**Memorandum on economic policy measures to be considered in preparation for the National Fiscal budget 2017/2018 under the theme "Consolidating Economic Gains in an Environment of Subdued Global Demand" on measures to create employment opportunities for youth, women and persons with disability.**

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*28/12/2016*

## ABOUT TISA

**The Institute for Social Accountability (TISA)** is a civil society organization committed towards the achievement of sound policy and good governance in local development, to uplift livelihoods of, especially, the poor and marginalized in Kenya. TISA has been operational since March 2008, and is a locally registered Trust that has engaged with various relevant state and non-state actors in the quest to promote effective local governance in Kenya.

## LIST OF ACRONYMS

| | |
|---|---|
| CDF | Constituency Development Fund |
| HELB | Higher Education Loans Board |
| KIPPRA | Kenya Institute for Public Policy Research and Analysis |
| LPO | Local Purchase Order |
| LSO | Local Service Order |
| MSMEs | Micro Small and Medium Enterprises |
| MSEA | Micro Small and Medium Enterprises Authority |
| NYS | National Youth Service |
| SMEs | Small and Medium Enterprises |

| | |
|---|---|
| TISA | The Institute for Social Accountability |
| WEF | Women Enterprise Fund |
| YEDF | Youth Enterprise Development Fund |

**Context**

The Constitution of Kenya 2010 establishes two levels of government. The county and the national government with article 6 (2) providing that these levels will work in a consultative and cooperative manner. The fourth schedule outlines the functions that entail aspects of self-rule at the local level and shared rule at the national level with counties specific mandate which include financial management and service delivery.

Vision 2030 is the Kenyan long-term development policy that aims to transform the country into a middle-income industrialized country from 2008-2030. This is anchored on existence of a skilled, productive, competitive and adaptive human resource base that can meet the challenges of a rapidly industrializing economy.

Thus, devolution enhances mechanisms through which local oriented activities can be rejuvenated to contribute to economic development. Devolution as a system has the capacity to deliver a conducive macroeconomic environment for economic activities benefiting sectors that have the capacity to promote local development, mostly players that are in their nature micro, small and medium enterprises.[1]

In Kenya, most Micro Small and Medium Enterprises operate in the informal sector and are known to contribute considerably to economic development and generation of employment. According to the 2016 economic survey, in 2015 the informal sector generated 713.6 thousand jobs against 128.0 thousand in the modern sector outside agriculture and pastoralists activities indicating the importance of MSME's in employment creation. According to the survey, the informal sector jobs include hawkers, bodaboda riders and other service providers though majority of the informal sector actors are in the manufacturing activities employing over 2.544 thousand people.

The micro and small business enterprises are defined locally and international in reference to turn over and number of employees. In Kenya business are identified as illustrated as follows:

[1] David Ongolo SME, Samson Awino (2013) Small and Medium Enterprise and Devolved Government System; An Assessment of the Regulatory and Institutional Challenges Affecting the SMEs Development in Kenya. Retreived from < https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwj4iqKtpoPRAhXBWRQKHa3UAkQQFggbMAA&url=http%3A%2F%2Fwww.trustafrica.org%2Fen%2Fpublications-trust%2Ficbe-research-reports%3Fdownload%3D342%3Asmall-and-medium-enterprises-and-devolved-government-system-an-assessment-of-the-regulatory-and-institutional-challenges-affecting-the-smes-development-in-kenya&usg=AFQjCNHZf6Ze51eGjZfjbPe728ursUhPrw&sig2=jarrO0UdElg1307Lyk_SIA>

Classification of micro and small business enterprises

| Entity (Trade, service, industry or business activity) | No of Employees/people | Annual Turn over | Investment in plant and machinery registered capital | Equipment investment + Registered Capital |
|---|---|---|---|---|
| Micro Enterprise | Less than 10 people | Not exceeding Kshs. 500,000 | Not exceeding Ksh. 10M | Not exceeding Ksh. 5M |
| Small Enterprise | More than 10 but less than 50 | Between Ksh. 0.5M- 5M | More than Ksh, 10M but less than 50M | More than Ksh. 5M but less than 20M |

**Source**: Micro, Small and Medium Enterprise Authority Act 2012

Recognizing the importance of the MSE sector, the government of Kenya has over the years attempted to address challenges being faced by the sector such as poor coordination of the various implementing agencies in the sector, resource management and allocations in the sector and lack of enthusiasm by policy makers to encourage growth of sector. However, according to Eric et al, 2002 government reluctant to address challenges the sector faces can be attributed to a perception that the informal sector demonstrates a failure in other areas.[2]

Additionally, the government has failed to recognize the importance of streamlining the MSE's management into the devolved government framework as provided in the Constitution.

## Background

According to a 2010 report by the Institute for Economic Affairs, 78.3% of the Kenyan population is under the age of 34 years. About 500,000 youth are annually released to the job market with only a fraction getting jobs due to slow economic growth, corruption among other factors.[3] Majority of the Kenyan youth are unemployed, underemployed or underpaid and are rapidly joining the working poor. Further, "a large proportion of young adults and a rapid rate of growth in the working-age population; exacerbates unemployment, prolongs dependency on parents, diminishes self-esteem and fuels frustrations, which increase the likelihood of violence or conflict." In 1998/99, the working age population in Kenya increased from 15.9 million to 19.8 million in 2005/06. "The largest rise in the working-age population over the period was recorded among the age cohort of 15-34 years where the working-age population increased from 9.7 million persons in 1998/99 to 13.1 million persons in 2005/2006. Female labour force participation rates edged downwards for all the

[2] Eric Ronge, Lydia Ndirangu and Hezron Nyangito (2002) Review of Government Policies for the Promotion of Micro and Small Scale Enterprises. Retrieved from
< http://pdf.usaid.gov/pdf_docs/Pnads072.pdf>

[3] Elayne Wanyalwa (2014) Kenya National Employment Police key to job creation. Retrieved from <http://www.cnbcafrica.com/news/east-africa/2014/07/28/kenya-policy-jobs/>

age groups with the highest being among the youth cohorts of 25-29 and 30-34, which declined by nearly 6 percent. Overall, females had a lower labour force participation rate than their male counterparts in both periods and mean monthly earnings from paid employment for males is about 1.5 times that of females."[4]

The level of education attainment also contributes to the challenge of youth participation in the labour market activity. Statistics show "62 percent of youth aged 15-34 years have below secondary level education, 34 percent have secondary education, and only 1 percent has university education." This then is reflected with the lack of skilled labour in the market and further the influx of youth in the informal sector. Further, even with the free primary and secondary education policy that greatly subsidizes basic education, it is estimated that about 14 percent of the approximately 10.6 million children (aged between 5 and 14 years) left school or never attended school in 2009, and about 68 percent of secondary school-age youth (between 14-17) were not in school. Currently, in higher education, the higher education loans board also contributes to the challenge of access to higher education in Kenya. HELB currently penalizes young unemployed graduates who pay a monthly penalty of Kshs 5,000, monthly which annually goes beyond the amount of school fees per semester an undergraduate in a government sponsored program pays. Thus, education level and quality greatly influences the employability of youth in Kenya.

**Problem Statement**

Through its fiscal policies, the government has attempted to address the challenge of unemployment either through demand side factors by increasing the number of job available through agricultural productivity, formal job creations, spending on youth employment projects/programs, providing access to credit and markets. Additionally, there are supply side factors entail addressing factors that reduce the employability of youth such as low education and skills, skills mismatch and lack of work experience.

The government has over the years put in place, policies to address the challenge of youth unemployment. However, policy interventions fail to distinguish between the informal and formal sectors entrepreneurs pushing unemployed youth into the formal, most of whom lack the skills to participate in the formal economy. Further, policy interventions fail to distinguish between "survivalist and growth oriented enterprises," all of which require different entrepreneurial support and have different capacity needs.[5] Moreover, a negative culture of corruption also undermines sustainability of the public initiatives[6] special notice on the *kazi kwa vijana* World Bank sponsored program whose main aim was to facilitate earning opportunities for the youth but was later cancelled due to corruption. Further, the National Youth Service under the Jubilee regime is almost being crippled due to corruption. Currently it is estimated that over 1.9 billion Kenya shillings have been

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[4] Institute for Economic Affairs (2010) Youth Fact book, Infinite possibilities of a definite disaster retrieved from < http://library.fes.de/pdf-files/bueros/kenia/07889.pdf>
[5] As above
[6] **Walter Menya** (2016 March). Daily Nation. Retrieved from http://www.nation.co.ke/news/Doomed-to-fail-The-trouble-with-special-projects-funds/-/1056/3135274/-/10bfywd/-/index.html

lost to corruption, and the magnitude of how much money was lost to corruption is yet to be conclusively ascertained.

Further, a majority of the public initiatives, which include the Uwezo Fund, Women Enterprise Fund, Youth Enterprise Development Fund and the 30% access to government procurement, Micro and Small Enterprise Act, 2012 among others, were designed and are being implemented outside the devolved system of governance as provided in the Constitution of Kenya 2010.

**A review of the employment creation initiatives under the National Government**

This paper is conceived in appreciation of government efforts in employment creation through the Uwezo Fund, Women Enterprise Fund, Youth Enterprise Development Fund, as well as the efforts under the Micro and Small Enterprise Act, 2012 and the access to government procurement. However, the paper considers the following issues for improvement of the aforementioned initiatives:

1. **Is the design of the initiatives sufficiently pro-poor?**

According to TISA's audit of the empowerment initiatives, whereas the Constitution of Kenya is keen in Article 55 to recognised youth, women and persons with disability, the environment created by the regime of the empowerment funds and the access to government procurement fails to honour the Spirit of Article 55 in that t**he funds are not pro-poor** as women, youth and persons with disabilities who have the financial capacity and knowledge to compete with other well established enterprises are merged together with women, youth and persons with disabilities enterprises that are disempowered in terms of access to capital, skills and opportunities.

2. **Do the initiatives facilitate access to credit for players in the informal sector?**

A social audit of the four initiatives undertaken by TISA found that among the challenges that applicants face in terms of accessing the funds, is that the design of the funds are unfavorable to the informal sector in regards to the requirements for application. The intended products meant for informal sector had the requirements for group applicants, which the research revealed that the youths mostly divide the money among them and end up not engaging in economic activity. This finding is troubling because according to the economic survey of 2016; salaried employees have the highest access to formal credit (52% per cent), followed by entrepreneurs, (40.4 per cent and agriculture (30.9 per cent)

Additionally, the funds, with the exception of WEF in practice, have admitted to taking a mainstream banking approach in designing of products and services and not a public interest methodology. Thus, these funds systematically leave out the informal sector, which is crucial to the economic development and employment creation[7].

3. **What are the structural and operational issues facing the initiatives?**

Whereas government at both levels has established numerous initiatives to address unemployment and to promote inclusiveness to employment opportunities, these initiatives face a myriad of problems. According to KIPPRA these include slow or delayed payments, corruption which increases the cost of doing business and distorts conventional competitive forces. The sector is also not able to access other business support services, including technology and infrastructure, which further affects the productivity of enterprises. Informality, limited access to credit, and inefficiency are other challenges cited by the Kenya 2013 Enterprise Survey (KIPPRA, 2016). The report calls for a comprehensive multiagency coordinated approach to deal with these challenges.

A social audit report of four initiatives by TISA found numerous accountability barriers in the administration of enterprise and affirmative action funds; They erroneously treat Youth, women and PWDs as a homogenous group and the subsequent design locks out the needy who are often not able to meet the requirements of the fund. They have a very high default rates implying ineffectiveness for the interventions.

In FY 2012/2013, 2013/2014 and 2014/2015, the women enterprise fund non-performing loans accumulated to Kes 63,370,000 , Kes 64,600,000 and Kes 92,577,000 respectively.

The TISA report found that despite the wide array of funds available, much needed LSO and LPO financing is not widely available and where it is, criteria for qualification are prohibitive thus undermining the implementation of the access to government procurement program.

The linkage of the Uwezo Fund needs to the Constituency Development Fund (CDF) framework, was also found to create a situation where the constituency fund structure does not have adequate accountability provisions resulting in abuse of powers by local officials by favouring beneficiaries or soliciting bribes. The study recommended that there is need to involve the youth, women and PWDs in the design of the fund products to ensure that the products and processes respond to the needs of the target population. The study also called to greater beneficiary involvement in the implementation of the funds for accountability purposes. Linking the funds to the member of Parliament has also created a culture of clientelism whereby MPs are able to influence allocation of the fund toward political allies.

Lastly, the presidential taskforce of Parastatals reforms[8] that recommended the merging of all agencies, funds and initiatives supporting, financing and developing SME's in Kenya into the

[7] Economic survey of 2016 indicates that the informal sector contributes significantly to the GDP and creates more employment than the formal sector.

Biashara Kenya entity. This has not happened. It is unfortunate that the Parastatal reforms report failed to address functional mandates in the administration of the enterprise and affirmative action funds.

4. **Do the initiatives accord to the Constitution of Kenya 2010?**

a. **Do the initiatives accord to functional mandate as prescribed in the Constitution?**

Decentralized fiscal governance is not new to Kenya, however functional overlaps and duplication have marred the effectiveness of service delivery in Kenya. The 2015 report of the Working Group on Socio-Economic Audit of the Constitution of Kenya, states that the 'division of functions enhances the concept of separation of powers and checks and balances' (RoK, 2015: 24). The report further stresses that the 'devolution of power and resources is perceived as a means of enhancing the concept of good governance by incorporating vertical separation of powers and increasing the ambit of checks and balances' (RoK, 2015: 23).

The Task Force to Devolved Government Report of 2011 stresses that the absence of clarity in the assignation of responsibility for service delivery greatly compromised service delivery under the previous constitutional dispensation. The Working Group report commissioned by the National Assembly also decries the impact of duplication of government initiatives and funds, and the resultant inefficiency stating.

> With the centralisation of power and resources came inefficiency and bureaucracy in governance. The centralised system of governance stifled service provision and led to a decline in service delivery. The government responded to this by proliferating central government channels with field offices of central government ministries, the Provincial Administration, specialised funds, and later the parliamentary constituency level structures. While these multiple channels may have been intended to address service delivery, they contributed to further decline by fragmenting efforts and resources, creating confusion of roles and causing general inefficiency (RoK: 2015, 29).

The report goes onto state another area that has historically compromised functional clarity in service delivery is the tendency for either level of government is to establish structures and assign resources to features within their limited mandate as opposed to the use of harmonised and coordinated intergovernmental mechanisms. The report notes that by failing to undertake elaborate scrutiny of policies and programs from a functional approach the legislatures are perpetuating functional overlaps and duplication and resultant wastage and inefficiency. The report recommends that

[8] http://www.cofek.co.ke/Report%20of%20The%20Presidential%20Task%20force%20on%20Parastatal%20Reforms.pdf

> All legislation emanating from National and County Assemblies should incorporate a schedule outlining the functions to be performed by each level of government and define to the lowest possible level the functions for the area under legislation, indicating exclusive functions for the National Government and County Government and concurrent functions. All the functions in the legislation should then be compiled into a compendium of assigned functions in a distinct legislation for the purposes of defining a comprehensive list. (RoK: 2015, 29)

The Fourth Schedule on the distribution of functions between the National and County Governments Part 1 assigns National Government the following relevant functions.

> *14. Consumer protection, including standards for social security and professional pension plans.*
>
> *32. Capacity building and technical assistance to the counties.*

In turn Part 2 assigns County Governments the following relevant functions;

> *7. Trade development and regulation, including—*
> *(a) markets;*
> *(b) trade licences (excluding regulation of professions);*
> *(c) fair trading practices;*
> *(d) local tourism; and*
> *(e) cooperative societies.*
>
> *14. Ensuring and coordinating the participation of communities and locations in governance at the local level and assisting communities and locations to develop the administrative capacity for the effective exercise of the functions and participation in governance at the local level.*

**b. Do the funds respect the principle of separation of powers according to the principles and objects of devolution as outlined in Article 174 and 175?**

The Uwezo fund is presently administered at the electoral constituency level and the County Women Representatives as well as the Members of Parliament in the National Assembly being patrons to the fund at their respective level.

Additionally, mobilization and application to YEDF and WEF are also at the Constituency level.

This offends the principles of separation of powers by purporting to use the constituency as a level for development contrary to the Constitution which only recognises the national and county government as levels of development. Further, the role of the County Women Representative and the Member of Parliament is also unconstitutional.

c. **Do the funds respect PFM principles in Article 201 on prudent and accountable use of public resources?**

As elaborated in the introduction there exist numerous funds and schemes which overlap and duplicate each other. It is noteworthy that county governments have themselves established enterprise and affirmative action funds ***(see accompanying schedule***). It is unfortunate that under the devolved system of government, historical duplication and overlap of development initiatives has reached a new fevered high resulting in wastage of public resources.

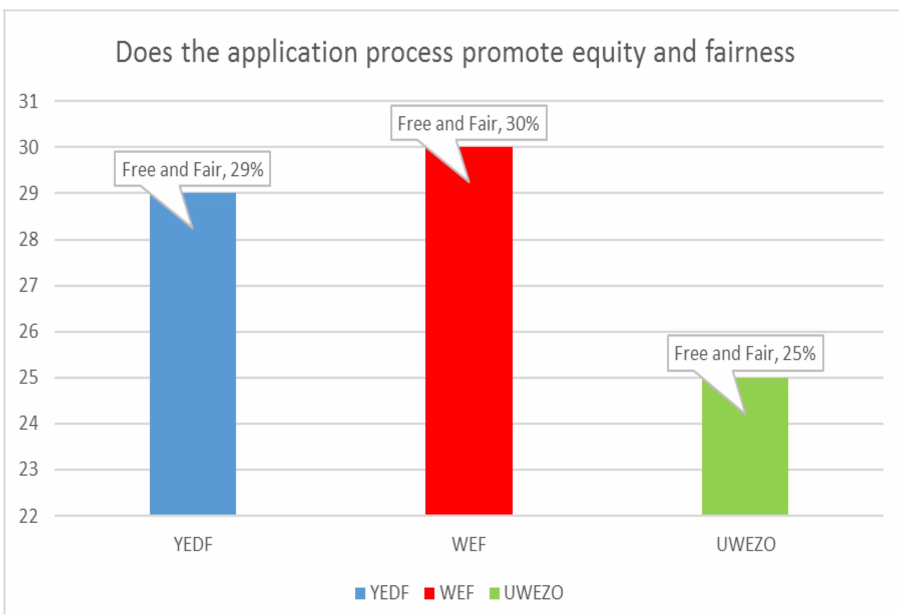
It is noteworthy that the funds proposed outside of a policy context and therefore have shortcomings including corruption and clientelism, ineffectual impact evidence by high default rates, inefficient, poor targeting and accessibility. in short the fund is political in nature and not a sound development solution and is unlikely to make an impact on unemployment.

***d. TAP provisions***

Similar to other funds established by government such as the CDF, the funds do not contain adequate transparency, accountability and public participation provisions. According to the Social Audit undertaken by TISA, it emerged that only 25%, 30% and 29% of the respectively for Uwezo, WEF and YEDF.

This exacerbates the culture of impunity in administration of the funds. As observed by the Working Group on Socio-Economic Audit of the Constitution of Kenya

> ...endemic corruption reached a level where it impacted negatively on the effectiveness of state institutions and particularly their ability to provide essential public services. The general decline of public services and ineffectiveness of public institutions, most of it traceable to endemic corruption, led Kenyans to question the *status quo* and added impetus for the clamour for reforms. (RoK, 2015: 17)




**Proposals for policy priority areas for creation of employment for youth, women and persons with disability**

1. **Increase employment opportunities by streamlining the MSE sector and aligning to principles of devolution**

The Labour ministry in conjunction with SME's stakeholders developed the Micro and Small Enterprises Act No. 15 of 2012 that would guide the MSE sector. The main objective of the Act is to provide for an enabling business environment;

facilitate access to business development services by micro and small enterprises; facilitate the formalization and upgrading of informal micro and small enterprises; and promote an entrepreneurial culture as well as promote representative association among micro and small enterprises

Among the key provisions of the Act are as follows:

1. The objective of the Act is to provide for the promotion, development and regulation of MSE's and establish an Authority
    a. The authority is further charged with the responsibility to mainstream women, youth and persons with disabilities enterprises into MSEs as well as maintain a database of MSEs in Kenya to allow for proper design of intervention programs in relation to the provision of the Act.
2. Section 4 of the Act establishes a registrar whose main function is to register MSE's in accordance with the provisions of the Act.
3. Section 51 of the Act establishes a fund known as the Micro and Small Enterprise (MSE) development fund which is yet to be capitalized
4. Section 54 of the Act establishes a tribunal to hear disputes related to MSE in Kenya

Following the policy development process in the MSE's sector, the Authority is culmination of government efforts to ensure the proper coordination of the MSE/ informal sector as well as establish a facility to provide access to credit for the sector.

However, the government has never capitalized the MSE fund as provided in the Act and has further established funds for enterprise development outside the regime of the MSE Act, 2012. These are:

a. The Government Finance Management (Women Enterprise Fund) Regulations, 2007 established the Women Enterprise Fund whose main objective among other "is to provide loans to credible micro-finance institutions (MFIs), registered non-governmental organizations (NGOs) involved in micro financing, and savings and credit co-operative organizations (SACCOs) for on-lending to women enterprises."
b. The Government Finance Management (Youth Enterprise Development Fund) Regulations, 2006 established the Youth Enterprise Development Fund whose main objective is among other "provide loans to existing micro-finance institutions (MFIs), registered non-governmental organizations (NGOs) involved in micro financing, and savings and credit co-operative organizations (SACCOs) for on-lending to youth enterprises."
c. The Public Finance Management (Uwezo Fund) Regulations, 2014 establishing the Uwezo Fund whose objective among other is "to expand access to finances in promotion of youth and women businesses and enterprises at the constituency level for economic growth towards the realization of the goals of Vision 2030."

**Recommendations #1**

Streamline the empowerments funds into the MSE in accordance with the Parastatal reforms report as the Authority is mandated to address both supply and demand side employment issues.

Additionally, the function of the Authority should be limited to provision of intergovernmental coordination between the national government and the County Executive trade and industry sectors in respect to the promotion of MSE's.

Further, noting the functional mandate of the Counties in regards to trade and the opportunities for intergovernmental collaboration in service delivery as outlined in Article 187 the National Government should provide conditional grants to counties for enterprise development that will ensure that Counties are empowered to promote the growth of industries across a myriad of high performing sectors in the respective counties such as milk in Kiambu County, Tea in Kericho et al in order to facilitate the growth of MSE's and small industries in these counties and sectors.

Another function of the Authority would be to support Counties develop and streamline their respective policies and laws on MSE's.

2. **Harmonization of Entrepreneurship training programs**

**Recommendation #2**
There are a number of programs that provide for entrepreneurship training such as the TVET as currently established by the Technical and Vocational Education Training Act, 2013, the Industrial Training Act, 2012 and the Micro and Small Enterprise Act 2012 and the National Youth Service Act, 2012 all mandated to provide technical skills to enhance employability for the NYS, TVET and ITA and boost performance of MSEs in respect to the efficiency of MSEA need to be synchronised in order to ensure that the curricula comprehensively responds to the capacity needs of MSEs in the industrial sector.

3. **Lesson from best practices**

   a. **Case Study: Taiwan**

In Taiwan, where 97% of the enterprises are SME's, there is established a SME authority whose functions are similar to the Kenyan MSE Authority in that it is tasked with the responsibility of ensuring the development of SME's in Taiwan.

In order to address the capital needs of the SME sector, the Authority is tasked with the responsibility of coordinating financial institutions and credit guarantee institutions in order to enhance their respective mandates for provision of finances and guaranty to SMEs. Further, banks within Taiwan are required to, within their scope of their respective business, set aside finances for SMEs and establish an SME assistance centre in order to enhance the provision of sector specific services.

Thus in addition to the Authority providing direct credit, the Authority in Taiwan also work with financial intermediaries with special financing for reinforcement of competiveness, research and market expansion of SMEs and also have a credit guarantee scheme to ensure that SMEs that are traditionally not attractive to credit institutions are able to access credit. Additionally, there is an emergency facility for enterprises during periods of economic crisis, natural disasters or any other emergency events.

Further, the Authority provides support for the establishment of industrial associations within various sectors and establish a joint credit guarantee scheme to prevent a chain close down of industrial based SMEs.

**Recommendations #3**

**Lessons for Kenya from Taiwan**

Taiwan can offer Kenya the following lessons towards increasing economic growth and demand for employment.

1. There is need for public credit institutions to diversify the loan products and services offered to SMEs in order to enhance the capacity of SMEs to contribute considerably to economic development.
2. Further, the government should rethink its strategy with working with financial intermediaries. In the recent past, working with financial intermediaries only presented opportunities for misappropriation of funds and not entrepreneurship development.
3. The Taiwan model has a very strong focus on promotion of primary and other industries in the Republic of China. In Kenya, the credit facility regimes lack a strategic focus on the promotion of industries towards the realization of Vision 2030. Further, in Kenya, the funds regime only promotes of an influx of business entities focusing on few easy entry sectors such as simple restaurant, government supplies (tenderpreneurs), exhibitions among other, and with the requirement of only funding existing business, does little to encourage innovation.
4. Alignment of the empowerment regimes to the Constitution would allow for the advancement of entrepreneur development within competitive sectors according to the competitiveness of the different Counties. This would then create an opportunity for national and county government to promote industrial associations that would further offer support to industries to ensure the continued growth and sustainability and their functions in terms of increasing demand for employment.