all workers from low-income families.

1.4. Economic growth channelled in these directions is the only way to ensure the provision of basic human needs to all Kenyans. Needs provided largely by families themselves--food, shelter, and clothing--depend on growing employment, productivity

and incomes. Needs in which Government takes a role along with families--education, health, and water--require a growing revenue base and thus growing national income. Without rapid economic growth, the provision of even the most basic needs will be in jeopardy.

1.5. Because the resources available to generate rapid economic growth will not be abundant, they must be used in the most productive ways possible. Limited land will require that agricultural growth depend foremost on the intensfication of crop and livestock production. Limited capital will require that most jobs be created in agriculture and the informal sector. It is estimated that, even with rapid growth and a continuation of the high investment rate of 25% of gross domestic product, Kenya will have only £ 23 billion to invest over the period from 1984 to 2000. It takes approximately £16,000 to create one new job in non-agricultural, modern wage-earning activities. If all the available £ 23 billion of saving went to finance investment in the modern sector and none of it were required to replace ageing capital, only 1.4 million new workers would find employment over the next 15 years, leaving 6 million workers--40% of the labour force--without jobs in 2000! Obviously, the modern, urban, industrial sector cannot be depended on to employ much of the growing work force. To employ people on small farms, in very small-scale industry and services, or in self-employment takes only a fraction of the £16,000 per worker required in the modern sector. Clearly the bulk of the work force will have to be productively employed in these activities.

1.6. There is no escape from these stark realities. For Kenyans to enjoy even modest improvements in their current standard of living, it will be imperative that:

--- economic growth becomes the primary concern of economic policy and that it is accelerated to average 5.6% a year to the end of the century;

--- agriculture remains the leading sector in stimulating economic growth and job creation;

--- the great majority of new jobs be created, not in the cities or in large industry, but on farms and in small-scale industries and services, both rural and urban;

--- most investment be directed to create a prosperous agriculture, to build rural market centres and towns, and otherwise to support informal sector growth;

--- what investment does occur in modern industry must be highly productive, capable of employing workers at low cost and capable of competing in world markets with modest protection or subsidy; and

--- Government policies and budget allocations be moved decisively, and soon, in these directions.

This Sessional Paper lays out a strategy to accomplish these imperatives.

1.7. The development strategy outlined in this Paper puts great stress on the rural economy. Yet this is not a blueprint for an agrarian society. For the next fifteen years, Government's strategy for industrialization must concentrate on two approaches. First, the domestic market for manufactured goods must be expanded markedly and this can only be done if incomes in the rural areas, where over 80% of the people live, rise rapidly. Second, Kenya's industry must be restructured to become much more efficient, capable of competing against imported goods in Kenya with moderate protection and of exporting profitably within the Preferential Trading Area and further abroad. The actions announced in this paper follow these two approaches and thus lay the basis for industrialization that meets Kenya's aspirations and that is based on its own resources.

1.8. Much of the development strategy announced in this Sessional Paper is derived from past development plans and other sessional papers. There has been an underlying continuity in development strategy since Independence, the principal elements of which have been (a) encouragement of a mixed economy with well-defined roles for both Government and the private sector; (b) a high priority to agricultural development even while industrialization was being undertaken; (c) an open economy that takes full advantage of the opportunities available in world markets; and (d) concentration of Government on the provision of economic infrastructure and social services, especially education, health and other basic needs. The major departures from the Government's previous development strategy have been (a) the shift away from a heavy dependence on import substitution and protection as the means to stimulate industrialization, towards a policy of exposing industry progressively to international competition and encouraging non-traditional exports; and (b) institution of the District Focus for Rural Development, which puts much greater emphasis and responsibility on the Districts, through the District Development Committees, in planning and implementing development.

1.9. This Sessional Paper proposes policies that contribute to Kenya's basic development strategy in the following ways:

(1) Increasing the productivity of Government investments and services in the face of severe fiscal constraints is established as a focus for budgetary policy (Chapter 3).

(2) Development strategy is firmly set in the context of improved economic balance between the rural and urban sectors (Chapter 4).

(3) The leading role of the "informal sector" in creating jobs and incomes is recognized and policies are announced to support its development (Chapter 4). Throughout this Sessional Paper, the term "informal sector" is used to include the self-employed and very small-scale firms (generally less than 10 employees) in both industry and services, whether located in cities or rural areas.

(4) A precise strategy is established for achieving food security, income growth, employment creation and export expansion within agriculture (Chapter 5).

(5) Measures are announced to extend and intensify Kenya's structural adjustment in modern industry and trade, including the announcement of a new policy on price and monopoly controls (Chapter 6).

The following chapter places this agenda within the context of a macroeconomic framework for development.

CHAPTER 2: MACROECONOMIC FRAMEWORK FOR DEVELOPMENT

The crucial role of renewed economic growth in achieving Kenya's development goals is elaborated further in this chapter. The first section establishes economic growth targets to the end of the century and shows how these interact with population growth to affect per capita incomes. Section two discusses the relationship between economic growth and four other major national goals: greater employment creation, provision of basic needs, food security, and improved rural-urban balance. A third section explores the constraints to accelerated growth in Kenya, especially the rate of saving, the productivity of investment, Government financial and managerial resources, and the adequacy of foreign exchange earnings. The fourth section defines the reinforcing roles to be played by the private and public sectors in achieving higher economic growth and an equitable distribution of its gains.

Growth Targets

2.2. Table 2-1 sets out growth targets for 1984-88 and for 1984-2000 by major sector. The 1984-88 targets are consistent with those in the Development Plan 1984-88, with allowance for actual 1984 results, dominated by the drought, and a gradual return to the Plan targets by the end of the period in all sectors. From 1988-2000, targets are based on successful implementation of the policies contained in the Development Plan and in this Sessional Paper. The economy should, over the long term, be capable of overall growth approaching 6% a year. Attaining this growth depends crucially on agricultural value added growing at over 5% a year. The programmes outlined in Chapter 5 should make this feasible. Similarly, the structural adjustment policies discussed in Chapter 6 should help stimulate manufacturing growth at the target rate of 7.5% a year.

Table 2-1: Target Growth Rates by Sector
(% p.a. growth of GDP at factor cost)

Section	1984-8	1988-2000	1984-2000
1. Non-monetary GDP	3.5	3.5	3.5
2. Agriculture	4.2	5.3	5.0
3. Manufacturing	6.5	7.5	7.2
4. Trade	5.0	5.5	5.4
5. Government services	3.7	5.4	5.0
6. Other sectors	5.2	6.7	6.3
7. GDP at factor cost	4.8	5.9	5.6
9. Population	3.8	3.7	3.7
10. GDP per capita	1.0	2.1	1.8

Population Growth and Per Capita Income

2.3. Perhaps the stiffest challenge facing Kenya's people over the next 15 years is to reduce the size of their families so that the economy can provide adequately for all Kenyans. During the 1970s, Kenya's population expanded at an estimated 3.8% a year. Today, an "average" woman, whose lifetime history of childbearing duplicates that of her contemporaries of all age groups, would give birth to almost 8 children; this is called the total fertility rate, and Kenya's is the highest in the world. Were this fertility rate to remain constant until 2000, Kenya's population would grow by 4.3% a year to reach 38.5 million in 2000, shown in Projection A of Table 2.2. If, instead, families were gradually to decide to have fewer children, so that by 2000

Table 2-2: Population and Income Per Capita in 2000

	1984	2000	
		Projection A	Projection B
1. Population(mns)	19.5	38.5	34.8
2. Fertility rate	7.9(a)	7.9	5.6
3. Implied average growth rate (% per year)	-	4.3	3.7
4. Dependency ratio	1.22(a)	1.24	1.04
5. GDP (b) per capita in 1984 prices with GDP growth			
(1) 4.5% per year	220	226	250
(2) 5.6% per year	220	267	295
6. 16-year increase(%) in income per capita			
(1)		2.7	13.6
(2)		21.4	34.1

Sources: Development Plan, 1984-1988, p.144; Economic Survey 1984, p.17

Notes
(a) Estimate based on 1979 census.
(b) At at market prices.

the total fertility rate falls to only 5.6 children, the population would be 34.8 million in 2000 (Projection B of Table 2-1), an implicit average annual population growth rate of 3.7% a year.

2.4. The decline in average family size implied by a fertility rate of 5.6 would be a considerable accomplishment for Kenya's family planning programme. The implied population growth rate, 3.7% p.a., is used in all projections contained in this Sessional Paper. Yet, under Projection B the population in 2000 would be only 10% below that of Projection A. Of course,

the benefits of slower population growth will gather force exponentially and become substantial one or two decades into the next century. Moreover, the impact of even a 10% reduction in projected population by 2000 could be considerable. For example, the cost of feeding and educating the nation's children would be much reduced, saving resources to invest in further growth. But for all practical purposes, Kenya cannot dramatically affect the size of its population at the end of this century and must plan to accommodate it.

2.5. To provide rising incomes for a population of 35 million in 2000, it is necessary to expand Kenya's productive capacity faster than its population. Table 2-2 also shows what would happen under two alternative projections of growth in Gross Domestic Product from 1984 to 2000: a slight improvement over the rate of the past 10 years, to 4.5% a year, or a major improvement to 5.6% a year. Line 6 of the table shows that with the slower growth rate, average incomes by 2000 would be only 14% above those in 1980, even if the rate of population growth is held to 3.7% a year; but would hardly improve at all if population grows at 4.3% a year. However, if the economy can grow at the target rate of 5.6% a year, average incomes can be 21 to 34% higher, depending on population growth. Clearly, for the next 15 years, economic growth is the only way to make a significant impact on average incomes. Beyond 2000, however, family planning measures that are undertaken today can also have a marked effect. Moreover, rapid economic growth and urbanization should begin to reduce desired family size and thus reduce birth rates in Kenya, as has been historically true everywhere in the world.

Interactions between Growth and Other Goals

Greater Employment Creation

2.6. Population growth for the past decade has already determined the size of the labour force in 2000: all those who will be potential workers then are alive today. Thus we know to a close approximation that the 1984 work force of 7.5 million will become 14 million in 2000 (Table 2-3). Even if the economy creates jobs at 3.4% a year from 1984 to 2000, which would be a small improvement over the decade from 1972 to 1982, the unemployment rate would increase substantially. Projection A of Table 2-3 shows the "residual"--a category that includes unsurveyed urban wage workers and casual workers, as well as the unemployed--rising from an estimated 13% of the labour force in 1984 to over 20% in 2000. If the residual is to fall from the 1984 level, Projection B shows that over 6 million jobs will have to be created by 2000. This employment growth rate, 4.2% a year, would be unprecedented in Kenya's history.

2.7. The concept of "unemployment" is closely tied to productivity. It is important, not only that workers find jobs, but also that jobs are sufficiently productive to yield adequate incomes. Given the projected GDP growth rate of 5.6% a year from

Table 2-3: Employment Creation, 1984 - 2000
('000 of workers)

	1984(a)	2000(b) A	2000(b) B
1. Labour force	7,500	14,000(c)	14,000(c)
2. Employment(d)	6,520	11,150	12,600
(growth rate,% p.a)		(3.4)	(4.2)
a. Modern wage sector	1,150	2,060	2,330
		(3.7)	(4.5)
b. Non-wage agriculture	3,860	6,490	7,030
		(3.3)	(3.8)
c. Rural non-farm (e)	1,310	2,250	2,840
		(3.5)	(5.0)
d. Urban informal sector	200	350	400
		(3.5)	(4.5)
3. Residual (e)	980	2,850	1,400
(% of labour force)	(13.1)	(20.4)	(10.0)
4. Implied productivity growth (% p.a.) (g)		(2.1)	(1.3)

Notes

(a) Estimated from the Development Plan 1984-88, Table 1-4, p.7,data for 1981 using actual 1984 CBS survey results for 2a and 2d and trend growth rates for all other estimates except 3.

(b) Projections for 2000:
A: Approximate historical levels of employment growth in each category.
B: Sufficient acceleration of employment growth to reduce "residual" to 10% of labour force.

(c) Based on demographic projections in Development Plan 1984-88, Table 6.4, p. 144, plus an assumed reduction in the participation rate of the working-age population (15-59 years) from 85% to 82%.

(d) Including self-employed.

(e) Most rural non-farm jobs are part-time work performed by family farm workers. As the rural economy develops, more of these jobs are expected to become full-time.

(f) Calculated as a residual between the estimated total work force, the number of enumerated workers in the urban modern wage and urban informal sectors, and the estimated rural work force. Includes (i) urban wage-earners not enumerated in the annual surveys; (ii) casual workers and (iii) the unemployed, including some of those not seeking work. This residual gives an upper limit estimate of the level of unemployment, for which direct estimates are not available.

(g) Based on 1984-2000 projected GDP growth rate of 5.6% p.a.

1984 to 2000, projection A in Table 2-3 implies that the productivity of employed workers would rise by 2.0% a year from 1984 to 2000. But in order to prevent the unemployment rate from rising over that period, as in Projection B, productivity growth could be only 1.3% a year, which means that labour productivity in 2000 would be only 23% above the level in 1984. Even to achieve this modest result, jobs will have to be created at historically rapid rates: from 3.8% a year on small farms to 4.5% a year or more in the modern wage and informal sectors, rural and urban. To find the capital to create sufficient jobs, the modern wage sector, both public and private, will have to find ways to reduce investment costs well below the £16,000 per worker cited in Chapter 1. One of Government's major development tasks is to find ways to help the rural and urban informal sectors take on additional workers equal to 116% of their current numbers, without sacrificing productivity gains.

2.8. In Sessional Paper No. 2 of 1985, the Government stated its policy on employment creation. The essence of this policy is that employment is valued as a means of participating in economic growth in a dignified and productive way; that the employment problem must be seen as an issue of increasing the productivity--and hence the incomes-- of all workers; and that the only lasting solution to the employment problem is long-term, rapid economic growth with rising productivity. The central theme of this Sessional Paper is to establish a strategy for achieving such rapid economic growth for the rest of the century.

Rural-urban Balance

2.9. For Kenya's development, it is important not only that economic growth should accelerate, but that it should take place as vigorously in rural as in urban areas. The goal of balanced development between rural and urban areas has been an explicit part of Government policy at least since 1970. District Focus is becoming an important instrument for achieving it. But the rate of population growth and the threatened explosion of Kenya's major cities requires an intensified concern--and possibly new directions--for this policy. If the urban population continues to grow at the same rate as during the decade between the censuses of 1969 and 1979, it will reach 9 to 10 million by 2000 and account for over 25% of the population, compared to 15% in 1984. This represents a massive shift from rural to urban areas and raises the question of where these new city-dwellers will work and where they will settle.

2.10. The goal of rural-urban balance is to manage development so that it brings benefits to all regions of the country, and fosters productive interaction between rural and urban areas. It aims to avoid the excessive concentration of population in the two or three largest cities of the country, to promote the growth of secondary towns and smaller urban settlements, and to ensure that migration from rural areas does not exceed the capacity of the cities to accommodate new residents.

2.11. The cornerstone of rural-urban balance is a productive agriculture and livestock economy that provides growing incomes and employment for rural families. Because this requires that the productivity of the land and its farmers and herdsmen continues to rise, there is a limit to the amount of labour the farms can absorb. Growth in agriculture also creates the potential for new industries and services in the small cities and towns of the rural areas. To ensure that this potential is realized, a second component of development strategy must address the growth of very small-scale manufacturing, commerce and other services in rural areas, for these will have to provide the bulk of rural, off-farm employment. These activities will supply material services which are essential to the development of a prosperous agriculture, while also processing and marketing farmers' outputs. The lack of such centres could handicap agriculture's adoption of more productive technologies.

2.12. A third component of rural-urban strategy concerns the pattern of settlement among the cities, towns and smaller centres through the country. Provision of transport networks will be crucial to reinforce the marketing and other links between farms and market centres that will spring up naturally in the wake of a growing agriculture. Water supplies and electricity will be essential to permit such centres to grow, as will housing for the expanding population. In building such infrastructure, local materials, labour-intensive methods and inexpensive designs must predominate. Small-scale, rural-based firms and the self-employed will be encouraged to build a substantial share of this infrastructure, especially low-cost housing. New infrastructure will and more productive if it follows, complements private sector activity. Finally, attention must also be paid to financing and managing this development at both the national and especially the district and local levels. These issues are explored at length in Chapter 4.

Basic Needs

2.13. Basic needs include the necessities of a decent life: adequate nutrition, shelter and clothing, convenient and clean water, good health, and education. Provision of these basic needs is essential to maintain the dignity of all people, but also to make them better able to increase their productivity and thus participate in a growing economy. However, the relationship between basic needs and economic growth is reciprocal: the best insurance of the availability of basic needs is a rapidly growing economy whose benefits are widely distributed.

2.14. The Government of Kenya has emphasized the provision of basic needs ever since Independence. In the first post-Independence budget, 1964/65, £17 million--measured in 1984/85 prices--was spent on education, health and other basic needs. In 1984/85, this expenditure had risen almost 12 times, to £197

million. On a per capita basis, public expenditure on basic needs increased by almost six times, from 74 to over 400 shillings per person in 1984/85 prices. In 1981, Government's expenditure on education, health and other basic needs equalled 8% of Gross Domestic Product, compared to 5.5% on average for all the lower-middle-income countries, with per capita incomes just above Kenya's. In 1985/86, over one-third of total Government outlays will go for water, health and education, while of the recurrent ministry outlays, over 42% is to be spent on these services. Total outlays would be much higher if private expenditures on basic needs were included, because most food, shelter and clothing are of course provided by individuals and families and a considerable share of public services such as education is actually financed by the beneficiaries and their families.

2.15. These public expenditures on social services, along with the growth of incomes, have made an important difference in the quality of life for Kenyans. Since 1960, the recorded overall death rate has been cut in half, to 12 per thousand of population per year, while recorded infant deaths have been reduced from 138 to 81 per thousand, and life expectancy has risen by more than 10 years. Less than half the eligible children were enrolled in primary school in 1960, while today more than 90% are enrolled. Primary enrolment rates for girls have more than tripled in that period. Adult literacy has risen from 20% to about 50% over the last 25 years.

2.16. These and other improvements in well-being give more Kenyans the potential for productive involvement in the economy. In that sense these have been good investments for the people and the Government. However, many such investments take a long time--up to 15 or 20 years--to result in additional tangible resources in the form of higher per capita output. Moreover, the individual realizes no economic return on investment in basic needs unless he or she eventually becomes productively employed. Of course, outlays on basic needs cannot be judged entirely as investments in future growth and employment. They have some very important immediate benefits in the well-being, dignity and greater satisfaction of the beneficiaries. But expenditure on basic needs necessarily competes with expenditures on other activities, many of which will enhance Kenya's productive capacity in a much shorter time. Moreover, even this apparent conflict disappears when it is recognized that families are the main providers of the most fundamental needs--food, shelter and clothing--and that growing employment and incomes are necessary to provide for these needs.

2.17. Among Government basic needs outlays, some offer more immediate growth-oriented benefits than others. Within education, for example, more emphasis should to be placed on imparting practical skills in primary school and in developing village polytechnics to train primary school graduates for immediately available work, mostly in the vital rural informal sector. Ultimately, the continued provision of basic needs depends on a more rapidly growing economy to provide the necessary resources.

Thus the balance must shift (a) away from expenditures on basic needs in favour of outlays on more immediately productive activities and (b) within basic needs, to favour those services more oriented to immediate economic returns and employment. In addition, (c) all basic needs must be provided more cheaply and efficiently to ensure that limited resources reach growing numbers of beneficiaries with inreasing effectiveness.

2.18. Some simple comparisons suggest the requirement for Government to contain the growth of expenditures on basic needs in the near future. Projections for the next four financial years--from 1985/86 to 1988/89-- show that ministry expenditures must be constrained to grow by less than 2% a year over inflation. By contrast, real expenditures on health, education and other basic needs have grown by 6% a year over the decade from 1974/75 to 1984/85. As these expenditures already account for over 42% of the recurrent budget (excluding debt service), it is clear that their growth must be slowed considerably if basic needs is not to swamp other essential services and investments by Government. With population growing at 3.7% per year, even maintaining per capita levels of outlays for basic needs will be difficult without endangering economic growth.

2.19. Part of the answer to this problem lies in contributions by the individuals and families who benefit from facilities providing basic needs. But contributions by beneficiaries is already a major item in many family budgets. For example, parents already contribute about a quarter of the cost of primary education and about two-thirds of the cost of secondary education. For most families these costs are major and for many they are prohibitive. They also compete with more immediately productive outlays, such as investments in family farms and small business, that are essential for private sector growth and for the provision of family-provided basic needs. So the balance between expenditures on long-term basic needs such as education and on more immediately productive activities is an issue not only for Government, but for the entire economy and society. More rapid economic growth is essential to provide both Kenya's families and the Government with the resources to finance long-term basic needs, even if renewed economic growth may require a slower growth of basic needs outlays for a time. Smaller families are also necessary to make it possible for limited expenditures on basic needs to provide a rising standard of living.

Food Security

2.20. Government will continue to pursue its long-standing goal that most of the nation's food requirements be met from domestic production. This aim will become increasingly difficult to achieve in the face of rapid population growth, rapid urbanization and a virtually fixed supply of land. A potential conflict with long-term economic growth may emerge if food production, especially of maize, wheat, milk and meat, begins to

encroach on land needed to produce export crops that are essential to economic growth, to rising farm incomes, and to foreign exchange earnings.

2.21. Fortunately, sound management of agriculture can avoid this damaging conflict of goals. Kenya's two major export crops, coffee and tea, are grown on less than 5% of the agricultural land. A 70% expansion of area in these two crops would reduce land available to food crops by just over 3%. Such an expansion, together with measures to increase the yields of coffee and tea on already planted land, is recommended in Chapter 5 as the most effective way to generate rapid growth in farm income, employment, and exports.

2.22. The long-term growth in production of maize, wheat, milk and other food crops necessarily depends upon increased yields from land already under food crops. To accomplish output growth of 5% a year, and a much more rapid growth in marketed output for urban consumption, three broad approaches must be pursued simultaneously. First, inputs, especially fertilizer, must be made widely available in convenient packages and at convenient locations. This will require attention to the marketing system and its development. Second, farmers, especially small farmers, must be made aware of improved farming practices by a more effective extension service and induced to practice improved husbandry through price and other incentives. These two approaches are capable of sustaining adequate increases in food production for less than a decade. After that, it will be necessary to introduce new, higher-yielding varieties of maize and other grains to sustain growth and provide food security. Thus the third essential approach is to focus Kenya's research capacity immediately on the development of new varieties, most particularly of maize, for introduction within the next decade.

2.23. If such a three-pronged effort is successful in more than doubling crop yields, food security can be achieved simultaneously with rising farm incomes and employment, without compromising the growth of agricultural exports. Indeed, rising exports will be necessary to achieve food security because even under the best of conditions, it appears inevitable that some food staples, certainly wheat and vegetable oils, will continue to be imported. Thus there is no question of trading off rapid growth for long-term food security: the two must be achieved together and Chapter 5 presents detailed plans for accomplishing both.

Industrialization

2.24. All countries develop into more industrialized societies as incomes increase and Kenya will be no exception. Indeed, the higher productivity and incomes that accompany industrialization are an integral part of Government's long-term development strategy. Industrialization has already made progress in Kenya: in 1964, manufacturing plus construction plus

utilities accounted for only 13% of GDP, whereas in 1984 they accounted for over 19% of a much larger economy. And industrial growth will continue to be leading contributor to income growth: in Table 2-1, manufacturing is projected to expand at over 7% a year for the rest of the century.

2.25. Industrialization must be soundly rooted in the economic resources and needs of the country. At this juncture in Kenya's history, three prerequisites for accelerated industrialization are missing. First, Kenya needs a larger and rapidly growing domestic market to absorp industrial goods. A larger market will permit more industries to achieve economies of scale while also providing more room for competitive firms within the country, both to the benefit of consumers. The strategies discussed in this Paper--especially the emphasis on rapid agricultural growth and non-farm job expansion in rural areas--are essential to create this larger domestic market for manufactured goods.

2.26. Second, Kenya needs a more efficient, low-cost and high-productivity manufacturing sector.. It must be able to compete with imports in Kenya under moderate protection, so that consumers do not pay undue costs for industrialization. And manufacturing must be able to export its products within the Preferential Trading Area and to countries in other parts of the world. This will require a sustained effort over the next 15 years, as highly protected industries reduce their costs and others learn to export. Moreover, the new industries that set up in Kenya must both conserve capital and create more jobs than in the past if they are to serve development goals. The programme of market-based incentives, outlined in Chapter 6, is designed to move industry in these directions.

2.27. Third, Kenyanization of industry requires a much larger supply of entrepreneurs to pioneer new products and markets. There will be several sources of new Kenyan entrepreneurs, including retail trade, other services and, most importantly, small-scale industry. Indeed, a large measure of Kenya's industrialization will be carried by small industries. The emphasis in this Paper on development of the informal sector, and the specific measures outlined in Chapter 4, will promote the emergence of Kenyan entrepreneurs, some of whom will expand into larger industrial ventures over time. Once the domestic market is enlarged, manufacturing becomes more productive, and small-scale firms are established as an important force in manufacturing, Kenya's industrialization can proceed on a sound basis, contributing far more effectively to the country's development.

Constraints on Growth

Saving

2.28. Kenya has, ever since Independence, been able to save and invest a substantial fraction of its Gross National Product. (For technical reasons, Gross National Product and Saving are used here; use of Gross Domestic Saving is misleading because it counts debt service and profit remittances as part of Kenyans' saving.) Table 2-4 shows that, over the past 15 years since 1970, about 25% of GNP has been invested on average. This has been financed increasingly by foreign aid and investment, which rose from 7.5% of GNP in 1970-74 to 9.5% in 1980-84. Thus Gross National Saving--the amount of investment financed by households, domestic corporations and the Government of Kenya--has fallen from 17.9% of GNP in the early 1970s to 16.1% in past five years.

2.29. The decline in the share of Gross National Saving in GDP is a matter for concern and needs to be reversed, for two reasons. First, average prices of investment goods appear to have been rising 3% a year faster than average prices of all goods. Hence the real value of saving has been declining; i.e. it takes a more saving in 1985 to accomplish the same real investment as in 1975. Second, Kenya cannot count on so high a level of foreign saving for the future. Indeed, Kenya will strive to increase its national saving to reduce both foreign indebtedness and its dependence on foreign aid and investment. Nevertheless, Kenya's investment and saving performance have been quite reasonable by international standards: the rate of

Table 2-4: Investment and Saving, 1970-1984

Percent of GNP* at current market prices	1965-69	1970-74	1975-79	1980-84
Gross investment	19.7	25.4	23.9	25.6
Foreign saving*	3.2	7.5	7.8	9.5
Gross national saving*	16.5	17.9	16.1	16.1
Government saving	(0.2)	2.0	2.4	(0.8)
Private saving	16.7	15.9	13.7	16.9

Sources: C.B.S. Economic Survey and Statistical Abstract (various).

* Gross national product and saving are used instead of GDP and domestic saving because the latter includes the net outflow of interest on debt and profit remittances as if these were the savings of Kenyans. Thus foreign saving is measured as the deficit on current account excluding transfers.

investment is above the average for lower-middle-income countries with income just above Kenya's, while the saving rate is only slightly below the average.

2.30. The further breakdown in national saving given in Table 2-3 suggests that some of the recent declines may be due to Government. Calculations of saving inevitably introduce large errors and are approximate at best. Nevertheless, the table shows that Private National Saving suffered a major drop in the late 1970s, but has recovered in the 1980s to 16.9%, a level not seen since the late 1960s. Meanwhile, Government, which had been a net contributor to national saving until 1980, appears to have been dissaving by close to one percent of GNP in the 1980s. Thus, although measures to increase private saving remain important, Government must bear a major responsibility for increasing saving by reducing its deficit of current expenditures over current revenues. This suggests that the recent decline in revenues as a share of GDP must be reversed, but that, nevertheless, continued fiscal stringency will become a long-term feature of Government operations.

Productivity of Investment

2.31. Rapid economic growth requires, not only that a country set aside part of its income as saving, but also that it invest its saving in high productivity uses. If Kenya had been investing 25% of its GDP productively, such that it took four units of new capital to yield each additional unit of output, then Gross Domestic Product in Kenya would be growing at 6% a year. In fact, however, for the past decade savings have been invested in much lower productivity uses--it has required nearly six units of new capital to produce one new unit of output--and consequently Kenya's GDP has grown at just over 4% a year. Thus a fundamental task becomes evident: to accelerate Kenya's growth, it will be necessary to increase substantially the productivity of investment. In order to understand how this might be accomplished, it is necessary to know why the productivity of investment has been so low in Kenya.

2.32. Part of the explanation for declining productivity of investment lies in the inflation of capital goods prices relative to those of other goods, which causes a progressive increase in the cost of investment needed to yield a given increment in output. This will happen as long as capital goods continue to have a higher import content than other goods and the price of imports rises more rapidly than domestic prices. To compensate for investment price inflation, Kenyans will have to save a larger part of their incomes and investors will have to reduce costs by shifting to less capital-intensive activities. Many of the policies discussed later in this paper will support these developments.

2.33. There are other reasons for the low productivity of private capital. During the 1970s, import substitution took

place behind high protective barriers and Government encouraged many large-scale investments--including its own--at high cost to the economy. The result is an industrial sector that, although it sometimes earns handsome profits, still produces at costs well above those in world markets and has had difficulty adjusting sufficiently to changes in market conditions. High protection often leads to overbuilding of industrial plant and may be responsible for some of the excess capacity observed in Kenya manufacturing today. The demise of the East African Community in the 1970s also created excess capacity. Exports to Tanzania and Uganda accounted for 30% of Kenya's exports before 1970, but only about 10% today. The depressed world market of the early 1980s discouraged export expansion and worsened Kenya's terms of trade, depressing domestic demand and exacerbating the problem of excess capacity. The 1984 drought extended this recession despite the recovery in export prices. Another cause of low returns to private capacity can be found in the rises in oil prices during the 1970s, which lowered the efficiency of existing capital stock in all countries.

2.34. Most of these causes of reduced private investment productivity have either eased for the time being or have been accommodated in Kenya, albeit at lower levels of productivity. What remains is to reorganize the domestic environment so that market incentives encourage precisely those private investments in all sectors that will contribute to substantially higher productivity. The converse is equally important: market incentives must discourage investments in low productivity uses, even though they have some appealing features and are promoted by strong interests. Four Government policies will play a crucial role in moving the private sector towards higher investment productivity. First, trade policy is already being reoriented to reduce the degree of protection afforded import-substituting activities and to increase the returns to non-traditional exports. No other set of policies will have a more profound impact on the productivity of private investment in manufacturing. Second, interest rates on loans are being maintained above the rate of inflation, to screen out unproductive uses of Kenya's saving. Third, renewed intensification of crop production of the major export and food crops, along with a relatively small shift of land into high-yielding export crop, as outlined in Chapter 5, will raise agricultural incomes and exports on already cultivated land. Fourth, measures described in Chapter 4 to promote very small-scale, informal sector manufacturing and services will channel investment into industries that promise high returns to capital and labour.

2.35. Government investment through parastatals has shown the same inefficiencies as private sector investment. The Report on Public Expenditures recommended fundamental changes in the Government's approach to parastatals. New measures to make parastatals more responsible borrowers were announced in the 1985 Budget Speech. Although this Sessional Paper focuses on private investment, continued progress to instill greater financial and operational responsibility in parastatals is an integral part of

increasing the productivity of capital in Kenya.

2.36. Government's direct investments, have also become less productive in recent years. Fiscal stringency has reduced the real level of resources to finance the development budget. Consequently, the implementation of many projects has been stretched out and, once completed, many projects do not receive adequate recurrent allotments for operating costs. In order to raise the productivity of Government investment in development projects, Government is undertaking an excercise in budget rationalization intended to identify high-yielding projects; concentrate resources on these to speed their completion; and provide fully for their operating expenses upon completion. At the same time funds will gradually be shifted from recurrent and development outlays on basic needs with long gestation periods towards more immediately productive outlays supporting agriculture, small-scale industry and rural infrastructure. Within basic needs, resources will be shifted towards immediately productive activities such as youth polytechnics and water supplies in growing rural market towns. Details of the budget rationalization programme are contained in Chapter 3.

Government Finance and Management

2.37. Fiscal stringency will place a constraint on the achievement of renewed economic growth and all other development goals. Two conditions are central to appreciating the fiscal constraint. First, revenues (tax receipts and payments for Government services) are expected to grow at only 3.8% a year net of inflation from 1984/85 to 1988/89. Second, at the same time the deficit must shrink as a share of GDP, in order to control inflation, restrain public indebtedness, increase Government saving and avoid "crowding out" private investors who need access to domestic credit. These requirements put a tight limit on ministry expenditures, which will grow by less than 2% a year net of inflation through 1988/89.

2.38. Government expenditure cannot continue growing at so slow a rate indefinitely. Hence, during the remainder of the Development Plan period it will be necessary to consider revisions to the tax structure in order to raise revenues from their currently low level, 21% of GDP, towards 24% of GDP by the end of century. This will enable ministry expenditures to grow at 5% a year to the end of the century, allowing for a reduced deficit (2.5% of GDP by 1999/2000) and growing interest payments on public debt. Indeed, it is anticipated that some revenue measures may be capable of raising expenditure ceiling even before the end of the Plan period. But there is a limit to the potential growth of ministry expenditures, which will be slower than the growth of GDP.

2.39. Given these restrictions on its resources, Government can no longer employ such a large number of graduates and others each year. Since 1974, Central Government employment has in-

creased by 7.4% a year, almost twice the rate of growth of the labour force. This employment policy has added so much to Government's salary costs that in 1984/5, 60% of ministries' recurrent expenditure went to pay salaries, compared to only 47% in 1979/80. Continuation of this trend threatens a sharp reduction in the productivity of Government services, as purchases of needed complementary supplies is reduced. Government will not abandon its active role in providing goods and services that are crucial to economic growth and people's well-being. But fiscal stringency requires that the private sector, whether small-scale or large, rural or urban, must account for an larger share of investment, economic growth, and employment creation in the coming years. It also suggests the important role to be played by District Development Committees, Local Government Authorities and Harambee groups in providing investments in rural areas.

2.40. Government's management capacity establishes another limit to its role in renewed development. Kenya is fortunate to have a capable civil service that is skilled in managing the traditional tasks of Government. In recent years, however, Government's tasks have multiplied and gone beyond the traditional roles, into the management of parastatals engaged in a wide range of activities and into the administration of a myriad of frequently complex development projects in every district and sphere of activity. Central Government has reached the limit of its ability to manage competently a growing number of parastatals and development projects. Renewed growth must take place within the context of fewer and more consolidated Central Government activities, pointing once again to the crucial roles of district and local authorities and of the private sector.

Foreign Exchange

2.41. It is generally accepted that developing economies require increasing quantities of certain imports they cannot themselves produce efficiently--especially capital goods, certain intermediate goods and many raw materials, especially oil. Even vigorous import substitution only tempers--but cannot eliminate--this growing demand for imports. To pay for these, countries must increase export earnings and, in most cases, also seek foreign capital. Because the demand for imports to fuel growth typically outstrips the growth of export revenues and the supply of foreign capital, many developing countries run into a foreign exchange constraint that limits the rate at which they can grow.

2.42. Most observers would agree that the Kenya's economy has been constrained in precisely this way. As Table 2-5 shows, the volume of merchandise exports has grown very little since the late 1960s, only 1.5% a year, and all that growth had taken place by the early 1970s. When service exports such as transportation and tourism are included, the picture brightens some, as total exports (including commodity and net non-factor service exports) have grown by 2.8% a year. But even that growth has been dampened by an adverse shift in the terms of trade:

Table 2-5: Foreign Exchange Constraint

		1965-9	1970-4	1975-9	1980-4
A.	Commodity imports as a share of GDP at factor cost(%)(a)	30	35	35	35
B.	Indices (1976=100) of				
	1. Real commodity imports	100	132	116	96
	2. Real commodity exports	72	98	98	90
	3. Net non-factor services exports(b)	58	83	109	142
	4. Income terms of trade (c)	83	105	102	70
	5. Real GDP at factor cost	65	87	108	133
C.	Share (%) of commodity imports financed by:				
	1. Commodity exports	73	63	66	57
	2. Commodity exports plus net services(d)	85	74	76	71
	3. Foreign saving (e)	13	26	26	29

Source: CBS, Economic Survey (various)

Notes:
(a) At current prices.
(b) Transportation, foreign travel plus "other services"; excludes "Government transactions n.e.s"; deflated by the GDP deflator.
(c) A measure of the international purchasing power of commodity exports = Commodity export earnings deflated by the commodity import price index.
(d) Includes net outflows of factor services as a drain on export earnings; i.e. the amount available to finance commodity imports is export earnings net of payments for interest on foreign debt and dividend repatriation.
(e) Equal to the current account deficit excluding transfers, as in Table 2-4; C2 + C3 = 100%

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the purchasing power of Kenya's commodity exports fell by over one percent a year from the later 1960s to the early 1980s. And annual debt service, which accounted for only 5% of export earnings in 1970, now takes about 30% of export revenues. Consequently, as the table demonstrates, the real value of imports has been stagnant over the entire period from 1965-69 to 1980-84 and has declined by 27% since the early 1970s. This decline in

imports helps to explain Kenya's sluggish growth rate of only 4.3% a year from 1970/74 to 1980/84.

2.43. Some of the growth that has occurred since the early 1970s is due to import substitution but it is difficult to say how much. Statistical analysis strongly suggests that the rising prices of all imports, especially of petroleum during the 1970s, caused Kenya's industries and consumers to cut back on their use of fuel and other imports and to substitute domestic goods and factors of production from the mid-1970s onward. Public and private investments in import-substituting industries such as paper and metal products contribution as well.

2.44. But this same statistical analysis also suggests that, in the absence of continuing increases in relative prices of imports, it will be necessary for imports to grow at close to the same rate as GDP. Some outcomes of the policies contained in this Sessional Paper will work to extend import substitution: rapid growth of agriculture and informal sector activities, which use relatively few imports; emphasis on growth of rural centres, whose inhabitants are not large consumers of imports; and the general shift towards labour-intensive methods, which will save on imported capital equipment. Against this, however, will be the intensification of crop production, which requires increased use of fertilizer and other imported inputs, and the general increase in the urban population, whose consumption depends relatively more on imports than does the consumption of rural residents. On balance, it is expected that the import dependence of Kenya's GDP will continue to decrease under these policies, but the extent of this structural change is not known. Under the circumstances, it is well to plan for export expansion sufficient to finance imports that grow at the same rate as GDP. Then, to the extent that import dependence continues to decline, foreign exchange revenues can be devoted to welcome increases in reserves or decreases in external debt.

2.45. During the period shown in Table 2-5, Kenya's exports have financed a decreasing share of its commodity imports. In the early 1980s, commodity exports paid for only 57% of commodity imports. When exports of services are added, but allowance is made for payments of interest on foreign debt and dividend repatriation, then net export earnings covered only 71% of commodity imports in the early 1980s, while foreign capital and transfers financed 29% of commodity imports, more than twice the share in the late 1960s. However, strong prices for coffee and tea improved the situation in 1983 and 1984, when net export earnings financed 80% of commodity imports. To reduce dependence on foreign capital while sustaining higher growth rates will require export growth of at least 5% a year, well beyond Kenya's recent experience.

2.46. This raises the issue of where such export growth might come from. Table 2-6 shows that Kenya's exports are quite diversified, especially if exports of services, namely transport and tourism, are included. The three largest commodity exports,

Table 2-6: Export Projections, 1982-4 to 2000
(Values at constant prices of 1982-4)

		1982-4 Average		2000		
		Value (£m)	Share (%)	Value (£m)	Share (%)	Growth Rate (% p.a)
A.	Commodities					
	1. Coffee	170	17	550	24	7.2
	2. Tea	130	13	280	12	4.6
	3. Petroleum products	132	14	160	7	1.0
	4. Others	212	22	570	25	6.0
	5. Total	644	66	1560	68	5.3
B.	Services (gross)					
	1. Transport	172	18	340	15	4.0
	2. Travel	135	14	310	14	5.0
	3. Others	24	2	60	3	5.0
	4. Total services	331	34	710	32	4.6
C.	Total exports(gross)	975	100	2270	100	5.1

coffee, tea and petroleum products, account for 44% of the total, while the two large service exports add 32%; hence it takes five different products and services to account for three-quarters of Kenya's exports. Although it would be desirable to diversify away from these five exports, the concentration is not so great that further development of these major exports should be neglected. On the contrary, the need for generating export growth is so great that Kenya will pursue the expansion of any existing export commodity or service that promises sufficient returns for its investment.

2.47. Chapter 5 on Agriculture contains proposals for expansion of coffee, tea and horticultural exports, while Chapter 6 on Industry and Trade deals with the incentive structure to promote exports of manufactured goods, which have shown little real growth over the past few years. In addition, it is expected that tourism will expand at about 5 percent a year, which is below the historic rate and should be feasible. Kenya's natural attractions are becoming even better known to a wider number of potential visitors. The Government is committed to preserving these attractions and promoting growth of the tourist industry. Both the attractiveness and competitiveness of the tourist industry will be kept under review and policies adopted as appropriate to maintain the growth of the industry.

2.48. Table 2-6 shows that it should be possible to achieve 5 percent annual growth in exports (at constant prices, except for coffee and tea) if the planned major expansions of coffee and tea are fully implemented, substantial investment take place in non-traditional exports, and the targeted expansion of tourism is realized. Otherwise, neither export growth nor GDP growth targets will be feasible.

2.49. The requirement for foreign exchange to finance accelerated growth also points to further import substitution as an instrument of growth. Although the Government is establishing a more open, competitive economy and is thus in the process of reducing general levels of protection, this does not mean that it is discouraging import substitution. Rather, the distinction needs to be made between efficient import substitution in both agriculture and manufacturing that can produce goods profitably with modest protection, and the highly protected, generally inefficient substitution of the past. Kenya cannot afford the latter, because it absorbs resources that employ relatively few workers, often wastes capital, and involves high costs to both consumers and the Government. The trade policy regime described in Chapter 6 will encourage efficient import substitution that is consistent with Kenya's other goals of high employment generation, better rural-urban balance and a more competitive economy.

Public and Private Roles in a Mixed Economy

2.50. Kenya's economy is and will remain a mixed economy. Government has long recognized the indispensable qualities that the private sector brings to development. In Kenya, the private sector covers a wide range of economic activity. At its core are the small farmers and livestock herders who directly employ over half the country's entire labour force. The second largest element is the informal sector, comprising very small-scale firms and the self-employed. Agriculture and the informal sector together employ almost three-quarters of the labour force (see Table 2-3), so clearly the future prosperity of the vast majority of Kenyans depends on development of these two elements of the private sector. The third element, modern large-scale farms and firms, is important because it employs Kenyans at higher productivity than the other two sectors. To some extent, rising incomes per capita will depend on the rapid expansion of this high-productivity group of activities.

2.51. Of the total labour force, Government employs close to half those engaged for wages in the formal sector, but in turn accounts for well under 10% of the total work force. Thus on the basis of sheer size and coverage alone, the private sector must play the dominant role in revitalizing Kenya's economy. Further, only the private sector, guided by price signals and other incentives set by Government, can make and implement the myriad of decisions required to run an economy as complex as Kenya's. Moreover, Kenya's private sector includes the kind of dynamic entrepreneurship that is essential to a long period of sustained

economic growth.

2.52. Although the bulk of employment and income growth will be generated by the private sector, Kenya's development will continue to be guided by Government through a variety of instruments to ensure both rapid development and the equitable distribution of the resulting benefits. First, at the heart of development is the need to maintain a stable political and economic climate in which the private sector can operate. This is sometimes taken for granted in Kenya, because despite economic vicissitudes there has been a stable and secure political and economic environment since Independence. A second need is the provison of administrative and social services that cannot readily be provided by private enterprise. Government will retain substantial responsiblility for basic needs such as education, health, and water, although private and Harambee efforts will remain important, and for the traditional public services. In exercising this responsibility, a balance must be struck between the desirability of asking beneficiaries to contribute increasingly to the cost of social services and the Government's concern that those least able to pay still have access to such services. Third, Government will continue to provide infrastructure to support private activity of all kinds, especially activities that occur in rural areas and the expanding rural market centers.

2.53. Fourth, Government will establish the market-based incentives and regulatory structures that will channel private activity into areas of greatest benefit for all Kenyans. In doing so, Government will rely less on instruments of direct control and increasingly on competitive elements in the economy. The general outlines of this fourth function have emerged clearly over the past six years, in the Development Plans for 1979-83 and 1984-88, in Sessional Papers No.4 of 1980, 1981 and 1982, and in the past several Budget Speeches. The underlying aim is to establish an incentive environment under which private participants of all sizes in all sectors can make profits while simultaneously contributing to widely shared development in Kenya.

2.54. Elements of this strategy have included a flexible exchange rate policy that maintains over time sufficient rewards for exporting of all commodities and for efficient substitution for imports; farm prices that enable small and large farmers to earn adequate incomes to cover increases in the costs of inputs and the cost of living, thus moving towards greater food security and an improved rural-urban balance; import tariff and licensing policies that reduce the costs of imported inputs and gradually achieve more moderate levels of protection, thus inducing industry to improve its efficiency and ability to compete in world markets; wage guidelines that contribute to reduced inflation and encourage employment creation, and contain the income disparity between wage workers in the modern and informal sector; interest rates that ensure returns to savers exceeding the rate of inflation and also that select from among potential borrowers only those with high-productivity uses for their funds; and, in general, prices that reflect real scarcities and thus influence

users to conserve on those commodities, such as petroleum and wood fuels, that are most scarce and therefore most costly to the economy. Government will also carefully scrutinize industry to ensure that resource allocation is not distorted by actions in restraint of trade such as monopoly exploitation. A vigorous private sector, responding to the incentive signals established by this strategy, will earn profits while contributing to accelerated growth, employment creation, improved rural-urban balance and enhanced food security.

2.55. A central purpose of this Sessional Paper is to spell out in detail the policies that have already established such an economic incentive environment, to extend these policies in certain areas, and to indicate ways in which implementation needs to be improved to make existing policies more effective. Suggestions along these lines are contained in Chapters 4 to 6.

CHAPTER 3: FISCAL AND MONETARY POLICY FOR RENEWED GROWTH

Goals for Fiscal Policy

The tasks for fiscal policy to the end of this century are inherent in the macroeconomic framework of the previous chapter. First, the budget must stabilize the economy, dampening any inflationary tendencies. To accomplish this, the budget deficit must be reduced gradually to a level not exceeding 2.5% of GDP at market prices. Second, Government must begin to contribute to gross national saving by restraining its expenditures in order to yield surpluses of current revenue over current expenditure. Third, Government will reduce its claim on private credit markets so that private investment can be financed increasingly from domestic sources. Fourth, Government must constrain the growth of public debt to manageable levels, to avoid an increasing drain on the balance of payments and to ensure that sufficient revenues remain available after debt service payments to finance necessary expenditures. Fifth, Government will ensure that allocations are adequate to implement the development priorities announced in subsequent chapters of this Sessional Paper. This is likely to require a significant reallocation of resources so that directly productive activities, especially agriculture, and carefully targeted infrastructure expenditures, especially those intended to promote rural-urban balance, obtain larger shares of total budgetary outlays than has been the case in recent years. Sixth, Government will ensure that all its investments become productive as soon as possible through a programme of budget rationalization described below. Finally, both fiscal prudence and the need to fund priority development expenditures may require some increases in the level of taxation relative to GDP. This level has been falling in recent years.

Fiscal Projections to 2000

3.2. These fiscal goals lead to projected budget outturns that are shown in Table 3-1. All such projections are approximate, of course, especially those for the end of the century. But even approximate estimates reveal several crucial features that will constrain Government's budgetary outlays and determine its budget policies for the rest of the century. First, estimates of ordinary revenue, dominated by tax collections, reveal a much lower share of GDP for 1985/6 compared to the levels of the early 1980s, when ordinary revenue approached 25% of GDP (lines 1 and 9 of the table). This decline is caused in part by tax changes consistent with Kenya's structural adjustment policies, especially reduced import tariffs. The projected rise of revenues to 24% of GDP by 1999/2000 will require adjustments in the tax structure, discussed below.

Table 3-1: Budget Projections, 1984/85 - 1999/2000
(£ million in prices of 1984/85)

	1984/5 Prov'l Actual	1985/6 Printed Estimts	1999/2000 Projected	Growth rate(%p.a.) 1984/5 - 1999/2000
1. Ordinary revenue (including A-I-A)	1009	1030	2490	6.2
2. Foreign grants	79	102	154	4.6
3. Total revenue(1+2)	1088	1132	2644	6.1
4. Deficit target	235	198	259	0.7
5. Total sources(3+4)	1323	1330	2903	5.4
6. Less: CFS(interest + pensions)	201	207	541	6.8
7. Total ministry expenditure (5-6)	1122	1123	2362	5.1
8. a. Recurrent	790	770	1663	5.1
b. Development	332	353	699	5.1
Share (%) of GDP				
9. Ordinary revenues	21.8	21.3	24.0	
10. Deficit	5.1	4.1	2.5	
11. Ministry expend.	24.2	23.3	22.8	
a. Recurrent	17.0	16.0	16.1	
b. Development	7.2	7.3	6.7	

3.3. Second, the deficit target of 2.5% of GDP by the end of the century (Lines 4 and 10), combined with modest growth in revenue, puts a constraint on the growth of total resources available to finance Government expenditures. Line 5 of the table shows that total resources will grow at only 5.4% a year, slightly less than projected GDP growth of 5.6% a year.

3.4. Third, deficits of past years have their continuing impact in the form of Government's growing obligation to service its debt. This obligation could only be reduced if Government runs a surplus for a substantial period. But that of course would cut into total resources available for expenditures for several years. Pension payments are an obligation of Government to retired civil servants and must also be honoured. Thus debt service and pension payments--which will rise at close to 7% a year until 2000--will continue to soak up growing shares of Government revenue (Line 6).

3.5. Fourth, the result of these forces is a limit to the potential growth of total ministry expenditure, shown as 5.1% a year to 1999/2000 (Line 7). But expenditure growth will be even

slower over the current forward budget period to 1988/9. Thus Government spending, which is projected to fall from 24.2% to 22.8% of GDP, will exert a slight drag on an economy projected to grow at 5.6% a year. This is consistent with the policy of encouraging the private sector to play a larger role in development.

Revenue Reform

3.6. The revenue projections of Table 3-1 imply changes in tax structure in order to increase collections to 24% of GDP by 1999/2000. To achieve this, the Ministry of Finance will soon undertake a comprehensive study of the tax system. The revised tax structure will meet the following criteria:

(1) Revenues should be raised to 24% of GDP over a number of years in order to permit expenditure to grow at an average 5% a year from 1984/5 to 1999/2000.

(2) The tax structure should favour saving and investment, thus placing the greater burden on taxation of consumption. Any disincentives to investment will be removed.

(3) The tax structure will have to promote rural-urban balance and meet other goals of an equitable distribution of income.

(4) The new structure must advance Kenya's structural adjustment by extending recent changes, especially in import duties and export compensation, that make industry more competitive; reductions in Preferential Trading Area import duties are among the more important changes to be accommodated.

(5) Tax revenues must be responsive to changes in GDP, so that Government revenues will keep pace with income growth without annual changes in rates.

(6) Taxes must be collectable and enforceable at low cost. Administration of all taxes must become more effective and efficient in collecting all revenues due. Although improved collection of existing taxes will increase revenue, this will not be sufficient by itself to meet Government's revenue target.

Participant Support

3.7. Even with revenue reforms, Government's resources will remain limited. At the same time, the entire thrust of this Sessional Paper is to shift resources toward growth-producing activities. Yet Government remains committed to doing as much as possible to ensure that both social and economic services are widely available to the public.

3.8. The only way out of this dilemma is to involve those who participate in Government services increasingly in financing the recurrent costs of these activities. Government has long charged fees for certain services. The coverage and level of these charges will be reviewed in specific cases where participant support has fallen behind the level of costs and the ability to pay; and certain new charges will be considered. In this Sessional Paper, specific proposals are made to increase the extent of participants' support, especially for services provided by local authorities, for livestock development, and for agricultural research.

3.9. If the strategy proposed in this Paper is successful in generating widespread economic growth, then families will have larger incomes from which to help support these services. However, in implementing measures to increase participant support, care will be taken to ensure that, while those who can pay will do so, no one will be denied access if they are genuinely unable to afford the fees. Moreover, it will be essential to convey to all participants precisely how they can benefit from the services being offered.

Harambee

3.10. Harambee activities have made a major contribution to development projects since Independence. Over the years, Harambee has provided capital equalling between 4 and 10 percent of Government's annual development expenditures. Many schools, clinics, and other facilities would not exist today without Harambee efforts. Government has already taken steps to ensure that these contributions continue to be used for their intended purposes by providing for the audit of Harambee funds.

3.11. Audit of funds makes possible a desirable innovation: the use of Harambee to support the recurrent costs of projects. At present, the operating costs of many Harambee projects are assumed by Government. But budget constraints and budget rationalization (see next section) will make that increasingly difficult. However, aid donors, though reluctant to finance recurrent costs, are ready to cover the capital costs of projects. If Harambees can be organized to raise finance for recurrent costs, then Government can seek donor support for the capital costs of projects. It is likely that more Harambee projets will be completed and fully utilized under these arrangements, contributing to the overall productivity of Harambee activities. Funds raised for the support of recurrent costs could be invested in Government securities or in savings accounts and the interest (plus a share of the principal) would be used each year to cover operating and maintenance expenditures.

Budget Rationalization

3.12. Two major changes in the allocation of budget resources will be implemented over the next several years. First, for reasons suggested in the previous chapter, it is imperative that Government begin spending proportionately more on immediately productive services. The following three chapters will propose strategies for rural-urban balance, agricultural development and small-scale industrialization that will require substantial new commitments of Government funds to both recurrent and development expenditures. Government will have to increase its outlays on infrastructure to promote the growth of smaller towns and rural centres, including roads, power and water supplies; on agricultural research, extension services, tea and coffee planting programmes and other projects to raise agricultural production; and on secondary polytechnics and credit programmes to assist very small-scale industry and services in both rural and urban areas. These expenditures will receive the first priority in allocations for future budgets.

3.13. As a consequence, the share of formal education, health and other basic needs expenditures will necessarily fall from their current levels. Government has been concerned about the rate of growth of expenditures on education since 1975. In previous development plans and sessional papers, Government has stated its intention to limit recurrent expenditures of the Ministry of Education, Science and Technology to 29 percent of ministries' recurrent expenditures. However, the institution of the 8-4-4 system has caused the share to rise to 34 percent in 1985/6, excluding another 4 percent spent on training programmes managed by ministries other than Education, Science and Technology. The share of the Ministry of Education will be reduced gradually to 30 percent, while that of the Ministry of Health will be reduced from 9 to 8 percent.

3.14. These reductions in budgetary share could be accomplished within three years without any decline in the real level of expenditure on education and health, so long as the overall level of ministry expenditure grows at the targeted 5 percent a year. The Presidential Working Party on Education and Manpower Training for the Next Decade and Beyond will study and recommend to Government precise means by which reductions in the budgetary share for education can be effected and the time it should take. The terms of reference for this study should include:

(1) the potential for and desirability of increasing fees for higher education.

(2) the potential for delivering education services using proportionally fewer facilities and fewer teachers in relation to the number of students;

(3) feasible rates of expansion at all levels of education; and

(4) the importance of increasing the proportion of students receiving vocational and technical education through secondary polytechnics.

To effect a reduction in the budgetary share of expenditures on health, a working party under the Ministry of Health will study and make recommendations to the Government on methods of reducing costs through improved management of health facilities and the health care system.

3.15. The second major change in budget allocations will involve a concerted effort to make all Government outlays more efficient and thus productive through a process of budget rationalization. Direct investments by Government through the development estimates have been suffering a severe decline in productivity. During the past few years of stringency, the development budget has grown more slowly than recurrent expenditure. In response, there has been a tendency to stretch out project completion over time, spreading shrinking funds over the same or a growing number of projects. This not only delays the benefits of all projects, but frequently increases their costs and even prevents some projects from ever being completed. At the same time, completed development projects require recurrent outlays that cannot be financed from the current revenue base, rendering these projects less productive than they might be.

3.16. In order to raise the productivity of Government investment in development projects, the Ministries of Finance and of Planning and National Development are undertaking budget rationalization, with the following goals:

(1) Projects with potentially high productivity (high benefit-cost ratios) will be identified and their completion will be advanced with an infusion of funds.

(2) Projects with low potential benefits will be identified and postponed or cancelled to free up funds for projects with higher rates of return.

(3) The recurrent expenditure implications of completed or almost completed development projects will be assessed and sufficient resources set aside to fund these expenditures in the coming years, to improve the utilization of completed facilities. This implies a shift of resources towards operation and maintenance expenditures of existing public existing facilities and away from investments in new projects.

(4) New development projects will be funded only if they are productive investments with a very high priority.

3.17. The general approach, then, is that available resources for the development budget will be concentrated on fewer projects to shorten the construction or implementation period,

instead of spreading them too thinly across a large number of under-funded projects. At the same time, recurrent allocations will be concentrated to improve the utilization of existing capacity and thus raise the productivity of public investments. Reforms in budget procedures and in project data management are already being implemented to support budget rationalization. Aid donors are being asked to co-operate with this approach by shifting funds from less to more productive projects; by financing recurrent costs of the projects they support; and by shifting from loan to grant financing.

Government Employment

3.18. Government has been employing people at an unsustainable rate. Between 1974 and 1984, total wage employment in Central Government rose by 7.4% a year (excluding teachers), compared to only 2.8% in the private sector. Government has been doing much more than its share to employ labour force entrants. The emphasis on private sector growth must and will shift this balance, so that over the next 15 years private employers will create jobs for the majority of entrants to modern sector, wage-earning employment.

3.19. Such a shift is necessary from another viewpoint: Government productivity. Outlays on salaries as a share of ministries' recurrent expenditure has grown steadily since 1979/80, when salaries equalled 47% of ministries' recurrent outlays, to 1984/5, when the share reached 60%. With Government employment growing much faster than revenues measured at constant prices, this fraction will rise over time. In some departments of Government it has already risen to critical levels. For example, salaries as a share of total expenditures in the research services of the Ministry of Agriculture range from 60 to 80%, while they exceed 90% of the allocations for the extension services (Chapter 5). With salaries absorbing so much of expenditure, there is not adequate provision for complementary resources, such as transport, typewriters, even paper and pencils, that are required to make these officers productive. Unless a better balance between personnel costs and complementary outlays is achieved, the productivity of many branches of Government will fall below acceptable levels. Eventually, many services may cease to be offered at all, while officers continue to draw salaries.

3.20. Government's productivity problem is made worse because the growing numbers of civil servants make it more costly to raise salaries. Consequently, civil service incomes fall behind those of private and parastatal firms, so that Government has more difficulty keeping its most senior and qualified officers, who contribute most to productivity gains through their managerial or technical abilities. This tendency is reinforced in many ministries because the number of non-technical and subordinate staff is considerably higher than required to support senior and technical officers. Additional staff in these grades

will not contribute to higher productivity.

3.21. Much of the problem of excessive expenditures on personnel can be traced to the current practice of guaranteeing employment in Government to all students who complete courses at Government training institutions. In 1983 there were approximately 32,000 such students. If half of them graduate each year, this adds about 4% annually to total wage employment in Government (including teachers). The recent practice of offering jobs to all University graduates adds to this figure.

3.22. To reduce the unsustainable growth of the civil service, the following measures will be taken:

(1) Employment in Government will be based on merit and achievement and will no longer be guaranteed for those graduating from Government training programmes, nor will all University graduates without private sector jobs be offered Government employment. The numbers actually hired will be reduced gradually to a sustainable level, consistent with available resources, staffing needs, and the required productivity growth of the civil service. Graduates will be encouraged instead to seek jobs in the private sector, where employment will be expanding, and Government will assist diploma and college graduates to find private sector positions.

(2) The intake of students into Government training programmes will be reduced commensurate with the number actually to be hired by Government plus those expected to find placements in the private sector. Training institutions will revise their curricula to impart skills and attitudes that prepare students for work in the private sector as well as in Government. Government will consider appropriate expansions of University places in engineering, business and other departments that prepare students for private sector jobs.

(3) Within Government, manpower will be redeployed to Districts consistent with District Focus for Development.

(4) Government will review its staffing requirements, job descriptions and evaluations to reduce overstaffing and increase productivity. The need to perform specified work productively will in future guide decisions on the number of civil servants to hire in any year.

3.23. The policy of containing the growth of Government hiring is aimed at reducing the share of labour costs without compromising economic growth. In fact, unless these policies are implemented, Government will become increasingly unable to contribute to growth. A reduced growth rate for the civil service does not mean reduced total employment. It does mean that a larger share of total resources will be devoted to expenditures

that make civil servants more productive. Thus Government will be able to provide the same or more services with a shrinking share of the wage labour force. With the renewal of economic growth under the policies announced in this Sessional Paper, the private sector should expand rapidly enough to employ most of those who might, under current policies, have been hired by Government. Indeed, a major implication of the development strategy outlined in this Paper is to encourage graduates of all kinds to look first to the private sector, either as wage employees or as self employed.

Financing of the Government Deficit

3.24. Budget projections for 1985/6 to 1988/9 show total deficits of some £775 million in 1984/85 prices over the four years. Some of that total, perhaps up to £200 million, may be obtained as net loans from external sources, leaving some £575 million of net finance to be raised in domestic markets. Since substantial amounts of Government debt mature over this period and have to be repaid, Government gross borrowing will be considerably larger. This demand for credit from the Government competes with demand for credit from the private sector. Over the past several years, between one third and one half of all bank credit has gone to finance budget deficits. If the private sector is to play its role in renewing economic growth, it is essential that Government does not absorb an excessive share of financial resources.

3.25. To create an appropriate framework for allocating financial resources between the public and the private sectors, and also within the private sector, monetary policy will continue to move towards a greater reliance on market forces. In obtaining finance for Government, the following principles will be applied:

(1) To the greatest extent possible, finance will be sought from non-inflationary sources, i.e., from institutions and markets other than the Central Bank and the commercial banks.

(2) To lengthen the maturity of the government debt, long-term finance will be sought.

(3) Secondary markets will be developed for government debt to increase the liquidity of this debt and thus make it more attractive to hold.

(4) To minimize the distorting effects on financial markets of Government debt operations, Government will develop an effective system for the competitive marketing of Treasury bills.

3.26. Finance for Government's budget deficit has traditionally been obtained by using "captive markets" for Government debt. These markets have been established by regulations which direct banks, non-bank financial intermediaries (NBFI) and other institutions to hold a certain proportion of their assets in government debt. For example, the commercial banks are required to maintain a certain ratio--currently 20%--between specific assets, of which Treasury bills constitute the major part, and total liabilities (mainly deposits). In addition, the National Social Security Fund (NSSF) and the Post Office Savings Bank invest in government securities according to guidelines provided by Government and their investment committees.

3.27. There are two principle instruments of government debt, short-term Treasury bills and medium- to long-term government bonds. The Central Bank sells these bills and bonds on behalf of the Government at predetermined interest rates. The issue rate for Treasury bills sold to commercial banks is currently 12.5% per annum, while all other issues of Treasury bills carry a 15.5% interest rate. Dealings in Treasury bills and Government bonds take place almost entirely through the Central Bank; no secondary market has developed. This means that holders of Government bills and bonds cannot easily sell those assets if they need to. As a consequence, Government bills and bonds are regarded as very illiquid and therefore less desirable than if they could be traded in an active secondary market.

3.28. Several institutional improvements will be made to facilitate Government debt operations and to realize the aims outlined above. Their implementation will be a gradual process involving close cooperation among the Treasury, the Central Bank, and the private financial institutions.

(1) The rules for issuing and trading in Treasury bills will be revised to develop an effective system for the competitive marketing of Treasury bills, so that forces of demand and supply can play a greater role in determining the price and thus the interest rate for such bills. Efforts will also be made to develop a secondary market for holders of Treasury bills. Similar steps may be taken for Government bonds.

(2) A wider variety of maturities of Treasury bills will be offered, such as 180-day and one-year bills.

(3) Information will be collated and published on the volume of new issues and on secondary market trading for public and private money market instruments.

(4) The establishment of full service brokers will be encouraged. Initially, dealers may act as discount houses, specializing in money market instruments.

(5) A Capital Market Development Authority will be established and eventually transformed into a permanent authority responsible for market development and regulation.

These changes will require open discussion and mutual trust between public institutions and the private sector. As a first step, to initiate discussion of these matters, the Government will issue a study entitled "Money and Capital Markets in Kenya."

Interest Rate Policy

3.29. Recent years have seen a general increase in interest rates so that for the first time in over a decade, most interest rates are positive in real terms, i.e. they exceed the rate of inflation. The Central Bank has initiated this upward movement in interest rates in order to contain inflationary pressures and to help protect the balance of payments. Government will maintain positive real interest rates and use interest rates actively to promote monetary stability and economic growth. Since the rate of inflation varies over time, sometimes sharply, it is important that nominal interest rates can be moved flexibly in response to the inflationary situation. Once Treasury bills and Government bonds are sold in more competitive markets, the resulting rates may be used as guideposts for determining the level of interest rates for bank deposits and loans, which may then be set in ranges of permitted rates rather than as single fixed rates.

3.30. The gap in interest rates between banks and non-bank financial institutions (NBFI) will be kept under review to ensure competition on equitable terms. Maximum lending rates for commercial banks are five percentage points lower than those for NBFI and deposit rates are also substantially lower in commercial banks. These differentials have enabled the NBFI to attract a significant part of commercial banks traditional business and thus to expand rapidly at the expense of the banks. Government will eventually adjust interest rate regulations for banks and NBFI to harmonize their competitive situation.

3.31. The development of broader markets in Government debt will take time and require some changes in banking legislation. It will also be a gradual process because the financial institutions will need to adjust to a different monetary environment as relative interest rates change. As a broader market for Government debt develops, with interest earnings on Treasury bills and bonds moving more freely, there will be a need to adjust lending and deposit rates more frequently in the banks and NBFI. These changes will be made at the initiative of the banks within a range announced by the Central Bank. The growth of bank lending to the private sector will eventually be determined by the prevailing interest rate; quantitative credit ceilings will become less relevant.

3.32. Although the changes in monetary policy instruments as sketched out above can only become effective gradually, it is important that a beginning be made. It is easier to initiate these changes at a time which Government's demand for finance (i.e. the budget deficit) is relatively small. Five years ago, when the budget deficit was equivalent to over 10% of GDP, a more market-oriented system would have pushed interest rates to levels which would have been harmful to the Kenyan economy. At present, the budget deficit is running at about 4% of GDP and will be falling in the next few years, so that Government's financing needs are much easier to accommodate.

3.33. It is difficult to predict how interest rates will move in a system such as that outlined here. Three important factors are worth bearing in mind. First, the size of the budget deficit and thus the need for government finance will be important in determining the level of interest rates; the larger the budget deficit, the higher will be the demand for credit from the government, causing upward pressure on interest rates, and vice versa. Second, the increased competition among banks and NBFI envisaged here will most likely lead to a lowering of lending rates compared to those now prevailing in the NBFI. Third, the rate of inflation will be an important determinant affecting interest rates once they are allowed to move more in line with market forces.

3.34. It is important to emphasize, however, that the Central Bank will retain a crucial role in determining monetary policy, primarily through its influence over interest rate levels. In fact, a monetary policy framework as outlined here, with a heavy reliance on interest rates as the main instrument of monetary policy, will give the Central Bank a stronger position to control monetary conditions than the complex set of regulations now in force.

Developing the Financial System

3.35. Chapter 2 emphasized the crucial importance, not only of raising more saving in Kenya, but of channelling savings towards the most productive investments. Only by increasing the productivity of Kenya's saving and investment can growth be renewed, incomes raised and employment generated. The allocation of savings between the public and private sector, and within each towards its most productive uses, is the central role of the financial system.

3.36. Kenya has a well developed financial system for a country of its income level. In addition to the Central Bank, the financial system includes 24 commercial banks, 48 non-bank financial intermediaries (NBFIs), more than 30 insurance companies, a postal savings bank, a social security system, numerous pension plans, six industrial development banks, other specialized institutions lending to agriculture, tourism and housing, a stock exchange, and over 900 savings and credit cooperative

societies. Linkages between financial institutions and the rest of the economy are well established. The objectives of economic growth and development will be served best by policies which encourage an improvement in efficiency and equity in the financial system and by increased innovation in establishing lending forms which can assist the growth of the private sector.

3.37. The present structure of Kenya's financial system is the result of a number of policy decisions taken over a long period of time. An important influence has been the need to secure financing for Government budget deficits. But a number of other policy motives have been embedded in the structure of legislation which now governs the banking industry. One result of this regulatory framework is that the financial system caters excessively to short-term financial needs. This is partly the result of interest rate regulations, which severely affect the commercial banks. The gradual freeing of interest rates will shift funds toward longer term uses. Two other areas require attention:

(1) A market should be developed in short-term private financing.

(2) Capital markets must be broadened and policies modified to provide more long-term finance, including risk capital, for industry.

3.38. To complement the market in Treasury bills, consideration will be given to the creation of private money market instruments. A money market based exclusively on Government paper will lack diversity and probably efficiency and so would not benefit the private sector. Government will therefore allow banks and NBFI that meet prescribed criteria to issue bearer negotiable certificates of deposit as a first step in introducing private instruments. Other private sector instruments, such as bankers' acceptances and commercial paper, can then be introduced over time.

3.39. The capital market, i.e. the market for long-term savings and loans including the supply of risk capital, is relatively underdeveloped in Kenya. Some of the development finance institutions are in a weak financial condition there is no market for private securities (bonds), and the Stock Exchange is not very vigorous. Government intends to strengthen the capital market so that more long-term savings will be raised for the financing of long-term investment; more equity (risk capital) will be available for entrepreneurs; more small savers will benefit from economic growth because of broader ownership of productive assets made possible through a securities market; and more market pricing of capital will lead to a better allocation of savings and thus to more productive investment.

3.40. A prerequisite for a broadening and strengthening the capital market is sound fiscal and monetary management. In addition, there are some legal and institutional weaknesses to

overcome:

(1) The financial situation of the development banks is weak. A restructuring of these companies may be necessary, perhaps involving a consolidation of some of them.

(2) Many industrial companies, both public and private, suffer from a very narrow equity base and a proportionately large volume of loan capital, often short term. This makes them--and the entire economy--unnecessarily vulnerable to changes in market conditions at home or abroad. A more active Stock Exchange and the provision of longer term funds from financial institutions would improve this situation.

(3) Commercial banks and non-bank financial institutions tend to extend credit primarily on the basis of formal security (collateral) while ignoring the assessment of the credit-seeking firm's economic potential. Security and collateral procedures and criteria should be reviewed by the banks. Bank staff will have to be trained to assess the financial viability and the economic growth potential of firms--especially small, newly established firms--seeking bank loans.

3.41. Business firms in Kenya rarely raise capital through public issues of equity and debt securities. The main sources of local equity for new investment are retained earnings of corporations, savings of family groups, direct government investment, and the development banks. For debt financing both parastatal and private firms rely to a large extent on direct borrowing, largely through bank over-drafts. Since 1977, there has been only one issue of corporate equity. There is thus a need to develop a primary market in private securities and to reactivate the Stock Exchange to allow secondary trading in long-term securities.

3.42. To develop a more active capital market, the following steps will be taken:

(1) The Capital Markets Development Authority, mentioned above, will be given powers to provide regulatory measures for the improvement and proper functioning of fair and orderly markets. These would include (a) disclosure of corporate and market information, both in public offering prospectuses and on a continuing basis; (b) adequate organization and self-regulatory duties of the Stock Exchange; (c) registration of securities professionals such as brokers; and (d) protection for investors.

(2) The tax reform study announced above will include questions relating to taxes on interest payments, corporate profits and dividends.

(3) The above mentioned study on capital market development will be published as a background document for discussions between the Government (primarily the Central Bank and the Treasury) and the private sector.

3.43. A programme with such breadth, necessarily conducted over several years, requires sustained commitment. Yet the results may neither be immediate nor always apparent. It is in the nature of financial markets that they depend on private initiative and ideas. The Government will provide a supportive environment and will work actively with the private sector to help develop a financial system that is conducive to more rapid economic growth.

CHAPTER 4: RURAL-URBAN BALANCE

A major objective of the District Focus Strategy is to promote more rapid economic growth in the rural areas. Central to such growth is the promotion of an improved balance between rural and urban development. The District Development Committees can, by setting their priorities in accordance with the guidelines elaborated in this chapter, ensure that their investments will take full advantage of the opportunities for small town and secondary city development that will arise from a rapidly growing agriculture.

4.2. More rapid rural development is not so much a matter of choice as a national imperative. By 2000, the urban population will reach 9 to 10 million--26 to 29% of the population--compared with 3 million in 1984, only 15% of the population. Where are these additional 6 to 7 million inhabitants going to settle? In the past, close to half the increase in urban population has arisen from the natural population increase and boundary expansions of existing cities and towns, while the other half has come from rural-urban migration and from residents of small towns that have become urbanized as they cross the definitional threshold of 2000 inhabitants. Over the next fifteen years, however, it is anticipated that migration from rural areas will account for a larger proportion of the growth of urban population.

Table 4.1: Urban Population, 1969-2000 (millions)

	Census Data			Projections		
	1969	Growth (% p.a)	1979*	1984	Growth (% p.a)	2000
Total population	10.94	(3.9)	16.03	19.48	(3.7)	34.79
Projection A:						
Urban pop'n	1.07	(7.1)	2.11	2.98	(7.1)	8.91
(% of total)	(9.7)		(13.2)	(15.3)		(25.6)
Rural pop'n	9.87	(3.5)	13.92	16.50	(2.9)	25.88
(% of total)	(90.3)		(86.8)	(84.7)		(74.4)
Projection B:						
Urban pop"n					(8.0)	10.21
(% of total)						(29.3)
Rural pop'n					(2.5)	(24.58)
(% of toal)						(70.7)

* Census data corrected for underenumeration.

4.3. The development strategy outlined in this paper hinges crucially on avoiding the concentration of this population in Nairobi and Mombasa, and in shifting emphasis towards the vigorous growth of secondary towns and smaller urban centres throughout the country. A more dispersed pattern of urban development, which includes the rise of new market centres throughout rural areas, is essential to support the expansion of agriculture and to facilitate the growth of related off-farm employment opportunities.

4.4. A central component of the larger effort towards renewed economic growth in Kenya is thus a strategy for the balanced development of rural and urban areas. The primary aim of this strategy is to promote the development of an urban system that supports the growth of agriculture and the development of rural areas, and that generates productive employment opportunities in non-farm activities for rural workers close to where they already live. The main objectives are: (1) to avoid the excessive concentration of population in Kenya's largest cities; (2) to promote vigorous growth of secondary towns and smaller urban settlements through the development of agriculture; (3) to foster productive linkages between agriculture and other sectors of the economy, between rural areas and local service centres, market towns, gateway towns, and secondary cities; and (4) to bring renewed economic growth to all regions of the country, so that even the least developed regions can share in the general growth of the economy.

4.5. To achieve these objectives, the Government will do three things:

1) It will concentrate scarce resources for urban infrastructure in selected small towns, designated Rural Trade and Production Centres (RTPCs), designed to provide a range of basic physical infrastructure and facilities to support agriculture and other productive, employment-generating activities.

(2) Government will strengthen local authorities to enable them to provide competent administration and management of growing rural centres and will provide them with sufficient resources to develop, operate and maintain these centres.
(3) Government will promote the growth of productive non-farm employment opportunities in rural centres, primarily in small-scale manufacturing and commercial activities, the bulk of which will be in the informal sector.

4.6. While these initiatives will contribute to the goal of balanced rural-urban development, their success depends crucially on the broader set of policies outlined in chapter 5 to raise agricultural production and increase farm incomes. Balanced rural-urban growth begins with agriculture since that is where more than 70% of all Kenyans are employed and where 30% of Gross

Domestic Product is produced. Farmers with rising incomes will demand a wide range of urban-based goods and services. This demand, spread widely throughout the country, will stimulate non-farm activities in secondary towns and smaller urban centres, thereby helping to curb the concentration of urban population in a handful of the largest cities.

Growth Centres and Infrastructure.

4.7. Rising productivity in agriculture is closely linked to the growth of small towns and rural centres. Just as a productive agricultural region promotes the growth of towns and villages in its midst, so a vigorous urban centre spurs economic growth in the surrounding rural areas. Such centres offer a wide range of materials and services needed to raise agricultural productivity, provide retail and wholesale markets for farm products, stimulate demand for crops and cottage industry goods produced in the surrounding area, and create employment opportunities for both urban and rural residents, which in turn generates remittances for rural relatives to invest in farm activities.

4.8. Some of the many possible employment-creating linkages between farms and small urban centres will include: the collection, transport and distribution of milk; small-scale milling of maize, wheat and other grains; coffee drying and tea processing; marketing of meat products, including the collection of livestock from semi-arid areas in gateway towns and distribution to consumers in nearby farming communities; wholesaling and retailing of farm inputs, especially seeds, fertilizer, insecticides and implements; production and marketing of simple consumer items, such as processed foods, clothing and footwear; manufacture of simple metal products, such as jikos and pans; fabrication of simple capital goods such as rain collection systems and storage tanks; construction of housing under revised building standards, of water supplies and farm-to-market roads; transport of all kinds; and the repair and maintenance of vehicles, farm implements, and processing machinery. These are only some of the most obvious linkages. Others will arise as demand grows, artisans learn new skills, and entrepreneurs realize new opportunities.

4.9. This chapter proposes means to foster these many linkages, through investments in infrastructure, financial and managerial support for local authorities, and measures to stimulate small-scale, often informal sector manufacturing and services. The first element in the strategy for rural-urban balance is infrastructure to promote the further expansion of small rural centres, the larger towns and small cities serving rural areas. Yet the evidence in recent years shows clearly that the provision of basic physical infrastructure has been lagging behind the increase in urban population. Given the limited resources available for new investment, hard choices have to be made about which towns, which parts of the country, and what kinds of infrastructure should be given priority.

4.10. Since the 1970s, the Government has targeted particular cities and towns as growth and service centres: the Fourth Development Plan identified and classfied some 1800 urban and rural settlements throughout the country and the Fifth Plan mentioned seventeen towns for priority consideration. To steer investments towards preferred locations, the Government will take steps to coordinate the preparation of plans and budgets at three distinct levels: at the national level, in the allocation of funds among major sectoral ministry programs and regions of the country; at the district level, in guiding the preparation of district annexes by the DDCs; and at the level of municipalities and other local authorities, in the preparation of Local Authority Development Programs.

4.11. Over the coming years, Government guidelines to DDCs and local authorities will place greater emphasis on building infrastructure that helps the private sector to create more productive employment in small towns and market centres. These Government guidelines will incorporate three general principles: giving priority to infrastructure that supports productive activities; strengthening linkages between secondary towns; and channelling resources to small urban centres of high potential.

4.12. Stress infrastructure in support of productive activities. Priority in the allocation of Government funds will be given to infrastructure investments that promote the growth of production and employment in small-scale agro-industry, manufacturing, and commercial enterprises. Without jobs and rising incomes, communities can scarcely afford investments in basic human services. With expanded employment and income, resources become available to support health, education, and other social facilities to serve the local population, either through local taxation, user charges for services provided by public authorities, or more generous harambee contributions from within the community. Towards this end, DDCs will be urged to support the growth of production and employment-generating activities in Kenya's small towns and market centres by giving priority to such investments as farm-to-market roads, market and storage facilities, power, water, and serviced sites for small-scale enterprises.

4.13. Strengthen links between secondary towns. Urban growth in Kenya is concentrated along the Mombasa-Nairobi-Uganda highway. Cities and towns that are distant from this "main street" are handicapped in attracting productive, employment-generating enterprises. To encourage the growth of these towns and to improve their access to larger regional markets, the Government will seek to expand this main street by upgrading highway links between a few selected secondary towns lying on either side, and by strengthening telecommunication linkages between growing urban areas throughout the country. Such transport and communications investments will be based on the potential for stimulating productive activity between towns and along the routes between them.

4.14. Channel resources to smaller urban centres with potential. While larger towns incorporated as municipalities and town councils have access to their own source of funds for infrastructure through the Local Government Loans Authority (LGLA), as well as internally-generated revenue, smaller urban centres depend on the county councils and central ministries through the District Development Committees. From the perspective of a strategy for rural-urban balance, it is vital that the limited resources available to DDCs are not spread too thinly across many towns, but be concentrated on urban settlements with the best potential over the long term to support economic growth and to generate employment in their region.

Rural Trade and Production Centres.

4.15. To facilitate the growth of these small towns in support of agriculture and other productive activities, the Government will launch a programme entitled Rural Trade and Production Centres (RTPCs). The purpose of this programme is to concentrate scarce resources for urban infrastructure in a limited but growing number of selected rural centres which have the best potential for supporting agriculture and its linked productive activities, including processing, manufacturing and services. The concentration of resources in a rural centre over a limited period of three or four years is designed to remove obvious bottlenecks in physical infrastructure, to maximise the aggregate impact of individual projects, and to yield greater benefits and financial returns.

4.16. Between now and the year 2000, the programme will aim to encompass a total of about 200 Rural Trade and Production Centres. The programme will take a year or two to get started; the first projects may be completed by 1990. From that year on, the goal is to complete some twenty projects each year. The target total of 200 rural centres covered under the programme compares with a 1979 total of 91 urban centres having a population of more than 2000. Half of these, about 45, would be eligible as Rural Trade and Production Centres, which means it would be possible to cover an additional 150 smaller centres, of which some 80 to 100 are likely to pass the threshold of 2000 inhabitants by the year 2000.

4.17. Based on guidelines prepared by the Ministry of Planning and National Development and the Ministry of Works, Housing and Physical Planning, District Development Committees will identify and rank a short list of towns and villages to be officially designated Rural Trade and Production Centres. Depending on the population of the District, each DDC can expect to undertake the promotion of at least one but no more than five of these rural centres at any given time. Typically, a Rural Trade and Production Centre will be an existing town or village with a 1979 population below 5,000 inhabitants, constituted either as an urban centre or simply as a trading centre under the jurisdiction of the county council. Municipalities and town

councils are already, or soon will be, required to prepare their own Local Authority Development Programmes, with the assistance of the Ministry of Local Government.

4.18. DDCs will be guided to select as RTPCs those settlements where a package of investments is likely to yield the maximum impact and benefits. Initially, it is anticipated that priority will be given to larger settlements that lack one or two key elements of basic infrastructure, such as a telephone service, adequate road links, or a marketplace; later, priority will shift to rapidly growing smaller settlements which may lack many or most of the basic elements of physical infrastructure.

4.19. In collaboration with local authorities, DDCs will prepare for each Rural Trade and Production Centre an investment package of essential basic infrastructure required to support agriculture and other productive activities, which can be carried out over a period of three to four years. This package should be restricted to essentials only and typically would include some combination of rural roads, water, power, post office, telephones, youth polytechnics, markets, and other facilities directly related to agriculture or small scale manufacturing and trading enterprises. It would specifically exclude social services such as schools and health facilities. The total cost of any package will be held within specified ceilings related to the size of population and/or productive activities.

Budget Allocations for Urban Infrastructure.

4.20. To ensure that resources for urban infrastructure are allocated according to these four principles and channelled into Rural Trade and Production Centres, the Ministry of Planning and National Development will work with key ministries, local authorities, and the DDCs to explain the objectives of policies for rural-urban balance and to evolve appropriate projects and programmes. The Office of the President and the Ministry of Planning and National Development will continue to improve procedures for assisting DDCs to identify suitable projects; the Ministry of Local Government will expand support for municipalities and other local authorities in the preparation of Local Authority Development Plans (see below); and the Ministry of Planning and National Development together with the Ministry of Finance will work with relevant ministries to ensure that rural-urban priorities and objectives are reflected in their forward budgets.

4.21. Where Central Government retains control over physical infrastructure, special emphasis will be placed on seven areas:

(1) To broaden the central Mombasa-Nairobi-Uganda corridor, Government will upgrade a few existing highways connecting secondary towns with superior growth potential.

(2) To stimulate economic exchange between productive rural areas and small towns, rural roads will be improved where they are likely to enable such towns to grow into distribution and marketing centres.

(3) To facilitate the timely provision of urban land for industrial, commercial, residential, and government purposes, and to assist local authorities in promoting orderly urban development, funding for the Government Estates Development Fund, administered by the Department of Lands, will be restored to earlier levels and the Fund will resume its activities.

(4) To spur the growth of new enterprises in rural areas and smaller urban centres, steps will be taken to enable the Ministry of Energy and Regional Development and local authorities to provide bridging finance for the cost of purchasing transformers for reducing the voltage of high power transmission lines to levels needed in small towns by manufacturing and commercial enterprises.

(5) To relieve bottlenecks to future growth, water supplies will be expanded in larger towns that have development potential but foresee deficiencies in current supply.

(6) Sewage treatment and storm water drainage systems will be constructed in larger towns where the costs of recycling water are lower than construction of pipelines to distant supply sources.

(7) To promote the orderly development of residential areas and to facilitate the role of the private sector in the provision of housing, the Government will use its resources to work with private developers in subdividing urban land; will accelerate the regularization of land tenure among existing sub-divisions; and will introduce more appropriate standards for the construction of housing which permit the use of low cost technologies and local materials, especially by the informal sector.

Financing and Managing Urban Development

4.22. The second component of the strategy for balanced rural-urban development addresses the problems of financing and managing urban development. By the year 2000, the urban population will reach 9 million or more, three times the 1984 figure. A rising share of national resources will be needed by ministries, local authorities, and DDCs to enable them to finance and maintain the required to support new manufacturing and commercial activities and to accommodate new urban residents. To fulfill their role effectively, cities and towns will have to be properly administered and competently managed, and must have adequate resources to operate and maintain public services efficiently.

Requirements for Capital Expenditure

4.23. In recent years, Government capital investment for urban development has not kept pace with the growth of urban population. Public investment in urban infrastructure--measured by gross approved development estimates for water, urban land, energy, roads, and housing, together with gross fixed capital formation by municipalities--declined as a share of gross fixed capital formation from 14.3% during the period 1971-77 to 12.1% for the period 1978-84 (Table 4-2). Per capita spending fell from K£610 for each new urban resident during the first period to K£507 per new resident during the second period, measured in 1984 prices. Capital spending declined according to both measures for five of the six sectors examined. The exception is gross fixed capital formation by municipalities, where the increase is attributable solely to massive investment in a water supply system for the city of Nairobi from 1981 onwards. As a result, more and more urban families are lacking basic urban infrastructure and the backlog in the provision of such services has been steadily increasing. Data from the annual rent survey, for example, show that the proportion of urban dwellings serviced with water, sewage, and electricity fell dramatically between 1978 and 1982.

Table 4-2: Public Capital Expenditure on Urban Infrastructure 1971-84 (Constant 1984 prices)

Sector	1971 - 77 Capital Expend. (K£m)	1971 - 77 Expend. p.capita (K£)(a)	1971 - 77 Share(%) total invest	1978 - 84 Capital Expend. (K£m)	1978 - 84 Expend. p.capita (K£)(a)	1978 - 84 Share(%) total invest.
Municipalities(b)	90.6	221	2.0	184.4	261	2.7
Water	61.5	82	1.3	87.9	72	1.3
Urban land	14.1	19	.3	10.1	8	.1
Energy	34.2	45	.7	23.8	20	.3
Roads(c)	357.2	115	7.8	451.1	80	6.5
Public Housing	96.2	128	2.1	80.0	66	.2
Sub-total:	653.8	610	14.3	837.3	507	12.1
Total investment(d)	4585.6	-	100.0	6944.5	-	100.0

Notes
(a) Per capita = per additional urban resident
(b) Per capita = per additional municipality resident
(c) Per capita = per additional national resident
(d) Gross capital formation.

4.24. To recover from the effects of the relative decline in public capital expenditure in urban areas during recent years and to promote increased investment in infrastructure that supports the regional growth of employment and productive activities, the Government will devote a larger share of national resources to infrastructure over the next 15 years. Depending in part on the rate of increase in urban population and in part on the level of per capita spending, capital expenditure required to finance urban development over the period 1985 to 2000 is mated to amount to between K£5.4 and K£7.4 billion, representing between 24% and 32% of the projected gross capital formation during this period (Table 4-3). This is a significant jump from 1978-84, when only 18% of gross capital formation was spent on infrastructure. The bulk of this is required for housing, most of which is expected to come from the private sector; for highways and roads connecting larger towns and linking them to their hinterlands; and for a wide range of investments by municipalities and other urban local authorities.

Table 4-3: Estimates of Public and Private Capital Expenditures Required for Urban Infrastructure, 1984-2000

Sector	Share (%) of total invest.(a) 1971-84	Capital Required, 1985-2000			
		K£ millions		Share(%)invest.(b)	
		Low	High	Low	High
Municipalities	2.8	682	996	3.0	4.3
Other Urban Loc. Auth.	.5	123	179	.5	.8
Water	1.2	450	591	2.0	2.6
Urban Land	.1	73	136	.3	.6
Energy	.4	175	328	.8	1.4
Roads	6.6	1417	1756	6.2	7.6
Housing (private and public)	6.6	2500	3364	10.9	14.6
Total	18.1	5419	7350	23.6	32.0

Notes
(a) Actual Gross Capital Formation
(b) Gross Capital Formation, 1985-2000, projected as 25% of GNP.

Financing Urban Infrastructure

4.25. Providing this greatly increased level of funding from both public and private sources presents a challenge. Several policies will be pursued. First, ministries and local authorities will be instructed to adopt and follow more appropriate engineering standards for the construction of

infrastructure such as roads, water supplies, and sewage systems. The revised standards will reflect the relative scarcity of capital and the trade-off between lower capital costs initially and higher maintenance costs later. Second, in order to stretch available funds to the maximum, resources will be concentrated on those projects which offer lower construction and maintenance costs per beneficiary.

4.26. Third, in order to maximize returns on public investments in urban development, Government agencies will be urged to charge market prices for the services and facilities they provide. This applies especially to the sale and rental of housing and housing plots and to the leasing of government lands in urban areas. These and other charges must be raised, in part because the stated objective of subsidizing the urban poor is rarely achieved and in part because the equity goal can be achieved more effectively by charging market prices to the few who currently benefit, in order to expand provision to the many more who are still in need. Fourth, in selecting investments, priority will be given to those that yield a high rate of return, thus generating additional revenues that can be used for further investment.

4.27. Fifth, policies will be formulated that encourage the involvement of the private sector in the provision of facilities and services, either as a partner or as the principal agent. Subject to appropriate procedures for public review, partnerships between government agencies and private firms offer a promising approach for the development of urban industrial or commercial sites, construction of residential housing, building of public utility infrastructure, or the leasing and operation of public facilities and services.

4.28. Sixth, the Government will encourage the mobilization of additional resources for urban infrastructure that supports productive activities. This will be achieved by steering the resources of non-governmental organizations toward investment in urban infrastructure under the guidance of DDCs, seeking aid from donors for such projects, setting up autonomous financial institutions to raise private capital for housing and other special purpose investments, restructuring the Local Government Loans Authority, and strengthening the financial capacity of local authorities, particularly for maintaining services and facilities.

Reform of Local Government Loans Authority

4.29. The Local Government Loans Authority is the principal conduit for channelling capital resources to local authorities for financing urban development. To enable it to fulfill its crucial role more effectively in the years ahead, LGLA will be restructured along the lines of a municipal development bank, offering loans at commercial interest rates. While this will result in higher interest costs to local authorities, it will also encourage prompt repayment of loans and stimulate savings

deposits from local authorities themselves. Furthermore, the LGLA will be authorized to seek funds on the capital market, both in Kenya and abroad, thus increasing the total resources available to local authorities and reducing their dependence on the central Government. Before the LGLA can be restructured as a bank, however, vigorous efforts must be made to restore its credibility as an effective financial institution. Towards this end, the Government will continue recent steps to strengthen senior level leadership, to increase the quality and quantity of professional staff, and to improve accounting practices and loan management procedures.

Financial Management of Local Authorities

4.30. While the DDCs are primarily responsible for coordinating central and local government resources for the initial provision of infrastructure, local authorities will be assigned increasing responsibility for the subsequent operation of this infrastructure. It is important to ensure that these towns and villages are competently managed and that local services and facilities are efficiently operated and maintained. Government will undertake a major initiative to strengthen local authorities, focused on two broad fronts: first, to upgrade management capabilities and ensure the competent administration of urban areas; and second, to consolidate local revenues, reducing dependence on central Government and ensuring adequate financial resources for needed services.

4.31. To strengthen the financial management capability of Kenya's local authorities, the Ministry of Local Government will expand efforts to institute improved administrative and financial management practices. Local authorities will be assisted to bring their accounts up to date, to raise their performance in collecting revenues, and to improve the preparation of annual estimates and forward budgets. The MLG will introduce a set of standardized accounting codes, revise the financial regulations for local authorities, prepare a set of performance standards, and carry out an extensive programme of training for local authority officials.

4.32. Emphasis will be given to improving the collection of revenues. Councils at all levels will be directed to review their revenue collection performance and develop plans for improving it. The Ministry of Local Government will prepare guidelines and performance standards against which to measure collection rates of each authority. Local authorities will be enabled to take prompt legal action to recover delinquent payments.

4.33. The Ministry of Local Government will also urge local authorities to revise the pricing of utilities and services to ensure that they reflect the real costs of operation, maintenance, and long-term capital stock replacement. To minimize the perennial gap between inelastic revenue sources and rising costs due to inflation, local councils will be expected to make more frequent but smaller price adjustments, avoiding the periodic

shock of large increases. Improvements in accounting methods will provide treasurers and town clerks with timely information with which to justify increases to local councillors. The Ministry of Local Government will take a more aggressive approach in reviewing annual estimates, if necessary withholding approval of local authority budgets until needed price revisions have been agreed.

4.34. Even with improved financial management, steps will be needed to increase the revenues of many local authorities, particularly town and urban councils, which lack the resources required to provide and maintain infrastructure. To generate such resources and reduce dependence on central Government, reforms will be introduced that expand and strengthen the fiscal base of local authorities. Given the diversity of revenue potential that marks Kenya's councils, the Ministry of Local Government will explore possibilities with each local authority on a case-by-case basis. Among the alternatives to investigate are: (1) updating of the schedule of activities subject to local authority fees and licences to reflect newer commercial and professional activities; (2) tying property rates to improved site value to reflect the scale of activity on each site; (3) introducing local retail sales taxes where appropriate; and (4) transfering responsibility for the operation of certain facilities and services, such as water, to councils which have the necessary administrative and technical capacity.

4.35. The funds raised from an expanded revenue base and improved collection of revenues must be put to the most effective uses. Available funds can be stretched considerably further by raising productivity in local government services through more efficient methods of operation and more appropriate standards of construction and maintenance. The MLG will provide local authorities with technical assistance on operational aspects of water supplies, sewage, refuse collection, and other local services. Special attention will be paid to possibilities for sub-contracting particular tasks--such as street cleaning and refuse collection--to small-scale private enterprises.

4.36. Measures will be taken to consolidate the capability of local authorities to plan the development of their jurisdictions and to design and implement projects. Over the last two or three years, through the introduction of its Local Authority Development Programme, the MLG has made considerable advances in improving the capability of local authorities to prepare plans for the development of their towns. During the course of preparing an LADP, a local authority identifies and prioritizes projects within its jurisdiction. After submission to the DDC, these projects are forwarded to an inter-ministerial steering committee for review and funding approval. To consolidate this process and coordinate it with the promotion of Rural Trade and Production Centres, the MLG will reinforce its planning department to extend the programme to all municipal and town councils, as well as the larger urban councils. Particular emphasis will be placed on providing technical support to local authorities for

project implementation, monitoring, and evaluation.

4.37. The Local Authorities Act will be reviewed to ensure that local authorities are properly empowered to carry out these responsibilities; that they bear effective accountability for their actions and use of funds; and that their legal structures and procedures are consistent with those of the District Development Committees.

4.38. These measures will focus on the authorities responsible for smaller towns and cities. However, they will also apply to larger municipalities, those capable of attracting not only small-scale, informal sector industry, but also large-scale firms in the modern sector. Government already gives a substantial fiscal incentive for such firms to locate outside Nairobi and Mombasa. Centres like Eldoret, Thika, and Nakuru have demonstrated that effective local authorities can provide facilities to attract large firms. Upgrading the management ability of authorities in the larger centres should make it possible to induce large-scale industry and services to locate throughout Kenya in accordance with Government policy.

4.39. To accomplish these improvements and to assist local authorities in undertaking the necessary reforms, the Ministry of Local Government will be given additional resources to reinforce its professional and technical staff. Two new units will be established within the Ministry of Local Government to provide technical assistance to local authorities, the first on fiscal matters and revenue generation (paragraph 4.35) and the second on the operation and maintenance of local services (paragraph 4.36). Existing units that support local anthorities will be upgraded and expanded, particularly the unit responsible for advising on financial management and monitoring accounts. Technical assistance will be sought from the donor community to train the necessary staff and to institutionalize the MLG's capacity to provide improved supporting services for Kenya's local authorities.

Urban Development and Environmental Protection

4.40. The developments outlined in this chapter will put additional strains on Kenya's natural resources, especially land, water, and forests. Plans for the Rural Trade and Productivity Centres will include provisions to create buffer zones between industrial and residential areas. Proper management of water catchements and soil conservation will become more urgent concerns as rural centres expand their provision of water, sewerage, electricity, and roads. The Ministry of Environment and Natural Resources will prepare guidelines to alert local authorities and DDCs to these environmental problems and appropriate solutions.

The Informal Sector

4.41. The third component of the strategy for balanced rural-urban development addresses the growth of non-farm activities, particularly the informal sector. Historically, educated youth have sought urban, often white-collar employment. Although this tendency will certainly continue, it is clear that the modern sector will be unable to raise enough capital to employ more than a fraction of Kenya's new workers from now to the end of the century. Improved agricultural technology, better marketing arrangements and rewarding commodity prices will raise the returns to agriculture and draw many new workers into farming. At the same time, the stimulus of higher farm incomes will create rural non-farm job opportunities, while youth polytechnics will teach the skills needed to take advantage of such opportunities. Unquestionably, the majority of future non-farm job opportunities will be in the informal sector--in small-scale manufacturing, marketing, repairs and other service activities--located mostly in market centres and moderate-sized towns throughout Kenya.

4.42. The informal sector suffers from a negative public image, yet it possesses many positive characteristics and has a vital role to play in contributing to renewed economic growth of the country. Informal sector activities conserve scarce foreign exchange, require very little capital to create jobs, rely primarily on family savings, often provide their own skill training at no cost to the Government, and are a prime training ground for future African entrepreneurs. Above all, the informal sector offers an unmatched potential as a source of new jobs for the expanding labour force, while the self-employed and small-scale enterprises represent the major part of business activity in market towns and smaller urban centres. They fulfill key functions in support of agriculture and other local production by marketing inputs such as fertilizer, making and selling small tools, maintaining vehicles and equipment, marketing produce, and providing local inhabitants with a wide range of inexpensive basic consumer goods and services for everyday life. Small local firms can be especially efficient at producing bulky or heavy items such as building materials, especially brick and tile, and furniture, thus saving on transport costs.

4.43. The opportunities opened up by rising rural incomes, together with the pressure for new jobs exerted by a growing work force, will perforce expand the informal sector. The challenge to the Government--as stated in Sessional Paper No. 2 of 1985 on unemployment--is to find ways to help accelerate this expansion while increasing productivity in informal sector activities. Established programmes aimed at supporting large modern industrial and commercial firms, and even those directed towards small-scale industry, are ineffective in assisting the vastly larger number of very small-scale, informal sector enterprises. Few of these firms have the collateral required to borrow money from financial institutions; even fewer are subject to corpora-

tion or income tax and therefore do not benefit from tax incentives. Furthermore, the cost of reaching the large number of potential recipients in the informal sector through traditional programmes is likely to exceed potential benefits.

4.44. Given the nature of small-scale activities, the primary thrust in stimulating their growth must come from macroeconomic policies aimed at the economy as a whole. First and most important is the strategy outlined in Chapter 5 to raise farm productivity and income and so to stimulate the demand for goods and services provided by the informal sector. Second, as part of the current effort to overhaul the structure of tariffs on imports, the Government will continue to lower tariffs on raw materials, semi-processed goods and other intermediate inputs, particularly those used widely by small-scale manufacturers. Third , the existing investment incentive structure, described in Chapter 6, encourages the substitution of labour for machinery and will thus boost small-scale activities that are characteristically labour intensive.

4.45. Macroeconomic policies will be complemented by efforts to provide direct assistance to individuals and small-scale businesses. Special attention will be paid to informal sector entrepreneurs in manufacturing, construction, transport, and housing, and those firms with the potential to acquire the experience and capital necessary to make a successful transition to large enterprises. Initiatives will be undertaken to expand access to credit for informal sector businesses; to disseminate information on market opportunities and appropriate production methods for small-scale manufacturing; to expand youth polytechnic training and focus it on appropriate skills and management techniques; and to relax current restrictions on informal sector activities.

4.46. Informal sector entrepreneurs generally lack the collateral to obtain credit. Past programmes designed to address this problem, such as the Ministry of Commerce and Industry's Joint Loan Board Scheme, have had inadequate resources to meet demand, often suffered from high default rates among borrowers, and are inherently limited in the numbers of firms they can reach. To overcome such constraints the Government will move on four fronts:

(1) Requirements for collateral will be amended, for example through recognizing letters of allotment on land and expediting land registration processes in urban areas.

(2) Aid donors will be encouraged to provide commercial banks and other lending institutions with low interest loans, allowing them a wide interest margin to cover the greater risks and higher costs of lending to informal sector firms.

(3) Cooperatives, non-governmental organizations, and other strong local voluntary associations representing in-

formal sector entrepreneurs will be encouraged to devise their own credit programmes for the informal sector. Such organizations should be better placed than centralized agencies to evaluate the personal capabilities of the borrower and enforce repayment.

(4) Government will promote schemes to provide graduates of youth polytechnics and other technical secondary schols with the tools of their trade and with small infusions of working capital to start up their own businesses.

4.47. Numerous opportunities exist for small-scale manufacturers to produce cheap alternatives to expensive imported items. To exploit these opportunities, the Government will take several steps:

(1) Technical institutes and other bodies, both private and public, will be encouraged to develop simple goods and production techniques to replace imported manufactures.

(2) Government will disseminate information on new products and production methods to potential producers via technical secondary schools and other channels.

(3) Government will issue new regulations on tendering to require central ministries and district authorities to favour small-scale producers.

(4) Building codes will be revised to encourage the use of materials that can be supplied locally by small firms and to expand the activities of informal sector builders, especially builders of low-cost housing.

(5) Informal sector firms and individuals, in manufacturing and services, will be encouraged to form cooperatives, through which they can obtain information and assistance on new technologies, access to credit, the purchase of inputs and the marketing of outputs.

4.48. Emphasis on rural-urban balance and intensified development of the informal sector will require a major expansion of domestic trade in all its aspects. Trading activities must continue to be a major absorber of new workers. If the economy expands as projected and if rural areas share fully in growth, jobs created in trade should be productive ones. The Department of Internal Trade of the Ministry of Commerce and Industry will continue to monitor the development of domestic trading activities and recommend actions to ensure that they are consistent with the strategy of rural-urban balance and the development of the informal sector. Specifically:

(1) The Joint Loan Board Scheme will be restructured to make it a viable financial institution for small busines-

ses in rural areas.

(2) District Trade Offices will be strengthened to enable them to provide more effective extension services to rural trades.

4.49. Technical and vocational training at the secondary level will play a crucial role in developing artisans, managers, and entrepreneurs for the informal sector in both rural and urban areas. It will also help to correct the inverted pyramid in Kenya's formal sector, where university-trained managers are supported by too many unskilled workers and too few well-trained technicians and artisans. At present, secondary technical and vocational training is offered in a variety of institutions: Youth Polytechnics (under the Ministry of Culture and Social Services), Secondary Technical Schools (Ministry of Education, Science and Technology), Harambee Institutes of Technology (private but supervised by the Ministry of Education, Science and Technology), National Institutes of Vocational Training (Ministry of Labour), Artisan Training Courses (Ministry of Labour), Craft Training by the Kenya Industrial Training Institute or KITI (Ministry of Commerce and Industry), and the post-secondary National Polytechnics (Ministry of Education, Science and Technology).

4.50. If this form of training is to serve Kenya's development needs effectively, it must be reorganized and rationalized. The principal goal must be to ensure that all institutes of technical secondary education offer relevant courses for the worker whose career will primarily be in the informal sector. Youth Polytechnics and other technical secondary schools should orient their courses towards specifically indentified local needs and skill shortages. They should also offer courses in management, marketing, accountancy, and other skills essential in the informal sector.

4.51. But at the same time students in technical secondary schools should have the option of continuing directly into higher education upon graduation, either into the National Polytechnic, a training institute, or a university course. Only a few students will do so, but technical secondary schools will be a more attractive option for all students if they provide a potential career track that includes higher education. The Presidential Working Party on Education and Manpower Training for the Next Decade and Beyond will undertake an urgent study of secondary technical education and recommend to Goverment ways to:

(1) rationalize and reorganize the various institutions engaged in secondary technical education;

(2) convert these institutions into a parallel stream that permits some students to enter institutions of higher education directly upon graduation; and

(3) include course on management, marketing, accountancy, and other essential skills.

4.52. A special task force will be established to review all policies to promote the informal sector. In particular, the task force will review current local authority bylaws and other regulations governing informal sector activities, to create a healthy legal and regulatory climate for informal sector activities by eliminating unnecessary constraints, recommending an appropriate scale of license fees and charges, and protecting street hawkers and other self-employed people from over-zealous policing.

4.53. These programmes to encourage informal sector development involve a number of Ministries--Commerce and Industry, Local Government, Labour, Cooperative Development, and Education, Science and Technology--as well as the Office of the Attorney General. To coordinate these efforts and give them emphasis in development planning and implementation, and to explore further policy options, the Ministry of Planning and National Development will establish a special unit for small-scale enterprises.

Energy Requirements

4.54. The strategy of economic growth based on agriculture, the informal sector, and rural-urban balance dictates a complementary strategy for energy development. Agricultural growth suggests relatively greater demand for fuelwood, while urbanization means greater demand for charcoal. Development of Rural Trade and Production Centres around the country requires a broader national electricity grid, which can to some extent substitute for wood- and petroleum-based sources of energy. However, widespread urbanization will also place greater demands on transportation and thus on imported petroleum.

4.55. These trends have been used to project the growth of demand for various sources of energy from 1985 to 2000, as shown in Table 4-4. Fuelwood demand is projected to grow at 3.0% a year and charcoal at 4.7%. Demand growth for both fuels is smaller than otherwise because of the assumed increased use of more efficient woodfuel stoves. With the inclusion of commercial demand for wood (in construction, pulp and paper), total annual wood supplies will have to expand by 75% by the end of the century. The encouragement of non-wood building materials may result in some reduction in the required growth of wood supplies.

4.56. The needed expansion of wood fuel supplies will be satisfied by three forestry programmes. All of these have long gestation periods, so planning and implementation are urgent matters. First, farmers will be encouraged to practice agroforestry, the system of intercropping traditional crops with trees. The species of trees selected are typically those which fix nitrogen and thus reduce fertilizer requirements; are fast

growing; allow sunlight to pass freely through foliage; and help

Table 4-4: Energy Requirements, 1985-2000
(1000 tonnes, except for electricity)

	1985	2000	Growth rate 1985 - 2000 (% p.a.)
Fuelwood	14972	23480	3.0
Wood for Charcoal	8754	17513	4.7
Commercial Wood	1077	2588	6.0
Biomass	1112	2177	4.5
Petroleum	2080	3821	4.1
Coal/Coke	97	180	4.2
Electricity			
--(kilowatt-hours)	2480	6077	6.2
--capacity (mega-watts)	586	991	3.6

to retain soil moisture. To meet projected fuelwood demand on a sustainable basis, a total of 3 million hectares of agroforestry must be developed in medium- and high-potential areas, yielding 8 tonnes of wood per hectare per year at an establishment cost of K£ 16 per hectare. Agroforestry will not conflict with food and export crop expansion because intercropping with appropriate trees does not reduce crop yields.

4.57. Second, reafforestation in all regions of the country will add to wood supplies while simultaneously protecting the environment. In medium- to high-potential areas, new and replanted forests will protect watersheds and prevent soil erosion. In arid and semi-arid areas, new forests and species will also increase the water carrying capacity of the land and help prevent deterioration of the environment.

4.58. Third, charcoal demand can be met on a sustainable only with the establishment of efficient woodfuel plantations in reasonably close proximity to urban centres. These plantations will have to utilize low - and medium-potential land to avoid conflict with agricultural growth targets, and this in turn will require research into new species. Alternative means to meet the demand for charcoal, including the use of charcoal based on waste from coffee, maize and sugar, as well as the substitution of other forms of energy, will be evaluated and proposed by the Ministry for Energy and Natural Resources.

4.59. Electricity demand is projected to grow at 6.2% a year, reflecting the requirement for a widespread power grid to deliver electricity to the fast growing towns and small urban centres in rural areas. To some extent the wider distribution of electricity, coupled with rising incomes, will reduce the demands for kerosene for lighting and for woodfuel. Because electrical

generating capacity will be used more efficiently, capacity need only expand by 70 percent to provide for demand in 2000. Half this additional capacity will be available from three projects already underway or planned: a 30-megawatt gas turbine plant at Mombasa will produce power in 1987, the Kiambere hydroelectric scheme will add 140 MW in 1988, and the Turkwell hydroelectric plant will produce 100 MW in the early 1990's. A national electric power master plan is being prepared to provide the balance of the capacity requirement for 2000.

4.60. Projected growth in demand for petroleum is only 4.1% a year. Transportation and large manufacturing firms are the major users of petroleum fuels. Both are expected to reduce their average consumption over the period, due to improvements in the public transportation system, conservation efforts by industry, and switching from fuel oil to electricity, biomass, and coal. The leading role of agriculture and rural centres in renewed growth will on balance temper the demand for petroleum fuels. Although the proportionately greater demand for electricity and wood fuels will require careful management of domestic resources, it will also reduce dependence on imported petroleum.

CHAPTER 5: AGRICULTURE AND FOOD SECURITY

Goals for 2000

The nation's farmers must continue to lead the country in economic development for the rest of the century. If the goals and targets laid down earlier in this paper are to be achieved, agriculture will have to (a) provide food security for a population of almost 35 million in 2000; (b) generate farm family incomes that grow by at least 5% a year for the next 15 years; (c) absorb new farm workers at the rate of over 3% a year with rising productivity; (d) supply export crops sufficient for a 150% increase in agricultural export earnings by 2000; and (e) stimulate the growth of productive off-farm activities in the rural areas, so that off-farm jobs can grow at 3.5% to 5.0% a year. These goals are consistent with the quantitative targets announced in Chapter 2. Two of them, food security and off-farm activity, require elaboration.

5.2. Kenya's food security remains a major objective of the Government. The country will continue to be self-sufficient in maize, beans, potatoes, vegetables, milk, beef and meat products and other foods. The biggest challenges will be to intensify maize and milk production so that output can keep pace with rapid population growth without a large increase in land devoted to these commodities. The country imports wheat, vegetable oil and rice to meet its needs. Government will strive to reduce the import gap in these three commodities. In the interim, this suggests that the rapid growth of export crops must be part of a strategy for food self-sufficiency. Agriculture will continue to be the major contributor to foreign exchange earnings that are sufficient to import foods when temporary shortfalls occur and to cover intermediate needs until increased production can reduce chronic deficits. A third element in self-sufficiency is growing rural cash incomes, which are necessary to ensure that rural households can purchase food when necessary.

5.3. It is clear from Chapter 4 that if Kenya is to reach 2000 with a healthy balance between rural and urban economic activities, agricultural prosperity is essential. There are few effective policy tools to stimulate growth of non-farm rural activities and employment. In the end, the only way to achieve such growth is to ensure a prosperous agriculture that will in turn stimulate off-farm activities. It will become apparent later that to attain goals for agricultural production, the widespread, localized marketing of inputs, especially fertilizer, will be crucial. If output does expand, localized processing and marketing of grains, milk and other commodities will also have to expand. Farmers will need maintenance and repair, transportation, financial and other services available in nearby market

centres and towns. And rising farm incomes will generate demand for many consumer goods, some of which can be made in local workshops, and for the construction of housing, water supplies and other farm improvements. These developments, which are essential to agriculture, will also provide opportunities for rural entrepreneurs and the self-employed to create new jobs at satisfactory incomes. Although this chapter will focus more on the means to promote agricultural growth than on the essential linkages, the latter are as important for Kenya's long-term welfare as agriculture itself.

5.4. To achieve these goals for agriculture, three broad strategies will be pursued. All three must operate within a constraint of available high-potential land, because no easy means exist to bring large amounts of new land into productive use. First, within exisiting crop patterns, farmers will be encouraged to adopt more productive practices, especially the wider use of improved varieties, fertilizer, and disease and pest control. Pricing policies, marketing policies and institutions, and the extension service will be the main instruments in obtaining much higher yields through known techniques. Second, research into new varieties, especially of maize and other grains, will be reorganized and accelerated to generate the new, high-yielding varieties that will be essential to keep pace with consumption. Third, to a limited extent the production pattern will be diversified in favour of crops such as tea, coffee, and vegetables that produce much higher incomes and generate considerably more employment per hectare than other crops and livestock activities. Small shifts in land use can yield relatively large gains in income, employment and export revenue when these crops are involved.

Production Characteristics

5.5. Scarce productive land is the central fact of Kenya's agriculture. Of Kenya's 44.6 million hectares of land, only about 8.6 million hectares are medium- to high-potential agricultural land. Of this, about 60% or 5.2 million hectares are devoted to crop and milk production. Much of the rest is used for extensive grazing for beef and small stock production, or is taken up by national parks and forest reserves. Although perhaps 500,000 hectares of land could be brought into production under irrigation, drainage or flood control, by and large Kenya's agriculture will have to provide for both food security and export growth on its existing crop and dairy land.

5.6. Milk production alone accounts for almost half (47%) of the 5.2 million hectares devoted to farming, while maize plus beans accounts for almost another quarter (23%), as shown in Table 5.1. These plus root crops, sorghum and millet account for 84% of the farmed land. Yet these same six basic foods produce only 43% of the total value of the commodities listed in Table 5.1. In contrast, three crops--coffee, tea and vegetables--produce 37% of the total value using only 5% of the land.

Table 5.1: Estimated Area, Value and Value per Hectare For Selected Commodities, 1983/4

Commodity	Area		Value(d)		Value per ha.	
	% of total	(Rank)	% of total	(Rank)	K£/ha.	(Rank)
Milk	46.6	(1)	16.3	(3)	70	(16)
Maize and beans (a)	22.6	(2)	16.6	(2)	153	(12)
Root crops (b)	7.9	(3)	8.1	(5)	205	(9)
Sorgum & millet	6.7	(4)	1.5	(11)	48	(17)
Coffee	2.9	(5)	21.6	(1)	1489	(1)
Wheat	2.2	(6)	2.1	(10)	191	(10)
Cotton	2.1	(7)	0.4	(18)	32	(18)
Fruits	2.1	(8)	3.1	(9)	296	(7)
Sugar	1.7	(9)	-3.6	(21)	-432	(19)
Tea	1.6	(10)	11.9	(4)	1325	(2)
Sisal	1.1	(11)	1.1	(12)	137	(14)
Vegetables	0.7	(12)	3.4	(8)	913	(3)
Cashewnuts	0.5	(13)	0.4	(15)	162	(11)
Groundnuts	0.4	(14)	0.2	(20)	84	(15)
Barley	0.3	(15)	0.4	(17)	249	(8)
Sunflower	0.2	(16)	0.2	(19)	141	(13)
Pyrethrum	0.2	(17)	0.4	(16)	419	(6)
Rice	0.2	(18)	0.5	(13)	519	(5)
Tobacco	0.1	(19)	0.5	(13)	885	(4)
Beef	(c)	-	6.8	(6)	(c)	-
Sheep & goats	(c)	-	4.9	(7)	(c)	-
Others	(c)	-	3.1	-	(c)	-
Total	100.0(e)		100.0(e)		170(f)	

Notes

(a) Because beans are typically interplanted with maize, the two crops are considered together; maize alone accounts or 13.3% of total value.
(b) Includes potatoes, which account for 5.3% of total value.
(c) No estimates available.
(d) Value at farm gate.
(e) The total area is 5.17 million hectares and total value is K£ 1035 million.
(f) Excludes beef, sheep and goats, and "others".

5.7. Two strategy implications follow from these statistics. First, rapid growth of rural incomes and GDP would be served by greater output of coffee, tea and vegetables, through both intensification and acreage expansion. Second, given the importance of maintaining self-sufficiency in maize, milk and most other basic foods, it will be essential to intensify production on existing lands without encroaching on land devoted to higher income-earning crops.

5.8. Other development considerations point in the same directions. Coffee, tea, vegetables and pyrethrum employ between 1.4 and 2.0 person-years per hectare, compared to only 0.3 to 0.6 for milk, maize and beans, root crops, sorghum and millet. Thus employment goals also dictate an expansion of the high-value crops. Similarly, the need to expand agriculture's net export earnings also requires an expansion of tea, coffee and horticultural production and other cash crops: coffee, tea and vegetables earn five to ten times the foreign exchange per hectare than can be saved by import substitution for food grains.

Commodity Programmes

5.9. Seven commodities are central to achieving the development goals established for agriculture. Coffee and tea expansion is the foundation for growth of both agricultural incomes and exports. Maize, wheat, milk, and meat production must be adequate for food security. Horticultural crops will serve both goals. Programmes to expand production of these seven commodities are given in this section. Their crucial significance justifies the concentration of the Sessional Paper on these seven commodities, because success of these programmes will ensure that agricultural income can grow at 5% a year to the end of the century. Other commodities --especially sorghum, millet, rice, root crops, sugar,and oil crops--will remain important to farmers and to Government. But if these seven intensification and expansion programmes do not succeed, there is no alternative package of investments of similar magnitude that could make Kenya agriculture prosperous in so short a time.

Coffee

5.10. Kenya has the potential both to grow and export more coffee. Moreover, because it has a very small share of the world coffee market, only 2.3%, Kenya could market substantially more coffee without driving down the price very much if at all. However, Kenya is a member of the International Coffee Agreement, under which it has a quota that restricts potential sales. Kenya has been working within the ICA to increase its quota in the near term and will continue to do so. Even under a major intensification programme, coffee output will not grow until after the current ICA expires in 1989 and Kenya will continue to adhere to the Agreement. Over the long term, especially when the current Agreement expires in 1989 and a new one is negotiated, Kenya's growing importance in the world market and its ability to export much more high-quality coffee should be recognized by other producing and consuming nations and accommodated within the ICA, as has been the case since Independence, when Kenya exported only a fraction of its current quantities. While continuing to adhere to the agreement, Kenya will also seek additional non-quota market sales.

5.11. To improve its position in the coffee market of the late 1990s, Kenya will begin now to prepare and execute a three-part production programme with the ambitious targets summarized in Table 5-2. First, Kenya will fully exploit the potential of the new disease-resistant, high-yielding variety Ruiru 11 and other varieties under development. These varieties have approximately double the yield potential of the present varieties, do not require spraying against either coffee berry disease or leaf rust, and consequently can roughly halve the unit cost of production. It is essential to Kenya's development strategy that farmers be encouraged to use better crop management and gradually to replant the existing coffee area with the new varieties by the year 2000. Smallholder and estate production will then total 215,000 tons from the same coffee area planted in 1984, compared with the record 1983/84 output of 129,000 tons.

Table 5-2: Coffee Expansion Programme

	Area (1000 ha)		Quantity (1000MT)	
	1984	2000	1984	2000
Production				
1. Arabica				
a. Replanting				
- Estates	35.7	35.7	41.6	78.1
- Smallholders	114.2	114.2	73.1	137.2
- Total	149.9	149.9	114.7	215.3
b. New planting				
- Estates	-	17.9	-	37.7
- Smallholders	-	57.1	-	66.2
- Total	-	75.0	-	103.9
2. Robusta	-	50.0	-	34.9
3. Total	149.9	274.9	114.7	354.1
Exports				
1. Quantity			96(a)	351
2. Value (K£mn)			170(a)	550(b)

Notes
(a) 1982-4 average
(b) Average price calculated from World Bank quota market forecast for 1995 with 70% of Kenya coffee sold in quota markets and a non-quota market price that is 37% of the quota market price. All estimates based on world prices of 1983.

5.12. Second, it is also vital that Kenya should exploit its comparative advantage in the production of arabica coffee by expanding the area planted by 50 percent by the end of the century. This new area, planted with high-yielding trees, could be producing a projected 104,000 tons by 2000. The combined effect of the replanting and area expansion for arabica will be almost to triple national production by the end of the century on an area some 50 percent greater than that planted at present.

5.13. Third, robusta coffee can be grown in large areas of western Kenya and Coast Province which at present have no high-value cash crop. A major aim is to establish the robusta variety as an important cash crop in these areas by the end of the century. The rate of adoption cannot easily be projected, but it is considered that a planted area of 50,000 hectares represents an achievable target for 2000. Such a planting programme would lead to a projected national robusta output of 35,000 tons of clean coffee by 2000.

5.14. This three-part production programme will be started immediately to enable Kenya to take advantage of the natural growth of the world coffee market, somewhat higher quotas under the ICA, and its ability to sell more in non-quota markets. The full realization of the programme will, however, be contingent on the conditions of a new coffee agreement after 1989 and Kenya's success in non-quota markets. If fully implemented, the programme is projected to yield foreign exchange revenue from coffee that grows by over 7% a year on average from 1984 to 2000. These projections are based on a World Bank forecast for quota-market coffee prices in 1995 and as much as 30% of Kenya's coffee being sold on non-quota markets at a discount of over 60%.

5.15. Major measures to achieve this expansion of coffee output include the following:

(1) Extension efforts in existing coffee areas will be focused on acreage expansion and replanting using the new Ruiru 11 variety.

(2) Extension services to smallholders will be enhanced through an increase in the extension-related activities of the Coffee Research Foundation and funded by the Coffee Board supplemented by the Ministry's extension service.

(3) The Coffee Research Foundation's seed programme for Ruiru 11 and other high-yielding varieties will be expanded.

(4) Government will develop an integrated programme for the planting, production and marketing of robusta varieties in Western Kenya and the Coast, with a special research, extension and credit programme focused on this effort.

(5) Government will, with the assistance of aid donors, institute a programme to reduce the delay in payments to growers.

Tea

5.16. Similarly, Kenya can also grow and export substantially more tea than it does. Government's target is to almost triple tea exports by 2000, through production programmes for smallholders, commercial tea estates and new Government-owned estates on the forest fringes. Average mature yields on smallholdings are less than half the average achieved on estates, although the genetic potential of the clones planted on smallholdings is higher. One reason is the large number of bush vacancies on many plots. The Kenya Tea Development Authority is conducting a programme of infilling which it anticipates will be completed within five years. A separate set of measures is expected to increase average smallholder yields by 1.5% a year on existing farms. There is considerable scope for expanding the area planted to smallholder tea on present tea farms, on other farms in tea areas, and in potential new tea areas. The aim will be to increase the area planted to smallholder tea by 50 percent by 2000. The combined effect of the targeted area expansion, infilling programme and yield increase will be to raise smallholder tea production to a projected 128 million kg. by 2000 compared to the record 1984 smallholder production of 53 million kg. (Table 5-3).

5.17. Kenya's commercial tea estates are the highest yielding in the world. However, the major estate companies expect to continue to increase yields by 1.5% per year through progressive improvement of field management and cultural practices. Within the existing boundaries of tea estates, perhaps 25% of the land suitable for tea is under other uses. Measures will be introduced to encourage conversion of this land to tea. In addition, Government will encourage estates to replant seedling tea with high-yielding clones. These measures will lead to almost a doubling of estate production by 2000.

5.18. Long-term experimentation by the Tea Research Foundation (TRF) has confirmed that replacing indigenous forest with tea does not adversely affect either rainfall or the environment, providing that ground cover is complete. Government has already begun to establish tea estates on the margins of forest areas, which will also serve to protect indigenous forests. An area of 6,000 hectares of forest land will be established in tea, yielding a projected 10 million kg.

5.19. The combination of measures proposed for tea will result in a 50% expansion of planted area, an average yield increase of 50%, and a 124% increase in output; exports will rise by 161% over the 1982-4 average quantity. Kenya is a major supplier of tea, accounting for 13% of the world market, and its expansion would account for 30% of the expected growth in world imports from 1985 to 2000. Conservative estimates suggest that Kenya's expansion will drive prices down by only 4% from projected levels, so that Kenya's revenues should grow by about 115% or 4.6% a year, from 1982-4 to 2000. As a low-cost and high-

quality producer of tea, Kenya is well placed to increase its earnings. Much of Kenya's agricultural strategy depends on this happening.

Table 5-3: Tea Expansion Programme

	Area (1000 ha.)		Quantity (1000MT)	
	1984	2000	1984	2000
Production				
a. Replanting				
- Estates	26.7	26.7	63.9	89.8
- Smallholdings	56.5	56.5	52.7	97.1
Total	83.2	83.2	116.6	186.9
b. New planting				
- Private estates	-	6.7	-	34.1
- Forest estates	-	6.0	-	10.2
- Smallholdings	-	28.5	-	30.8
- Total		41.2		75.1
c. Total	83.2	124.4	116.6	262.0
d. Exports				
- Quantity	-	-	90(a)	255
- Value (K£mn)	-	-	130(a)	296(b)

Notes
(a) 1982-4 average
(b) Uses World Bank price forecast for 1995 (based on 1983 world prices) reduced by 4% to account for price decline due to increased Kenya marketings not accommodated in World Bank forecast.

5.20. Consequently, the following major measures will be undertaken to expand tea production:

(1) Government will formulate a plan to expand the smallholder tea areas under the aegis of the Kenya Tea Development Authority.

(2) Government will adopt a national policy of encouraging new planting of tea on existing estates, including a cooperative programme coordinated by the Tea Board and the estates to determine the unplanted area suitable for tea.

(3) Government-owned tea estates of 6,000 hectares will be established on the perimeters of indigenous forests.

(4) Funds will be mobilized with the assistance of donors to increase the size of the first payment to smallholders.

(5) The domestic price of tea will gradually be increased towards export parity to encourage exports.

Food Crops

5.21. To accommodate the area expansion for coffee and tea, while providing for food security, it will be necessary to manage a major intensification in the production of all basic food commodities. The implications for four of these are shown in Table 5-4. The target of self-sufficiency in maize and milk will require more than a doubling of production from current average levels on somewhat less than the existing land devoted to these commodities. Though targets for wheat and meat production are less than expected demand, Government will continue to promote expanded production.

Table 5-4: Food Production Targets, 2000

Commodity	Average Production			Consumption, 2000	
	1984	2000	Growth (%p.a)	Total(c)	Unmet demand
Maize (1000MT)	2100(a)	4400	4.7	4400	0
Wheat (1000MT)	214(a)	400	4.0	1000	600(d)
Milk (mn.litres)	1600(b)	3600	5.2	3600	0
Beef and small stock (1000MT)	190(b)	420	5.1	540	120

Notes
(a) 1981-4 average
(b) Estimate of trend value for 1984
(c) Assumes 3.7% p.a. growth in population (7.0% urban growth and 3.2% rural growth) and 5.6% p.a. growth in GDP from 1984 to 2000.
(d) Substitution of domestic triticale or sorghum flours will reduce imports by as much as 200,000 MT.

5.22. Intensification of export and food crops will require greater outlays by Government on research and extension. To help fund these outlays, the principle of participant support discussed in Chapter 3 (3.7 - 3.9) will be applied. Coffee and tea farmers already support research on those crops and the principle will be extended to maize and wheat (see later section on Research). Dairy farmers will also be asked to support artificial insemination services to a greater extent than at present. Fees will be structured in such a way that only those who benefit

from increased productivity will be required to pay. Farmers will be given the opportunity to observe the benefits from the use of the services for which fees are charged. In some areas, where the introduction of improved methods is blocked by the need to pay fees, they may be reduced or waived for a short introductory period.

Maize

5.23. Among the major foods, white maize is the only one that cannot be secured easily or economically on world markets. To maintain self-sufficiency in maize will require a concerted effort to increase land productivity through improved technology and the intensification of input use, combined with sound pricing and marketing policies. New technology is required urgently. Although input intensification is a critical factor in generating maize productivity, even optimal use of modern inputs by all farmers could produce the required 4.7% rate of growth for a decade at best. However, optimal utilisation by all farmers is an unrealistic expectation and the need for new varieties is more urgent. Research must be directed at agro-climatic zones where the potential for successful results is high. A well-managed programme of maize research, taking full advantage of both domestic and international resources, will be given highest priority. Continued improvement in the extension service and an adequate incentive environment for private and public marketers of fertilizer and other inputs are also necessary to ensure that new technologies are adopted quickly by farmers.

5.24. Rapid growth in off-farm demand for maize, approaching 8% a year, will place a heavy burden on the internal marketing system. Growth of the marketing sector offers many rural employment opportunities and proper marketing policy will facilitate agricultural and general economic growth at little public expense. The current effort to improve internal management in the National Cereals and Produce Board will assist the Board in its principal function, the efficient implementation of food security policy.

5.25. Major measures:

(1) Maize research will be accelerated through a well-managed programme aimed at identifying high potential research areas and achieving rapid results.

(2) Maize will be priced of the levels necessary to keep the trend of domestic production in line with domestic consumption, within a range above export parity and below import parity.

(3) To promote food security, on-farm storage will be encouraged by extension service advice and credit allocations.

Wheat

5.26. Rapid urbanisation is expected to cause wheat demand to grow at 7.5 percent annually. Currently the country is dependent upon foreign sources for 33-40 percent of domestic needs. Without encroaching on land needed for maize, this dependence will continue. A wheat expansion rate of 4 percent is an ambitious target in the face of continued land subdivision. Analysis shows that under small farm conditions maize production for subsistence has a substantial comparative advantage over wheat. The net foreign exchange generated by wheat import substitution is probably less than that associated with maize production in regions where the two crops compete for land.

5.27. The increasing demand for bread and related products, such as chappatis and mandazies, can be partially satisfied with other grains. Triticale, a high gluten wheat-rye cross, which has a higher yield than wheat in drier regions of the country, must be examined seriously as a substitute for imported wheat flour. Sorghum, a traditional small-farm crop in semi-arid zones, has similar potential. Triticale and sorghum breeding will be stepped up to produce marketable varieties for flour milling. A high level committee will be established to evaluate the potential of these commodities and to work cooperatively with the milling industry to develop policies that encourage their utilization.

5.28. Major measures:

(1) Wheat and flour prices will continue to be set at projected long-term import parity levels.

(2) The economic and environmental feasibility of continued expansion of wheat and triticale production on open range land will be examined.

(3) Policies will be developed to encourage domestically produced wheat substitutes, such as triticale and sorghum, in flour production, with the initial objective of mixing these commodities with wheat flour up to 15-20% of total consumption.

(4) Research will be continued to ensure that the level of disease resistance is maintained in local wheat varieties and to facilitate continuation of the recent record of productivity growth. The identification and implementation of incentives for encouraging wheat production under appropriate environmental conditions such as open range land will be pursued.

Milk

5.29. The annual average national production of milk is estimated to be about 1.6 billion litres. Of this, 60% is produced by the smallholder herd in the high potential areas, 30% by herds on large scale farms and 10% by the pastoral herd. Of the total, almost 40% enters the formal and informal markets and over 15% is sold in urban areas. If present consumption patterns continue, then by 2000 total production will have to more than double. The bulk of the increase in production will have to come from the smallholder zebu herd in the highlands, which must be upgraded and more than doubled in size to over 4 million head by 2000. Production targets for milk will require massive investment--about £175 million over 15 years-- by smallholder livestock farmers in improved dairy production systems.

5.30. The essential component of a strategy to double milk production by 2000 is a successful programme of artificial insemination (AI). The Kenya National Artificial Insemination Service (KNAIS) provides this crucial input, but at declining levels: whereas the number of inseminations reached 548,000 in 1979, they dropped by 20% over the next five years. To double the improved dairy herd, this trend will have to be reversed. More zebu cows will have to be inseminated and their owners brought into the process of upgrading their herds, and the service now available will have to be improved. A major reason for the decline in AI service is the deterioriating fleet of vehicles available to KNAIS: the 1979 fleet of 185 roadworthy vehicles was down to 130 in 1983. In addition, the number of bull calves recruited by the Central Artificial Insemination Service (CAIS) has been insufficient to maintain the effectiveness of AI: over half the bulls are too old for reliable inseminations. Improved recruitment of bull calves depends on the revitalization of the Kenya Milk Records (KMR), the foundation for all improved dairy breeding.

5.31. These necessary improvements in AI will require greater expenditures by both Government and dairy farmers. The current average cost to Government is about Sh.130 per pregnancy, though the cost ranges from Sh.30 to Sh.1300. The farmer pays only Sh.1.00 per insemination and Sh.2.20 per pregnancy. To bring the KNAIS back to its 1979 level of inseminations, upgrade the CAIS, rehabilitate the KMR, and then extend the coverage of AI to new districts with good dairy potential, will require an increase in outlays from £1.7 million to £4.5 million. Much if not all of this increase in cost can be covered by an increase of fees paid for each insemination, which farmers would willingly pay to obtain reliable AI service. This is consistent with the general policy of increased support for Government services by participants, as discussed in paragraph 5.22.

5.32. To supplementary programmes should be tried as well. First, since natural service already exists and is probably preferred by farmers, there should be official guidance and encouragement for farmers who keep improved bulls for the service of other farmers' cows. The current policy of discouraging

natural service is counter productive. Second, the placement of a static AI service at cattle dips will be tried experimentally, depending upon the outcome of a study into the future of cattle dips (see section below on disease control). This would reduce transportation costs for AI, provide the service at the preferred time for successful insemination, and make the cattle dip a centre for extension work. The higher costs for Government of operating this kind of service may be offset by farmers' willingness to pay more for a convenient and more effective service.

5.33. Major measures (see also paragraph 5.42 on disease control):

(1) The KNAIS, CAIS and KMR will be improved and expanded, and annual budget allocations increased from £1.7 million to £4.5 million by 2000. A necessary condition for this expansion is an increase in the fees paid by farmers, which will defray part of the cost to Government.

(2) Government will guide and encourage farmers who keep improved bulls to service other farmers' cows. In zones where AI is ineffective, improved bull schemes will be utilized.

(3) KNAIS will experiment with stationary AI service at cattle dips.

(4) Although the Kenya Cooperative Creameries will continue to play a central role, Government will encourage private distributors to emerge outside the KCC marketing system. This private marketing network will create competition for farmers' milk, encouraging maximum production at enhanced net farm gate prices, and will become an important source of non-farm jobs in rural centres.

(5) Investment by smallholders in zero-grazing production systems will be encouraged by pricing policies and the extension service.

Beef and other meats

5.34. Total consumption of beef is expected almost to triple by 2000 because (a) urban dwellers consume 150% more beef per person than rural dwellers and (b) per capita consumption is expected to rise at the same rate as per capita incomes. Current consumption is supplied mostly from within Kenya by the beef herd on large-scale farms, the smallholder zebu herd, the pastoral herd and the dairy herds on small- and large-scale farms. Production is largest from the smallholder zebu herd. An increase in the supply of beef is technically possible to meet demand in 2000, but will require substantial effort.

5.35. Several problems face the beef industry. First, beef production is not profitable enough to encourage investment.

With present returns on investment of only 6-8% a year, it would take a 30% increase in beef prices relative to dairy and other farm prices to encourage private investment in beef. Second, tsetse infestation prevents expansion of land under beef herding. Yet elimination of tsetse would require an investment of K£25 million, cooperation with both Somalia and Tanzania, and research to overcome the new strains of trypanosome that are resistant to existing drugs. Other requirements to increase meat production include the improvement of stock routes; massive private investment in water facilities to increase range utilization; improved security in pastoral areas; and an efficient, widespread and effective system of reporting and disseminating information on market prices.

5.36. Major measures to stimulate an increase in beef production include the following (see also paragraph 5.42 on disease control):

(1) The the Livestock Marketing System will be improved, including completion of the trunk system of stock routes and holding grounds to serve pastoral areas and establishment of a national livestock marketing reporting and information system.

(2) Water supplies will be developed at strategic points for nomadic herders and fees charged to cover maintenance costs. Ranchers will be encouraged to develop their own water supplies, possibly sharing cost with Government as appropriate.

(3) A programme to reduce infestation by the tsetse fly will be developed in cooperation with Tanzania and Somalia.

(4) Improvement of security in pastoral areas will be given increased priority to enable full utilization of available rangelands.

5.37. Sheep and goats provide a major source of meat for Kenyans: consumption is about 60,000 tons a year, almost a third of total meat consumption. Moreover, the main concentrations of production and consumption are in zones of low and marginal potential. Thus improvements in this industry can have important benefits to low-income rural families. To improve the productivity of sheep and goat raising, the following measures will be undertaken:

(1) Extension activities must become more effective through provision of adequate complementary resources to extension officers and the development of zone-specific extension packages.

(2) A national breeding policy will be developed, with a focus on those aspects of breeding that have the greatest potential for raising incomes of sheep and goat herders.

(3) Herders' investments in improved stock will be considered in formulating national agricultural credit programmes.

5.38. The poultry industry has been one of the most rapidly growing sectors in agriculture, with the poultry population expanding at close to 6% a year. The rise in incomes forecast in this paper should give a further boost to the production of poultry meat and eggs. Poultry is raised both in modern, large-scale hatcheries and on small farms. Although market forces will largely determine where and how this industry expands, the MALD will formulate a policy to address the industry's major problems: large fluctuations in the production of day-old chicks, inadequate disease control, high feed prices, insufficient credit facilities, and inadequate market information.

5.39. Fishing is both an important source of protein in Kenya and a major employer near the large lakes and the Coast. Measures outlined in the Development Plan 1983-1988 form the basis for a continuing programme to develop fisheries further as a source of both food and, in the case of coastal fisheries, expanded exports.

Livestock Disease Control

5.40. Diseases have been a major obstacle to increased livestock production in many parts of the country. Rinderpest is a potentially devastating disease that is kept under control by regular vaccination of yearlings and of cattle near the country's borders. Foot and mouth disease, which can sharply reduce dairy production among improved stock, is controlled by a combination of vaccination and movement restrictions; for every shilling of increased production due to control of the disease, the Veterinary Department spends only Sh. 0.22. Tick-borne diseases are controlled by dipping cattle, but the costs are high and some farmers and herders show a reluctance to dip their cattle, especially if fees are charged. Consideration will be given to the development of an immunization programme to control tick-borne deseases and eventually to replace cattle dips.

5.41. Charges are generally made for the use of disease control services. Following the principles of participant support laid out in paragraph 5.22, these charges will be set to cover full costs in cases, such as the control of foot and mouth disease among improved dairy herds, where farmers enjoy clear and realizable benefits in excess of the costs of control. In other cases, where users may not be able to realize such clear net benefits, yet disease control is important to prevent widespread damage to the national herd, it may be necessary to subsidize disease control.

5.42. The Ministry of Agriculture and Livestock Development will review its strategy to control livestock disease and make recommendations relating to:

(1) the possibility of replacing cattle dipping with immunization as a measure for controlling tick-borne diseases;

(2) the potential and precise methods for increasing charges paid by the beneficiaries of disease control, using the principles of paragraphs 5.22 and 5.41;

(3) means to increase the effectiveness of collecting user charges that are already established;

(4) a shift of the responsibility for managing cattle dips to the districts; and

(5) increases in the efficiency of vaccine production through joint ventures between Government and private pharmaceutical firms.

Sugar

5.43. Government is concerned about the high cost of producing sugar in Kenya. Very low and even negative returns are a serious barrier to the expansion of this basic food crop, which is a major employer in Western Kenya. Yet it is important to maintain self-sufficiency in sugar because import prices fluctuate considerably and future dependence on imports would destabilize Kenya's foreign exchange balance. It is essential that the costs of growing and processing sugar cane be reduced substantially before further investments can be considered. To this end, the Ministry of Agriculture and Livestock Development will undertake a study of the management and structure of the sugar industry and recommend measures to reduce costs.

Horticulture

5.44. Fruits and especially vegetables have the desirable characteristics of both food and export crops: they will increasingly become part of Kenyans' diets as incomes increase, yet the potential for productivity gains is great enough to provide a growing surplus for export. Table 5-5 shows this potential. Most of the required increase in vegetable production will come from more intensive land use, with the introduction of new vegetables, better varieties of existing vegetables, improved rotations, more effective soil preparation, an increase in interplanting and relay planting, and closer spacing combined with higher levels of fertilization. Increases in domestically-consumed fruit production are expected largely from better-quality planting materials.

Table 5-5: Production and Exports of Horticultural Crops, 1983 - 2000 (1000MT)

	Actual 1983	Growth (% p.a)	Projected 2000
Production	809	(6.0)	2180
Consumption	724	(5.6)	1830
Export	85	(8.7)	350

5.45. The marketing of horticulturals in major cities is becoming a constraint to increased consumption. The construction of new marketing centres in Nairobi, Mombasa, and Kisumu will be necessary to put fresh vegetables and fruits within reach of potential consumers and thus create expanded markets for horticultural farmers. This urban-based infrastructure will contribute to a production and marketing chain that has several desirable characteristics: horticultural production requires relatively little land and much labour, while marketing in both the rural and urban areas is quite labour-intensive.

5.46. Exports of fresh horticultural produce are constrained by restricted air freight volume and changing patterns of international demand and supply. Produce with the highest unit value will be accorded priority in air shipment, particularly mangos, off-season strawberries, french beans and asiatic vegetables. Sea-freighted fresh produce, especially to countries in the Gulf, began in 1985 with trial shipments. Plans are being completed to reach an annual export total of 45,000 tons of fresh vegetables and fruits within six years. The future demand for bulk sales of fruit juices--especially pineapple and passion fruit--and canned pineapple should make feasible annual increases of around 10% in value terms.

5.47. Major measures:

(1) An expansion of the domestic market potential and an increase in marketing margins in favour of growers will be achieved by improved market infrastructure--including the construction of wholesale marketing centres in urban areas where these would relieve constraints to the expansion of urban markets; and by improved market organization--including more effective utilization of cooperatives.

(2) To reduce costs and price fluctuations, Government will provide improved access roads, introduce new varieties of vegetables, and work for the cooperatives to promote more intensive husbandry methods and to establish an improved network of price information.

(3) The Horticultural Crops Development Authority will be strengthened and its role redefined to include the provision

of technical advice to growers and to Government; the collection and dissemination of information on market demand and prices; provision of specialized inputs to farmers; and assistance in marketing of produce through the operation of collection, storage, and transport facilities. These activities will be directed particularly towards small farmers.

(4) Government will pursue its experiments in exporting fresh horticultural produce by sea to the Middle East.

Development implications of commodity programmes

5.48. If the commodity production targets for coffee, tea, food commodities and horticulturals are realized, while the rest of agriculture expands with population growth at 3.7% a year, value added in agriculture would rise by 5.1% a year from 1984 to 2000, just over the rate necessary to reach the overall GDP growth target of 5.6% specified in Chapter 2. Moreover, this growth is consistent with employment creation in agriculture of 3.3 to 3.8% a year and productivity growth in agriculture of 1.3 to 1.7% a year, close to the national average as projected in Chapter 2 (Table 2-3). But the results depend crucially on both the expansion of tea and coffee area and the intensification of maize, milk, tea and coffee production. Should the intensification of food crop production not to be sufficient to free up 3% of total cultivated area for new tea and coffee plantings, then agricultural value added could not grow faster than 4.1% a year. This would barely keep pace with population growth; would permit very little productivity and per capita income growth in agriculture; and would thus destroy any chance of creating the kind of vigorous agriculture on which overall growth, not to mention rural-urban balance, depend.

Provision of Inputs

5.49. Dramatic increases in agricultural yields are central to Kenya's entire development strategy. Kenya can achieve these targets in two steps. First, farmers must be induced to apply improved practices within the existing body of technology. To make this happen, farmers must have ready access to inputs of seed, fertilizer, insecticides, mechanization, water, animal feeds, and credit. This section covers these inputs and the next section deals with the extension service, which must provide advice on how to use them. The second step in increasing yields is the development of new varieties, especially of maize and horticultural crops. The research needed to acomplish this is covered in a later section.

Seed

5.50. The ten-fold increase in the production and marketing of hybrid maize seed since the late 1960s has made a major contribution to the growth of Kenya's agriculture. The Kenya Seed Company continues to be an effective producer and marketer of seed. It is vital that it remain so, with sufficient margins to maintain its financial health. The major outstanding concern, apart from the need for intensified research into new maize varieties, is to increase the strategic reserve of hybrid seed to guard against shortages following future droughts. Such a reserve cannot be commercially viable and will be maintained at Government expense.

Fertilizer

5.51. Increased application of fertilizer is pivotal in achieving higher yields, especially from coffee, tea, maize and horticulturals. The wide variation in fertilizer use per hectare from one part of Kenya to another and the large shortfalls from recommended use for many crops both testify to the need for improved fertilizer availability. For example, smallholders in Muranga apply 26 times the fertilizer to their coffee as do smallholders in Meru, while tea smallholders in Central Province apply two to three times the fertilizer as their counterparts in Rift Valley, Western and Nyanza Provinces. It is estimated that coffee and tea smallholders apply no more than one third of the recommended fertilizer, whereas tea estates use close to the recommended applications. Maize growers use even less fertilizer: as low as 5% of recommended levels in Nyanza Province to a high of 60% in Trans Nzoia.

5.52. The returns to farmers from increased fertilizer use are attractive enough to require little additional price incentive. In 1983/84, a shilling spent on fertilizer yielded 10 to 14 shillings of revenue to tea and coffee growers, 4 shillings to wheat growers and 3 shillings to maize farmers. Thus if fertilizer and information about its benefits can be made available widely throughout Kenya and if credit can be obtained, farmers will use more fertilizer. However, national fertilizer supplies are not always adequate or available on time. And smallholders have difficulty obtaining fertilizer even when it is available nationally, for a variety of reasons: long distances from farms to retail outlets discourage farmers; price margins for retailing fertilizers are too small to encourage local shopkeepers to transport and stock them; the minimum package of 50 kilograms is much too large for most smallholders; and cooperatives often lack the managerial abilities and cash flow to satisfy members' needs for fertilizer. Removal of these impediments will not only play an important role in increasing agricultural productivity, but will also stimulate marketing activities and create employment opportunities in rural centres.

5.53. Impediments to the import, distribution and use of fertilizer will be removed as follows:

(1) Government will continue to license a number of established dealers to import and market fertilizer, including the KGGCU, cooperatives with adequate management capability, and private firms with established competence in the field. The MALD will determine the suitable types of fertilizer for Kenya's crops and conditions, and license applicants will be judged partly on their ability to supply these fertilizers.

(2) Control prices for fertilizer will be set for a limited number of distribution centres only and retailers will be permitted to set their own prices. This will encourage local dealers to move fertilizer into more remote locations while assuring farmers the opportunity of purchasing at controlled prices in the major centres. It is expected that under this policy most small farmers will have improved access to fertilizer on a timely basis and at lower overall cost than at present.

(3) Gazetted prices will leave substantial margins to encourage rebagging fertilizer into smaller quantities convenient for small farmers.

(4) The extension service will actively promote fertilizer use; will publicize the suitable types to be used for each location, crop and time during the season; will make spot checks on the types of fertilizers being stocked in local market centres; and will inform farmers where and from whom they can purchase the correct fertilizers.

(5) Credit facilities (discussed below) and crop payment systems will be improved to enable farmers to purchase fertilizer when needed.

Farm mechanization

5.54. On large farms that produce maize and wheat, land preparation accounts for up to 50% of total production costs. This suggests the need for measures to ensure the continued availability of appropriate machinery and equipment and to encourage the most economic use of this costly resource. Government has a procedure to control and standardize importation of farm machinery, including testing and evaluation for performance and reliability. Licensed dealers will be required to have adequate capacity for the service and repair of farm machinery, including sufficient stocks of spares. Government will also encourage private contractors and owner-operators of machinery to provide service to farmers. A mechanization extension programme will be designed to help ensure improved machinery utilization by farmers.

5.55. The MALD's Tractor Hire Service (THS) will charge commercial rates for its services and will be withdrawn from areas where private contractors provide adequate service in land preparation. The Plant Hire Service (PHS) will, first, be mobilized to help farmers institute soil conservation programmes on large farms and in arid and semi-arid areas, where mechanization is essential. Second, PHS will help farmers build small dams and other works for micro-irrigation systems that conserve water and utilize it more productively. Enhanced user charges will be an important source of funding for PHS.

5.56. Land preparation is also a constraint for achieving higher production on small farms. Reliance on hand tools limits a family to planting half a hectare or less of annual crops and much of this will be planted late and weeded inadequately. Use of oxen reduces preparation time to less than 40% of that required with hand tools alone, markedly expanding the area planted and thus raising yields to both land and labour. Development and use of improved ox-drawn equipment requires efforts in research, manufacture, marketing and extension. The Rural Technology Unit of MALD will be the focal point for these efforts. It will identify new technologies and test market them, then encourage private manufacturers to produce and market the new equipment. A parallel extension programme will be developed to investigate the use of different types of draught animals, to train farmers in the conditioning of oxen, and to encourage farmers to adopt supplementary dry season feeding. Small-farm mechanization using appropriate technologies will provide an important opportunity for rural, small-scale industry in manufacture, sales and repair of equipment.

Irrigation

5.57. Large-scale irrigation systems, especially those requiring pumped water, are costly undertakings all over the world and generally require subsidization. In Kenya, of seven large schemes covering 9,000 hectares, only the gravity-fed Mwea Tabere scheme has had positive cash flows. Construction costs and subsidies have averaged 25% of MALD's budget for the past four years. Large-scale pumped irrigation has not been a cost-effective way to provide jobs and incomes for rural families. In some situations, especially on lands near existing transport, gravity-fed systems may be economic and such schemes will be investigated. But priority will be given to the consolidation and rehabilitation of existing schemes.

5.58. Low-cost smallholder irrigation gives greater promise, including land reclamation via flood control, valley bottom development, and drainage of water-logged lands. To realize this potential, the budget for small-scale irrigation will be raised gradually from the 1985/6 level of £213,000 to £ 2 million by 2000 (in constant prices).

5.59. The MALD has instituted a task force with representation from all relevant ministries, charged with examining and making comprehensive recommendations on (a) total irrigation potential, (b) alternative cost-effective approaches to developing this potential, (c) broad aspects of land and water management, (d) changes in the Irrigation Act (1966) to bring large and small-scale irrigation under the same organization, and (e) the institutional framework for planning and implementating irrigation and drainage programmes under District Focus. Three important aspects of future irrigation development are (i) the assessment of irrigation technology, especially in arid and semi-arid areas, to find suitable low-cost methods; (ii) means to reduce the infrastructural costs of irrigation schemes; and (iii) the training of Kenyan experts to plan and operate irrigation projects.

Animal feeds

5.60. Increases in dairy and meat output will require more attention to the production and use of livestock feeds. A market for sorghum, millet, and triticale as livestock feeds would increase grain production and incomes in marginal rainfall areas where these crops do better than maize, wheat, or rice. Similarly, multiple cropping of maize or sorghum may produce immature crops suitable for livestock feed. By-products of sugar, pineapple, sisal and other processed crops can augment feed-stuffs. And the expanded planting of soya bean, sunflower, rape seed and groundnut promises significant protein supplements, as would the utilization of waste products from livestock slaughter and fish processing. MALD will undertake a study of the potential for production and use of livestock feed with the aim of developing a comprehensive policy to promote this industry.

Credit

5.61. The strategy of crop intensification cannot succeed unless farmers have adequate cash flow to purchase inputs. Kenya's existing policy of maintaining remunerative prices for farm commodities, together with prompt payments from purchasing agencies, are essential to providing purchasing power to farmers. It is recognized that payment is not always as prompt as it could be and Government is undertaking a systematic programme to speed up payment wherever feasible.

5.62. No matter how prompt and remunerative are cash payments to producers, it will be necessary to provide both seasonal and long-term credit to help farmers adopt and intensify their use of modern practices. Government is committed to increasing the amount of credit available to farmers from its own resources and from aid donors. It also accepts the principle that some degree of subsidy will be necessary for agricultural credit, especially to smallholders. This may be accomplished by

offering loans at low rates to financial institutions to cover their costs of relending at commercial rates to farmers. However, credit schemes have been hampered by late repayments and widespread defaults.

5.63. The following steps will be taken to improve the credit system and make funds more widely available to farmers:

(1) The Agricultural Finance Corporation and Cooperative Bank of Kenya will be given full support for its efforts to collect loan principal and interest.

(2) No borrower will be given access to more than one public or quasi-public loan scheme for the same purpose and credit records will be coordinated to ensure this.

(3) The needs of livestock producers will be served by developing loans that have longer grace and repayment periods.

(4) Private livestock traders who provide acceptable immovable collateral will be allowed credit to procure stock for slaughter and immatures for resale to ranches.

(5) To encourage commercial banks to extend their agricultural lending, especially to smallholders, aid donors will be encouraged to channel funds through Government to the banks at concessional rates of interest, earmarked for lending to smallholders.

(6) To mobilize rural saving for agricultural and other rural credit needs, Government will encourage cooperatives, churches, non-governmental organizations and private individuals to establish local savings and loan associations.

Arid and Semi-Arid Lands

5.64. About 80 percent of Kenya's land area is arid or semi-arid. This area supports 20 percent of the country's people and half of its livestock. Arid and semi-arid lands (ASAL) have fragile environments, subject to degradation as more people move into them from the overcrowded lands of medium and high potetial. Yet these lands represent a potentially important resource which, if managed carefully, can help serve the income, employment, and food self-sufficiency goals of this Sessional Paper.

5.65. Most of the elements for the continued development of ASAL have already been discussed in this Paper:

(1) Livestock is the basis for the ASAL economy. Measures to improve the breeding of sheep and goats, to develop stock routes and water supplies, and to control livestock diseases are central to ASAL development. Links between ASAL regions

and the higher potential areas can be intensified through a programme under which ASAL herders produce immature animals for fattening in the high potential areas.

(2) Crop research and development will focus on drought resistant crops and suitable grasses to prevent erosion.

(3) Small-scale irrigation, if suitable and inexpensive technologies can be found, will help provide food security. Exploitation of sub-surface water, dams to conserve run-off water, and roof catchments will all be explored as ways to tap water resources.

(4) Environmental protection will be essential to maintain a viable economy in ASAL regions. Reafforestation will serve the three purposes of protecting watersheds, preventing soil erosion, and providing fuelwood.

5.66. Kenya's formal development programme for ASAL was begun in 1979, funded largely by aid donors. Direct financing and procurement, outside Government's budgetary system, has been common. Budget rationalization requires that these programmes be brought within the system and given scrutiny similar to all development projects. Moreover, these programmes are district-specific and will thus be managed within the system of District Focus for Rural Development. In this context, ASAL programmes will be integrated into the policies for rural-urban balance discussed in Chapter 4. Indeed, the resources devoted to ASAL can make an important contribution to furthering the goals of rural-urban balance.

The Role of Cooperatives

5.67. Cooperatives have made it possible for many thousands of small farmers to participate in Kenya's economic development. In 1984, for example, cooperative societies marketed 60 percent of all the coffee and 72 percent of all the dairy products sold to marketing boards. The programmes for crop intensification and expansion announced in this chapter will depend in important ways upon the further development of the cooperative movement.

5.68. Cooperatives already play a major role in the provision of credit to smallholders. Government will ensure that the Cooperative Bank is accorded a sufficient share of the funds available for agricultural credit to meet the needs of society members, especially those farmers participating in the specific crop intensification and expansion programmes outlined in this chapter. A few cooperatives have become highly successful in the direct procurement and marketing of fertilizer and other inputs. This is an effective way of broadening the marketing channels for fertilizer and thus increasing its use. Other societies will be encouraged to enter this market once they have the managerial

capacity to do so.

5.69. Cooperatives can broaden their role in the marketing of outputs. For some crops such as horticulturals, good quality and prompt delivery are essential. Cooperatives can, by gaining a reputation for good quality control and efficient marketing, secure larger and more remunerative markets for their members. They can also feed back information on the kinds of crops in high demand, keeping up with changes in market conditions and giving their members the advantage of growing those crops and varieties likely to fetch the best prices. Cooperatives may also be able to transport crops to market, either themselves or through private contractors, in ways that reduce marketing costs and hence raise farm gate prices. And cooperatives have the potential for seeking export markets in ways that individual farmers cannot. These possibilities extend, not only to agricultural commodities, but to handicrafts and simple manufactures of the informal sector, as discussed in Chapter 4.

5.70. Perhaps the major constraint preventing more cooperatives from undertaking these important tasks is the lack of management capacity. Government will encourage cooperatives to invest in the training of managers, both in Kenya and abroad. The curriculum and teaching performance of the Cooperative College will be kept under review to ensure that cooperative managers are learning skills relevant to the management of these expanded responsibilities. Government will also encourage cooperatives to look to other Government training programmes as a source for new managers and technical officers.

Extension Service

5.71. The intensification of both food and export crops within the next decade is a matter of national survival. A price incentive system to accomplish this is already in place and steps to improve the marketing of fertilizer and other inputs are contained in this Sessional Paper. The remaining element for a successful programme is Government's extension effort. As an indication of the importance of extension, consider the potential for raising yields of maize on smallholdings. The returns to fertilizer use are substantial: as indicated in paragraph 5.48 above, one shilling spent on fertilizer can yield three shillings' worth of maize. But the returns to improved husbandry are considerably greater: maize yields can be tripled over current practice on many farms, with or without the application of fertilizer. It is the crucial role of the extension services of the MALD to help farmers to achieve these vastly greater yields. Extension is carried out within the Ministry by the Extension and Agricultural Services Division and outside the Ministry by the Kenya Tea Development Authority, various chemical companies, and three major specialized processors of agricultural products: Kenya Breweries, East African Tobacco and East African Industries.

5.72. The key to a successful extension service lies in its ability to put well-trained officers into the field, supply them with timely and useful advice for farmers, and maximize the number of contacts that officers have with farmers. The Training-and-Visit (T&V) System currently being implemeted is intended to do these things. This World Bank-funded programme will be continued until its formal completion. When fully implemented, this intensive and systematic approach to extension will reach the major arable areas of the country, where close to 90% of the farm population lives. Once completed, the T&V programme will be evaluated and an appropriate follow-up version of T & V will be absorbed into the regular activities and budget of the MALD, funded with the highest of priorities.

5.73. Absorption of the T&V System and other improvements in extension will require a reorientation of budgetary expenditures. Currently, expenditures on extension account for 8% of the MALD's recurrent budget and less than 6% of its development budget. Close to 90% of these expenditures are for salaries, leaving totally inadequate amounts for transport and other necessary complementary expenditures. The current practice of hiring all graduates from Government-supported training programmes tends to push up expenditures on personnel while further reducing funds for complementary expenditures. This trend threatens to shackle the extension service and thus threatens the very goals of food security and agricultural income growth. Government will increase the budgetary allocations for extension services while basing its hiring policy on the numbers of new diploma graduates needed for greater effectiveness and productivity. The cost will be substantial. It is estimated that to absorb the 1985/6 recruits into the service, but without any further expansion of staff; and to bring complementary (non-salary) expenditures up to a minimum 30% of total outlays; will require a 142% increase in extension service recurrent expenditures over 1984/5 estimates, to £ 11.1 million in 1984/5 prices. This estimate is in constant 1984/5 prices.

Research

5.74. It is estimated that, with effort, it should be possible to remain self-sufficient in maize and other food crops for close to 10 years on the basis of improved husbandry using known technologies and more inputs. But after that, it will be essential to have available a new generation of high-yielding varieties of maize and other major food crops. For this to happen, a major effort in agricultural and livestock research must get underway almost immediately.

5.75. Once research is seen as an integral part of a well-defined long-term strategy for agricultural development, the directions of needed change become evident. First and foremost, research must be concentrated on those crops and those kinds of farms on which the strategy depends most heavily. The first priority is maize and especially maize grown by smallholders.

Although maize accounts for 23% of the total farmland and 13% of the value of marketed output, it only receives 8% of the research funding. This share will be increased. Another high priority is dairy production, which must more than double on existing land in order to maintain self-sufficiency to the end of the century. Research needs for these products plus wheat, horticulturals and beef production must be fully funded before other research programmes are pursued. To maintain Kenya's healthy competitive position in world tea and coffee markets, continuing research on these crops will have a priority equal to that on maize and dairy production. However, coffee and tea research are conducted by the independent Coffee and Tea Research Foundations and will continue to be funded by cesses on producers.

5.76. Research suffers from a number of structural problems that will be corrected as a matter of urgency:

(1) It will be necessary to raise total funding for research from £6.9 million in the 1984/5 recurrent estimates to almost £10 million. This estimate allows for 1985/6 recruitment, but for no more hiring beyond that, and for non-salary expenditures of 45% of the total; it is in 1984/5 prices.

(2) Increased support from the beneficiaries of research, especially growers of wheat and maize, will be employed to help fund this increased outlay. Charges may take the form of a levy on improved seeds or on produce sold to the NCPB, using the principles enunciated in paragraph 5.22.

(3) Research suffers from excessive salary costs relative to complementary expenditures. Generally, staff costs should not exceed 60% of the total to permit researchers to do effective work. In Kenya today staff costs range from 60% to over 80% and if hiring trends continue, they will soon claim virtually all available expenditure. Consequently, Government will base its hiring policy on the need for additional personnel to carry out well-defined research and on the resources available to support productive research work.

(4) Research efforts are spread over too many stations and projects. These will be concentrated on the activities of highest priority. The existing network of research stations will be rationalized.

(5) More research effort will be devoted to problems of smallholders, especially to issues of labour productivity and farmer risk.

(6) A programme of training and upgrading research staff will be undertaken and the terms of service modified to promote the best researchers and retain them in Government service.

(7) Private research efforts will be encouraged by a combination of private and Government financing.

Land Tenure and Use

5.77. It was said in paragraph 5.5 that Kenya has only 5.2 million hectares of land devoted to crop and milk production. Even if all irrigable land were put under production, total crop and dairy land could be expanded by only 10 percent. To ensure both food security and adequate export growth to the end of the century, this limited quantity of land must be used as productively as modern seed technology, complementary inputs, and farming methods can make possible. Anything short of optimal land use would jeopardize the economic future of the country.

5.78. In this situation, private owners have a social obligation to put their land to its best use. The sanctity of private land ownership will be respected in Kenya. But it can only operate if private land is used in socially responsible and productive ways. Two misuses of land must be prevented if the strategy for agricultural and economic growth presented in this Paper is to be realized. First, despite growing population pressure on the land, there must be limits to the subdivision of small farms. Subdivision should be prevented beyond the point where total returns to land begin to diminish. Second, Kenya cannot feed itself and produce sufficient exports if land is allowed to lie idle or underutilized in large landholdings. Steps must be taken to induce landowners to put underutilized land to more productive use. Government recognizes the sensitivity of land issues. But the economic future will be bleak unless these twin problems are faced and solved.

5.79. There has not been a major review of land policy since Independence. The existing situation combines colonial land tenure laws with recent practice in a complex pattern that makes it difficult to operate a land policy. To correct this situation, Government will appoint a high-level commission to review the land tenure laws and practices of the country and to recommend legislation that will bring the law into conformity with Kenya's development needs. The commission's terms of reference will include consideration of the following elements of a land policy:

(1) taxation and other measures that provide an incentive to use land more productively;

(2) regulations limiting the extent of subdivision to ensure that farmland can produce adequate income for a family unit, including potential criteria governing subdvision, which must vary by agro-ecological zone;

(3) laws that could encourage and protect holders of large

tracts who lease their land to those able to farm it more intensively;

(4) means by which authorities in urban centres of all sizes can obtain land expeditiously for needed expansion, especially to accommodate small-scale manufacturing and service industries.

(5) the appropriate infrastructure to utilise land allocated for public facilities to promote rural-urban balance.

The commission will be appointed early in 1986 and will be required to complete their report within one year.

CHAPTER 6: INDUSTRY AND TRADE

Strategic Goals for Industry

Policies that stimulate rapid agricultural growth and a dynamic rural economy will simultaneously create a growing domestic market and investment opportunities for Kenya's industrialization. Over the long run, Kenya will be able to industrialize more effectively based on the greater purchasing power of rural and urban consumers and on larger supplies of low-cost agricultural raw materials. For the next 15 years, industry must be restructured to become far more productive and attain rapid growth in order to serve five basic aims.

6.2. First, industry must help to expand and diversify Kenya's export base. Over 1980 to 1984, industry processed or manufactured 36% of Kenya's commodity exports, but only 15% when petroleum is excluded. If the country is to finance imports sufficient to enable the economy to grow at 5.6% a year for the rest of the century, industrial exports will have to expand at over 6% a year in real terms. By contrast, from 1980 to 1984 the volume of non-fuel manufactured exports fell by 2% a year.

6.3. Second, industry and trade must create jobs at a rate exceeding 4% a year. Chapter 1 made it clear that the bulk of off-farm job creation will be in the informal sector, consisting of the self-employed and very small firms in both industry and services. Government will look to modern industry to expand its labour force more rapidly than other sectors, through new investment, the highly productive deployment of its capital, and innovations that conserve capital while using more labour. However, the savings available to finance investment in industry will not result in sufficient new jobs unless a large share is channeled to informal sector manufacturing.

6.4. Third, manufacturing must develop on the basis of relatively high and rising productivity. Most jobs will be created in agriculture and the informal sector, where labour productivity is below that in modern manufacturing. Nevertheless, it is important to lay the basis for expanding employment in manufacturing at productivity and wages above those in other sectors. As modern manufacturing expands to account for a much larger share of employment and output, it will eventually lead the way to higher average earnings for a substantial and growing number of workers.

6.5. Fourth, manufacturing needs to attract and generate indigenous Kenya entrepreneurs and managers. The informal sector is the most likely breeding ground for new entrepreneurs and received prominent attention in Chapter 4. Focus on youth polytechnics as part of the secondary educational system will also

contribute to the emergence of a large cadre of technically able Kenyans who will become the owners and managers of small-scale enterprises. Larger-scale manufacturing must continue to indigenize its management and ownership by an extension of measures already in place.

6.6. Fifth, industrial growth must support and promote the development of agriculture and of the rural areas. The value and range of agricultural products will be enhanced by Kenya's ability to process them efficiently. This holds for a broad mix of products: an effective canning industry could open new export markets for Kenya's fruits and vegetables, just as an efficient textile industry could widen the domestic market for Kenya's cotton. Small and medium-scale industry, located in rural areas, can supply inexpensive inputs to agriculture, manufacture goods for local consumption, develop inexpensive building materials and furnishings, and provide jobs and incomes for growing rural centres, towns and small cities.

Industrial Strategy

6.7. The five basic goals for industrial development can be achieved by the private sector acting under price and other incentives established by Government. In the face of severe fiscal stringency, direct investment by Government in modern industry would be an uneconomic use of scarce public resources that are urgently needed to support agricultural growth, extend rural infrastructure, and maintain social services. Direct intervention by Government in investment, production and pricing decisions by the private sector also diverts scarce public managerial capacity from completing essential tasks, including several that can support private manufacturing development. The structural adjustment strategy, which has been implemented progressively since 1980, is essentially a move away from direct Government involvement in manufacturing and other sectors where the private sector can operate effectively. This chapter will detail specific policies to reinforce structural adjustment and extend it.

6.8. The broad outline of a market-based incentive structure was given in Chapter 2, paragraphs, 2.51 and 2.52. The following features of that structure are particularly relevant to industrial development:

(1) Rapid growth in agriculture will provide expanding rural markets for all manufacturing, especially for small-scale, rural-based firms.

(2) Exchange rate management will seek to maintain stability in the real profitability of manufacturing for export and for efficient import substitution, despite international and domestic inflation and changes in tariff structure.

(3) More uniform import duties and more liberal import licensing will together make industrial inputs readily available at lower cost while inducing manufacturers to produce for export markets and to provide import substitutes at prices much closer to world standards, thus benefiting consumers.

(4) Special export incentives, such as export compensation, manufacturing in bond, and the green channel, will help exporters to overcome the particular problems and costs of breaking into foreign markets.

(5) Wage guidelines will continue to encourage investors to use more labour-intensive methods of production, while boosting investments in sectors that are inherently labour-intensive.

(6) Interest rates will be maintained above rates of inflation, high enough to encourage only those investors who can make productive use of their capital and who can conserve capital by employing more workers.

(7) Practices in restraint of trade will be brought under Government scrutiny to make domestic markets more competitive and more open to the entry of new, especially smaller, firms.

(8) Price controls will be streamlined to operate more rapidly and flexibly, while formulae for price determination will be broadened to include all costs and data on competing import prices.

(9) Streamlined procedures will make the remaining administrative controls less onerous to investors in general and to exporters in particular, reducing the costs and delays in making new investments and in operating existing manufacturing facilities.

(10) Legal and administrative conditions specific to foreign investors will be reviewed to ensure that overseas firms can work within of Kenya's market-based incentive structure.

6.9. It is important to recognize the crucial feature of this incentive system: under it, private investors--large and small, domestic and foreign--can make attractive profits while directly contributing to the broad-based development of Kenya. Government acknowledges that investment in manufacturing is a risky venture for the individual entrepreneur or firm. To make it worthwhile for investors to bear such risks, they must have the potential to earn substantial profits and a return on capital at least as great as in other sectors or other countries. Actions by Government that reduce profits of companies already producing in Kenya discourage other potential investors. At the

same time, the social justification for private investment is its direct contribution to widespread income growth, employment generation, export expansion, rural-urban balance and the development of African entrepreneurs and managers. The purpose of a market-based incentive system is to reconcile the private and social motivations for private investment. Investors who succeed in making profits under the incentive system will, at the same time, automatically be contributing to Kenya's development goals.

6.10. A supportive incentive structure is crucial to attract new investment. But it is equally important to investors that the incentive structure be stable over a long period. It takes several years for an investment to yield its profits and investors must be able to rely on a stable set of market-based and other incentives over that time. The incentive structure discussed in this chapter has been evolving over the past few years and will continue to change in ways that improve the investment climate The basic aims are clearly stated in this chapter. Government recognizes the importance of keeping the incentive system in place for many years and plans to do so.

6.11. Three kinds of industry will be encouraged by market-based incentives: (a) export-oriented manufacturing, (b) efficient import substitution and (c) small-scale, employment-intensive industry . It has been Government policy for some time to reduce the emphasis on highly protected, import-substituting industries in favour of those capable of exporting. The incentive structure now in place--based on realistic exchange rates, moderate protection, reduced taxes on industrial inputs, and special export incentives--should over time begin to induce manufacturers to build capacity with export markets primarily in mind. However, it is important to recognize that Kenya's strategy also encompasses import substitution as a continuing avenue for industrial growth. The main qualification for new import-substituting industries is that they compete with imports at moderate rates of protection and without quantitative restrictions, rather than the very high rates of duty augmented by protective import licensing that were used frequently in the past. Export-oriented and import-substituting firms that can prosper in this incentive environment will be welcome to invest in Kenya.

6.12. The third kind of desirable industry can be loosely termed "informal sector" manufacturing. It, too, will do best in an openly competitive environment. Moreover, vigorous agricultural growth will itself stimulate informal sector expansion by generating demands for a variety of rural-based manufacturing and service activities. However, two factors point towards continued Government involvement in the encouragement of informal sector manufacturing. First, Government is already involved in the necessary regulation of the location and size of such activity. These regulatory activities need to be reviewed to reconcile the sometimes conflicting aims of maintaining public order and environmental standards, and promoting more informal sector activity. Second, existing capital markets may not be adequate to channel

resources to very small-scale enterprises. Support for the development of new capital market institutions to facilitate informal sector investment is an appropriate function of Government in a market economy. Proposals to support informal sector manufacturing are contained in Chapter 4.

Incentive Structure

Protective System

6.13. Much manufacturing industry in Kenya today was built under a highly protective incentive system. The three central elements of this system were (a) licensing that limited or prohibited the importation of goods competing with domestic manufactures; (b) high duties on competing imports; and (c) relatively low duties on industrial inputs. More liberal licensing of imports in recent years has reduced the importance of licensing as a protective shield for local manufacturers, but remnants of this protection are still effective for certain products. Industries that are shielded from import competition by bans or strict licensing become monopolies, unless a number of competing domestic firms exist. They are in effect exempted from the market-based incentive structure that is to guide industrial development. Their typically high costs penalize consumers and other industries--especially export industries--that use the outputs of protected firms. Such industries are thus able to earn substantial profits without improving their efficiency and without contributing to Kenya's development. Hence Government will continue to move away from restrictive import licensing as a means of protecting local industry and will instead depend more on the tariff system and the exchange rate.

6.14. The tariff structure is in a state of transition. The regime that emerged from the import substitution strategy placed high duties on imports that compete with domestic manufactures, while keeping the duties on non-competitive raw materials and intermediate goods at lower levels. The effect of this system was to create very high protection for finished goods industries and some manufacturers of intermediate goods, but quite low protection for some backward-linked industries that might otherwise have supplied intermediate goods. Under these conditions, it has been possible for some firms to earn large profits, even though they save very little foreign exchange, employ few workers and use their capital inefficiently. Thus the tariff regime permitted and even encouraged investments that did not promote Kenya's development.

6.15. Adjustment of the tariff regime has been underway since 1981. So far the emphasis has been on reducing duty rates on industrial inputs to help industry reduce costs. The next phase of tariff adjustments will focus on the remaining high duty rates, those that afford excessive protection to industry. These rates will be reduced gradually, slowly exposing domestic industry to competition from imports as an inducement for them to

become more efficient. Firms that can produce profitably within this protective structure will in all likelihood be serving Kenya's development goals. Those that cannot work within this protective structure are unlikely to be contributing to development and are thus wasting Kenya's resources. Given the extreme scarcity of investment, fiscal resources and skilled labour in Kenya, the existence of non-competitive industries exacts a high cost from unemployed workers who would have jobs if those resources were invested in more labour-intensive activities; from farmers and other rural dwellers who are denied resources to improve their productivity; from consumers who pay unnecessarily high prices for manufactured goods; and from taxpayers who must make up for revenues lost when inefficient firms fail to uphold their share of the tax burden.

6.16. As tariff rates come down, the exchange rate will be managed to provide some compensating protection to industry. The Kenya shilling will be maintained at realistic values in terms of the major trading currencies, with the aim of establishing Kenya's competitiveness in world markets. Those import substituting manufacturers whose operations result in net foreign exchange saving will benefit from this policy. Those whose foreign exchange costs are close to their foreign exchange saving will not and should not benefit.

Export Incentives

6.17. In the long run, the best incentive for export industries is the flexible management of the exchange rate, which will maintain profitable margins of export earnings over domestic costs of production. However, additional incentives may be necessary to convince potential exporters to make investments of time and money to break into foreign markets. Export compensation has been a feature of the incentive regime since the 1970s. The purpose of this payment is to compensate exporting firms for costs of production that are higher because of tariffs on their imported inputs or because their protected domestic suppliers produce at high cost. The 1985/6 Finance Act established a 20% rate for export compensation. This rate is to be maintained for several years. A positive list of eligible exports is being prepared and will be published. Steps are being taken to ensure prompt payment of compensation to qualifying exporters. These actions should establish export compensation as a dependable component of the incentive structure, so that qualified exporters can count upon prompt compensation payments when they make investment and marketing decisions.

6.18. Manufacturing in bond is being implemented. A set of procedures has been worked out and Customs officers designated to administer bonded facilities will start an accelerated three-month training course early in 1986. Applications for several bonded manufacturing facilities have been received and decisions on them will be taken as soon as trained Customs officers are available to administer the new facilities.

6.19. The green channel is a means of simplifying and speeding up the steps required for an exporter to receive the necessary administrative approvals. Qualifying exporters will be given documents with green borders that require priority action by those responsible for import licensing, foreign exchange allocations, and export approvals. An interministerial committee is being appointed to work out and implement the details of this innovation.

6.20. Government-financed export credit guarantees have been discussed for some time as a means of overcoming the inherent risk in loans to exporters and thus promoting a flow of credit to exporters. Government's financial situation, as described in Chapter 3, makes such a credit guarantee scheme infeasible for the foreseeable future. However, if commercial and political risk is a factor inhibiting the flow of credit to exporters, then it should be profitable for commercial banks and other financial institutions to provide a credit insurance facility. These institutions can pool their export credit portfolios, thus diversifying their risk, and thereby provide a credit insurance scheme privately. Exporters would have to pay a premium to participate in such a guarantee scheme, but the pooling of credit would make that premium less than the risk faced by individual exporters. Government is prepared to facilitate the creation of such a scheme, although it cannot participate either as a source of capital or as a guarantor. It may be possible to attract foreign assistance to get the scheme started.

6.21. The Preferential Trade Area, encompassing countries in East, Central and Southern Africa, can eventually have a profound impact on Kenya's trade. Common preferential duty rates will open potential nearby markets to qualified Kenyan exporters, but will also provide competition within the Kenyan market for hitherto protected manufacturers. Currency clearing arrangements should also reduce the risks of default on export credits. Kenya's relatively advanced industrial base should enable it to compete effectively for markets within the PTA and to withstand competition in its own markets. Because the PTA will increase competition within its boundaries, it is consistent with the market-based incentive environment being established within Kenya.

6.22. For the most part, the market-based incentive structure outlined here should be adequate to create a profitable environment for investments in export industries. However, the structure will be kept under continual review to ensure it is adjusted to accommodate changing conditions. From time to time, investors may approach Government to obtain special concessions over and above the generally available incentives described here. If such concessions are warranted by special circumstances, they will be considered and may be granted. But in the future, such consideration will only be given to firms that are or soon can be successful exporters. The Government of Kenya is determined to promote the export of manufactures and will employ all possible

means to achieve rapid export growth. In contrast, firms that produce for the domestic market will necessarily do so within the market incentive structure described here and will not be eligible for special concessions.

Other Investor Incentives

6.23. Government's basic approach to encouraging both domestic and foreign investors is to use broad fiscal, monetary and pricing policies to establish a hospitable investment climate. Domestic and foreign investors will be attracted by the fundamentals of a sound, dynamic economy backed by stable political conditions. Investors with projects that contribute to Kenya's development goals should be able to earn attractive profits without any special tax incentives. Thus tax holidays, special depreciation rules, customs duty and sales tax remissions, and other special tax treatment will generally not be used to promote investment. These devices, which can be costly to the Treasury, are of uncertain benefit in attracting investment and in any case are often nullified for foreign investors by the tax laws of their home countries. If used extensively, tax incentives tend to establish a confusing and often contradictory array of signals to investors. Notwithstanding this basic policy, the tax reform study announced in Chapter 3 will seek ways to adjust existing tax rules to remove significant disincentives to investment--such as the 15% withholding tax on foreign interest payments--and ensure the tax system is compatible with Government's underlying strategy to promote private investment.

6.24. The major exception to this policy is locational incentives. The aim of locating industry in rural areas and the smaller cities of Kenya is an important element in achieving rural-urban balance. Ultimately, the best incentive for the development of rural-based industry is a prosperous agriculture and no tax-based incentive will be effective in the absence of agricultural growth. However, to give an additional boost to rural investment, the 1985/86 Finance Act raised the investment deduction from 20 to 50%: new facilities locating outside Nairobi and Mombasa are able to take a once-and-for-all deduction equal to 50% of the cost of plant and equipment, thus reducing income taxes in the early years of a project. It is estimated that this allowance, discounted over the life of investment, is equivalent to a subsidy of about 10% of the initial cost of an investment under typical circumstances.

6.25. The Government encourages foreign investment on the same terms as domestic investment. That is, foreign investors who can earn attractive profits under the market-based incentives structure described in this chapter are encouraged to invest in Kenya. A stable political system, a sound and growing economy, its central position in Eastern Africa, a record of fiscal and monetary responsibility, and Kenya's steady record of facilitating profit remittances, all make Kenya an attractive country for foreign investment. Although Government will depend on the

general incentive climate to attract foreign investors, it will also take steps to remove existing constraints that may have inhibited some overseas investors.

6.26. Firms with foreign ownership have been restricted in their access to domestic credit markets. These restrictions will be eased as follows:

(1) All firms, including foreign-owned firms, will be permitted to borrow locally up to the amounts required to pay customs duty on imported capital equipment.

(2) In addition to (1), foreign-owned firms will be permitted to borrow from local financial institutions amounts proportional to the share of equity owned by Kenya citizens. That is, if the domestically owned protion of equity is 40% then for every £6 borrowed from foreign sources, the firm may borrow £4 in Kenya.

6.27. In addition to these immediate steps, Government will undertake a general review of the Foreign Investment Protection Act with the aim of amending it to account for the increased risks being borne by foreign investors in an international environment of inflation and fluctuating exchange rates. Changes will be considered in the valuation of assets for purposes of repatriation of capital and in the terms under which such capital is kept in Kenya should it be necessary to withhold repatriation temporarily during a foreign exchange shortage.

Investment Approvals

6.28. As announced in July 1985 by the Minister for Commerce and Industry, investments of over Shs.5 million no longer require approval of the Ministry. However, investors do require as many as 30 specific approvals, for everything from the purchase of land to work permits for expatriates and the importation of capital goods. Many of these are necessary, but the delays in obtaining them are not. The process of gaining Government approval for an investment can take as long as three years, itself a strong deterrent to investors. Government is determined to simplify, coordinate and shorten the process of investor approvals. An interministerial committee will be established under the chairmanship of the Ministry of Finance to recommend a set of simplified procedures for investment approvals, eliminating unnecessary approvals and consolidating those that remain into a streamlined process.

Monopoly and Price Controls

6.29. The market-based incentive system spelled out in this chapter can only work to channel resources into their most productive uses if markets function competitively in Kenya. In

many cases they do not. Some markets are dominated by monopolies or oligopolies (markets of very few firms) because in Kenya's still very small markets only one or a few manufacturers can produce at reasonable cost. These are the large-scale industries in which costs decline with the volume of output. To prevent such manufacturers from exploiting their monopoly positions requires a combination of liberal import policy and price controls, as described below.

6.30. Other markets in Kenya, though not dominated by the "natural monopolies," are nevertheless distorted by monopolistic and other restrictive practices. The techniques are numerous, but they all conspire to yield three adverse effects: smaller competitive manufacturers, wholesalers and retailers are weakened and forced out of business; potential new entrants are discouraged from setting up competitive businesses; and, because of this reduction in competition, consumers are forced to pay higher prices. These restrictive practices thus thwart Government's intent that savings and other resources should be channelled to their most productive uses.

6.31. At present, Kenya has no comprehensive legislation making restrictive practices illegal and no administrative or legal mechanism to prevent them. The Working Party on Government Expenditures recommended the establishment of a Prices and Monopolies Commission to promote competitive markets and prevent practices in restraint of trade. Government will propose legislation prohibiting restrictive trade practices and establishing an administrative mechanism to enforce it. Over time, successful prevention of restrictive trade practices will make it possible to shift emphasis away from most price controls towards greater dependence on market forces to ensure that prices reach competitive levels. Moreover, administrative and legal barriers to restrictive practices are essential to promote small-scale manufacturing and service activities, especially those in the informal sector, which are often discouraged by the predatory practices of larger firms.

6.32. Even after the new administrative mechanism has become effective in reducing restrictive practices, price controls will remain necessary to accomplish two purposes. First, controls will remain in place to stabilize the prices of necessities, especially basic foods, and to give both producers and consumers well-advertised annual prices on which they can depend. Second, the "natural monopolies" must be restrained from raising prices above competitive levels and earning monopoly profits. The best way to prevent this is the liberal importation of competing commodities, forcing local firms to meet world market prices plus a moderate protective tariff. However, to the extent that foreign exchange shortages continue to restrict competitive imports, price controls will remain essential to curb monopoly pricing.

6.33. But it is equally important to know what price controls cannot accomplish and what price control administration

is not intended to achieve. First and most basically, it is not possible for administrative controls to keep the prices of any commodity permanently below their long-run cost of production, including an allowance for profit. If prices are set too low to cover the costs of production for farmers or manufacturers, these producers will eventually either shift into other, generally non-controlled commodities for which market prices do generate adequate profits, or else they will go out of business altogether. New investors will avoid industries that produce commodities under price controls. So, over time, less of the price-controlled commodity will be produced, relative to growing demand, consumers will not be able to obtain all they would like, and there will be a strong tendency for the price to rise even higher than in the absence of controls.

6.34. Second, it is difficult to control prices for very long below the levels set by supply and demand in the market, even if these are substantially above the costs of production and thus provide generous profits for producers. This is true because, when consumers are willing to pay much more than the controlled price level, there is a strong tendency for illegal, parallel markets to spring up, evading controls. Both consumers, who cannot otherwise obtain all they would like of a good, and producers, who can earn large profits, benefit from dealing in parallel markets. Hence these become hard to police. Worse, the profits earned in parallel markets can be used to corrupt officials charged with enforcing price controls and those earning such incomes evade paying taxes on them.

6.35. Third, it is sometimes thought by the public that controls over the prices of necessities will make it cheaper to buy them, so that the living standards of poor families can be protected. Although controls can keep the prices of necessities down for a time, for the reasons explained above producers will eventually offer less of these goods for sale. Low-income families, who have less access to central city markets where price controls are effective and who cannot afford to pay the higher prices in parallel markets, will simply obtain less of the price-controlled commodities. So controls cannot protect the living standards of low-income families for any length of time. Fourth, and for the same reasons, price controls cannot dampen general inflation for very long. Instead, it requires responsible monetary and fiscal policies to keep general price levels from rising too fast.

6.36. Price controls in Kenya have been administered to accomplish the two feasible goals mentioned above: stablizing the prices of necessities and controlling monopoly pricing in the absence of sufficient import competition. To make price controls more effective as a tool to promote increased productivity and growth, the functions of price control should be integrated with those of control over restrictive market practices. And to make price controls more equitable for both consumers and producers, price control rules and procedures should be streamlined. Thus the following steps will be taken:

(1) A Department of Price and Monopoly Control (DPMC) will be created in the Ministry of Finance to take over the functions of the existing Department of Price Control. The expansion and upgrading of staff will make it possible to obtain and utilize more information on prices and trade practices both within Kenya and abroad.

(2) The DPMC will, under new legislation to be prepared, monitor actions in restraint of trade and enforce rules prohibiting unfair practices. This function will be developed gradually and cautiously to ensure that all affected parties--consumers, producers and their competitors--have ready access to an impartial and effective enforcement process.

(3) Under the DPMC, the administration of price controls will be improved and applications for price increases handled more quickly. Applications will be acted upon within 90 days. If no action has been taken by that time manufacturers will be permitted to charge the price applied for until official action is finally taken.

(4) The Determination of Costs Order will be revised for those items remaining under price controls, so that costs now excluded from consideration can be brought into the formula. This will permit manufacturers to be compensated for many costs that are not now a basis for permitting price increases, even though these costs are necessary for producing and selling their commodities and are often beyond the firm's control.

(5) The new Determination of Costs Order will permit the Price Controller to shift some industries from a cost-based formula to one based on import parity for a protective tariff. The advantage of this formula is that it introduces effective import competition without actually having to import the commodity. Manufacturers able to reduce their costs relative to competing imports could then earn higher profits. Thus the most productive industries will be most profitable and attract most investment, as is essential in a growth-oriented economy. Under cost-based formulae, no matter how comprehensive, there is little incentive to reduce costs and raise productivity because lower costs only result in smaller allowances for price increases. Once sufficient data on import costs are accumulated, the Price Controller will begin to apply the import parity formula for some firms on a selective and experimental basis.

(6) Items that are not produced by monopolies and are not essentials for low-income families will be considered for decontrol on a gradual basis.

CHAPTER 7: AGENDA FOR ACTION

Development Goals and Strategy

This Sessional Paper has reasserted a set of goals that will guide Government's economic development policy to the end of the century:

(1) renewed economic growth, with a target rate of 5.6% for GDP from 1984 to 2000;

(2) accelerated employment creation, especially in the private sector, to ensure that all Kenyans can participate in a growing economy;

(3) rising productivity in all parts of the economy, public and private, so that all workers can enjoy rising real incomes;

(4) provision of basic needs for all Kenyans, firmly based on rising employment, productivity and incomes so that private households can provide for themselves most of the food, shelter, and clothing, and even part of the water, education and health needs of the country;

(5) food security based on increased productivity in the production of both food and export crops;

(6) improved rural-urban balance, to ensure that the benefits of economic growth are spread widely throughout Kenya; and

(7) gradual structural change from an agrarian into an urban-based industrial economy, with agriculture and small-scale industry and services leading the way for the next 15 years as modern industry is restructured to play its essential development role.

7.2. A strategy for achieving these goals has been set out in Chapters 2 through 6, containing the following major elements:

(1) Emphasis on family planning will be continued to reduce the rate of population growth so that the expanded resources generated by economic growth can improve the lives of all Kenyans. [Chapter 2]

(2) The mixed economy will continue to be Kenya's instrument for development, with increasing activity by the private sector, which will be encouraged and regulated more by Government-guided market forces than by direct intervention

and controls. [Chapters 2 and 6]

(3) Government's direct investment in development will be guided by the need to work within limited budgetary resources, to increase its resources via tax reform, and to invest those resources as productively as possible through a programme of budget rationalization and by limiting Government employment to levels dictated by the requirement of rising productivity. [Chapter 3]

(4) Money and financial markets will be developed and interest rates will be determined increasingly by market forces, to make monetary policy effective and to channel savings into higher productivity uses (Chapter 3).

(5) Resources will be directed to the development of promising rural market centres, towns and small cities to encourage the creation of productive non-farm employment opportunities in rural areas. [Chapter 4]

(6) Operations of District Development Committees, County Councils and Local Government Authorities will be strengthened to enable them to administer programmes for rural-urban balance. [Chapter 4]

(7) Informal sector and other small-scale industry and services will be encouraged. [Chapter 4]

(8) Production of the major export crops--coffee, tea and horticulturals--will be increased through a combination of crop intensification on existing land and modest area expansion. [Chapter 5]

(9) Production of food crops--especially maize, wheat and other cereals, milk and meat--will be increased to achieve food security through research, extension and marketing programmes aimed at major intensification of production without an increase in land area devoted to these commodities. [Chapter 5]

(10) Liberalization of import policy will continue through a reduction in the use of licensing and greater dependence on tariffs to control imports; protection will be decreased gradually and made more uniform to induce manufacturers to lower costs and to become more competitive in the PTA and world markets. [Chapter 6]

(11) Current measures to encourage non-traditional exports will be continued and improved. [Chapter 6]

(12) Legislation will be introduced to deter actions in restraint of trade and thus foster market competition, while price controls will be reformed to ensure rapid administrative responses to applications for price adjustments and to broaden the criteria for adjustments. [Chapter 6]

Agenda for Early Action

7.3. The balance of this chapter is devoted to a summary of the major policies requiring early action by Government. Not all policy actions discussed in earlier chapters are included here. Those that suggest gradual shifts in policy or implementation over a long period are omitted. And policies already in effect are mentioned only to the extent that significant changes in implementation are required. The policies given below can thus be taken as an agenda for priority action within the next 12 to 18 months.

Fiscal and Monetary Policy [Chapter 3]

7.4. The Ministry of Finance will soon undertake a comprehensive study of the tax system as a step towards tax reform that will aim to raise revenues towards 24% of GDP; encourage saving and investment; promote rural-urban balance; advance Kenya's structural adjustment by extending recent changes, especially in import duties and export compensation; ensure that revenues can keep pace with income growth; and improve tax enforcement at low cost. [3.6]

7.5. Despite revenue reform, Government will not be able to continue offering social and economic services at current or improved levels unless participants contribute more to support certain services, especially some amenities offered by local authorities, agricultural research, and livestock development. [3.8]. Also, Harambee contributions can be more productive if funds are raised to support the operating and maintenance costs of projects, in which case Government would seek support from aid donors for capital expenditures. [3.11]

7.6. Beginning with the Forward Budget exercise for 1987/88 to 1990/91, expenditures will be increased for infrastructure to promote the growth of rural centres and small towns; agricultural research and extension; planting programmes for coffee and tea; youth polytechnics and other technical secondary schools; and credit programmes to assist very small-scale industry and services. [3.12] Recurrent expenditures on education and health will be reduced gradually as a share of total recurrent expenditures to 30% and 8%, respectively, under recommendations to be provided by the Presidential Working Party on Education and Manpower Training and by the Ministry of Health, respectively. [3.13]

7.7. Forward Budgets will be further guided by a programme of budget rationalization that will identify high-productivity projects for additional funds and speeded implementation; identify low-potential projects to be postponed or cancelled; ensure that recurrent resources are available in the future to operate and maintain completed priority projects and generally to improve the utilization of completed facilities; and fund new projects

only if they pass stringent tests of high productivity and cost effectiveness. Aid donors are being asked to adjust their assistance to conform with this approach. [3.15]

7.8. Employment in Government will no longer be guaranteed for graduates of University and training programmes; rather, Government will employ only those actually needed on the basis of increasing productivity of Government services. The numbers hired will be decreased gradually, consistent with available resources, and others encouraged and assisted to seek employment in the growing private sector. The intake of Government training programmes will be reduced gradually, commensurate with the number to be hired by Government plus those expected to find jobs in the private sector. Training institutions will revise their curricula to prepare graduates for private sector work. Government will review its staffing requirements, job descriptions and evaluations to reduce overstaffing and increase productivity. [3.22]

7.9. Monetary management of the economy and management of Government's debt will be improved by:

(1) developing an effective system for competitive marketing of Treasury bills, along with a secondary market;

(2) offering a wider variety of maturities of Treasury bills;

(3) collecting and publishing information on the volume and prices of new issues and on trading in secondary markets for public and private money market instruments;

(4) keeping the gap in interest rates between the commercial banks and the non-bank financial intermediaries under review to ensure their ability to compete on an equitable basis; and

(5) establishing a Capital Market Development Committee to oversee the development of money and capital markets. [3.28]

7.10. Financial (capital) markets will be developed to channel savings into more productive investments. Among the primary tasks are to broaden the criteria on which commercial banks make loans; to revitalize the stock exchange; and thus to create sources of more long-term debt and especially of more equity finance for growing companies. This will help to correct the excessive and risky dependence on short-term debt to finance economic activity in Kenya. These reforms will require extensive discussion and close cooperation between Government and the private sector. To promote this discussion, Government will soon release a joint study entitled, "Money and Capital Markets in Kenya". [3.42]

Rural-urban Balance [Chapter 4]

7.11. The growth of Rural Trade and Production Centres [4.15] will be promoted by both the District Development Committees and central Ministries under guidelines that:

(1) ask DDCs and local authorities to place greater emphasis on building infrastructure that assists the private sector to create more productive employment in their towns and small market centres; [4.12]

(2) ask all levels of government to concentrate resources on a few small urban centres of high potential in each district; [4.14]

(3) encourage central ministries to focus development expenditures on rural roads, transformers for local electricity supplies in smaller centres, and water supplies and sewage treatment in larger towns where these have become bottlenecks to growth; [4.21] and

(4) instruct Ministries, DDCs and local authorities to follow engineering standards for roads, water supplies, sewage systems, buildings, etc., that reduce capital costs and employ more labour. [4.25]

7.12. Resources have been inadequate to finance local infrastructure in recent years. To ease this limitation on the achievement of rural-urban balance,

(1) all government agencies, central and local, will be urged to charge market prices for the sale and rental of housing and housing plots; to cover full costs in their charges for services such as water, sewage, electricity and other services; and to adjust these charges frequently; [4.26 and 4.33]

(2) the Local Government Loans Authority will be restructured along the lines of a municipal development bank, offering loans at commercial rates of interest; [4.29] and

(3) the Ministry of Local Government will work with local authorities on a case-by-case basis to expand and strengthen their revenue base. [4.34]

7.13. The foundation for this effort must be dynamic and competent DDCs and local government authorities. A programme will be developed by the Ministry for Local Government, including training and technical assistance, to improve the financial and operating management of local authorities. [4.31 and 4.36] The Ministry will be strengthened to accomplish this. [4.39] The Local Authorities Act will be reviewed to ensure that local authorities are properly empowered to carry out their responsi-

bilities and are organized to operate within the framework of District Focus. [4.37]

7.14. Growth in the rural areas will intensify concerns to preserve Kenya's natural environment. Guidelines to local authorities will stress ways to avoid environmental damage in planning the development of towns and cities. [4.40]

7.15. Informal sector industry and services will be promoted in five ways. First, Government will establish a programme to open a flow of credit to very small-scale enterprises by:

(1) investigating and implementing means to reduce the requirements for collateral commonly established by commercial and public banks;

(2) encouraging aid donors to provide grants and loans for onlending to commercial banks and other financial institutions at low interest rates, allowing them to cover the greater risks and costs of lending to very small firms;

(3) encouraging cooperatives, non-governmental organizations and strong local voluntary associations to devise their own credit programmes for the informal sector;

(4) promoting schemes to provide graduates of technical secondary schools with the tools of their trade and with small infusions of working capital to start their own businesses. [4.46]

7.16 Second, to promote new products and technologies appropriate for very small enterprises, Government will:

(1) encourage technical institutions and other bodies, both private and public, to undertake research and development on simple products and techniques to replace imported manufactures;

(2) disseminate information on such products and techniques via technical secondary schools and other channels;

(3) issue new regulations on tendering to require central ministries, district and local authorities to favour local, small-scale suppliers and contractors;

(4) issue revised building codes to permit the use of local materials and simple technologies that can be supplied by small local firms; and

(5) encourage informal sector producers and marketers to form cooperatives that can assist in obtaining appropriate technologies, credit, inputs, and access to markets. [4.47]

7.17. Third, to promote domestic trade in all its aspects:

(1) The Joint Loan Board Scheme will be restructured to make it a viable financial institution for small businesses in rural areas.

(2) District Trade Offices will be strengthened to enable them to provide more effective extension services to rural traders. [4.48]

7.18. Fourth, secondary technical and vocational schools of all kinds will be major contributors to the supply of workers and entrepreneurs in the informal sector. The Presidential Working Party on Education and Manpower Training will recommend ways to:

(1) rationalize and reorganize the various institutions engaged in secondary technical and vocational education;

(2) convert these institutions into a parallel stream that permits some students to enter institutions of higher education directly upon graduation; and

(3) include courses on management, marketing, accountancy, and other essential skills. [4.51]

7.19. Fifth, a task force will be established to review all policies to promote the informal sector, including current local authority bylaws and other regulations governing informal sector activities. The Task Force will recommend ways to create a healthy regulatory climate for these activities. [4.52]

7.20. These programmes to encourage informal sector activities come under the responsibilities of the Ministries of Commerce and Industry, Local Government, Labour, Cooperative Development, and Education, Science and Technology, and the Attorney General's Office. To coordinate Government's efforts, monitor progress and explore alternative approaches, the Ministry of Planning and National Development will establish a special unit for small-scale enterprises and informal sector activities. [4.53]

7.21. The rural-urban strategy has implications for the expansion of energy sources. Demands for charcoal and wood fuel will require a 75 percent expansion of sustainable wood supplies, while widespread urbanization will require a larger electricity grid and a 70 percent expansion of generating capacity by 2000. The gestation period to increase energy resources can be quite long, especially in the case of fuel wood, and planning to meet these requirements is a matter of urgency. [4.54-4.59]

Agriculture [Chapter 5]

7.22. Coffee production will be expanded substantially within the context of the International Coffee Agreement through the following methods:

(1) extension efforts in existing coffee areas will be focussed on acreage expansion and replanting using the new Ruiru 11 variety;

(2) the Coffee Research Foundation's extension-related activities and Ruiru 11 seed programme will be expanded, with additional costs funded by an increase in the Coffee Board levy;

(3) Government will develop an integrated programme for the planting, production and marketing of robusta varieties in western Kenya and the coast;

(4) Government will, with assistance from aid donors, institute a programme to reduce the delay in payments to growers. [5.15]

7.23. Tea production and exports will be more than doubled by 2000. To accomplish this:

(1) Government, working through the Kenya Tea Development Authority, will formulate and implement a plan to expand the area under smallholder tea;

(2) Government will encourage new planting of tea on existing estates;

(3) Government-owned tea estates of 6,000 hectares will be established on the perimeters of indigenous forests;

(4) Funds will be mobilized, with assistance from aid donors, to increase the size of the first payment to smallholders;

(5) the domestic price of tea will gradually be increased towards export parity. [5.20]

7.24. Maize production will be more than doubled by 2000 without an increase in land area in order to keep pace with rising local demand. To achieve this target:

(1) maize research will be accelerated through a well-managed programme to identify high potential research areas and to achieve rapid results; and

(2) maize prices will be set at levels that balance domestic supply and demand, within the range of export and import

parity prices. [5.25]

7.25. Wheat production will be nearly doubled by 2000 and the production of wheat substitutes promoted by the following means:

(1) wheat and flour prices will be set at projected long-term import parity levels; and

(2) policies will be developed to encourage the substitution of triticale and sorghum for wheat in flour production. [5.28]

7.26. Milk production and marketing will be encouraged to match growth in demand, which is expected to more than double:

(1) artificial insemination services will be improved and expanded through an increase in Budget allocations to £4.5 million a year, much of it funded by an increase in the fee paid by farmers; and

(2) Government will develop a programme under which private distributors can emerge outside the KCC marketing system. [5.33]

7.27. Meat production will be encouraged in the short term by:

(1) completing the trunk system of stock routes and holding grounds to serve pastoral areas and establishing a national livestock marketing reporting system;

(2) developing water supplies at strategic points for nomadic herdsman and charging fees for maintainence; and

(3) developing a national breeding policy for sheep and goats. [5.36 and 5.37]

7.28. The Ministry of Agriculture and Livestock Development will review its strategy to control livestock disease and make recommendations on:

(1) the possibility of replacing cattle dipping with immunization to control tick-borne disease;

(2) ways to increase charges to beneficiaries of disease control, allowing for possible subsidies in cases where users cannot realize substantial benefits but where control is important to protect the national herd;

(3) means to increase the effectiveness of fee collections;

(4) a shift of responsibility for cattle dips to the districts; and

(5) increases in the efficiency of vaccine production through joint public-private ventures. [5.42]

7.29. Any future expansion of sugar production is dependent upon substantially reduced costs in growing and processing cane. The Ministry of Agriculture and Livestock Development will study and recommend changes in the management and structure of the industry to achieve such reductions. [5.43]

7.30. Horticultural production will cater to both domestic and export markets through an increase in output of about 6% a year. Government will support this industry by:

(1) planning and implementing infrastructural investment that will reduce the costs of marketing horticulturals and expand the market in major urban areas;

(2) providing improved access roads, introducing new varieties of vegetables, promoting more intensive husbandry methods, and establishing an improved network of market information;

(3) strengthening the Horticultural Crops Development Authority to assist in these tasks; and

(4) pursuing measures to increase air freight capacity and finding feasible ways to ship fresh produce by sea to the Middle East. [5.47]

7.31. Intensified production of all crops is a central theme of this Sessional Paper. Higher yields will require substantially improved husbandry practices, including especially the increased use of fertilizer. To promote fertilizer use, regulations governing its marketing will be reformed:

(1) control prices for fertilizer will be set for a limited number of distribution centres only and retailers will be premitted to set their own prices; this will encourage local distribution and make fertilizer available at lower overall cost to small farmers;

(2) gazetted prices will leave substantial margins to encourage rebagging of fertilizer into smaller quantities convenient for small farmers; and

(3) the extension service will promote fertilizer use; publicize the suitable types to be used for each location, time, and crop; and inform farmers where and from whom the correct fertilizers can be purchased. [5.53]

7.32. The Ministry of Agriculture and Livestock Development will examine the potential for small-scale irrigation schemes and make comprehensive recommendations on the total potential, alternative cost-effective approaches to small-scale irrigation such as land reclamation through flood control or drainage, and the institutional framework for planning and implementing small-scale irrigation projects. [5.58 and 5.59]

7.33. To increase the flow of agricultural credit, especially smallholders:

(1) the Agricultural Finance Corporation and Cooperative Bank of Kenya will be given full support in its efforts to recover loans;

(2) no borrower will be given access to more than one public or quasi-public credit scheme for the same purpose;

(3) livestock producers will be given loans with longer grace and repayment periods and livestock traders will be given credit to obtain stock for slaughter and resale;

(4) aid donors will be encouraged to channel funds to commercial banks at concessional interest rates for onlending to farmers;

(5) Government will encourage cooperatives, churches, non-governmental organizations and private individuals to establish local savings and loan associations to serve farmers. [5.63]

7.34. Development of arid and semi-arid lands will continue within the context of both budget rationalization and District Focus for Rural Development. The major ingredients of the programme will be livestock development, research on drought-resistant crops and grasses, small-scale and inexpensive means to environment and provide fuelwood. [5.64]

7.35. Government will encourage cooperative societies to enhance their management capacity, through training and other means, in order to undertake expanded tasks in the channeling of credit, the marketing of agricultural inputs, and the marketing of produce such as horticulturals for which quality control and more efficient transport and distribution are crucial factors. [5.68, 5.70]

7.36. Achievement of improved husbandry practices to raise yields depends crucially on the improved performance of the extension services. Two measures will contribute to this improvement:

(1) Government will provide for a major increase in expenditures on the extension services; and

(2) the number of diploma graduates hired into the extension services each year will be governed by the need to increase the services' effectiveness and productivity. [5.73]

7.37. To maintain food security to the end of the century, development of higher-yielding varieties, especially of maize and other food crops, is essential and urgent. To improve the effectiveness of Kenya's research effort:

(1) budget allocations to agricultural and livestock research will be increased.

(2) increased support from the beneficiaries of research--especially users of improved maize and wheat varieties--will help to fund this increase;

(3) the rate of hiring into the Research Service will be controlled to levels required for effective performance;

(4) the existing network of national research stations will be rationalized and their efforts concentrated on activities of the highest priority;

(5) more research effort will be devoted to problems of smallholders, especially to issues of labour productivity and farmer risk;

(6) a programme of training and upgrading research staff will be undertaken and the terms of service modified to promote the best researchers and retain them in Government service. [5.76]

7.38. Kenya's ability to feed itself and generate adequate growth in agriculture depends upon increasingly productive use of its land. Both the excessive subdivision of smallholdings and the underutilization of large farms work against increased productivity. Government will establish a high-level commission to review land tenure laws and practices and to recommend legislation that will bring the law into conformity with Kenya's development needs. The commission will consider taxation and other incentives designed to increase the productivity of land. [5.79]

Industry and Trade [Chapter 6]

7.39. Goals for industry are ambitious: annual growth of 7.5% a year to the end of the century and a restructuring to make manufacturing more competitive, whether against imports in the domestic market or in export markets within Africa and abroad. The basic incentive structure to achieve these goals is already in place and consists of (a) reduced dependence on import licen-

sing to control imports and increased reliance on tariffs; (b) more uniform and moderate protection from competing imports for manufacturers; and (c) a set of export incentives, including the export compensation scheme and manufacturing in bond. These incentives will harmonize public and private goals: the price system will ensure that firms, in pursuit of private profits, will simultaneously be achieving social aims of widespread employment creation and income growth. The immediate task for Government is to improve the administration of all these incentives to make them more effective.

7.40. Government will continue to encourage domestic investors to participate fully in Kenya's development. The broad incentive system being put into place, along with the development of financial markets (paragraph 7.10) will help achieve this end. Specific measures for very small-scale informal sector investors in manufacturing and trade are given in paragraphs 7.14 - 1.18. Additional steps are needed to encourage foreign investors to join Kenyan investors in marketing development:

(1) firms owned by foreign investors will be permitted to borrow from local financial institutions up to the amounts required to pay duty on imported capital equipment;

(2) foreign-owned firms will be permitted to borrow from local financial institutions amounts proportional to the share of equity owned by Kenyan citizens. [6.26]

(3) Government will undertake a review of the Foreign Investment Protection Act with the aim of amending it to account for the increased risks being borne by foreign investors in an international environment of inflation and fluctuating exchange rates. [6.27]

7.41. Investment approvals procedures are cumbersome and time-consuming. To reduce the discouraging impact of these procedures on investors, an interministerial committee will be appointed under the chairmanship of the Ministry of Finance to simplify the process, eliminate the unnecessary approvals, and consolidate the remaining approvals into a streamlined procedure. [6.28]

7.42. Price controls in Kenya are administered to stabilize the prices of necessities and to restrain monopoly producers from raising prices above competitive levels in the absence of sufficient import competition. To make price controls more effective as a tool to increase productivity and growth, the functions of price control will be integrated with those of control over restrictive market practices; and to make controls more equitable for both consumers and producers, the rules and procedures will be streamlined:

(1) a Department of Price and Monopoly Control (DPMC) will be created in the Ministry of Finance, under new legislation

to be prepared, to monitor actions in restraint of trade and to enforce rules prohibiting unfair practices;

(2) administration of price controls will be streamlined and applications for adjustments acted upon within 90 days, in the absence of which price adjustments will be automatically permitted;

(3) the Determination of Costs Order will be revised to include costs that are not currently a basis for price adjustments and will permit the introduction (on an experimental basis at first) of import-parity formulae on which to base adjustments;

(4) items that are not produced by monopolies and are not essentials for low-income families will be considered for decontrol on a gradual basis. [6.36]

Development Plan 1989 - 1993

7.43. The development strategy outlined in this Sessional Paper will be the basis for the next Development Plan, to cover 1989 - 1993. The Ministry of Planning and National Development will prepare guidelines for all ministries based on this strategy. Ministries will then prepare comprehensive plans based on these guidelines. The resulting Plan will consist of detailed proposals for the implementation of programmes and policies announced in this Sessional Paper and an extension of its principles to the development activities of all ministries.