BRIEFING PAPER

CUTS International

5/2008

Services Trade and Domestic Regulation in Kenya

Introduction

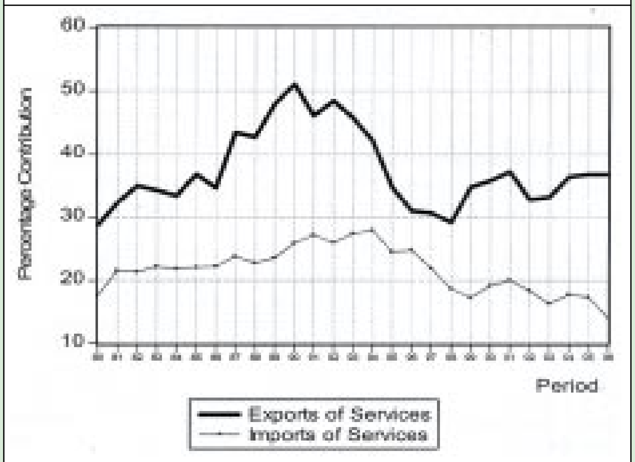
Services have been the most important sector in Kenya's post-independence economy in terms of employment creation, contribution to gross domestic product (GDP), foreign exchange earnings, foreign direct investment (FDI), productivity growth, regional development, competitiveness and poverty alleviation. The sector's contribution to GDP increased from 44 percent in 1960 to 60 percent in 2006 while its contribution to employment grew from 49.6 percent in 1970 to 68 percent in 2006.

As a member of World Trade Organisation (WTO), Kenya has largely met its obligation, as specific commitments were made in telecommunications, financial services, tourism and travel-related services and transport services. Further liberalisation in a number of sectors has already taken place beyond what was committed in the previous round of General Agreement on Trade in Services (GATS) negotiations. In spite of these reforms, the government is still grappling with enforcement problems in a number of sectors that emanate from corporate governance issues within the regulatory agencies. The Kenya Vision 2030 is the new development blueprint covering the period from 2008 to 2030 wherein it recognises the pivotal role of services especially information communication technology (ICT), financial services, education, health, water, environmental services, construction and research, etc.

Contribution to International Trade

The growing importance of the service sector in national output and employment generation has been accompanied by an expansion of the share of commercial services in total exports of goods and services. Unlike other African developing countries, Kenya has a positive balance of trade (see Figure 1). However, the share of services in international transactions lags behind in terms of its rising importance in the structure of production and employment. This is attributed to a number of factors. First, there are substantial constraints on international trade in services caused by intangibility and transitoriness of services. Many services in Kenya are still non-tradable internationally because the transaction costs remain prohibitive. Consequently, local sales through foreign affiliates are the prominent source of international transactions.

Figure 1: % Contribution of Services to Trade in Goods and Services



Source: UNCTAD Handbook of Statistics, 2006-07

Second, the relative importance of services is underestimated because of the difficulty in tracing service trade in the context of intra-firm trade by transnational corporations (TNCs). Despite the limited contribution of services to total trade in Kenya, the sector is opening up to international competition.

Kenya's Trading Arrangements in Services

Kenya's trade policy objectives include: moving towards a more open trade regime; strengthening and increasing overseas market access for Kenyan services; and further integration into the world economy. These policy objectives have been pursued through unilateral liberalisation and regional and bilateral trade negotiations, in particular within the African region, as well as through its participation in the multilateral trading system at the WTO.

At the WTO, Kenya aims to ensure that the multilateral trade in services creates market access for export of services, enhances supply capacity and preserves the policy space necessary to address development challenges such as poverty reduction, sustainable economic growth and development; more equitable income distribution; unemployment reduction; and full integration into the world economy.

With the support of

COMMONWEALTH SECRETARIAT

General Agreement on Trade in Services (GATS)

Under the GATS, Kenya scheduled three specific 'horizontal' commitments regarding commercial presence and movement of natural persons pertaining to all sectors included in its schedule. First, commercial presence entails that foreign service providers incorporate or establish the business locally. Second, Mode 4 is unbound except for measures concerning the entry and temporary stay of natural persons employed in management and expert jobs for the implementation of foreign investment. Finally, the employment of foreign natural persons for the implementation of foreign investment shall be agreed upon by the contracting parties and approved by the government.

Kenya is a net exporter of services mainly in tourism and has potential to export other services, such as financial, transportation and communication services. Kenya has one of the most developed banking systems in the region and its geographical location endows it with the potential to provide maritime services to its land-locked neighbours. However, services trade negotiations by Kenya, as with other African countries, are hindered by a lack of capacity to analyse negotiating interests.

GATS and Domestic Regulations

Communication Sector

Communications services comprise the postal services, courier services, telecommunication services and audio visual services. This sector (excluding broadcasting) is regulated by the Communications Commission of Kenya (CCK), which acts as an independent regulator. CCK's main function is to regulate and license telecommunications, postal and radio communication services though it does not regulate the broadcasting services. However, the proposed Kenya Communications (Amendment) Bill of 2007 seeks to bring the regulation of broadcasting services under the CCK.

Telecommunication and audio visual services

Between 1994 and 1999, Kenya made commitments in telecommunications and audiovisual services. The country made commitments in all four areas of telecommunication services: fixed telephony; mobile telephony; value added services; and internet services. In terms of Mode 1 and Mode 2, the state of liberalisation in the sector is much more open than the commitments made in 1999. In terms of Mode 3, foreign firms which want to establish business in Kenya can own a maximum of 70 percent equity shareholding in the telecommunications sector. This provision is largely to attract foreign investment and technology.

There have been requests made by other WTO Members in the current round of negotiations to Kenya to deepen its commitments in scheduled telecommunications areas and make others in new sectors. Greater liberalisation beyond what was committed in the previous round of GATS services negotiations has already taken place in a number of sectors. However, the Kenya Communications Bill is currently underway (pending in Parliament). It is therefore not prudent for Kenya to make further commitments since that would reduce the country's policy space. However, there are some sectors where the country has limited supply capacity and needs foreign investors to build the same. In such cases, Kenya could make further commitments or schedule the sectors with some restrictions that ensure that the government still has policy space to direct the ICT sector.

Audiovisual service is one of the fastest growing service sectors in Kenya. There are over 24 radio and 16 TV stations in the country. The digital revolution has reduced the Kenyan Government's ability to restrict the entry of foreign content into the domestic market. Kenya has made commitments in 2 out of the 5 service sectors in audiovisual services (see Table 1).

Postal and courier services

The services that the Postal Corporation provides are largely managed by it and other participants have a limited or restrictive role. The other operators are required to be licensed by the CCK. Some regulatory problems like those created by illegal operators, violations of basic postal tariffs and poor quality of service are common in this sector. These problems may be attributed to the fact that the Kenya Communications Act 1998 is too lenient. Kenya has not made any commitments in this sector.

Box 1: Information Communications Technology (ICT)

ICT is an important sector in Kenya since it contributes to employment and income creation. It is one of the fastest growing sectors in Kenya though it still faces challenges in harnessing economic growth and reducing poverty, which include lack of comprehensive policy and regulatory frameworks, inadequate infrastructure, insufficient skilled human resources and inadequate access to ICT services especially in the rural areas where most Kenyan live. As a WTO Member, Kenya made commitments in all five areas of telecommunication services. It also inscribed the disciplines in the reference paper and in the Global Mobile Personal Communications by Satellite Memorandum of Understanding (GMPCS-MoU) into her schedule.

The current regulatory regime in Kenya is far much more liberal than the commitments made in 1999. For instance, in terms of Mode 3 foreign firms that want to establish business in Kenya can own up to a maximum of 70 percent equity shareholding in telecommunications sector. The existing regulations administered by the CCK largely comply with the core principles of the reference paper, namely: CCK's independence from telecommunications suppliers and government; the need for CCK to provide safeguards to prevent anti-competitive practices especially by Telkom Kenya and Postal Corporation; the existence of procedures for interconnection negotiations; and dispute settlement, universal access, procedures for allocation and use of scarce resources, etc.

Table 1: Kenya's Commitments on Audiovisual Services		
	Initial Offer	
Sector or sub sector	Limitations on market access	Limitations on national treatment
a) Motion picture and video tape ` production services (excluding distribution services)	(1)None (2) None (3) Unbound (4) Unbound, except as indicated in . the horizontal section	(1) None (2) None (3) Unbound (4) Unbound
b) Motion picture projection services	(1) Unbound* (2) None (3) None (4) Unbound, except as indicated in the horizontal section.	(1) Unbound* (2) None (3) None (4) Unbound
Source: Adapted from WTO web site: www.wto.org/english/tratop_e/serv_e/serv_commitments_e.htm		

Financial Services

Financial services play a key strategic role by providing means of payments, mobilising deposits, lending, and insuring risks. The financial sector in Kenya comprises banking and other financial services and all insurance and insurance-related services.

Banking services

The banking sector is regulated and supervised by the Central Bank of Kenya (CBK). Organisations such as the Kenya Bankers Association and the Kenya Institute of Bankers play a critical role in regulating the banking industry in Kenya. By the time Kenya made its commitments in banking services (1994 and 1998), the Structural Adjustment Programmes (SAPs) were underway. The European Union (EU) argues that Kenya has committed this sector only partially as the trading of negotiable instruments and other financial assets, underwriting of securities, money broking, pension fund management, settlement and clearing services, while provision and transfer of financial information are not covered in the schedule. However, Kenya has emphasised the need to develop a strong and transparent regulatory regime before undertaking further liberalisation of the banking industry within the GATS framework.

Insurance services

The insurance services is controlled by the Commissioner of Insurance. The sector was quite liberal until the 1980s when the Insurance Act was amended to introduce restrictions like provision of one-third of shareholding and board membership to be held by Kenyan citizens, a ceiling on the level of funds that an insurance company could invest outside the country, etc. The Association of Kenya Insurers and Association of Insurance Brokers have been successful in lobbying with the government on a number of issues that affect the sector. By the time Kenya made its commitments in insurance services (1994 and 1998), the SAPs were underway. However, the current regulatory regime is more open, for instance, in broking foreign investors are allowed to own up to 50 percent of equity.

Capital markets

The capital market in Kenya is regulated by the Capital Markets Authority (CMA). In spite of the regulations existing in the capital market, the sector still suffers from the problem of corporate governance at the CMA. However, Kenya has not made major commitments at the WTO in this sector.

Tourism and Travel Related Services

Kenya's tourism sector has generally been open. This is reflected in the presence of non-discriminatory policies such as free repatriation of profits, ease in issuance of visitors and work permits, among others. This resulted in the emergence of a tourism sector heavily dominated by foreign investors. The liberal policies that Kenya has in the tourism sector are reflected in its GATS commitments schedule of 1994. Kenya made commitments in all sectors of tourism (hotels and restaurants, travel agencies and tour operator's services and tourist guides services). Under these commitments, Kenya does not impose any market access and national treatment restrictions in almost all tourism services. Despite the country's deep GATS commitments in tourism, it faces many challenges especially in the EU which is the main catchment area for the tourists. These include state-specific regulations on health tourism and Economic Needs Tests (ENTs) in some EU countries. Only Kenyan nationals are allowed to offer tour guide services in Greece, Spain, France, Italy and Portugal.

Transport Sector

The transport sector is regulated by numerous statutes, which are divided into two groups: the overarching statutes; and road-sector specific statutes. The overarching statutes affect all modes of transport.

Road transport

Road transport in Kenya is managed by a number of Acts. However, the problem with the statutes is that they are outdated and do not reflect the current dynamics in Kenya. The EU in 2000 requested Kenya to make full commitments (both market access and national treatment) on freight road

Table 2: Commitments on Tourism and Travel-Related Sector		
		Initial Offer
Sector or sub sector	**Limitations on market access**	**Limitations on national treatment**
a) Hotels and restaurants (including catering)	(1) Unbound (2) None (3) None (4) Unbound, except as indicated in the horizontal section.	(1) Unbound (2) None (3) None (4) None, for those categories of access persons referred to in the market column of the horizontal section
b) Travel agencies and tour operators services	(1) None (2) None (3) None (4) Unbound, except as indicated in the horizontal section.	(1) None (2) None (3) None (4) None, for those categories of persons referred to in the market access column of the horizontal section
c) Tourist guide services	(1) None (2) None (3) None (4) Unbound, except as indicated in the horizontal section.	(1) None (2) None (3) None (4) None, for those categories of persons referred to in the market access column of the horizontal section
Source: Adapted from WTO web site: www.wto.org/english/tratop_e/serv_e/serv_commitments_e.htm		

transportation (Mode 3) and maintenance and repair of road transport equipment (Modes 1, 2 and 3). In addition, the EU has requested for full commitments for services auxiliary to all modes of transport, including storage and warehousing (Modes 2 and 3); freight transport agency/freight forwarding services; and pre-shipment inspection (Modes 1, 2 and 3). It may be quite difficult for Kenya to make further commitments because the road transport is undergoing major reforms.

Rail transport
Currently, the railway network is run by the Rift Valley Railways (RVR), which is a South African company. Kenya has not made any commitments in this sector. There have been no requests made to the country to open this sector either.

Pipeline transport
Statutes governing the pipeline transport are outdated and do not reflect the current dynamics in the pipeline industry. Kenya has not made any commitments in this sector.

Air transport
Kenya has made commitments in air transport. The EU in 2000 requested Kenya to make full commitments for market access and national treatment in maintenance and repair of aircraft and parts thereof (Modes 2 and 3); selling and marketing (Modes 1, 2 and 3); computer reservation systems (Modes 1, 2 and 3); ground handling services (Modes 2 and 3); and airport management services (Mode 3). It may not be possible for Kenya to make further commitments due to supply capacity limitations.

Maritime transport/inland waterways
Although Kenya did not make GATS commitments at the WTO, it has been requested by the EU in 2000 to make offers with respect to international transport (freight and passengers), ability of international transport suppliers to operate vessels of any flags for the purposes of pre and onward carriage of the international cargo between ports of Kenya. It is also asked to offer access to and use of ports facilities, maritime auxiliary services (maritime cargo handling, storage and warehouse services, customs clearance services, container station and depot services, maritime agency services), ability to rent, lease or access/use multi-modal facilities for inland forwarding of cargo and permission to reposition equipment such as empty containers between ports of Kenya.

Health Services
The regulation of health sector in Kenya is done by the Ministry of Health (MOH), which is the overall government watchdog. The main aim of the regulations is to control the entry into the medical profession, ensure high standards and quality of health services provided by practitioners and public safety. MOH is the main regulatory agency. Kenya has not made commitments regarding the health sector except for health insurance under the financial services.

Education Services
Kenya has no GATS commitments in education services. However, it has received requests in four areas namely primary education; secondary education; higher education; and adult education. There have been many requests by

Box 2: Health Sector in Kenya

Despite regulatory reforms in the health sector, Kenya has not made commitments at the WTO on health services except in health insurance. Cross-border delivery of health services (Mode 1) through telemedicine can enable healthcare providers in Kenya to cater to remote and underserved segments of the population in the rural areas. However, the requisite ICT infrastructure is not developed in Kenya. Additionally, it is difficult to apply Kenya's domestic regulations to electronic supply of health services by foreign health professionals.

Consumption of Kenya's cheap and quality medical services by foreigners will enable the country improve its national health systems by generating foreign exchange and additional resources for investment in healthcare. However, consumption of health services abroad could also result in a dual market structure in Kenya by creating a higher quality, expensive segment that caters to the wealthy nationals and foreigners, including a much lower quality, resource-constrained segment catering for the poor.

Commercial presence in health services can generate additional resources for making investment in and upgrading healthcare infrastructure and technologies. It can also create employment or reduce underemployment of health personnel in Kenya. However, it may result in a two-tiered system with the attendant problem of internal "brain drain", as the best medical personnel (doctors, dentists, nurses etc.) flow from the public healthcare segment to the corporate segment, with its better pay and superior infrastructure.

Trade through movement of natural persons (through mobility of Kenyan healthcare providers to foreign countries) can generate remittances and transfers, help promote exchange of clinical knowledge among professionals and upgrade skills and standards in Kenya. However, a permanent outflow of health service providers from Kenya will lead to shortages of highly trained personnel, and public resources invested in their training will be lost in the outflow of human capital.

Still, Kenya can use international trade in health services to address some of these challenges by committing some modes of supply such as Mode 1, 2 and 3. The main risk in allowing international trade in health services is the creation of a dual healthcare system explained above. However, these problems can be forestalled within the GATS framework by inscribing specific restrictions on the country's schedule that ensure Kenya's interests are taken into consideration.

other countries wishing to offer higher education services through commercial presence.

Professional Services

Professional service is an area of export interest to Kenya since there is a constant increase in migration of Kenyan professionals to the Eastern and Southern Africa, the US, the EU and the Middle East.

The potential market, the EU and the US, for Kenyan professionals remains restricted due to lack of recognition and visa entry requirements coupled with competition from other countries such as India, Nigeria etc. Consequently, Kenya has made requests to the other WTO Members on Mode 4 in areas like removal of employment quotas; removal of ENT; transparent and streamlined administrative procedures affecting entry and stay especially with regard to visas and work permits; recognition of academic and professional qualifications; and reduction of prohibitive licensing fees.

Kenya does not have commitments in professional services. However, in its horizontal schedule there is a restriction on movement of natural persons since only entry of managers and experts required for the implementation of foreign investment. However, the difficulty Kenya faces today is that there is no clear policy framework in place to address the challenges faced in vetting professionals entering the domestic market. The country could, however, make commitments in some professional services, for which there is a dire need and regulation is in place, such as architectural services.

Conclusions and Recommendations

Though Kenya has a surplus in the services trade account, its share of services in international transactions lags behind its role in the economy as a whole. It has a revealed comparative advantage in communication, travel and transportation. Indeed the communication sector is one of the major drivers of Kenya's Vision 2030.The common problems in services in Kenya include lack of supply capacity to meet the domestic demand, inadequate distribution of infrastructures related to services, lack of integration with other services, vandalism of services infrastructure etc. To a large extent, Kenya has an adequate regulatory framework but the main problems are with enforcement.

As a WTO Member, Kenya has largely met its obligation. Further liberalisation in a number of sectors has already taken place beyond what was committed in the previous round of GATS services negotiations. There are some sectors where the country has limited supply capacity and needs foreign investors to build the same. In such cases, Kenya could make further commitments or schedule the sectors with some restrictions that ensure that the government still has policy space to direct the sector.

In this context, the following policy recommendations can be made:

- There is an urgent need to implement the UN Manual on Statistics of International Trade in Services 2002 to improve the data on services trade.
- Export promotion strategies need to be enhanced and marketing excess capacity in some services industries (e.g. health tourism), reposition of some service industry like business process outsourcing through adherence to international quality standards should be given priority.
- The country needs to develop comprehensive competition and consumer protection laws. The Consumer Protection Bill, 2007 is a major step towards this direction.
- There is a need to update all outdated laws, including the Clinical Officers Act
- Kenya needs to develop laws to deal issues like intellectual property, content, data protection, security, cyber crime, anti non-ionising radiation.
- The country should address corporate governance issues for the regulatory agencies whereby they should be granted structural, financial and functional autonomy.
- There is a need to harmonise the services trade negotiations at different levels (WTO, COMESA and EAC) to avoid duplication of effort and conflict etc.
- Kenya needs to enter into comprehensive negotiations with its trading partners on trade in professional services. The definition of Mode 4 in Article I as read together with Annex on movement of natural persons supplying services is not pro-development. Kenya has a comparative advantage in professional services but the mode of supply entails migration of skilled professionals seeking employment in other countries, which is explicitly excluded from the GATS negotiations (Paragraph 2 of the Annex on Movement of Natural persons). The net effect is that Kenya has been subsidising developed countries.
- The country needs to deal with land policy so that investors could get access to land for expansion of service infrastructure.

CUTS CITEE Briefing Papers in 2008

- Trade as a Tool for Employment Generation
- Domestic Regulation and Service Trade Liberalisation – A South Asian Perspective
- Integrating India’s Service Sector with the Global Economy
- Aid for Trade – The Process So Far, But What Next?
- Mainstreaming Development in the WTO – Developing Countries in the Doha Round
- The Saga of Rising Food Prices
- From UNCTA XI to UNCTAD XII – A Stocktaking
- Evolution of Service Sector in Zambia toward Greater Trade Orientation-An Overview
- Up-scaling Aid for Trade – A Kenyan Perspective
- Trade Openness: The Only Path to Sustainable Growth

This Briefing Paper is an abridged version of Kenya’s country background paper prepared by Moses Sichei, Lecturer, University of Nairobi, with support from the Economic Affairs Division of the Commonwealth Secretariat, London under the project entitled, ‘Services Trade and Domestic Regulation: A Multi – Country Study in Commonwealth Asia, Africa and the Caribbean’.