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Up-scaling Aid for Trade – A Kenya Perspective

Gideon Rabinowitz*

Introduction

The World Trade Organisation's (WTO's) Aid for Trade (AfT) agenda has thrown a spotlight on the trade capacity constraints facing the poorest countries and challenged donors to respond. The recent trends show that financing gaps are most pressing in public spending and development assistance to the agriculture, road infrastructure, micro and small enterprises (MSEs) and manufacturing sectors in Kenya. In fact, public spending and development assistance to these sectors has experienced generally decreasing trends over the last two decades. However, signs of change are occurring as can be seen by the new interest by Government of Kenya and amongst donors in investing in infrastructure and to a lesser extent in agriculture though such trends are only very recent and have not yet fully emerged in relation to agricultural/rural development, especially manufacturing development.

The AfT agenda therefore provides an opportunity for the government to better articulate its trade related needs and for the development community to take renewed attention of these sectors by up-scaling overall aid levels in order to protect social sector spending. This paper intends to contribute to the literature emerging on how to take forward the AfT agenda in Kenya, a country which has been putting increasing attention on trade related issues in recent years. The productive sector and infrastructure are key pillars of Kenya's Economic Recovery Strategy, the successor to its Poverty Reduction Strategy Paper (PRSP) and the main plan directing development efforts.

The emergence of AfT

The growing awareness that national development planning and donor financing for such efforts in the poorest countries has paid only limited attention to issues of production, trade and growth (with these efforts predominantly focussing on social sectors to date), has led to a renewed interest in these aspects of the development process amongst recipient countries and donors alike.

This is clearly illustrated by the emergence of the AfT initiative within the WTO process, following demands from developing countries for improved donor support for trade development. Developing countries have argued that such support is critical to their success in taking advantage of the market access opportunities offered by WTO negotiations and has been neglected by donors in recent decades. These discussions have in turn prodded donors into taking a renewed look at their support for trade related activities and thinking about future approaches.

> **Box 1: Hong Kong Ministerial Declaration, paragraph 57**
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> "We welcome the discussions…that have taken place this year on expanding Aid for Trade. Aid for Trade should aim to help developing countries, particularly LDCs, to build the supply-side capacity and trade-related infrastructure that they need to assist them to implement and benefit from WTO Agreements and more broadly to expand their trade...We invite the Director-General to create a task force that shall provide recommendations on how to operationalise Aid for Trade…We also invite the Director-General to consult with Members…"

The WTO AfT agenda has to date spawned a number of key processes which are guiding the response of the development community, including: the report of the AfT Task Force; improved monitoring of AfT flows (culminating in the AfT Global Review in November 2007); and efforts by donors to develop AfT strategies (with the EC, Germany, Norway and the UK most prominent amongst these).

Need for country perspectives

Although the emergence of the AfT agenda has played an important role in pushing trade development up the agenda of recipients and donors, much of the analysis to date has focussed on global AfT flows and to a lesser extent needs with very limited analysis of the country specific needs related to up-scaling AfT (see OECD 2007). If the AfT agenda is to lead to a new dynamic for promoting trade development in the poorest countries, it is vital that efforts are made to better articulate country-specific perspectives on the challenges ahead so that action can be taken.

Although AfT incorporates a wide range of activities (after all any number of factors contributes to productive activity

* *Campaigns and Policy Officer,CUTS London Resource Centre*

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and trade) the July 2006 AfT Task Force report identified five core categories of AfT:

- trade policy and regulations;
- trade development;
- trade related infrastructure;
- building productive capacity; and
- trade related adjustment.

Public Spending on Productive and Trade Sectors

There has been quite a sharp (and in many respects encouraging) move to increase public spending in the social sector in Kenya in recent years. The budget framework for 2005-06 for Kenya proposed that 27 percent of public spending (the majority spent on the universal primary education programme, launched in 2003) be directed towards education, 13.8 percent towards public safety and law and order and 9 percent towards health.

However, with an increasing amount of resources going towards social sector priorities there is the possibility that this has left other priority sectors competing for a more limited pot of funds. The recent trends of public spending in productive and trade sectors and to what degree it has received attention in recent decisions on public spending priorities is explained below.

Agriculture

Agriculture is the single most important sector in the Kenyan economy, contributing approximately 25 percent of the gross domestic product (GDP), and employing 75 percent of the national labour force. Over 80 percent of the Kenyan population live in the rural areas (many amongst the most impoverished) and derive their livelihoods directly or indirectly from agriculture (Alila/Atieno 2006). However, the agricultural sector has performed very badly in recent years, with growth below two percent during the 1990s, becoming negative by 2000, before rising to around three percent in the early 2000s. It is estimated that only two percent of land and six percent of land-holdings are irrigated (the rest relying on increasingly unreliable rains); productivity has been low due to limited access to and affordability of farming inputs and technologies; and the majority of farmers are small-holders barely able to produce enough for their families (Alila/Atieno 2006).

It is therefore a major concern that a sector that is so important for poverty reduction efforts and overall economic growth and faces such extreme physical, technical and institutional constraints has attracted a dramatic decline in public spending since independence which has only been marginally rectified in recent years.

In the decade immediately following independence around 10 percent of government spending went to agriculture. This fell to an average of 8.5 percent in the 1980s, an all time low of 2.9 percent in 2004-05, before rising to 4-5 percent in 2006-07. Despite the absolute spending increases associated with these relative increases this is an incredibly low share of spending for such an important sector and is also well below the 10 percent target agreed by African countries in their Comprehensive Africa Agriculture Development Programme (CAADP) under New Partnership for Africa's Development [(NEPAD, Akroyd/Smith 2007)].

Spending on agriculture is currently managed by three ministries: Ministry of Agriculture (with 61 percent of spending in 2003-05); Ministry of Livestock and Fisheries Development (with 29 percent of spending in 2003-05); and Ministry of Cooperative Development and Marketing with 10 percent of spending in 2003-05). However, only around 15 percent of total spending by these ministries currently goes on operations and maintenance (including only 8 percent of the research and extension budget), with the majority of funds spent on capital investment, salaries and transfers to parastatals (Akroyd/Smith 2007).

In addition, the effectiveness of public spending on agriculture has also been poor in recent years, with excessive spending on salaries and capital expenditure, as well as the poor performance of extension services, attracting criticism (World Bank 2000). It therefore seems clear that if the performance of the agricultural sector is to improve so that it can contribute more effectively to poverty reduction, then investment in the sector needs to increase in a wide array of areas. It will also be necessary to implement the reforms required (and under discussion) for improving the effectiveness and accountability of spending on agriculture.

Table 1: Expenditure by Three Agricultural Ministries (Kenyan Shilling in million)

	Actual Spending			Projected Spending	
Year	2002/3	2003-04	2004-05	2005-06	2006-07
Total spending	7,071	9,262	8,957	12,859	17,019
Proportion of total spending of Government Kenya	3.8%	3.6%	2.9%	3.7%	4.4%
Agriculture spending as proportion of total GDP	0.7%	0.7%	0.6%	0.8%	1.0%

Source: Akroyd/Smith 2007

Road infrastructure

Most recent studies of the Kenyan economy point to the dilapidated road network as one of the major impediments to increasing agricultural and industrial productivity in Kenya, which is not surprising given that road transportation accounts for roughly 80 percent of all transport in the country (Pollin *et al.* 2007). A 2002 survey found that approximately 43 percent of Kenya's national and urban roads were in poor repair or failed condition. In addition, only 60 percent of rural roads, which service the poorest sectors in

Kenya, were found to be in maintainable condition (a rather loose categorisation that does not project confidence, especially as most of these are unpaved). This data does not include unclassified rural and urban roads, which by definition are probably in even worse condition (Kenya Roads Board 2002).

Public spending on roads and transport infrastructure suffered major reductions in the late 1980s and early 1990s falling to 2.7 percent of total spending in 1993-04, which contributed to a major deterioration in the road infrastructure. However, from mid-1990s public spending on roads did start to increase and (although it has been variable) was 4-5 percent of public spending during the mid-1990s and early 2000s. While it is impossible to isolate rural roads from the data on total road investment, it is reasonable to conclude that total expenditure on agricultural and rural infrastructure has declined over the last decade (Thurlow *et al.* 2007).

Table 2: Planned Expenditures on Road Development (Kenyan Shilling in millions)

Year	2005-06	2006-07	2007-08	2008-09
Major roads	2,560	8,311	8,726	9,163
Other roads	2,389	7,050	7,403	7,773
Other spending	2,040	2,187	2,295	2,411
Total	6,989	17,548	18,424	19,347

Source: Medium Term Expenditure Framework, 2005/6-2007/8, Government of Kenya, 2006

However, the government is planning major new investment in the road transport network with the current Medium Term Expenditure Framework (MTEF) projecting an increase in road development spending of over 250 percent between 2005-06 and 2008-09, taking infrastructure spending up to around 15 percent of total spending.

Increases in funding of this nature will though depend on revenue generation and development assistance being maintained, both of which are far from guaranteed. In addition, this level of funding will need to be maintained (and probably exceeded) for some time if it is to comprehensively deal with road infrastructure deficiencies in both urban and rural areas and make up for the limited funds spent on this sector in recent years (Pollin *et al.* 2007).

Micro and small enterprises/informal sector

One of the most economically active and important sectors in Kenya comprises of many micro and small enterprises (MSEs, defined as enterprises with 1-50 employees). According to the Department of MSEs Development, this sector experienced substantial growth during 2000-02, increasing to 2.8 million enterprises (from 1.3 million in 1999) and employing 5.1 million persons (from 2.4 million in 1999), accounting for 74.2 percent of total employment in 2002 (Stevenson/St-Onge 2005). Moreover, out of the 465,000 jobs created in 2006 (an increase of 5.7 percent from 2005), 89 percent were from the informal sector (CUTS NRC Policy Brief 01/07).

This dramatic growth in the MSE sector in recent years is in large part down to retrenchments in the public and private sectors and poverty reduction and growth efforts will in no small part be determined by the performance of this sector. However, this sector faces a range of constraints which limit the ability of MSEs to provide suitable jobs for a growing workforce. These include limited access to affordable credit, supportive transport and marketing infrastructure and business training, and dealing with obstructions posed by local bureaucracy and officials (Stevenson/St-Onge 2005). A major question therefore is: what level of resources is being set aside for supporting MSEs to overcome these constraints?

For MSEs categorised as cooperatives and carrying out some processing of agricultural products the Ministry of Cooperative Development and Marketing provides support through its operations, and it was responsible for around 10 percent of the agricultural budget during the period 2003-05 (Akroyd/Smith 2007), equivalent to around 0.22 percent of public spending of around £10 million (US$19.8mn). In addition, the Department of MSE Development provides support to MSEs, although only limited amount of funds are made available for such programmes, as the ministry of Labour and Human Resource Development's Strategic Plan for 2004-09 proposes around £5 million (US$29.7mn) be set aside for MSE development during this period.

Besides the interventions of central government, local authorities also play a role in facilitating MSEs activities through being responsive to the challenges MSEs face in their day to day operation. This is especially the case outside the major towns and in rural areas, where there is less central government investment. However, due to the slow progress in decentralisation in Kenya and the limited range of revenue sources available to local authorities, the vast majority of them do not have the resources to play an effective role in supporting local commerce.

For example, the District and Town Council's of Kajiado District in the Rift Valley which in 2003-04 had combined revenues (from local collection and central government

Table 3: Distribution of MSEs in Kenya by Employment Size (1999)

Enterprise Size	Number of Enterprises	Share of Enterprises by Employment Size (5)
1	899,787	70.1
2	229,759	17.9
3-10	145,045	11.3
11-25	7,701	0.6
26-50	1,283	0.1

Source: National Baseline MSE Survey, 1999, p. 1.1

transfers) of around £1.75 million (US$3.4mn), to spend on a population of just over 400,000. Around 35 percent of this went to local authorities personnel's salaries, and the remaining amount was able to cover debt repayments and small number of road improvement and other local infrastructure projects (Government of Kenya 2004).

Although the Kenyan Government's role in promoting MSEs development is seen as that of a hands-off facilitator (Government of Kenya 2003) it is clear that it is only setting aside a very limited amount of funds for interventions aimed at supporting the vital and growing MSEs sector. Relevant government departments are very under-resourced and local authorities have only limited funds to play an effective role in promoting commerce at the local level. Greater support for relevant ministries (especially for programmes targeted at MSEs) and further measures to promote decentralisation and the provision of public resources to local authorities are likely to help in this regard. However, improvements to the effectiveness of this spending will also be important.

Private sector/manufacturing

The formal private sector in Kenya employs around one million people, with the major sectors being social and personal services (24.9 percent of formal sector employment), agriculture (24.3 percent) and manufacturing (19.5 percent). However, the most significant contribution to the economy is the manufacturing sector, which contributed around 13 percent of GDP in 2003. The formal manufacturing sector has experienced erratic growth in recent years, with stagnation in 2000 and 2001 being followed by growth of 7.3 percent in 2002 and 6.3 percent in 2003 (IFC/World Bank 2004).

Table 4: Chief Constraints to Competitiveness

Constraint (selection)	Proportion of manufacturing firms rating constraint as "major" or severe"
Corruption	74%
Cost of finance	73%
Tax administration	51%
Electricity	48%
Telecommunications	44%
Transport	37%

Source: Kenya Investment Climate Survey, IFC/World Bank, 2004

Nevertheless this growth has masked continued stagnation in productivity in the manufacturing sector, with poor training services, poor infrastructure, pervasive corruption and financial sector weaknesses are the chief constraints responsible for this (IFC/World Bank 2004).

Besides investment in general (transport, energy and telecommunications) infrastructure and implementing regulatory and policy reforms, the government plays a role in manufacturing development through the provision of resources for training programmes, standards supervision and a range of legal services. Although there is a clear need for the effectiveness of public investment in the manufacturing sector to be improved (with a possible role for public-private partnerships (IFC/World Bank 2004)) there is also a question whether the current level of resources set aside by the government for relevant ministries is sufficient for managing their regulatory and service provision responsibilities.

The main ministries that provide support to the industrial sector are the Ministry of Trade and Industry and the Ministry of Labour and Human Resource Development: the Ministry of Finance's Budget Outlook Paper 2005 that fixed the spending ceiling for former at £33 million (US$65.4mn), which is equivalent to 0.71 percent of public spending and that of the latter at £12.4 million (US$), which is equivalent to 0.27 percent of public spending) for 2005-06, with only limited spending increases foreseen for future years.

However, at current levels of funding both of these ministries report that they face problems in operating effectively, including in attracting and retaining skilled staff, training their staff effectively and accessing adequate physical facilities and information and communication technology (ICT) infrastructure. Many of these problems are in part due to weak management and wastage of resources (including through corruption) but the strategic plans of both of these ministries state that public resources are insufficient to fund their activities and their intention to source additional funds from donors and the private sector (Government of Kenya 2005 + 2006).

It therefore seems necessary for future development efforts to focus more attention on the trade, manufacturing and labour development sectors, with relevant ministries better resourced to attract skilled staff, develop suitable partnerships for delivering training and other services and carry out their regulatory responsibilities.

Assistance to Productive and Trade Sectors

During the first two decades after independence Kenya received huge inflows of development assistance, peaking at around US$1bn per annum in 1990, equivalent to 11.5 percent of GDP. However, from 1990 development assistance flows decreased as donors held back funds due to slow progress on economic and social reforms, and by end of the 1990s development assistance was a small proportion of GDP. During the 2000s a more donor friendly Kenyan Government had been attracting increased levels of aid, with aid increasing from US$310mn in 1999, to US$521mn in 2003 to US$943mn in 2006, although real levels might be higher as donors do not always report all their aid (OECD 2008). Development assistance was estimated to be about 3.9 percent of GDP in 2004 (SIDA 2004) is likely to have increased as a proportion of GDP since and presently contributes at least 10-12 percent of public spending.

It is difficult to find data on which sectors this development assistance has been delivered to because many donors deliver assistance outside of central government structures (due to concerns about corruption) and reporting is often weak. However, one tool we can use to explore the direction of development assistance is the budget

Table 5: Kenyan Government Estimates of the Direction of Development Assistance		
Sector	**Proportion of total development assistance**	**Proportion of sector budget covered by ODA**
Agriculture and rural development	8.5%	24.9%
Public safety and law and order	12.5%	16.4%
Health	15.1%	30.7%
Education	14.5%	9.6%
Physical infrastructure	41.5%	38.2%
General economic services (including labour, trade, industry, tourism, gender)	2.7%	17.4%
Public administration	4.7%	7.4%
Source: Budget Outlook Paper 2005, Ministry of Finance, Kenya		

frameworks prepared by Ministry of Finance. These present estimates of government expenditure as well as of disbursements by donors and therefore tell us where the government believes development assistance is being delivered (although not a fully accurate picture due to weaknesses in budget procedures). The 2006-07 budget framework for Kenya predicted that development assistance would be split amongst priority sectors as indicated in the Table 5.

As can be seen from Table 5, the social sectors (understandably) were predicted to attract a substantial proportion of development assistance, with health and education collectively predicted to attract almost 30 percent of development assistance and public safety and law and order an additional 12.5 percent. The sector that was predicted to attract the largest proportion of development assistance was physical infrastructure, with road building and transport to be the main priority within this sector (60 percent of funding). In addition, it can be seen that development assistance to this sector was predicted to contribute almost 40 percent of the sector's budget.

These statistics are a clear indication of the contribution that donors are making to infrastructure development in Kenya and the priority that donors are putting in place on this area of assistance. This is certainly in line with the priority that the Kenyan Government is placing on infrastructure development and such efforts have the potential to contribute significantly to production and trade development if they are sustained and better managed than what at used to be previously.

However, of some concern from the perspective of production and trade development is the limited proportion of aid that was predicted to be directed at agriculture/rural development (8.5 percent, with about half of this for agriculture) and general economic services (2.7 percent). These sectors are clearly not priority sectors for donors, a trend which has been observed amongst donors for most of the last two decades.

Donors are currently loathe to provide development assistance to these sectors in part because of concerns about the slow progress of relevant reforms and the poor performance (including corruption) of past spending in these areas. In addition, there also seems to be an ideological reluctance amongst donors to deliver development resources to these sectors, with many believing that investment in these sectors should be left to the private sector.

However, with the agricultural sector having performed so poorly and many productive sectors having struggled to deal with the challenges of market liberalisation over the last two decades, maybe the time has come for donors to reconsider their reluctance to support these sectors. This question is especially pressing given the low priority given to these sectors within the Kenyan Government's public spending plans (which is also in no small part due to the influence of donors). Such a response should of course not come at the expense of reducing investments in social sector priorities, which continue to require substantial investment.

Therefore, increases in aid for productive and trade sectors should be provided through an up-scaling of aid in general and AfT in particular. Such efforts will hopefully help countries like Kenya to stimulate an expansion in production and trade and promote higher levels of economic growth, which can in turn underpin a more sustainable process of social development.

Conclusion

It is clear that public spending and development assistance efforts have neglected trade, production and infrastructure priorities over the last two decades. The similarity in Kenyan Government and donor resource allocation decisions is no coincidence, given that donors have had a major say in Kenya's development efforts for much of the last two decades. In addition, donors have also responded to government-led social sector programmes such as universal primary education.

This move away from spending on trade, production and infrastructure priorities has in part been determined by a view that development in these sectors should be fuelled by the private sector and market forces. However, over the last two decades the private sector has failed to emerge as a major investor in many of the key factors that constraint the development of productive and trade sectors (especially with regard to the poorest producers). There has also been increasing evidence that public spending on agriculture and infrastructure can make an important contribution to growth and poverty reduction (Thurlow *et al.* 2007).

This state of affairs has led many to openly question whether supportive public and donor investments in trade,

productive and infrastructure sectors need to be increased, an agenda which has led to emergence of the AfT agenda in the WTO. AfT Trade agenda therefore provides an opportunity for the development spotlight to be widened to take in production, trade and infrastructure in Kenya. This will require government to think more concretely about its priorities and undertake the type of popular public dialogue/analysis on these issues that it has undertaken on poverty. It will also require the government to implement the desired reforms to make implementing agencies more accountable and effective, so that they could make a greater contribution towards development efforts and better attract external support.

On the part of donors, it will require them to more consciously accept the need for improved resource mobilisation for productive, trade and infrastructure sectors and to upscale their overall aid provision to Kenya. This will ensure that social sector spending can be protected (and even increased) whilst simultaneously increasing provision for production, trade and infrastructure priorities.

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