

AIDE MEMOIR

Accelerating Reforms to Improve the Commercial Legal Frame and Remove Administrative and Regulatory Barriers to Investment

Based on the Fact-Finding Mission
by
Foreign Investment Advisory Service (FIAS), World Bank Group

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A. The Project

1. In October 2003, Mr. Mukhisa Katuyi, Minister of Trade and Industry (MoTI) made an official request for FIAS assistance in reviewing the commercial legal frame and regulatory and administrative barriers to investment. The Government seeks a focused effort to identify and remove the bureaucratic bottlenecks in the current regulatory system that governs the establishment and operation of businesses in Kenya. The ultimate goal of the GoK is to advance an enabling environment for domestic and foreign investment that will serve as the main engine of employment and income generation and poverty alleviation in the next stage of economic recovery and growth.¹

2. In response, FIAS conducted a preparatory mission in December 2003. In collaboration with the World Bank and DFID, FIAS proposed an approach that linked this project to the other key Government reform initiatives, either underway or being prepared, to ensure continuity and complementarity. It was agreed that the project would draw from the studies that had already been done, select a few areas that appear most problematic for investors for focused investigation, and provide specific and action-oriented recommendations that can help speed up the implementation.

3. Using the indicators of several previous studies, especially the Investment Climate Assessment survey recently completed by the World Bank, FIAS and the GoK further agreed on the selection of the following areas for focused review: commercial legal framework (with emphasis on investment protection and dispute resolution), company registration, business sector and activity licensing, access to land and property rights, construction and utilities hook-up, tax administration, and customs procedures.

4. FIAS and the GoK further agreed that success of the project would require a joint effort of international and local experts. The latter would include both the private sector of the country and representatives of relevant ministries and authorities.

5. FIAS and DFID agreed to jointly provide the funding support for the project, while the GoK agreed to make in-kinds contributions to the project.

¹ Foreword by President Mwai Kibaki, "Kenya: Economic Recovery Strategy for Wealth and Employment Creation, 2003-2007," by the Government of Kenya, June 2003, p.xi.

B. The Fact-Finding Mission

6. On February 3-13, a FIAS team of seven international experts visited Nairobi to start the fieldwork.² Once in the field, a local counterpart team representing both the public and private sectors joined the FIAS team. On the government side, a multi-ministerial counterpart team coordinated by the MoTI included professional officials representing MoTI, the Attorney General, the Ministry of Finance (MoF), the Kenya Revenue Authority (KRA), the Ministry of Local Government (MoLG), the Ministry of Land (MoL), the Ministry of Roads and Public Works (MoRPW), the Ministry of Agriculture (MoA), the Ministry of Tourism (MoT), and the national Investment Promotion Center (IPC). The officials teamed up with the international experts for most public sector meetings and prepared the logistics on the public sector side. On the private sector side, the Kenya Private Sector Alliance (KEPSA) and, through KEPSA several key sector boards,³ helped arrange most private sector meetings including focus group meetings and individual interviews with investors and private professionals. In addition, DFID (Kenya) provided assistance in coordinating this project with other donors of interests.⁴

7. With support from all sides, the mission fully succeeded in its primary objective, which was fact-finding. The team met with a large number of investors, business associations, and private professionals, to learn about their experience and concerns with both the laws and regulations and with government operations. The team also met with the relevant government institutions and officials in charge of policymaking and implementation at both the central and local levels. In addition, the team met with independent institutions and individuals closely involved in policy discussions, e.g., KIPPRA and the University of Nairobi. These meetings helped the team gather information and perspectives from different sides, gain insights into their respective concerns, and collect ideas and suggestions from all stakeholders in the country.

8. By involving all concerned parties in the fieldwork, the mission further contributed to a process of public-private sector cooperation and cooperation among multiple ministries and public authorities – a process that is as important as the substance in reforms of removing administrative and regulatory barriers to investment. All sides

² Xiaofang Shen, FIAS staff, led the team which was composed of Clare Manuel (on the legal frame), Marc Reichel (on licensing), Sam Levy (on land access and property rights), Ali Beba (on site development), Gerard McLinden (on customs) and Peter Maher (on tax administration). Judy Thongori, a locally based private lawyer, assisted Clare Manuel in the legal frame review. Manuel de la Rocha of the World Bank Nairobi office joined Gerard McLinden in the fieldwork on customs. In addition, Amanda Ellis of FIAS joined the mission for its first week to explore the gender dimension in the business environment in general and in administrative barriers in particular.

³ The private sector boards that provided active support included: the Kenya Association of Manufacturers, Kenya Flower Council, Kenya Federation of Tourism, Architectural Association of Kenya, and Kenya National Chamber of Commerce and Industry.

⁴ Major donors with which the project was coordinated include: DFID, USAID, GTZ, EU and UNDP.

that participated in the process saw a common interest in this work, and gained a sense of ownership of the project starting from the stage of information collection. This should contribute to a stronger commitment of the various parties to the needed changes when it comes to the stage of implementation.

9. The fruitful results of the mission were evident at the wrap-up meeting, chaired by Mr. Alex Ketter, Permanent Secretary of MoTI and well attended by senior representatives from the private and public parties involved, as well as representatives from donor agencies. The FIAS team made an informal presentation of its preliminary findings and possible ideas for improvements at the meeting, for the purpose of generating discussions and additional inputs from all participants. Attendees expressed appreciation for the level of details of the findings and the practical approach of the suggested ways forward. Many further appreciated the process of engaging all stakeholders, and expressed a desire to see this process continue to its full fruition.

10. The rest of this report summarizes the preliminary findings of the FIAS team as presented at the wrap-up meeting. It takes into account the additional inputs collected from the participants at that meeting. *All issues raised below are preliminary and will be further elaborated in the main FIAS report to be developed in the upcoming months. The general ideas for improvement provided below, especially, will be further developed into more specific and prioritized options and recommendations in the main FIAS report, in continued collaboration with the relevant parties both in the country and among the donor agencies.*

C. The General Message Based on the Preliminary Findings

The momentum of reforms to support private sector growth is strong

11. Since the National Rainbow Coalition (NARC) came into office about a year ago, profound changes have been underway in Kenya. The new Government is determined to reverse the trend of the last two decades of economic decline, increased poverty and governance deterioration. To this end, it has launched reforms on several fronts ranging from macro-economic stability restoration to anti-corruption and from legal justice reforms to key economic sector reforms. Creating an enabling climate for private investment, both local and foreign, has been a clearly stated government priority as seen in the national Economic Recovery Strategy (2003-2007). All this has generated optimism and high expectations among investors and the general population, which the FIAS team sensed positively during the mission.

..... but speeding up the implementation is urgent.....

12. However, the FIAS team also observed a strong and increasing sense in the private sector and among the general public that most of the reforms initiated by the Government have not moved effectively from “talk the talk” to “walk the walk.” Many

government officials interviewed also pointed out that the implementation process had been slower than expected. One repeatedly heard explanation from the various public institutions was that the needed changes were waiting for the outcome of the constitutional review and the completion of the legislative reforms that are both underway. Many also blamed the lack of active implementation on insufficient resources and capacity.

13. The FIAS team recognizes that problems in all areas of the economy are deep as a consequence of 10-20 years of accrual. Resolving the problems would not be easy and certainly could not be over-night. However, this should not prevent an accelerated reform implementation as demanded by the private sector and the general public. Investors and unemployed workers cannot wait for too long to see active implementation to happen if their support for the announced reform programs are to be sustained.

14. Moreover, the FIAS team does not agree with the notion that reform actions have to wait for the completion of the constitutional and legislative reforms, which will take some time. Nor does the team believe that changes at the operational levels entirely depend on substantial increases in budgets. Indeed, the team found that many of the laws in the investigated areas, albeit requiring improvements, are not entirely inappropriate, and they do not prohibit many of the changes urgently required at the various operational levels. Moreover, despite the fact that most public institutions are resource constrained, many actions could be taken by each of them to improve their daily operation even within the current capacity. The mentality of sitting and waiting is dangerous and could jeopardize the public trust and confidence in the new Government and lead to loss of the momentum of the reforms recently created.

15. The FIAS team, thus, suggests that the GoK put an increased emphasis on accelerating implementation in the current reform process. While comprehensive reforms in the legislative framework will remain essential and a long-term objective, the various public institutions should also become active in search of short-to-medium term solutions that could demonstrate quick and concrete results to the private sector and the general public. To this end, the FIAS team, while identifying the major policy and legal causations of the problems, also gave a special attention to identifying possible improvements that could be considered by the various government institutions relatively quickly even under the existing legal framework. These will be seen in the specific sections later in this paper related on each of the areas examined.

..... and the key to accelerating the implementation lays in the political will to support the private sector – at all operational levels

16. Quick fixes, however, do not necessarily mean easy fixes. Indeed, many of the actions that could be taken in the relatively short run at the operational level require institutional changes that are sometimes more difficult than legislative changes. The former have an impact on the roles and functions of public agencies and require individual staff to transform the mindset and skills in their operation. All this will not be

achieved unless there is a strong political will at the top and a shared commitment of the civil servants at all operational levels.

17. Although the new GoK has been unequivocal about the leading role of the private sector in the upcoming stage of the country's economic recovery and growth, the various regulatory authorities and public agencies interfacing with the private sector on a daily basis have yet to see the importance of their role in supporting the private sector. Our fieldwork revealed that most public authorities and agencies were unaware of the time and cost factors critical to doing private businesses, few ever thought about the cumulative burden imposed on investors by the multiple and often redundant bureaucratic procedures, and most agencies considered themselves "regulators" only and seldom "service providers" *vis-a-vis* private investors.

18. The lack of a private sector thrust is also observed in several important sector reform programs being developed in the country. The legal sector reform program prepared by the Ministry of Justice, for instance, fails to have a private sector focus when highlighting seven key result areas, despite the fact that commercial legal reform is essential to private sector growth.⁵ Similarly, the land policy and administration reform program being discussed within the Ministry of Land, while including a range of economic policy objectives, fails to highlight the need for a land policy that would support new investment led by the private sector.⁶ Discussions of reform programs within the tax and customs authorities, likewise, focus on revenue collection which whereas needed by the economy fails to take into account the need for facilitating and encouraging trade and private investment.

19. The FIAS team thus perceives a need to develop a stronger private sector thrust in the overall government reform programs, if the goal of the Government to make the private sector is the true engine for the economic growth in the next stage is to be realized. The current project, putting the various concerns of the private sector in one place, should be a step towards this goal.

..... as well as public-private sector collaboration and multi-ministerial cooperation ...

20. Reforms with the private sector focus will be successful only if public and private sectors work closely with each other and take a joint ownership of the reforms. It is also essential that the process of the reforms involves all the key ministries and public authorities whose functions have inter-related impact on private sector. Indeed, in most countries, reforms to remove regulatory and administrative barriers require the effort to generate mutual trust and institutionalize cooperation among the multiple parties. This institutional need could be as challenging as – sometimes even more so -- that in addressing the policy and procedural issues.

⁵ "Governance, Justice, Law and Order Sector Reform Program - Short Term Priorities Program; fiscal year 2003/04", Nov 2003.

⁶ "National Land Policy Formulation Process," draft concept paper, December 2003.

21. In its fieldwork, the FIAS team noticed that, due to a long period of disconnection and power abuse, private-public sector trust is extremely weak in the country today. In many of the areas investigated by the team, there appears an ironic situation in which the businesses trying to comply with the system are more likely to be penalized by the lengthy and unfriendly procedures of registrations, tax filings, etc.; whereas those trying to evade the system are likely to be awarded as evading registrations and tax payment is relatively easy (often with some unofficial payments). This has created serious doubt about the “level playing ground” among investors, encouraging a vicious circle of cheating/abusing the system, and in the end defeating the functioning of the system.

22. Moreover, information sharing and cooperation among ministries and between central and local government authorities are missing in almost all areas examined. As will be seen later in the paper, regulatory power is highly dispersed among multiple and overlapping regulatory authorities, which do not communicate with each other despite the fact that their performance affect each other. This has not only led to the delays and uncertainties in the investment procedures for the private sector, but also caused an enormous amount of confusion and frustration among the various executing agencies and officials.

23. Apparently, successful reforms for removing administrative barriers will require as much improved process, and the institutional solution will be as crucial as the policy and procedural recommendations. The current effort made by the MoTI to engage KEPSA, KIPPRA and several key ministries and authorities in this project is very encouraging and should be continued and expanded throughout the Government. Public-private sector cooperation and inter-ministerial collaboration have helped the project team to gather the good ideas and inputs from the various parties in the country and will continue to help the study to reach it full fruition. However, once the issues are clearly identified and recommendations provided, it will require the GoK as a whole to turn the study results into effective implementation plan. Decisions will need to be made at the high level, based on open and frank discussions with the private sector and all involved ministries and authorities. At the stage of implementation, all parties have to be involved to support and reinforce each other in succeed in the reform goal.

.....and, finally, more attention to be devoted to the details.

24. Although many studies have been done, more detailed analysis of the problems at the operational levels is in order, in order to develop concrete and implementable solutions that could be considered by the GoK in relatively quick fashion. To this end, the FIAS project takes a closer look at the operational procedures in the prioritized areas with a view to identify bottlenecks and possible solutions. The rest of the report highlights the preliminary findings in each of the areas examined. It also provides the preliminary thinking of the FIAS team with regard to possible ways forward, based upon both the good ideas collected from many parties in the country and FIAS experience around the world.

D. Legal Framework for Investment

25. The fieldwork revealed serious deficiencies in the current legal framework for investment in Kenya causing investors to have limited confidence in the system. Lack of compliance and enforcement of legal requirements is an issue in two key respects:

- In relation to legal requirements (e.g. for licenses, to register business names) which should be enforced by Government agencies. Enforcement is in some cases non-existent, in other cases erratic and is frequently an opportunity for rent seeking.
- In relation to private commercial transactions where the mal-functioning of the court system means that commercial relationships are seriously undermined because of the lack of a credible sanction for non-compliance. There is evidence that the effect of this, particularly on smaller enterprises, is that contractual networks are very restricted – people only do business with those they trust. The chaos in the business registries and the mal-functioning of the courts means that commercial information on credit-worthiness, which should be publicly available (through filing of annual returns and registers of judgment debtors), is difficult to obtain.

1. Business Registration

26. The Registrar General's Department in the Ministry of Justice administers various types of registers of importance to investors. The three key ones are – the Business Names Register; the Companies Register; and the Chattels Transfer Register. None of these systems of registration are fulfilling the purpose for which they were created, and the whole system requires a fundamental overhaul.

27. The Business Names Register is for unincorporated businesses using a trading name (which is not the name of the proprietor). The register, which dates back to pre-colonial times, is not up to date. There is no enforcement of the requirement to de-register when a business stops trading; and there are many unincorporated businesses trading without having registered their business names, with no action taken against them. On the other hand, both the tax authority and local authorities require registration of business names – apparently considering that such registration confers some sort of legality to the operation. The system of searching and registering business names requires personal attendance at the Registry in Nairobi – and due to the disarray in the Registry is a time consuming and (particularly for small businesses) a disproportionately costly affair.

28. *To improve the situation, the GoK may consider abolishing the requirement to register business names. The mischief of confusion between different business names could be addressed through private actions, rather than State control.*

29. The Companies Register is for incorporated companies – most of which in Kenya have limited liability status and are small privately owned businesses. The regime under which registration takes place is the Companies Act – based on the British 1948 Companies Act. The regime was designed for nineteenth century publicly owned companies, rather than small privately owned enterprises. There is a need for a fundamental overhaul of Kenya’s Companies Act in particular addressing the need to de-regulate and create a much more transparent and realistically enforceable regime. Filing requirements for small and medium sized companies need to be addressed, as do the formalities for initial registration, which, especially for small businesses are onerous. Advocates in Kenya have a monopoly on company formation, creating a barrier for small enterprises wishing to incorporate.

30. The Chattels Transfer Register relates to charges (mortgages) over property (except land). It is impossible to search the register as entries are made chronologically, rather than alphabetically. In general, the system for registering charges (against land and other property) in Kenya is archaic, making the granting of secured credit to a business a complex and risky affair. The legal requirements are scattered (in the Chattels Transfer Act, the Companies Act, land legislation and the common law). They are inconsistent with each other - depending on the nature of the debtor and the type of agreement; and are highly technical with rigid requirements.

31. *Reform of the system of land charges is clearly required, but will be complex and lengthy. In the meantime, the GoK may consider the adoption of a modern Personal Property Securities law (combined with a modernised Companies Act) to create a streamlined and transparent system for non-land charges would be relatively more straightforward.*

2. Commercial Dispute Resolution – the Courts

32. Most commercial disputes in Kenya are determined in the Magistrates Courts. In Nairobi alone the backlog of civil cases to be heard in the Magistrates Courts is 60,000, and growing. Claims of more than Ksh 3 million are determined in the High Court. In Nairobi there is a special division of the High Court dealing with specifically commercial cases - the Commercial Court. Although the performance of the Commercial Court has been impressive, it has to some extent become a victim of its own success with a growing backlog. Although the backlog can be addressed through more resources, and appointment of more Judges and Magistrates, there is also scope for administrative and legislative reforms, which would streamline the system and improve case flow.

33. The rules of procedure for dealing with civil cases are complex, lengthy and technical. Although there have been some amendments, they basically date back to colonial days – and are way out of line with civil procedures in other common law countries (including the UK). *Urgent reform is needed in particular to deal with technical issues such as granting ex parte injunctions and to incorporate the use of*

alternative dispute resolution to reduce the burden on the formal court system. The system of listing commercial cases is also archaic – requiring personal attendance by advocates in cases where it is clear that their case has no hope of being heard, not only wasting Court time, but also increasing costs for litigants.

E. Sector/Activity Licensing

34. To help understand the need for reforms in the licensing regime, the FIAS team looked at *general business licenses* and *special activity licenses*, using *tourism* and *horticulture licenses* to illustrate the latter.

35. General Business Licenses. There are two licenses every business needs to obtain before commencing operation, the single business permit from the Local Government and the trade license from the Ministry of Trade and Industry. The single business permit has no requirements and it is effectively a business levy collected by local authorities. The trade license is granted free of charge and its purpose is not clearly explained. The added value of both licenses to the businesses is questionable.

36. Activity Licenses. Almost all activities need special licenses. The regime is highly fragmented, with almost every ministry and authority issuing licenses in one way or another. The Schedule II of the new investment bill summarizes over seventy activity licenses currently required, and the list is not complete. This results in a high number of licenses that needs to be obtained by any single entrepreneur. It is not uncommon that a simple business needs more than six licenses from various ministries and authorities before commencing business.

37. Moreover, the authorities issuing licenses (even when they are just different units within the same ministry) do not coordinate their efforts or exchange information, which results in duplicating paperwork, time and money cost to investors who try to fulfill the licensing requirements.

38. What seems more problematic than the initial licensing is the requirement of the annual renewals of the licenses and the licensing inspections. Most of the licenses in existence require annual renewals. Each licensing body may send out inspectors to the business premises for inspections. Investors report that most inspectors are not professional and often use inspection as an opportunity to seek unofficial payments.

39. In the two sectors closely examined, i.e., tourism and horticulture, it is clear that investors in both areas struggle with the same problems described above. Especially, they are subject to multiple licenses issued by different line-ministries and regulatory authorities, which do not coordinate their requirements and sequence. An investor in tourism, for instance, has to deal with, respectively, the Ministry of Tourism, the Ministry of Health, the Ministry of Environment, etc. Likewise, an investor in horticulture must deals with the Ministry of Trade and Industry and the regulatory agencies such as HCDA

and PCPB, etc. None of these ministries and agencies has established information exchange and coordination system with the others.

40. During the last five years, reform efforts have been undertaken with some success. For example, a so-called single business permit replaced numerous licenses on the local level. Furthermore, the fees for the trade license issued by the MoTI were abolished. However, the effort is far from being sufficient. The whole licensing regime continues to impose significant costs on the private sector. Many large companies have employees dealing exclusively with licenses, renewals and inspections. One retail chain employed three full time employees in charge of monitoring and updating more than 100 licenses needed to operate the business. In a smaller business, it is often the general manager who has to do it all by him/herself.

41. *The situation clearly needs improvement. The GoK may benefit by a focus effort of licensing reform, with a view to abolishing unnecessary licenses, merging duplicating or overlapping licenses and licensing requirements, and streamlining those licenses that will remain because they are important to ensure vital public interests such as health & safety and environmental standards.*

F. Access to Land

42. Access to land by investors is extremely difficult in Kenya today. There are five principal issues in this respect that warrant concentrated attention by Government.

1. Land Administration

43. Until very recently, land administration in Kenya has been characterized by widespread corruption. The practice of allocating public land in derogation of the procedures set forth in law was reportedly common for many years. Also frequent were fraudulent transactions that depended, at least in some cases and in some significant measure, on the connivance of persons in the institutions responsible for land administration. The practices in question are amply described in a document prepared by the Government, "Report of the Commission of Inquiry into the Land Law System of Kenya on Principles of a National Land Policy Framework, Constitutional Position of Land and New Institutional Framework for Land Administration." These practices have eroded investors' confidence in land administration in Kenya.

44. These practices were in part facilitated by the severely degraded physical state of the land records of Kenya. Older records are often in tatters; some newer ones, for lack of funds, are collected in homemade cardboard "binders" and are deteriorating all the more quickly as a result. The shelving for this trove of manual files and binders is inadequate, and it is normal in registries to see records spilling onto the floor. Roofs on some registry buildings leak, imperiling the records. Clearly, the degraded and

sometimes chaotic state in which many records are kept in turn facilitates practices such as removing records or altering entries.

45. Like in most other parts of the public service, the staff of the registries is inadequate in number and, at more junior staff levels, deficient in training. The poor remuneration makes them much more vulnerable to solicitations to corrupt conduct. In addition, the resources available to the officers to do their jobs are inadequate. In the main national registry in Nairobi there is no consistently working photocopy machine. The fuel allotment to the Kiambu District Land Administration is insufficient to get surveyors out to the field to mediate boundary disputes for more than a few days a month.

46. Communication within the land administration is poor. The inherent difficulties in organizing and shuffling volumes of paper records further aggravate the problem. The Ministry of Lands seems to have insuperable difficulty locating any copies of documents that should be ubiquitous, such as a reportedly existing handbook of land administration. And it has made little effort to communicate its procedures to the public, in order to improve transparency.

2. Using Land as Security

47. In part as a result of the foregoing, it is very difficult to use land as security in Kenya. Banks are reluctant to lend against the security of land title outside the major urban areas, and even then commonly insist also on all-assets debentures from their debtors. Also contributing to this serious problem is the high transactions cost of establishing a security interest in land, in registration charges, attorney's fees and lost time. The particularly chaotic state of the Companies Registry, and its inhibiting effect on the registration of security interests against the assets of legal persons, was noted by a number of interlocutors.

48. Also contributing to this problem is the conduct of commercial courts in Kenya. Courts are reportedly very quick to grant injunctions against enforcement of security interests but slow to schedule the inter partes hearings needed to resolve cases definitively. As a result, it is relatively simple for debtors to postpone their day of reckoning, and creditors as a class are concomitantly reluctant to lend. In rural areas, the need for the local Land Control Board's consent to transfer in order to realize on security causes banks to steer clear.

49. Finally, it bears note that only between 5% and 10% of titled land is in the control of women, while women make up 75% of the agricultural labor force. It is from this sector that the Government projects that the majority of new jobs will come. But rural women entrepreneurs who need finance are doubly hindered: not only are they in areas into which banks are reluctant to venture, they cannot muster the title even the boldest bank will require in order to secure a loan.

3. Dispute Resolution

50. Resolving disputes about land in Kenya is slow and expensive, considering both court procedures and the attorneys' fees. Moreover, the process is unpredictable. Kenya has a modern arbitration law, but it is not used for land or lending. Notwithstanding a recent judicial decision that casts an unfortunate shadow over the enforceability of arbitral awards, it seems that the very limited recourse to arbitration is more the result of an unduly conservative, leather bound culture among lawyers and judges than it is a consequence of hostile legislation or precedent. With some exceptions, there is no obvious effort to resolve disputes using means appropriate to the economic interests in question. Recourse to the High Court is not limited by such filters as confining appeals to questions of law, mandatory attempts at mediation or arbitration. It is no surprise that, without such filters, justice in respect of land in Kenya is a clogged sink.

51. A notable exception in this regard is the Land Dispute Tribunals. These operate in rural areas. Land Dispute Tribunals hold good potential to resolve land disputes quickly and cheaply. Unfortunately, they are irregularly funded and in danger of breaking down.

4. State Land Allocation and Redressing

52. State Land allocation is currently put on hold, partly due to the need to clean up the corrupted scene in this area, and partly due to the fact that most of the State Land available for allocation had already been given away illegally. Redressing the state land illegally grabbed in the past years presents an enormous challenge to the GoK, of which solutions are not yet clear except that they will be politically difficult. There are also technical difficulties to be faced. No one knows for certain how many properties are in question: estimates range between 50,000 and 200,000 plots. Many of these properties were subsequently sold to third parties who purchased without knowledge of the questionable origin of such properties' titles. Further, commercial banks financed many of these transactions with the same ignorance. Thus, one major challenge is in reconciling the need to return the land grabbed illegally back to the State and the need to prevent the harm done to the innocent individuals, investors, and financiers, who have paid the market prices for the land titles now in their possession.

5. Private Land Transactions

53. Kenya has a relatively large and active private land market, at which buyers and sellers can negotiate the transactions relatively easily. However, private parties face serious difficulties in registering their transactions due to the disarray at the land registrar. Complaints have been particularly strong about the official valuation, which is required for each transaction. The waiting time for this official valuation is easily up to 3-4 months; and the resultant value is always higher than what the individuals report.

54. Moreover, there is an increasing concern among the investors and modern developers that the private owners of the land being transacted, if the transaction involves land use conversion (e.g., from agricultural use to industrial/commercial use), are under the pressure of the State to surrender the ownership to the State at the Land Registrar and, in exchange, be given a long-term lease of up to 99 years. Many investors have accepted this official practice, which is not required by law, as they see no other choice in getting the land they need for investment registered securely and in time.

55. There is no doubt that the current land situation is highly undesirable for investors, and it deserves a priority attention of the GoK, especially if the GoK is to succeed in encouraging investment in manufacturing, tourism and horticulture, all of which happen to be land-intensive businesses. *While many of the land related problems are resulted from political problems in the past and their solutions will wait for political decisions, there is still much to be done in the meantime to rationalize the legal and administrative systems, which are required to assure land market accessibility and property right security. Efforts are urgently needed to improve the current state of land registration. Efforts are also needed to strengthen the land survey service and rationalize the official land valuation systems. Finally, the GoK should re-examine the justification of putting pressure on private investors to surrender the land ownership to the State.*

56. *In addition, although state land allocation is halted at the moment, the GoK may wish to ask the question of how the state land can be allocated to private parties in future, when and fs such an allocation becomes possible again. The Government may wish to further reflect on what the specific allocation criteria and process ought to be. Among the options to consider are: (i) first-come, first-served; (ii) lottery; and (iii) public auction, depending on the social and economic objectives the Government may decide on.*

G. Site Development and Utility Connections

57. Investors who have acquired land continue to face the bureaucratic problems in obtaining the various official approvals for developing the site. There are three areas in which difficulties are outstanding.

1. Obtaining Approvals for Change of Land Use

58. Kenya does not have a “national plan for land use” at the present. Integrated plans for regional development are carried out for only 3 of the total of 71 districts. While land availability of land (private) for investments is not a major issue, purchasing the land and especially change of land use (from agricultural to industrial use) is. The process involves both local government (i.e., land control boards and City Councils) and central government (i.e., Ministry of Lands and Settlement). Except in EPZs, there are no written procedures, benchmarks, guidelines or formats to be followed by the investors. There are

overlapping functions and unclear divisions of roles and responsibilities in between governmental bodies. Lack of trust and lack of coordination cause excessive repetitions; which result in delays, uncertainty, and inconsistency for the investors.

59. In Nairobi, applications for land use conversions must be submitted to the city council, which designates technical committees to evaluate the project proposals. Investors found that the staff of the committees is often technically competent, despite the general problems of resource constraints. The final decision, however, must be made by the city council itself, which is a highly political process often without respecting the opinions already reached by the local technical committees. The council meets only once a month, and each meeting is reportedly overloaded with cases for decisions. Often, the council simply puts aside or rejects the cases for no clear reasons. Investors and staff of the technical committees have no choice but wait or restart the process again.

60. *To improve the situation, the GoK in the short run may consider introducing in the Act of Local Administrations the allowance of the approval process to end immediately after the technical committee approvals. The GoK could also consider setting time limits in the approval process, developing guidelines/formats for investors, and making information available for investors. In the long run, the GoK will need to complete district plans and national plans for land use, so that land use changes will be examined based upon clear and pre-set plans rather than on a case-by-case decision.*

2. Site Development Approvals

61. Kenya's Physical Planning Act (PPA '96) and its annexes provide fairly clear rules and procedures for the investors. They also include an approximate time frame for the approval process. In reality, however, procedures are applied differently for different types of investments. Also, the time needed for the "final" approvals are not certain since, similar to change of land use, final decisions are left to the politicians who meet monthly and make decisions without understanding the individual needs and technical aspects. Also like in land use change, very high number of applications overwhelming the council meetings.

62. Kenya's Building Codes of 1968 are too general and are out of date in many respects (e.g., focusing on "material" specifications). There exists a set of new building by-laws entitled "Planning and Building Regulation of 1998", which appears of a good quality, focusing on "performance" specifications, and reflecting the lessons drawn from many countries that have similar climatic and social-economic conditions of Kenya. However, these codes are not yet implemented.

63. Environment protection presents another important link in the site development process. The current Environmental Act introduced in 1999 and the Environment Impact Assessment (EIA) Regulation issued in June 2003 were steps in the right direction. However, investors are concerned of Schedule 2 of this regulation, which makes no

distinction between the size and nature of the activities, and thus treat almost all industrial developments the same way. Such a practice is inconsistent with best international practice, such as those issued by the WB and European Community's EIA directives. In addition, time and cost in implementing the EIAs are important concerns to investors. Presently, the National Environmental Management Authority (NEMA) charges a flat fee at the rate of 0.1% of the project costs, which appears to be a high cost to investors as this is in addition to the costs of executing an EIA. Further, the NEMA has recently announced the deadline of annual Environmental Audits (EAs) to be completed by all existing businesses by the end of 2004. This could cause severe backlog in the already jammed system.

64. *To improve the system, the GoK may need to consider the same measures as suggested in the area of land use change. Options could introduce immediate change through the Act of Local Administrations to shift more decision power from the city council to the technical committees. The idea of replacing the building codes dated back to 1968 with the "Planning and Building Regulation" drafted in 1998 could also be considered. Finally, the existing Physical Planning Act (1996) would require some amendment to include the relevant sections of the of the EIA regulation introduced in 1999.*

65. *With regard to the EIA requirement, the deadline did not seem realistic and should perhaps be reconsidered. At least, there should be a grace period for investors until such time when the major portion of the infrastructure (such as connection of water and sanitation services, a wider coverage of sanitary waste disposal and realistic emissions standards) are put in place. Further, the system could benefit from amending Schedule 2 to align it with the Schedules of WB or EC Directives. Finally, the idea of implement a scaling instead of the flat fee of 0.1% of the project costs to be charged by the NEMA seems worth considering.*

3. Utilities

66. While it may differ in order of priority, overall raking of the difficulties in utilities may be identified as follows:

67. Water: sewerage (sanitation): Investors complained about the availability, quality, and cost of water supply. The administration (covering metering and billing) is also among the most frequently complained problems of investors.

68. Roads: Almost all existing roads including the roads in "serviced areas" such as the

69. EPZs, are in very poor condition. Investors have often to build and repair the roads immediately needed for their operations, at their own costs. Sometimes, they have to fight for a "permit" from the local authorities to allow them to do the work for the local authorities.

70. Power (electricity): Power blackouts are daily experience of investors, most of whom have to install own generators to ensure their operation. Quality (varying voltages) of power supply is poor and unit cost (about 9c/kw-hr) is extremely high. The rules and time frame for connections seem to be tolerable. However, the Kenya Power & Lighting Co (KPLC) often asks investors to bear the costs of the standard power delivery equipment including transformers, poles, high voltage lines, underground cables, airbreak switches, surge diverters, etc.

71. Telecommunication: While the situation has improved in recent years thanks to the expansion of wireless services, serious issues exist in the land lines and in costs. State monopoly and closed markets are the main reasons for these problems.

72. *Many of the problems mentioned above are related to the governmental monopoly. Therefore, privatizing the services in the area of utilities and/or opening the closed markets to new investment entries remain priority solutions. In the meantime, the GoK could work with donors assistance in developing private-public participation schemes for improving the quality of the existing roads and constructing new roads, and in upgrading the power transfer and distribution systems. The GoK may also explore the possibility to interlink Kenya to the Southern African Power Pool (SAPP) via Tanzania to Zambia to South Africa where the average electricity costs are in between 2–4.5 c/kw-hr.*

H. Tax Administration

Kenya has a largely sound tax regime with tax laws operating fairly effectively. Tax rates (30% corporate and 16% VAT) are competitive in the region, particularly taking into account the generous appreciation rates and other investment performance based incentives. By and large, the business community does view the current tax regime either a major incentive or a major disincentive for doing business in Kenya.

The Kenyan Revenue Authority (KRA) was established in 1995 as the central body for the administration and collection of Income Tax, Value Added Tax, Customs & Excise, and Road Transport Collections. The KRA has a very successful track record in revenue collection over recent years, as evidenced by impressive revenue yields in the face of a challenging economic and political environment. Staff at high and middle management levels within the KRA are quite competent and business is reporting relatively low incidences of corruption as compared with other areas of government administration.

Nevertheless, the KRA is widely regarded in the business community as an organization obsessed with maximizing revenue collections, with little interest in the legitimate needs or circumstances of taxpayers. This is evident in a heavy reliance on financial auditing, punitive penalties (including a compounding interest component of 2% per month) with no corresponding interest paid on refunds or overpayments, delays in refunding monies owed to taxpayers (particularly VAT refunds), and a perceived reluctance to issue rulings. Penalties are automatically imposed irrespective of the taxpayer's circumstances

with the taxpayer then generally needing to apply, through the Commissioner, to the Ministry of Finance for any remission.

The KRA has a significant focus on the large taxpayer sector (their stated aim being to conduct an audit of each taxpayer in that sector annually), whilst little appears to have been done in terms of the very large informal sector which exists in Kenya – the consequence being an uneven playing field and little broadening of the tax base. Not surprisingly, the large business sector claims to be a visible target which is continually “harassed” by the KRA.

A Taxpayers Charter has been released which establishes various performance targets for the KRA. As a document it reads well but unfortunately the KRA is currently unable to measure its performance against these targets (in part due to the lack of computerization). What is clear however is that their performance is presently falling well short of the targets.

The end result is that the level of distrust and antagonism that exists between the business community and the KRA seems to be on the increase rather than abating.

The planned computerization program for KRA has not been implemented which is severely hampering its effectiveness in all areas of tax administration, e.g., PAYE and withholding taxes are currently being administered on manually based systems.

There is little evidence of harmonization between the VAT and Income Tax Departments (and Customs for that matter). The departments are still segmented with a strong internal focus, departmental collection targets, little co-ordination of audit activities, poor information sharing, and differences in legislation (e.g., record keeping requirements, amendment periods, and penalties).

Kenya has eight double tax treaties in place but there is an urgent need for more, particularly with its neighboring countries – a point conceded by the KRA and the Ministry of Finance.

Based on the above observations, the FIAS supports the KRA to maintain the good record of revenue collections, but urge the KRA to introduce a client service focus in its operation. A fair and user-friendly tax administrative regime encourages compliance, encourages businesses to move out the informal sector into the formal sector, and, thus, helps broaden the tax base at the end.

I. Customs and Excise

Customs systems and procedures appear to be much more problematic than the tax administrative system. They contribute to excessive delays in the processing of imports, exports and transit cargo and present a significant barrier to business activity in Kenya.

Customs is, however, only one of many government agencies involved in the processing and clearance of imports and exports. To achieve significant improvement in border processing and cargo clearance times, a “whole of government” approach will be required.

Like in tax administration Customs appears solely focused on revenue collection at the expense of a range of other critically important priorities such as trade facilitation, community protection and national security. Organizational performance is assessed almost exclusively by its success in meeting revenue targets and little or no data is available on its performance in relation to other organizational functions. While the KRA Taxpayer’s Charter sets a standard of two days for the processing of Customs entries, anecdotal evidence suggests that the process typically takes much longer.

The Customs import/export processing system is characterized by excessive documentation and extremely high levels of physical verification of cargo. Little or no use is made of modern approaches to Customs administration such as risk management, post clearance audit, and the use of intelligence.

The current information technology system lacks essential functionality, is difficult to maintain and is badly in need of replacement. The Customs Department recognizes the limitations of the current system and has undertaken an evaluation to identify a suitable replacement. While there is no doubt that Customs desperately needs a new automated system, it is considered highly unlikely that a new system will achieve the performance improvements required unless it is accompanied by a range of complementary initiatives in a number of the areas described above.

Little attention or value is currently placed on the compliance record of traders resulting in the need to inspect a high proportion of consignments. Certainly, where any selectivity is applied to the inspection of imports and exports it is based entirely on the memory and intuition of individual officers. Moreover, no meaningful compliance improvement strategy is in place. As a result, incentives to reward high compliance and disincentives to reduce non-compliance are non-existent.

The relationship between customs and the traders is characterized by distrust on both sides. Customs officials claim there is an extremely high level of non-compliance within the trading community and the traders claim Customs is non-transparent and heavy handed in its dealings. The actual level of compliance is difficult to determine as no meaningful statistics and records are collected.

While the WTO Valuation Agreement was implemented in 2001 it is doubtful whether the current practices employed by Customs are consistent with the spirit of the agreement. Customs routinely uplift the value of a high proportion of import declarations. Such an approach often leads to a self-perpetuating cycle of non-compliance and introduces an unhelpful degree of uncertainty into the system. While implementation of the WTO Valuation Agreement provided for the establishment of a

suitable appeal mechanism and KRA publicity material makes mention of a Valuation Appeals Tribunal, the body has not yet been convened.

Customs is aware of all of the above described problems and acknowledges its current approach will not be able to deal with the many challenges it faces in the future. Membership in the proposed Eastern African Community Customs Union being just one of these. It has therefore committed itself to a process of reform and modernization and has prepared a detailed Customs modernization program and incorporated many of the most important reforms in its current three-year corporate plan. Unfortunately, the current program is almost entirely IT focused and the long term funding required for successful implementation is far from certain.

To improve the situation, it seems that priority attention should be given to the selection and implementation of an appropriate automated system. Implementation of the system should, however, only proceed as a component of a wider and more comprehensive reform and modernization program. The program should be aimed at introducing modern approaches to Customs administration in line with the principles that underpin the WCO's Revised Kyoto Convention on the Simplification and Harmonization of Customs Procedures.

It also seems urgent that the GoK pay attention to developing a national Border Processing Master Plan. Development of the Plan should be led and coordinated by Customs with the active participation of all key stakeholders and be focused on achieving a rationalization of activities and a significant reduction clearance times and physical inspections

J. The Gender Dimension

The exploration of the gender dimension by FIAS resulted in several interesting findings. Apart from the land issues, which was already mentioned earlier, it is also clear that many additional impediments to women entrepreneurial development exist in today's business environment in the country. A brief summary of the findings in this respect is attached to this BTOR, which indicates a need for further efforts to look into the roots of the problems not only in the legal and regulatory areas but also in the areas of cultural, customary and religious issues.

Considering the important role of women in the economy development and poverty alleviation, especially in the rural and informal sectors, these issues require some focused attention of the GoK. FIAS may consider collaborations with the World Bank and other interested donors to support the Government efforts in this aspect.

K. The Next Steps

It was agreed at the Wrap-up meeting that, for the purpose of the on-going discussions in the country, FIAS will prepare an interim report, in the form an Aide Memoir, which could be shared with the relevant ministries and authorities in the Government, the private sector, and the donor agencies with interest. The Aide Memoir will highlight the preliminary findings of the mission, as summarized in this BTOR.

All the issues raised in the Aide Memoir will be further elaborated in a main FIAS report, which will also provide detailed, and action-oriented recommendations based on both the needs/conditions of Kenya and international best practice. The draft report should be ready for internal peer review by the end of April, and the final draft of the report should be delivered to the GoK by the end of May.

The GoK will be responsible for disseminate the report to a broad audience of both the public and private sector. Approximately one month after the delivery of the draft, the FIAS team will return to Nairobi for a series of workshops to discuss with both private and public sector representatives the FIAS recommendations and the implementation matters.

Cc: Makhtar Diop, Country Director, WB; Saleem Karimjee, Regional Manager, IFC; Dileep Wagle, AFTPS; Michael Fuchs, AFTFS; James Emery, CAFSC; Dan Kasirye, CAFE1; John Panzer, PRMTR; Christiane Kraus, AFTP2; Manuel de la Rocha, ISGCR; Catherine Gachukia AFCO5; Daniel Kanyi, CAFAK; Simeon Djankov, CICMA; Axel Peuker, CICIC; Vyjayanti Desai, AFTPS; Andrei Mikhnev, CSMSE; Qimiao Fan, Iva Ilieva, WBI; Minneh Kane, Rober Buergenthal, LEGLR; Beat Heggli, David Bridgman, MIGIM

Samuel Itam, James Walsh, David Kloeden, Robert Tchaidze, John Crotty, IMF

Clare Manuel, Marc Reichel, Samuel Levy, Ali Beba, Peter Maher, FIAS Consultants; Gerard McLinden, PRMTR; Amanda Ellis, FIAS; Andrew Singer, ESW Consultant

Neil Roger, CICDR; FIAS Staff.