



# HIGHWAY ROBBERY

Budgeting for State Capture



## **Who we are**

The Africa Centre for Open Governance (AfriCOG) is an independent, non-profit organisation that provides cutting-edge research and monitoring on anti-corruption, governance and public ethics issues in both the public and private sectors so as to address the structural causes of the crisis of governance in Kenya and the region. The overall objectives of our programme activities are: to promote the implementation of the Constitution of Kenya 2010; to strengthen anti-corruption and good governance in Kenya with objective, high-quality research and advocacy and to build citizens' capacity to be permanently vigilant, demand accountability and monitor progress on governance issues in the public and private sectors. We also work at regional and international levels to promote collective efforts towards anti-corruption, accountability, transparency and openness in governance. Our publications and advocacy add value to anti-corruption and governance reform processes by stimulating policy discussion and supporting evidence-based advocacy and the mobilisation of our partners.

# HIGHWAY ROBBERY

**“Budgeted Corruption” as State Capture**

A case study of infrastructure spending  
under the Jubilee administration

David Ndii





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# Abbreviations and Acronyms

AfriCOG	Africa Centre for Open Governance
AfDB	African Development Bank
CAG	Controller and Auditor General
CDF	Constituency Development Fund
CS	Cabinet Secretary
DCI	Directorate of Criminal Investigations
EACC	Ethics and Anti-Corruption Commission
FY	Financial Year
GDP	Gross Domestic Product
GDC	Geothermal Development Company
GNU	Government of National Unity
GWh	Gigawatt hours
ICT	Information and Communications Technology
IMF	International Monetary Fund
IPPs	Independent Power Producers
JKIA	Jomo Kenyatta International Airport
KADU	Kenya African Democratic Union
KENGEN	Kenya Electricity Generating Company PLC
KETRACO	Kenya Transmission Company
KfW	Kreditanstalt für Wiederaufbau
KCB	Kenya Commercial Bank
KNBS	Kenya National Bureau of Statistics
KPLC	Kenya Power and Lighting Company
LCPDP	Least Cost Power Development Plan
MTEF	Medium Term Expenditure Framework
MW	Mega-Watts
NPL	Non-performing Loans
NYS	National Youth Service
O&M	Operations and Maintenance
PAC	Public Accounts Committee
PER	Public Expenditure Review
PBO	Parliamentary Budget Office
PIC	Public Investments Committee
PFM	Public Financial Management
RDF	Rural Development Fund
SACE	Servizi Assicurativi del Commercio Estero
SGR	Standard Gauge Railway
SOTN	State of the Nation (address)
US	United States of America

# Foreword

The Africa Centre for Open Governance (AfriCOG) is pleased to present its latest report “Highway Robbery: “Budgeted Corruption” as State Capture. A case study of infrastructure spending under the Jubilee Administration”.

This follows the report entitled “State Capture: Inside Kenya’s Inability to Fight Corruption”, which examined Kenya’s failed history of anti-corruption reforms and campaigns and concluded that the reasons for this failure lie in the phenomenon of state capture. The report defined state capture as “a political project in which a well-organised elite network constructs a symbiotic relationship between the constitutional state and a parallel shadow state for its own benefit”<sup>1</sup>.

Former Auditor General Edward Ouko, speaking at the launch of AfriCOG’s “State Capture” report, spoke of a phenomenon he referred to as “budgeted corruption,” through which the budget is inflated by monies that are earmarked to be stolen. Ouko characterised the budgeting process as a “highway”, and such projects as “exit lanes”.

With the “Highway Robbery” study, we set out to test the hypothesis that the runaway corruption that has dominated headlines during the Jubilee administration is evidence of “budgeted corruption”, which is in turn a manifestation of state capture. Budgets and expenditure in three key infrastructure sectors, electricity, roads and water are examined to see the extent to which there is systematic deviation of project choice from PFM value for money norms, and whether that divergence can be construed to be “exit lanes” for budgeted corruption as postulated by the former Auditor General.

This report represents part of a project aimed at uncovering and understanding the phenomenon of state capture not only in Kenya, but around the Africa region, in collaboration with partners. AfriCOG’s hope is that this latest study will contribute to the continuing exposure and naming of the structures and operations of state capture, which seem to obviate the conventional reform strategies that civil society has been advocating. Our aim is for citizens to understand that while democracy is the only protection against capture by special interests, at the same time, democracy is fragile, tenuous and must be permanently defended, deepened and imbued with real meaning by a vigilant and enlightened public.

We welcome your engagement and feedback.

## **Gladwell Otieno**

Executive Director

Africa Centre for Open Governance (AfriCOG)

<sup>1</sup> See the discussion in AfriCOG, 2019, “State Capture: Inside Kenya’s Inability to Fight Corruption, p.6. Available at <https://africog.org/wp-content/uploads/2019/05/STATE-CAPTURE.pdf>

“In absolute terms the **county governments** spent on average **KShs7 billion per county**, while the **national government** spent **KShs47 billion** per county. In whichever county a Kenyan lives, they should be experiencing seven times as much development impact from the national government as from the county governments. It is very doubtful that there is a county where the national government’s development spending is felt more than the county governments’, or even CDF sometimes!”



## Part 1

# Introduction

That Kenya is facing debt related fiscal distress is now widely acknowledged. The deteriorating fiscal situation has been noted by sovereign rating agencies as well as the IMF.<sup>2</sup> The Government itself is pursuing various policy and austerity budget measures consistent with fiscal distress.

The fiscal challenges emanate from debt. Since assuming office seven years ago, the Jubilee administration has increased the country's public debt four-fold, from KShs1.5 trillion to KShs6 trillion as at end December 2019, raising the country's public debt to GDP ratio from 42 percent to over 60 percent, on par with the country's historical peak indebtedness reached in the late 90s.

### – the Jubilee administration has borrowed upwards of KShs4 trillion...

In money terms, the administration has borrowed upwards of KShs4 trillion (US\$4b) and presumably invested it in various development projects. It is helpful to put a perspective on just how much investment capital this money represents. In the four financial years 2013/14 to 2016/17, the national and county governments spent, respectively, KShs2.25 trillion and KShs334 billion on development projects. For every shilling spent by the county governments on development projects, the national government spent KShs6.70, close to seven times.

In absolute terms the county governments spent on average KShs7 billion per county, while the national government spent KShs47 billion per county. In whichever county a Kenyan lives, they should be experiencing seven times as much development impact from the national government as from the county governments. It is very doubtful that there is a county where the national government's development spending is felt more than the county governments', or even the Constituency Development Fund (CDF) sometimes!

### Based on documented budgets, the national government could have funded 336 'Makueni Hospitals' in every county.

The County Government of Makueni earned accolades for completing a 200 bed women and children's hospital at a cost of KShs140 million. The KShs47 billion county spending average works out to the equivalent of 336 Makueni hospitals per county. The Kibra Constituency Development Fund (CDF) under the leadership of the late Kenneth Okoth also made news for completing a girls' secondary school at a cost of KShs48 million. The KShs47 billion average works out to the equivalent of 160 Mbagathi Girls Secondary schools per constituency. These are mind boggling figures. Where are these projects that the national government has sunk well over KShs2 trillion into?

<sup>2</sup> Prior to the COVID19 crisis, the IMF had raised Kenya's risk of debt distress from "low" to "moderate" and from "moderate" to "high" in the wake of the COVID crisis.

Such is the mystery that Kenyans joke that to see the projects, you need to log onto “the portal”, referring to the administration’s 2017 election campaign website [www.gokdelivers.go.ke](http://www.gokdelivers.go.ke).

### At the same time, the Jubilee administration has been stalked by “mega” corruption scandals.

Five cabinet secretaries have vacated office because of corruption allegations. The National Youth Service, one of the administration’s flagship programmes, was engulfed by two egregious corruption scandals, commonly referred to as NYS I & II. The first NYS fraud exposed what seemed to be serious fraud vulnerability of IFMIS, the government’s financial management software. The public would have expected corrective action. Instead NYS II occurred, seemingly exploiting the same vulnerabilities as NYS I. Several large projects are mired in controversy of one kind or another. Notable ones include the Galana-Kulalu irrigation project, the JKIA “greenfield terminal project, the medical equipment leasing scheme, and several large dams that have either stalled or turned out to be ghost projects.

At the end of his tenure, former Auditor General Edward Ouko, speaking at the launch of AfriCOG’s report *State Capture- Inside Kenya’s inability to fight corruption* spoke of a phenomenon he termed “budgeted corruption.” Conventionally, we view corruption as affecting the budget at execution stage, typically through the procurement process. At worst, we conceive corruption as distorting priorities such that projects that confer bribes and other private benefits crowd out more socially valuable spending. The idea of budgeted corruption goes beyond this. It implies that the budget is inflated by monies that are earmarked to be stolen. Projects are conceived for the purpose of siphoning the money out of the budget. Ouko characterized such projects as “exit lanes”.

“From where I sit, I would like to introduce another theory, the theory of budgeted corruption. If we are starting on a journey, say from here to Thika, you can imagine the Thika highway, it has several lanes and the most important thing is the exits. Is our budget really loaded with corruption where you know exactly (at) which exit point it is going to be taken? This is where I am concerned—that we are in a situation where our budget is loaded with corruption.”

### “State capture as rule rigging”.

State capture is a specific manifestation of political corruption characterized as the subversion or “re-purposing” of public institutions to serve private interests by fashioning law and policy into means of extracting public resources. State capture terminology was introduced in the corruption discourse in the late 90s to characterize a type of corruption that was observed in the transition of the former Eastern bloc countries from centrally planned to market economies. State capture corruption was associated with the emergence of “oligarchs,” powerful individuals who were able to rig the laws, policies and regulations to their advantage, particularly in privatization transactions. In essence, the state capture vis a vis “conventional” corruption dichotomy postulates the latter as bid rigging, and the former as rule rigging.

“Budgeted corruption” would seem to fall within the ambit of state capture, as it suggests corruption that is embedded in the public financial management (PFM) system, the framework of laws, institutions and processes that govern how public money is raised, budgeted, spent and accounted for. Instead of the PFM system serving the financial control and accountability purpose for which it is intended, it has been rigged to extract public resources. If true, it is a total indictment of Kenya’s public financial management system (PFM). It implies that the PFM system exists in name only.

**“Budgeted corruption” falls within the ambit of state capture, as it suggests corruption that is embedded in the public financial management (PFM) system.**

Is Kenya’s PFM system captive to corruption cartels? This question is the subject of this paper. The paper addresses the question by reviewing expenditure in three infrastructure sectors, namely electricity, roads and water. These three sectors feature some of the Jubilee administration’s flagship initiatives, notably the 5000MW initiative and “last mile connectivity” electricity projects, several large dam projects and in the words of President Uhuru Kenyatta, “the most aggressive road construction programme ever seen in Kenya.” In the first four years of the Jubilee administration, these three sectors absorbed KShs843 billion, equivalent to 43 percent of government’s capital budget over the period, and 53 percent excluding the new Mombasa Nairobi Standard Gauge railway, which accounts for 17 percent on its own.<sup>3</sup>

**We find budget and expenditure irregularities consistent with budgeted corruption...**

We find budget and expenditure irregularities consistent with budgeted corruption in each one of the three sectors reviewed. In the roads sector, we find progressive increase in big budget urban road upgrading projects contrary to economic evidence that trunk and rural access roads have a higher rate of return, as well as cost inflation to the tune of KShs50b, enough to build 760 km of road. In the electricity sector, we find that power generation and distribution investment was scaled up against rational economic criteria including the Government’s own power development plan to justify unnecessary projects whose only beneficiaries are private investors and suppliers. In the water sector we find the systemic problem of flawed, stalled and outright ghost projects affecting nearly the entire portfolio of large dams and a completely irrational project pipeline and budget inflation that defies any reasonable planning parameters and can only be construed as budgeted corruption.

These findings coupled with the numerous cases of egregious corruption executed at the highest levels of government that are already in the public domain, leave no doubt that the public financial management system has been completely fully captured and subverted by corruption cartels. Indeed, it is fair to say that corruption is now the primary business of government.

The paper consists of seven sections as follows. Section 2 following this introduction discusses public financial management. It constitutes the conceptual framework of the paper. Section 3 provides the fiscal context. The fourth, fifth and sixth sections, which form the core of the paper, analyze roads, electricity and water expenditures respectively. The seventh section concludes.

<sup>3</sup> Capital budget is the component of development budget that goes directly into physical assets (i.e.excludes overheads and operational costs), also referred to in fiscal accounts as “acquisition of non-financial assets.”

## Part 2

# Public Financial Management: An Overview

*“The finance of the country is ultimately associated with the liberties of the country. It is a powerful leverage by which English liberty has been gradually acquired. If the House of Commons by any possibility lose the power of the control of the grants of public money, depend upon it, your very liberty will be worth very little in comparison. That powerful leverage has been what is commonly known as the power of the purse – the control of the House of Commons over public expenditure.”<sup>4</sup>*

William Gladstone



*“For seven years, we have lied about our debt, we have cooked books, we have cheated people that we do zero-based budgeting. We have taken loans at 9 per cent that left people offering us money at one per cent...As Parliament, we have failed Kenyans because we have sold to them the romantic story that all is well. We failed in our oversight role because we could have said NO, but we said YES, selling lies that all was well because we believed in respecting the Executive, and most of us are members of the ruling party. We have lied to Kenyans.”<sup>5</sup>*

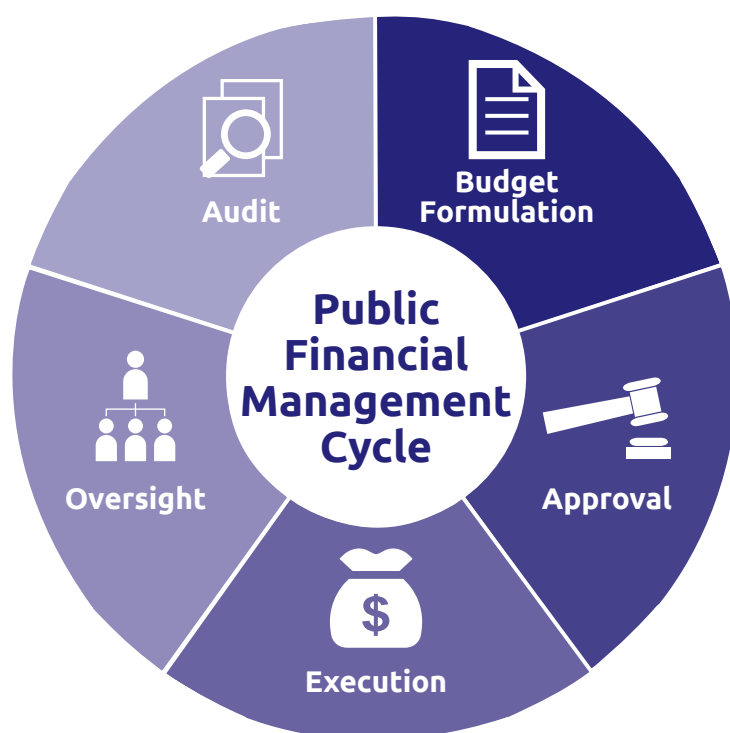
Moses Kuria, MP

4 Quoted in P. Einzig, *The Control of the Purse: progress and decline of Parliament’s financial control*, London, 1959, p.3. <https://publications.parliament.uk/pa/cm201617/cmselect/cmpubadm/95/9507.htm#footnote-151>

5 “State cooked books and lied about big debt, Moses Kuria reveals” *The Standard* 16 November 2019 <https://www.standardmedia.co.ke/article/2001348275/we-have-destroyed-kenya-says-uhuru-s-mp>

The public financial management system (PFM) is the legal and institutional architecture that governs how public monies are raised, allocated, spent and accounted for. Public monies here refers to all sources of revenue including taxes, fees, investment income, grants and debt. PFM is a cycle that consists of five stages: budget formulation, approval, execution, oversight and audit. Perhaps because of the term “finance”, the general public, by and large, perceives PFM as a technocratic affair best left to experts in the finance ministries. People are not as alive to the fact that financial accountability is at the core of democratic governance. The centrality of financial matters in democratic governance can be gauged from the fact that up to two-thirds of legislative time in most parliaments is taken up by budget process and related work.

**Figure 1: The stages of public financial management**



The primacy of financial accountability in democratic governance can be traced back to the enshrinement of the “no taxation without representation” doctrine in the Magna Carta in 1215. This tenet of constitutional democracy confers to parliament the “power of the purse”, meaning that parliament is the custodian of public money. Public money cannot be spent without its approval and authority, and those authorized to spend it must account to parliament. Strengthening parliament’s control of public money has been an integral feature of the evolution of democratic governance (see box). As William Gladstone, an ardent PFM reformer as British Chancellor of the Exchequer and Prime Minister observed, if this authority is usurped, constitutionalism and democracy are imperiled.

## Power of the Purse

### International Historical Landmarks

- **1215** No taxation without representation principle enshrined in the Magna Carta.
- **1689** The power of the purse explicitly enshrined in the British The Bill of Rights following the Glorious Revolution.
- **1713** UK Parliament enacts executive prerogative providing that only the Executive arm of government can appropriate public money (i.e. submit requests to parliament).
- **1787** UK Parliament establishes the Consolidated Fund.
- **1789 - 1791** US Congress introduces line item appropriations.
- **1807** Napoleon establishes the cour de comptes (Court of Auditors) first Auditor General's office.
- **1832** UK Parliament makes audit reports mandatory.
- **1861** First Public Accounts Committee established, part of Gladstone's public finance reforms.
- **1865** US Congress separates taxation and spending functions by establishing an Appropriations Committee to approve and oversee spending. Hitherto, both were functions of the Ways and Means Committee.
- **1866** UK Office of Comptroller and Auditor General reporting to Parliament established by merging Comptroller General of the Exchequer and the Commissioners of Audit. Hitherto, the merged offices reported to the Treasury.
- **1941** California pioneers establishment of dedicated legislative/parliamentary budget offices (Office of Legislative Analyst).
- **1974** Establishment of the US Congressional Budget Office to "bolster Congress's budgetary understanding and ability to act" (copied from California).

PFM architecture varies across jurisdictions. In the Westminster parliamentary tradition, the executive has the exclusive mandate for the formulation of the budget. Parliament may not alter the budget. It has to approve or reject it as presented (other than by a token amount to register displeasure). Rejection of budget is construed as a vote of no confidence in the government, hence it is an option that is seldom exercised. At the other end of the spectrum are parliaments, the US Congress for example, which formulate their own alternative to the executive's proposals. The two arms negotiate a compromise budget. Accordingly, Westminster style parliaments are often referred to as budget approving parliaments, and presidential system ones such as the US Congress as budget making parliaments.

The executive has primary mandate for execution (i.e. implementation) of the budget. Parliament has the exclusive mandate for approval and oversight. Parliament oversight work is undertaken by its various departmental committees. The audit function is undertaken by the Office of the Auditor General, which is an independent constitutional office, on behalf of parliament. Audit reports are reviewed by the Public Accounts Committee (PAC) and Public Investments Committee (PIC) which make recommendations for adoption by Parliament.

While audit recommendations have the force of law once they are adopted, parliament cannot enforce them. The Auditor General may find certain individuals culpable for violations of financial responsibility and accountability, and parliament may vote to impose sanctions against them, such as being surcharged for the monies lost, barring them from holding public office, opening of investigations to establish criminal culpability and recommending prosecution. But implementation of sanctions and recommendations is dependent on the goodwill of the executive. In this regard, public financial accountability is contingent on the rule of law and democratic accountability.

As a former British colony, Kenya at independence adopted the Westminster style PFM architecture which, as noted, gives parliament a limited role in budget formulation. Parliament's oversight, which in the Westminster system is essentially an opposition function, was undermined by adoption of a one-party system following the dissolution of the opposition Kenya African Democratic Union (KADU). That said, the Auditor General's office enjoyed considerable independence and financial discipline remained quite strong, and although corruption was prevalent, the cases were by and large episodic.

In 1986, under President Daniel arap Moi, the public audit function was split into two by establishment of an Auditor General for state corporations, but without the security of tenure enjoyed by the bona fide Auditor General. Two years later, the Auditor General's security of tenure was also removed, alongside the security of tenure of judges. The audit function was further undermined by deliberate underfunding. This onslaught on the audit function reduced parliament's PFM function to a perfunctory one of approving the budget—a rubber stamp so to speak.



**Daniel arap Moi**  
Kenya's President, 1978-2002

During this period, several hitherto healthy state corporations ran into financial difficulties. Corporate giants like the Kenya National Assurance Company and KENATCO, until then the leading insurance company and largest haulage company in East Africa respectively, collapsed. Others like Kenya Railways and the National Bank of Kenya became perennial loss-makers and have never recovered. The National Bank was recently absorbed into the Kenya Commercial Bank (KCB).

After Kenya reverted to multiparty politics, parliament sought to become more assertive, including in its public finance functions. While the presence of an opposition invigorated debate, legislators found the Westminster system too limiting. This prompted a reform initiative that eventually culminated in the enactment of a new budget law, the Fiscal Management Act 2008, that effectively changed the system from a budget approving to a budget making parliament. The Fiscal Management Act established a new transparent budget formulation calendar and reporting process that opened budget formulation to parliamentary (and public) scrutiny and input before it was tabled. Hitherto, the budget was a top secret that was only revealed with great pomp and ceremony on budget speech day. To enable parliament to execute this expanded mandate, the Fiscal Management Act established a technical analysis unit, known as the Parliamentary Budget Office (PBO).

## **Strengthening the public financial management system**

The rewriting of the constitution presented another opportunity to strengthen the PFM system. With regard to budget formulation at the national level, the Fiscal Management Act framework was carried over more or less intact into the new constitution. The Constitution of Kenya 2010 introduced three significant innovations. First, it sought to create fiscal parity between the three arms of the national government. In the single party era, the executive dominated the other two arms of government in terms of budget formulation, in that parliament and Judiciary submitted their budget proposals to the Treasury just like ministries and departments. After reverting to the multiparty system, parliament had been able to leverage its legislative power to achieve a degree of fiscal autonomy, by pushing through a constitutional amendment establishing a Parliamentary Service Commission that provided for budget autonomy for itself. The new constitution conferred on the judiciary the same budget autonomy that parliament enjoyed.

Second, the Constitution unbundled the Office of the Controller and Auditor General (CAG) into two namely, the Auditor General and the Controller of the Budget. This was informed by several concerns. One concern was that there is a potential conflict of interest between the two functions. More importantly, with the office chronically underfunded, the statutory audit function took priority and the control function became ineffectual, so much so that very few people were aware that the two were distinct functions. The separation of the functions was expected to strengthen both functions, thus making for more effective reporting and oversight. The Controller of the Budget was mandated to publish and submit to parliament a quarterly report on budget execution. This was seen as a remedy to a perennial complaint that the annual audits amounted to “postmortems” that came long after the horse had bolted. It was thus envisaged that Parliament would be able to take pre-emptive action on issues flagged by the Controller of the Budget.



Third, the restructuring of the PFM system to align it with devolution made for a more transparent budget. How so is already demonstrated by the examples presented in the introduction of this paper i.e. that we are able to evaluate the development expenditure of the national and county governments, and ask questions about the value for money. We would not have been able to do this under the old budgeting system; the budgets that were disclosed to the public were organized in terms of sectors and programmes. It was very difficult, sometimes impossible, to know where the money was spent, and on what projects.

By way of example, in the early 90s, a corruption scandal involving a multi-donor funded programme called the Rural Development Fund was exposed. The RDF financed community based development projects in marginalized districts. It turned out that for years, when donor representatives went to monitor projects, they would be taken to sites where boards listing them as RDF projects had been put up a few days before. Since the members of the community did not know how and by who the projects were funded, they were unaware that it was a running scam. A disgusted advisor had this to say in his resignation letter:

“In January and February 1991 I investigated some projects’ accounts and records and established as a fact that persons working with me and with whom I had co-operated and been involved deeply, had been deeply involved in embezzlement. This experience was so disagreeable that I started to analyze the RDF programme and my own role, and subsequently at the moment, I am not able to envisage any power in the Government of Kenya, who is willing to correct the course, therefore I resign.” (Hansard 15 July 1993) This scam ought to be more difficult to sustain in the current budget system because the PFM structure and processes make the budget much more amenable to scrutiny.

Yet it is under this “state of the art” PFM system within the framework of a new constitutional dispensation that the country has experienced what is arguably the most egregious corruption in its history.

**These developments seem to be sufficient cause to raise a fundamental question: What does the collapse of public financial accountability within the context of Kenya’s new constitutional dispensation mean for democratic governance?**

# Fiscal Developments

In October 2019, the Presidency issued a stern memo to all heads of government agencies, outlining a raft of austerity measures they were directed to implement immediately. This memo was the first explicit acknowledgement of, and response to, the financial distress that the administration has downplayed for several months at least. Among the manifestations of the distress is the accumulation of “pending bills” that is, failure to pay suppliers, thereby transmitting the Government’s financial woes to the private sector. As at end of June 2019, the national government put its pending bills at KShs92 billion, while the auditor general had validated county government pending bills to the tune of KShs52 billion, for a combined total of KShs142b, equivalent to 10 percent of the non-wage, non-interest expenditures. The IMF has also recently moved Kenya’s rating from “low” to “medium” risk of debt distress.

This fiscal distress is against a backdrop of Kenya’s headline GDP growth remaining quite buoyant, averaging 5.6 percent (2015-19). But it is also the case that the buoyant growth contrasts with weak business performance, as reflected by a record number of ‘profit warnings issued by listed companies, a sharp increase in private debt distress as reflected in a two and a half fold increase in banks’ non-performing loans (NPL) from 5 to 12 percent, and pages and pages of distressed assets listed for auction in the newspapers.

This paradox, a growing economy on the one hand, and public debt distress and a struggling private sector on the other, has confounded many people. It is not as inexplicable as it seems.

The most significant fiscal development under the Jubilee administration is deficit spending, as reflected in the rise of the budget deficit from an average of 5 percent of GDP under the government of national unity (GNU) administration that preceded it, to an average of 8 percent of GDP. In actual money terms, the Jubilee administration deficit spending during the first term was KShs2.72 trillion, more than three times the GNU administration, which spent KShs862b. The cumulative deficit over a period is the same as the increase in debt (although the figures may not correspond with reported debt due to exchange rate movements). The runaway deficit spending is connected to the “paradox” in four ways.

First, the deficit spending itself is an economic stimulus.<sup>6</sup> This spending is captured in the GDP and reflected as growth, for example, it was estimated that the construction of the standard gauge railway (SGR) would boost the GDP growth by 1.0 -1.5 percentage points. This means that for the

<sup>6</sup> Deficit spending is the expenditure in excess of revenue and is typically financed by borrowing abroad or domestically (and occasionally by privatization proceeds).

three full years the railway was under construction (2014-16), it would have boosted the growth rate by 20 percent. However, because the railway construction was a largely insular project with very limited linkage to the rest of the economy, this growth would not have impacted on people the same way as equivalent investment in commercial sectors of the economy e.g. manufacturing, agriculture, tourism enterprises would have. Indeed, given that most of the railway was delivered in kind from China, it is fair to say that the project stimulated the Chinese economy more than Kenya's. This should not come as a surprise because, like all other national trade finance banks, the mission of the China EXIM Bank which financed the project is to promote Chinese exports.

Secondly, the deficit spending has been financed by both foreign and domestic borrowing in equal measure. Domestic borrowing has entailed a very substantial crowding out of the private sector from the credit market. A surge in government borrowing in mid 2015 precipitated a decline in bank lending to the private sector from a normal growth of between 15 - 25 percent a year to less than 2.5 percent per year.

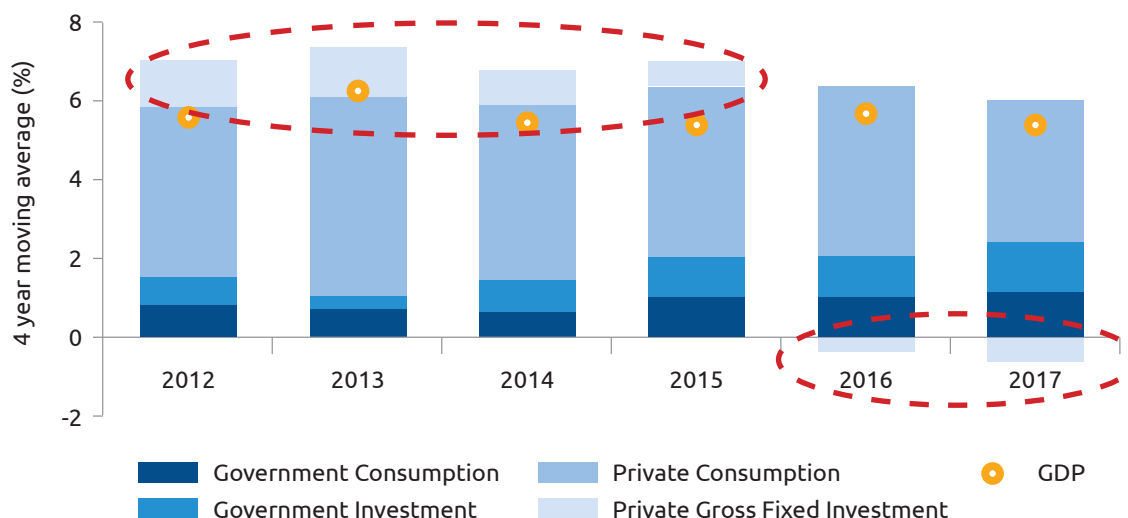
### Under the Jubilee administration, the government is “borrowing to consume.”

Third, the rapid accumulation of debt has precipitated an even steeper increase in debt service cost. In FY2018/19, the government paid KShs375 billion interest on debt, a three-fold increase from KShs121 billion paid in FY2012/13, the year before the Jubilee administration took office. Over the same period, tax revenue increased 96 percent from KShs8670b to KShs1.7 trillion that is, interest cost growing at more than double the growth of revenue. The rapid increase in the interest cost reflects both an increase in the volume of debt as well as its cost. When the Jubilee administration took over, the country did not have commercial foreign debt (with the exception of one syndicated loan that was offset with the first Eurobond proceeds). Beginning with the Eurobond, the Jubilee administration has built a large portfolio of foreign commercial debt comprising of Eurobonds and syndicated bank loans that, as at end of 2019, constituted 36 percent of foreign debt. Another 20 percent is owed to Chinese development banks on terms that are similar to commercial loans. The commercial loans and Chinese debt together constitute just over half of the foreign debt, but they take up three quarters of the interest payments on foreign debt.

Debt service is a first charge on revenue (i.e. it is paid before anything else). In FY2012/13 revenue and interest cost amounted to 19.2 and 2.7 percent of GDP respectively, meaning that government had revenue equivalent to 16.5 percent of GDP to spend after the interest charge. In 2018/19 revenue was 18 percent, while interest cost had risen to 4 percent of GDP, thus reducing the revenue net of interest cost to 14 percent of GDP. This 2.5 percent of GDP difference is far from trivial—it is a significant financial squeeze, translating to a loss of KShs234b in FY2018/19.

A related and notable comparison is that GNU government cumulative spending (i.e. over its five year term) on development budget totalled KShs1.135 trillion, KShs273 billion (30 percent) more than its cumulative deficit spending. By contrast, the Jubilee administration's first term deficit spending exceeded its development outlays by KShs322 billion (13 percent). In fiscal parlance, this difference is referred to as “government saving.” It means that government is able to finance its consumption (taken to correspond to recurrent expenditure) out of tax revenue, and have a surplus for investment. The converse, as in the case of Jubilee administration means that government is “borrowing to consume.”

**Figure 2: Growth decomposition by expenditure 2012-17**



**Source:** Comprehensive Public Expenditure Review 2017, National Treasury and Planning

**If debt finances poor investments that do not stimulate business investment, debt distress is to be expected.**

Fourth, although public investments, roads for example, do not directly generate incomes, when governments borrow to finance them, it expects that the projects will be a catalyst for business investments that in turn generate tax revenue to service the debts. If debt finances poor investments that do not stimulate business investment, debt distress is to be expected. If domestic resources are diverted from productive uses to low return investments, then double jeopardy ensues—the poor public investments undermine both the current and future revenues. That poor quality public investment projects may be doing just that has been noted for some time. A 2014 Public Expenditure Review (PER) report by the World Bank notes declining contribution to growth even as public investment was rising, and goes ahead to postulate poor quality of public investment as the probable cause:

“The composition of growth during the three growth periods 2003-07, 2008-11 and 2012-14 shows that investment contribution to growth has declined to 1.3 percentage points in the recent years, compared to 2.4 percentage points during the high growth period 2003-07. The declining contribution of investment to growth coincides with rising government investment, which raises the question of efficiency of ongoing investments” ...The decline could be due several factors which are closely related and mutually reinforcing. These factors include: (i) weak budget implementation which means that development projects have long gestation periods and cost overruns; (ii) challenges in investment appraisal, selection and management; (iii) underutilization of existing capacity, which is closely linked to and; (iv) inadequate budget provisions for Operations and Maintenance (O&M).”<sup>7</sup>

<sup>7</sup> Decision Time: Spend More or Spend Smart? Kenya Public Expenditure Review 2014 Washington DC. World Bank, p.20

In other words, low return projects are financed, which are then poorly implemented and cost more than they should, and are not useful after completion either because they have no operating budget, or because they were not needed in the first place. The common name for this is white elephants.

A more recent public expenditure review report by the government also decries the same problem, zeroing in specifically on private investment. Analysis presented in the report shows that the contribution of private investment to growth has turned negative in recent years (see chart).

“Growth has been driven largely by an increase in private consumption and government expenditure, while the contribution from private investment has contracted. Private sector investment is essential for replenishment of capital stock, adoption of frontier technology, boosting firm productivity and ultimately private sector led growth. However, the contribution to growth from Kenya’s private sector investment has been falling over the review period, contracting by 2.8 per cent in 2016.”<sup>8</sup>

The “paradox” of growth and debt distress turns out to be no paradox at all. The growth in question is wasteful spending of debt that has not translated into income generating assets in the economy. Still, these debts have to be paid. Debt service is the fastest-growing component of government expenditure. Interest payments increased by over 200 percent from KShs121b in FY12/13 to KShs376b in FY18/19, compared to 70 percent increase in other recurrent expenditures. As a result, interest payments increased from 15 percent to 25 percent of the recurrent expenditures in effect, crowding out other expenditures, thereby undermining governments ability to meet other obligations, such as paying suppliers as discussed above, employing and adequately remunerating teachers and health workers, and maintaining infrastructure, among others.

The rest of the paper provides an insight into the public investment dysfunction and corruption that underlies these outcomes. By way of introduction and context, we conclude this discussion with a brief overview of the infrastructure budgets involved.

## Infrastructure Spending Overview

Table 1 provides a summary of the budget in which the three sectors covered by this study (i.e. electricity, roads and water) fall. The data is obtained from the Medium Term Expenditure Framework (MTEF) Sector Reports that feed into the budget process. The most recent year in the publicly available reports (posted on the treasury website) is FY2016/17, which covers the first four years of the Jubilee administration’s first term (FY2013/14). The expenditure for the preceding four years (FY2009/10 to FY2012/13) is provided for comparison. In the Medium Term Expenditure Framework (MTEF) budgeting system, electricity and roads fall under “Energy, ICT and Infrastructure” cluster while water projects fall under the Environmental Protection, Water and Natural Resources” cluster.

The cumulative expenditure for the energy, infrastructure cluster plus water for the four Jubilee years is KShs1.4 trillion, 2.2 times the KShs642 billion spent by the GNU in the preceding four years. The expenditures represent 64 percent of the Jubilee administration’s development spending over the period, compared to 50 percent in the preceding period. Within this, electricity, roads and water outlays amount to KShs843 billion, up from KShs559 billion in the previous period. This represents 60 percent of the total expenditure on energy, infrastructure and water, compared to 87 percent in the previous period. This difference in proportion is explained by the expenditure for the new standard gauge railway (SGR) amounting to KShs335 billion. Excluding the railway, the share rises to 80 percent.

**Table 1: Infrastructure Spending FY2008/9 - FY2016/17**

	FY08/09-FY12/13(GNU)		FY13/14-16/17(Jubilee)	
	Budget	Actual	Budget	Actual
<b>Expenditure Kshs.Billion</b>				
Roads	376	294	577	445
Electricity	199	174	362	254
Water	122	91	179	143
Roads, Electricity & Water	697	559	1,119	843
<b>Total, Energy, Infrastructure &amp; Water</b>	<b>809</b>	<b>642</b>	<b>1,857</b>	<b>1,409</b>
<b>Budget share, %</b>				
Roads	46.4	45.7	31.1	31.6
Electricity	24.6	27.0	19.5	18.1
Water	15.1	14.2	9.7	10.2
Roads, Electricity & Water	86.2	87.0	60.2	59.8
<b>Total Energy, Infrastructure &amp; Water</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Sector MTEF Reports, Various Issues

Roads take up the largest share of the budget- half the expenditure at 32 percent, and 42 percent excluding the railway. The higher road budget is partly a reflection of the fact that roads have a much higher maintenance requirement than other infrastructure, which is reflected in a much bigger recurrent budget, 25 percent of the total, compared to less than 10 percent for other infrastructure. But it is also the case that government only partially funds the electricity sector, as power generation and distribution investment is financed primarily by the utilities (Kenya Power and Kengen) as well as independent power producers (IPPs). The bulk of the government electricity budget has financed high voltage transmission lines and geothermal resource development.

## Part 4

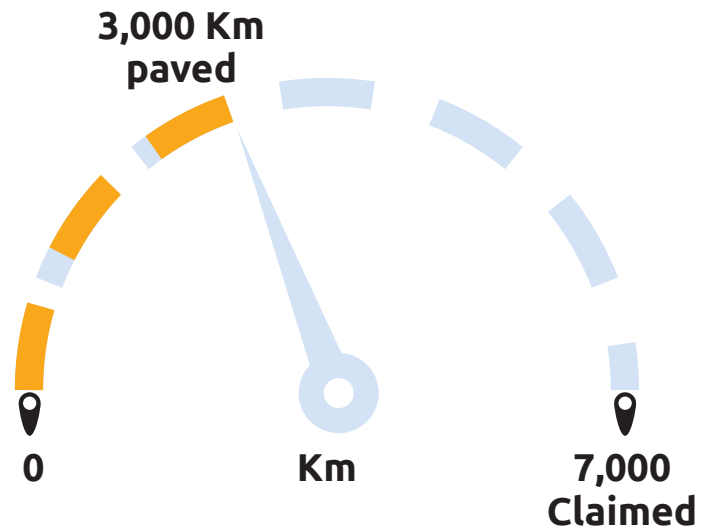
# Roads (with exit lanes)

*"In the last three years, my administration has tarmacked approximately 3,000 km—or an average of 1,000 km per year."*

President Uhuru Kenyatta,  
State of the Nation Address 2016

*"In 2013, we promised to undertake the most aggressive road construction programme ever seen in Kenya. With 1,950 km of new roads completed and another 7,000 km under different phases of construction, we have kept the promise."*

President Uhuru Kenyatta,  
State of the Nation Address 2017



Published data show that during the Jubilee Administration's first term (2013-2017), the national network of paved roads increased by 5,800 km, from 7,685 km to 13,485 km. This includes 2000 km of newly paved roads that were under construction when the Jubilee administration took over. The data shows that in total, Jubilee Administration-initiated road projects in this period add up to 3,120 km (the balance being roads build by county governments).

It is difficult to fathom why the president would exaggerate the administration's achievements, on a subject where it is as easy to counter-check his claims as road construction. But even simple knowledge of the country's geography was sufficient to raise eyebrows. The breadth of the country from Mombasa to Kisumu is only 830 km, and the length from Namanga to Moyale a mere 940 km.

The claim that the government had 7,000 km under construction translates to seven times the breadth and eight times the length of the country, or to use a more familiar distance, 14 times the distance from Nairobi to Mombasa.

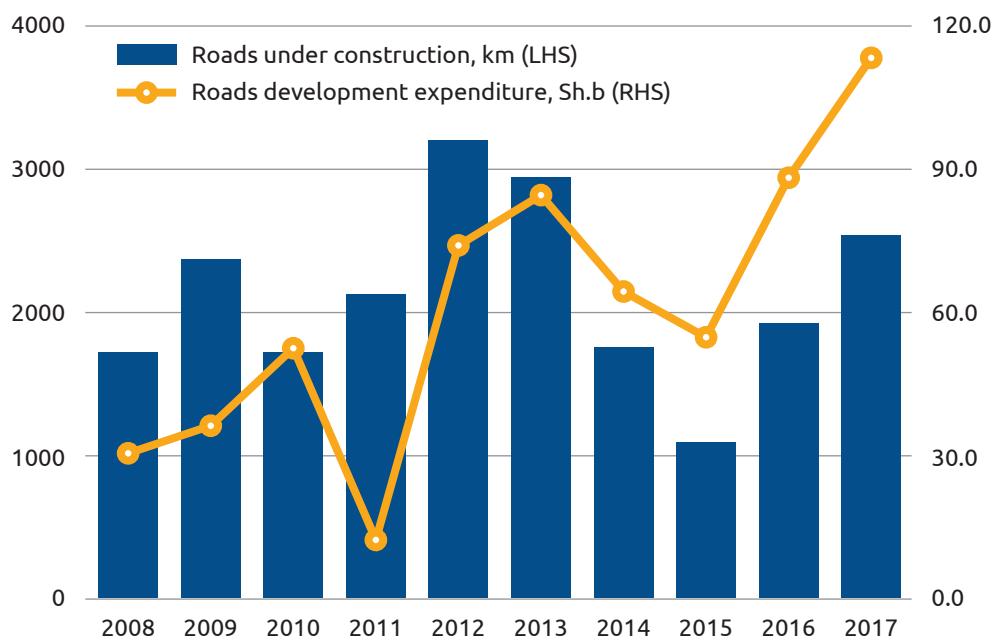
## Elusive Eurobond

In March 2016, the Jubilee administration was under intense public pressure to account for the proceeds of the country's first sovereign bond. Of KShs240 billion (US\$2.8 billion) raised, KShs51 billion (US\$600 million) was used to offset a foreign loan, and KShs2 billion on fees, leaving a balance of KShs187 billion. When put to task, the administration issued a schedule showing that the KShs187b balance was disbursed to ministries and spent on development projects in FY14/15. But the national government's budget for that year was fully funded without the use of the Eurobond proceeds. Moreover, those same reports decry low absorption of funds, raising questions as to how the same government system that struggled with implementation of projects could absorb a sudden injection of funds equivalent to a year's development budget.

As one of the major infrastructure sectors, it would be expected that the roads would have absorbed a substantial share of the Eurobond funds. This is not evident. On the contrary, the Economic Survey reflects 465 km of new road valued at KShs42.8 billion started in FY14/15 down from 1,091 km valued at KShs71.4b started in the previous year, while actual development expenditure on roads declined to KShs80.6b from KShs87.6b. Thus, there is no evidence at all of a Eurobond boost to the road building budget.

The Jubilee administration spent KShs614b on roads during its first term, 60 percent more than its predecessor's KShs376b. But contrary to the president's claims in the two SOTN speeches quoted above, the higher outlay is not on account of a massive road building programme. Measured in terms of length of roads or number of projects, road construction peaked in 2012, the last year of the GNU coalition, at 3,200 km of road under construction (Fig 3). These roads constitute the bulk of the 5800 km of roads completed during the Jubilee administration's first term.

**Figure 3: Roads construction and budget 2008-17**





In the first term (FY2013/14-FY17/18) the Jubilee administration initiated 80 road projects with a total of 3,120 km, which just about matches the roads that its predecessor had under construction at the end of its term. The 3120 km of road commissioned by the Jubilee administration were contracted at a cost of KShs. 303b. This works out to an average cost of KShs96 per km compared to an average cost of KShs51 per km for the portfolio inherited from the GNU administration, that is KShs45m more per km, a 90 percent increase.

## Why did the cost of road construction rise so sharply?

An increase in the unit cost of a road project portfolio can result from different factors. These include actual increases in construction costs (i.e. labour and materials), a different mix of the types of roads (complicated urban roads are more expensive to build than trunk roads), market factors such as lack of competition in the construction industry, project management challenges, as well as corruption.

Our analysis shows that the single largest contributor to the cost escalation is a bias for expensive roads.

Table 2 shows how the cost structure of the roads has evolved. At the start of the Jubilee administration's tenure, roads costing less than KShs50 million per km account for 58 percent of the portfolio in volume terms and 32 percent in value terms. Roads costing under KShs100 million account for 72 percent of the budget and 88 percent of the volume. There are only two roads costing more than KShs200 per km, and none costing more than KShs300m per km. Five years later, nine roads costing over KShs300 per km account for 20 percent of the portfolio in value terms but only 3 percent in volume terms. The cost of these roads ranges from KShs. 300b per km (Nyamasara-Kisumu Airport) to an eye-popping KShs1,155b per km (Mombasa Southern Bypass). The share of KShs200-300m per km roads also increases from 2 to 7 percent of the portfolio in value terms.

**Table 2: Road projects cost and portfolio composition comparison FY2012/13 and FY2017/18**

Cost Range Kshs.m/km	Unit Cost Kshs .m/km	Projects No.	%	Volume km	%	Value, Kshs.b	%
<b>FY2012/13</b>							
>200	234	2	2	30	1	7	4
100-200	117	12	12	365	11	43	24
50-100	66	34	33	1,045	30	69	40
<50	28	55	53	2,004	58	56	32
<b>Average/Total</b>	<b>51</b>	<b>103</b>	<b>100</b>	<b>3,444</b>	<b>100</b>	<b>175</b>	<b>100</b>
<b>FY2017/18</b>							
>300	606	9	11	99	3	60	20
200-300	246	5	6	85	3	21	7
100-200	116	12	15	499	16	58	19
50 - 100	75	42	53	1,856	59	140	46
<50	41	12	15	613	19	25	8
<b>Average/Total</b>	<b>96</b>	<b>80</b>	<b>100</b>	<b>3,152</b>	<b>100</b>	<b>303</b>	<b>100</b>

Source: Economic Survey, various issues

The small number of mega-projects are not an isolated phenomenon, but rather part of a shift of the portfolio composition to bigger projects. The number of projects costing more than KSh5b increases from three to twenty. This would be explicable were the Jubilee administration building much longer roads, but this is not the case. While indeed the average size of project measured by length (with the high cost roads excluded) does increase by a third, from 34 to 45 km, the contract value per project doubles from KSh1.7b to KSh3.4b.

Excluding the nine high cost roads, the unit cost of the rest of the portfolio drops to KSh80 million per km which, at 57 percent, is still a considerable increase. As per the construction cost indices compiled by the KNBS, road construction cost increased 26 percent between 2013 and 2017, comprising of 13 percent increase in civil engineering costs (materials and other non-labour), and a 42 percent increase in labour costs. Thus, even excluding the high cost roads, the cost escalation is still 31 percent higher than what can be explained by inflation. If the costs increase was only due to inflation, the unit cost, excluding the high cost roads, would be at most KSh64 million per km, that is KSh16 million per km lower.

As observed at the outset, one of the corruption impacts is associated with the distortion of priorities where high return projects are crowded out by low return projects that have more corruption opportunities. In this regard we are compelled to ask how spending KSh60b on 100 km of urban roads can be justified vis a vis trunk and rural access roads.

**The opportunity cost of these projects assuming a cost of KSh64m per km is a total of 930 km of trunk roads. Similarly, the KSh16 million per km unexplained cost escalation on the rest of the portfolio works out to KSh49 billion. In term of roads, at a unit cost of KSh64m per km, this is enough to build 760 km of trunk roads.**

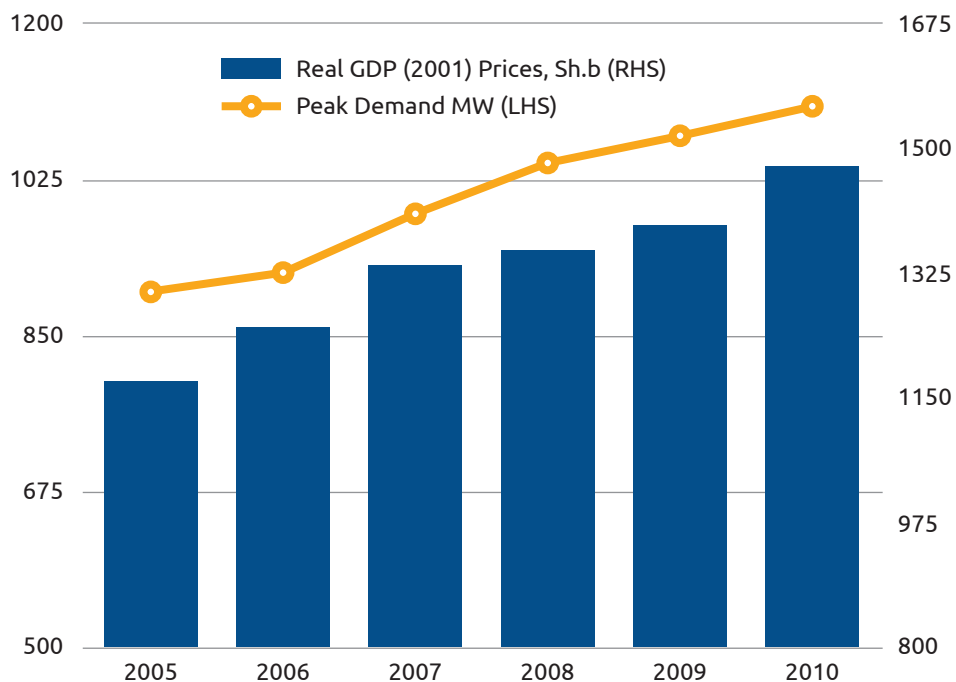
# Electricity

## If we build, they will come

Shortly after assuming office, the Jubilee administration unveiled an ambitious plan to add 5,000 MW electricity generation capacity in four years (i.e. by 2016). The installed capacity was 1,800 MW. Adding 5,000 MW would have increased the installed capacity to 6,800 MW. Electricity consumption generally tracks economic growth quite closely (Fig. 4). Given that the installed capacity was adequate at the time, it is readily apparent that this would have resulted in massive excess capacity.

The initiative was all the more baffling because there is an electricity development planning process known as the Least Cost Power Development Plan (LCPDP) that has served the country well for many decades. The LCPDP is a rolling plan that is updated regularly. The LCPDP 2011-2030 which was in force at the time of the pronouncement, had three demand forecasts which are referred to as low, reference and high scenario. The 6,800 MW capacity requirement would be reached in 2024 in the high scenario, 2027 in the reference scenario and 2029 in the low case scenario. In effect, under the most optimistic scenario, the country would be saddled with excess capacity for eight years in the most optimistic growth scenario and 12 years in the low case scenario.

**Figure 4: Electricity consumption and GDP trend 2005-2010**



In reality, even the low case forecast has turned out to be optimistic. Under this scenario, electricity demand in 2018 was forecast at 13,260 GWh requiring 2,300 MW generation capacity. Actual demand was 11,057 GWh, 17 percent short of the forecast. Based on the LCPDP's planning parameters, this translates to a peak generation requirement of 1,900 MW. In the meantime, generation capacity has increased to 2,800 MW, an excess capacity of 47 percent. And this increase in generation capacity is all accounted for by projects that were already under construction or at an advanced stage of development when the 5000 MW initiative was being mooted.

The LCPDP 2011-30 plan has since been updated to LCPDP 2017-37. In the updated plan, the demand forecast has been revised downwards very significantly. The low case scenario generation capacity requirement is forecast at 4,760 MW at the end of the plan period in 2037, 30 percent below the 6,800 MW that the 5,000 MW initiative was targeting for 2016. Even the reference scenario is also slightly short, with a forecast requirement of 6,640 MW in 2037. It is only in the most optimistic scenario that the 6,800 MW capacity requirement is reached, and then only in 2032.

The Jubilee administration was planning massive excess capacity while at the same time promising to bring down the cost of electricity to consumers. The two are incompatible. This is because power producers' payment has a fixed cost component, known as a capacity charge, that is paid whether they generate power or not. In the updated LCPDP, the planned excess capacity (over and above the reserve requirement), which is projected to reach 30 percent by 2025, will double the cost of power from 0.083/kWh in 2018 to \$0.169/kWh in 2024 (KShs8.30 to KShs16.90 at current exchange rates). We are compelled to ask why a government would pursue such a perverse policy?

The Lamu Coal Plant, one of the projects key to the 5,000 MW initiative, illuminates an explicable motive—profit. The project, which is now in abeyance following a court ruling suspending its construction on environmental grounds, is slated to add 981 MW generation capacity. Four expert assessments, including the updated LCPDP, a consultancy report commissioned by the Ministry of Energy (which informed the LCPDP) and two independent experts have all concluded that if needed at all, it will not be needed until 2030 at the earliest. But the weight of the expert opinion is that Kenya has sufficient cost effective renewable resources (geothermal and wind in particular) that make investment in coal power unnecessary.

If the plant is built, according to one of these studies, the investors would be paid a capacity charge of up to \$360 million a year. According to the investors, the plant will cost \$2 billion. The capacity charge alone works out to a gross annual income of 18 percent. Allowing for operating costs, and tax, the investors would still earn a virtually risk free 15 percent return at the minimum. By way of comparison, this is between two and three times what investors earn on emerging market sovereign bonds. Over the 25 year term of the power purchase agreement, the capacity charge will generate a revenue of \$9 billion, that is \$7 billion net of the capital outlay. By contrast, an investor in high yield emerging market bonds earning 7.5 percent per year, will earn a cumulative income of \$3.75 billion over the same period.

In short, independent power producers are guaranteed extremely attractive returns on investment. The excess capacity cost is borne by Kenya Power in the first instance, and consumers too, as and when Kenya Power is able to obtain tariff increases from the regulator. If however, the KPLC was unable to pass on the cost, it would cripple the company financially. And given the strategic

significance of KPLC for the economy, it is inescapable that the cost would ultimately be borne by the public purse by way of subsidies or financial bailout. The massive scaling up of electricity generation capacity begins to assume the character of an “exit lane.”

## Power (Money?) Transmission Lines

The national grid infrastructure consumed 56 percent of electrification expenditure, amounting to KShs156 billion for the four years (FY14/15-FY17/18) for which there is published budget data broken down to this level. Building and operating the national grid infrastructure (high voltage transmission lines, switch gear and sub-stations), is the mandate of the Kenya Transmission Company (KETRACO), one of the entities that emerged out of the liberalization of the electricity sector. KETRACO provides power transmission services between power stations and KPLC for a fee known as wheeling charge. On its website, KETRACO reports that it has completed seventeen transmission line projects by 2017, totalling 1,791.5 kilometres. It had another 17 projects totalling 2,359 km under implementation, all of which are listed as due for commissioning by early 2019.

The updated LCPDP includes a schedule of all ongoing and planned transmission projects as well as their projected costs. The total cost of the projects listed by KETRACO as ongoing is \$1,217 billion (KShs123 billion), an average cost of \$0.5m (KShs50 million) per km of transmission line (See Table 4 below) However, one outlier, the 500 kV Kenya-Ethiopia line at \$510 million (KShs51b), accounts for 43 percent of the total, at an average cost of US\$0.83m (KShs83 million) per km. Excluding this project, the average cost comes down to \$0.38 million (KShs38 million) per km.

The rest of the project portfolio totals 1,741 km at a cost of KShs69 billion. The government’s budget data reflects a cumulative expenditure of KShs156 billion, and KShs106 billion for the portfolio excluding the Kenya-Ethiopia line. The latter figure is KShs33 billion more than the cost of the same projects as given in the LCPDP. It is a very substantial discrepancy. Taking the average cost of KShs38 million per km of transmission line, it is equivalent to 870 km of transmission lines. It is plausible that the difference is explained by capital outlays on other things, but it is difficult to see what these could be.

## Power to the people, *wapende wasipende* (whether they like it or not)

Hot on the heels of the 5,000 MW investment drive, the administration launched a universal electricity access initiative, popularly known as the Last Mile Connectivity project. The project aimed to achieve 70 percent electricity access by 2018, and universal access by 2020. It was to be implemented in three phases. In the first phase, an estimated 314,200 households who are within 600 metres of existing transformers would be connected. This phase was funded to the tune of KShs13.5 billion co-funded by the government and the AfDB.

*“Whether you live in a wooden house or a hut, we will supply you with electricity beginning April 2, without the constraints of requesting it.”<sup>9</sup>*

Charles Keter CS Energy



9 Quoted in The Standard “Last Mile Connectivity: The costly project that ruined Kenya Power 26 November 2019 <https://www.standardmedia.co.ke/business/article/2001350865/costly-project-that-ruined-kenya-power>

The second and third phases entailed installation of new transformers and extension of the network expected to add another 500,000 connections. Working with an average of five persons per household, the government calculated that this expansion would benefit four million people.

Two years on, the project was mired in controversy and scandal. In 2018, KPLC's external audit flagged financial losses on 880,000 inactive connections. This figure is of the same order of magnitude as the project's targets. The Last Mile project customers were required to pay KShs15,000 for the connection, a total of KShs12b, but KPLC had only managed to collect KShs120 million over three years. And since most of the customers were not consuming power, indeed it was reported that most of the connections had not been activated, there was little likelihood of collecting the outstanding amount. As a result, KPLC's financial performance deteriorated sharply, with 2018 profit dropping 60 percent from KShs7.7 billion to KShs3.3 billion. Provisional 2019 results show further deterioration with profits dropping to KShs262 million. Unless there is a drastic turn-around the corporation is clearly heading into loss-making territory in 2020.

Whether the project was rigorously appraised is doubtful. As observed, the first phase was financed to the tune of KShs13b, to connect 314,200 households to existing transformers. This translates to KShs41,375 per connection. Households were required to contribute an additional KShs15,000 for a total of KShs56,375. On the market, households can buy a basic solar power package for KShs20,000 that includes four LED bulbs and other peripherals for cash, or on loan for a deposit of KShs3,000 and KShs50 a day for 14 months. It seems reasonable that many households would see this as better

**Table 3: LCPDP Cost Estimates of National Grid Projects under implementation**

	Length (km)	Cost (US\$)	Cost (Kshs)
Loyangani - Suswa 400kV	428	161.0	16.3
Nairobi Ring substations		46.2	4.7
Kisii - Awendo 132kV	44	4.0	0.4
Nanyuki - Isiolo - Meru 132kV	96	54.3	5.5
Turkwell - Ortum - Kitale 220kV	90	18.6	1.9
Isinya - Namanga 132kV	96	12.6	1.3
Wote - Sultan Hamud 132kV	44	6.8	0.7
Mwingi - Kitui 132kV	46	9.7	1.0
Kitui - Wote 132kV	66	9.7	1.0
Nanyuki - Rumuruti 132kV	79	20.3	2.0
Lesos - Kabarnet 132kV	65	16.6	1.7
Olkaria - Narok 132kV	68	17.5	1.8
Olkaria - Lessos - Kisumu 400/220/132kV	300	156.0	15.8
Lessos Tororo 400kV	132	50.0	5.0
Eastern Project (Kenya Ethiopia) 500kV	612	510.0	51.5
Sondu - Homa Bay - Awendo 132kV	96	28.8	2.9
Mariakani substation		30.0	3.0
Kenya - Tanzania 400kV	97	65.0	6.6
<b>Total</b>	<b>2,359</b>	<b>1,216.7</b>	<b>122.9</b>

value for money than an upfront payment of KShs15,000 to KPLC for a connection, additional costs for wiring, bulbs and peripherals, and monthly bills.

The KPLC would have realised fairly early in the project that the consumers they were connecting were not a commercially viable proposition, but they continued to roll out the project nonetheless. Indeed, KPLC connected a record 518,000 new customers in 2018 who the chief executive is quoted attributing to the project.<sup>10</sup>

Why did the government and the KPLC continue rolling out the project? We can only conclude that universal access to electricity was incidental to the real objective of the project. Who are the real beneficiaries? The obvious ones are of course equipment vendors (transformers, meters, poles, cables etc) and contractors. In June 2018, KPLC was virtually decapitated by the arrest of most of its top management on procurement related corruption charges that included purchase of defective transformers and irregular pre-qualification of suppliers.

## **Geothermal development: Where there is smoke...**

Geothermal power has become Kenya's leading source of electricity. In 2018, geothermal power accounted for 46 percent of the electricity generated in country, with hydroelectric power a distant second at 36 percent. Kenya's geothermal potential is estimated at over 10,000 MW. Unsurprisingly then, geothermal exploration absorbs the lion's share of the power generation budget. Out of a cumulative power generation expenditure of KShs54.5b in the three-year period FY14/15-17/18), geothermal development absorbed KShs52b, equivalent to 96 percent.

The Geothermal Development Company (GDC) is the principal recipient of the budget allocations for power generation. The GDC was established in 2009 specifically as a vehicle to channel public financing into geothermal resource development. The rationale was that high capital outlay and risk involved in exploration was a deterrent for commercial investment in geothermal power. By using public money, exploration and resource development would be accelerated. Once a geothermal field was developed, GDC would invite private investors to build power plants and recoup the money and invest it in more exploration from selling steam to them.

The bulk of the geothermal power that the country is producing is due to investments that predate the establishment of the GDC. They were done by the KPLC before liberalisation of the industry in the late 90s and by KENGEN, which inherited KPLC's generation assets after liberalisation. KENGEN accounts for close to 80 percent of the country current geothermal capacity, and the balance is owned by an Independent Power Producer (IPP).

The GDC has three fields under development. These are Olkaria, a developed field inherited from KENGEN, Menengai and Baringo Silali, and a fourth, Suswa, where work is yet to start. The Menengai field has an estimated potential of 1600 MW. The GDC has been on site since 2011 and was aiming to develop 400 MW at a cost of KShs116 billion, financed by the Government, the AfDB and internally generated funds (principally proceeds of steam sales in the Olkaria wells inherited from KENGEN).

<sup>10</sup> Business Daily 3 December 2018 "Connecting the poor hands Kenya Power Sh3bn debt" <https://www.businessdailyafrica.com/corporate/companies/Connecting-poor-hands-Kenya-Power-Sh3bn-debt/4003102-4878676-bb1m98/index.html>



As per the GDCs 2018 audited accounts, KShs75 billion (i.e 65 percent) of the budget had been spent. This suggests that the GDC should be well past halfway to the 400 MW target. GDC reports on its website that it has so far realised 170 MW of steam which is 43 percent of the 400 MW project target.

The cost of developing the Menengai field raises value for money questions. The GDC inherited 27 wells from KENGEN in Olkaria. GDC drilled another 36 wells for a total of 59. In its accounts GDC reports selling the equivalent of 320 MW capacity of steam to KENGEN from these wells. On the balance sheet, it reports the value of its income generating assets at KShs29 billion, which works out to a capital cost of KShs90 million per MW. By contrast the Menengai project works out to KShs290 million per MW—three times as much. This is assuming that the 400 MW target will be achieved within the KShs116b budget. So far the 170 MW developed at KShs75b works out to KShs440m per MW, almost five times the capital cost of the Olkaria field.

It is worth noting that part of the AfDB's financing was for buying drilling rigs so as to reduce cost and speed up drilling (cost of hired rig is put at US\$6.5 million per well while using own rig was expected to bring it down to \$3.5 million per well). This objective has clearly not been achieved. The financing also included a budget for wellhead generators. Wellhead generators are temporary installations which generate power during construction of the permanent power plant. There is no indication that the field is generating power. In 2015 it was reported that the EACC was investigating GDC's procurement contracts worth KShs10b for corruption. The allegations included inflating contracts for relocation of drilling rigs from KShs780m to KShs1.7b. It was alleged also that GDC procured the services while its own equipment, acquired at a cost of KShs400m, was lying idle.

### **GDC had awarded a drilling contract to a phantom company**

The GDC borrowed EUR80 million from Kreditanstalt für Wiederaufbau (KfW), a German development bank, to develop the Baringo-Silale field. The project suffered a setback after it turned out that GDC had awarded a drilling contract to a phantom company, to which it paid KShs1.4 billion shillings upfront. Evidently, GDC awarded the contract and paid money to a company without such basic due diligence as verifying the company's physical address. Instead, GDC relied wholly on a bank guarantee. Given the country's extensive experience and intimate knowledge of the geothermal industry, it is remarkable and suspicious that GDC would fall for what appear to be briefcase conmen. After a protracted dispute, it has recently been reported that the bank has agreed to honour the guarantee. There is no indication that the culprits will be pursued.

Going back to the budget figures, KShs52b was spent on geothermal development in three years FY14/15 - FY17/18. If we take the capital cost of KShs90m per MW from GDC's books, this translates to 580 MW capacity, just about 13 percent below the current installed capacity of 663MW, which as noted, is now contributing 46 percent of the country's capacity. At best we have 170MW, just under a third of that development, but not being utilized.

**This is a clear case where the return on this investment so far is zero. And the fate of these projects now hangs in the balance. In 2019, the KPLC announced that it was suspending all new power purchase agreements due to the excess power generation capacity discussed earlier.**



## Part 6

### Water:

## Dammed if you do, dammed if you don't.

In mid-February 2019, the local media was awash with photographs of the lush, pristine site of the proposed Arror dam in West Pokot County, for which the contractor had already been advanced \$7 million (KShs7 billion) months before. As the public was digesting this, the Directorate of Criminal Investigations (DCI) published a notice summoning 107 companies that the contractor had paid from the advance for supplies ranging from hotel linen to consumer electronics, that had no bearing on dam construction. It also emerged that even though the contractor had been paid, the dam was yet to be designed, raising questions as to how the contract price was arrived at.

*Even though the contractor had been paid KShs7 billion, the dam was yet to be designed, raising questions as to how the contract price was arrived at.*

At the time of the “award” of the Arror dam construction contract, CMC di Ravenna, who have since gone into insolvency, was already experiencing financial difficulties and was not performing on the Itare Dam project awarded in 2016. Yet, when questioned on whether they conducted due diligence, the officials who awarded the Arror-Kimwarer contracts claimed that they relied on the Itare Dam and another project in South Africa as references.<sup>11</sup>

The amount of money that has been lost remains murky, notwithstanding a detailed public statement by the National Treasury.<sup>12</sup> According to the statement, CMC di Ravenna was contracted to build the Arror dam at \$277.4 million (KShs28.5 billion) and the Kimwarer dam at \$224.4 million (KShs23.1 billion) a total of \$501.8 million (KShs51.6 billion), with financing from SACE (Secura) an Italian government agency and a consortium of four European commercial banks. SACE provided 87.7 percent of the financing, and the banks the balance of 12.3 percent.

The total outlay included another KShs12 billion in financing costs, for a total of KShs63.6 billion. This includes credit insurance provided by SACE, costing KShs11billion, and fees and commissions amounting to KShs900m. The insurance premium and fees were paid by the Treasury upfront, while the contractor was advanced KShs7.8 billion, a total of KShs19.8 billion.

11 “Untold story of a Sh63bn theft scheme planned in high offices” Daily Nation Monday, July 22, 2019 <https://nation.africa/kenya/news/untold-story-of-a-sh63bn-theft-scheme-planned-in-high-offices-188452>

12 Financing of Arror & Kimwarer dams multipurpose projects - Setting the record straight. National Treasury and Planning Press Release dated 28 February 2019

According to Jaindi Kiseru, a business journalist, the recently updated public debt register, which is yet to be made public, reflects drawdown of KShs66 billion from the banks in the dam financing syndicate as of September 30, 2019.<sup>13</sup> Kiseru also observes that the register contradicts the Treasury's assertion that SACE is the main lender, observing that SACE does not appear in the debt register. It is conceivable that the government has taken out other loans from the same banks, but it could also mean that the loans have been substantially drawn down even though the projects have not been started. Whatever the case, this ambiguity, and the attendant risks of impropriety, is precisely what the constitutional requirement for transparency in public financial matters is meant to address.

The Arror-Kimwarer dams scandal is arguably the most egregious and high profile case, having claimed the scalps of both the Cabinet Secretary and Principal Secretary in the National Treasury, the joint custodians of the public purse. The statement the National Treasury issued on the scandal lists seven other dams that are either under implementation or planned that are financed the same way as Arror and Kimwarer, namely Thiba, Thwake, Mwache, Northern Collector, Ruiru II, Itare, Karimenu, Bosto and Bunyunyu. According to a report of the parliamentary committee on environment, five of these projects are stalled or collapsed (see table).<sup>14</sup> The committee also raised the red flag on two other projects, the Northern Collector Tunnel and Chemususu dam.

**Table 4: Stalled and failed dam projects**

Dam	Loss KShs.b	Status
Itare	4.2	Stalled, contractor CMC di Ravenna insolvent.
Karimenu II	4.0	Contractor paid before acquisition of the land. No work done two years later.
Badassa	2.4	KShs 2.4 billion of KShs 3.3 billion paid (73 percent). Contract terminated with only half the work done.
Umaa	1.6	Contract terminated. Government lost arbitration.
Thwake	7.4	KShs7.4 paid, very little work done on the ground.

**Source:** Inquiry into the Status of Dams Report

The stalled mega-dam projects are by no means the only scandals in the water sector. Kiserian Dam, built at a cost of Sh1 billion, is not only a complete failure but also an environmental hazard. The 1.22 million cubic metre capacity dam was meant to serve 250,000 people in the rapidly growing Kiserian-Ongata Rongai- Ngong suburban area, supplying 15,700 cubic metres of water per day. But the dam was built downstream from informal settlements that do not have basic sanitation. "The poor works on the dam have seen it become a collection point of sludge and sewage. It was poorly procured and sited," the Water CS told parliament. The dam, he said, could not be salvaged, and the only solution was to refill it.

13 "There is more muck in Kimwarer, Arror than we are told" Daily Nation 19 November 2019 [https://www.nation.co.ke/oped/opinion/There-is-more-muck-in-Kimwarer--Arror-dams-scam/440808-5346846-view-asAMP-cj6ho4z/index.html?\\_\\_twitter\\_impression=true](https://www.nation.co.ke/oped/opinion/There-is-more-muck-in-Kimwarer--Arror-dams-scam/440808-5346846-view-asAMP-cj6ho4z/index.html?__twitter_impression=true)

14 Inquiry into the Status of Dams in Kenya Report of the Departmental Committee on the Environment and Natural Resources. The National Assembly, October 2019

The Water Sector Strategic plan reflects a cumulative development expenditure of KShs143 billion during the Jubilee administration’s first four years FY2013/14 to FY16/17, an increase of KShs51b over the preceding four year period. This is a lot of water. The table below provides a value for money analysis of a sample of five water projects. The key parameter in the table is the per capita investment, the capital outlay required to provide water to one person given in the last column. This is calculated as the cost of the project, divided by the number of people that the project can serve based on the UN recommended requirement of 50 litres of water per person per day.

We observe that the range of per capita investment is quite wide, ranging from Kiserian dam KShs3,185 to KShs26,750 for Kiserian and Ruiru II respectively. Some of the cost disparities are explained by the complexity of the civil works such as tunnelling, and distances covered by the water reticulation infrastructure, for example the Itare project includes a 115 km pipeline. But in so far as these projects are broadly representative, it is reasonable to take the average cost KShs12,000 as a benchmark per capita cost of providing water in the country.<sup>15</sup>

**Table 5: Value for money analysis of selected dam projects**

Project	Discharge (Cubic Metres/Day)	No. of beneficiaries	Supply Capacity (DWR)*	Capital Cost KShs.billion	Capital Cost/ Person (DWR)
Kiserian	15700	250,000	314,000	1.0	3,185
Northern Collector Tunnel	140,000	1,200,000	2,800,000	20.0	7,143
Chemususu	35,000	600,000	700,000	2.9	4,143
Itare	100,000	800,000	2,000,000	35.7	17,850
Ruiru II	40,000	300,000	800,000	21.4	26,750
<b>Total/Average</b>	<b>330,700</b>	<b>3,150,000</b>	<b>6,614,000</b>	<b>81.0</b>	<b>12,247</b>

\*Daily Water Requirement

**Source:** Project reports and author’s computation

Based on this benchmark, the KShs143 billion expenditure translates to water for 11.7 million people, a quarter of the country’s population. According to the Strategic Plan water access improved from 53 percent to 60 percent population coverage over the period. This works out to an additional 5.9 million people with good access, and an average capital cost of KShs24,000 per person. It would be expected that projects would provide for population growth in their catchment area, in which case the high capital cost would be reflecting the difference between actual and potential population coverage. But the Strategic Plan calls this possibility into question. The plan targets to increase access to safe water from 60 to 80 percent by 2022, at a cost of another KShs496b. The targeted increase in coverage translates to providing access to 13.7 million people.

15 The stated number of beneficiaries targeted by the five projects is 3.15 million people which works to a capital cost of Sh45,400 per person. However, these are the immediate beneficiaries in the catchment area, not the potential of the project hence in so far as the projects provide for population growth, as they should, it is higher than the actual cost. However, the projected populations of the catchment areas are not provided.

The budget of KShs496 billion works out to a capital cost of KShs36,000 per person, three times the benchmark cost of KShs12,000. If we work with the KShs12,000 figure, the planned budget is enough to provide water for 40.5 million people. This means that if this is accomplished, we would have invested in this decade enough money to provide water for 52 million people. Adding this to the 53 percent that had access in 2013 (22 million people), we would have water infrastructure for 74 million people.

It is doubtful that is the intention, given that we will reach this population in 2040 if current population growth rate is sustained, and later if it continues to decline. Far from forward planning, it points to a lack of seriousness in budgeting. Appraising projects and evaluating all public expenditure to ensure that public resources deliver the best possible value for money is at the core of public financial management. A 50 percent increase in the unit cost should raise eyebrows in very many quarters before such a budget outlay is proposed, let alone approved.

In the Aror/Kimwarer dams scandal statement, the National Treasury claims that it has no role in project identification, that it only comes in at the financing stage. This is an astounding case of dereliction of duty. As the custodian of public financial management, the National Treasury's responsibility spans the entire budget cycle. It is duty bound to ensure that funded projects are rigorously appraised, that the public will get value for money, and that the country's debt is sustainable. If the government consistently finances projects of dubious value with borrowed money, it will sooner or later, run into debt distress.

# Conclusions

This paper set out to test the hypothesis that the runaway corruption that has dominated headlines during the Jubilee administration is evidence of “budgeted corruption”, which is in turn a manifestation of state capture corruption. The paper has examined budgets and expenditure in three key infrastructure sectors, electricity, roads and water to see the extent to which there is systematic deviation of project choice from PFM value for money norms, and whether that divergence can be construed to be “exit lanes” for budgeted corruption as postulated by the former Auditor General. In each of the sectors there is prima facie evidence, such as can be surmised from research as opposed to investigation, in support of the hypothesis, as follows:

## Roads

- Systematic shift in the project portfolio away from low to moderate budget trunk and rural access roads in favour of big budget urban road upgrading projects.
- A 20 percent (KShs16 million per km) escalation in road construction costs over and above the cost escalation due to project portfolio shift. In financial terms this translates to KShs49 billion, or 760 km of road equivalent.

## Electricity

- 5000 MW initiative. An irrational escalation of investment in power generation in total disregard of a well established investment policy and masterplan, intended to fast track private power plants which, though not needed and costly to the public, would have nonetheless been lucrative to the investors.
- Last Mile Connectivity Programme A financially and economically unviable scaling up of connectivity, whose principal beneficiaries are suppliers.
- A KShs33 billion discrepancy between the expenditure on national electricity grid reflected in the government budget and the actual cost of construction reflected in the LCPDP report.
- Inexplicable escalation of the cost of geothermal development under GDC and evidence of outright corruption, notably inflated procurement of unnecessary drilling rig services at highly inflated costs, as well as “incompetent” procurement of the same.

## Water

- A systemic problem of flawed, stalled and outright ghost projects affecting nearly the entire portfolio of large dams.
- Hugely inflated project pipeline and budgets that are way beyond the country's water investment requirements.

That this phenomenon is systematic between and within these three key infrastructure sectors is symptomatic of a severely compromised PFM system— consistent with state capture.

## The limits of conventional reform

It is tempting to focus the attention on reforms to the PFM system. Such attention would be misplaced. The efficacy of a PFM system is contingent on functional democracy and ultimately on the rule of law. It presupposes that the institutions work as they should. But as observed at the outset, the safeguarding of public monies through parliamentary control and oversight is not just a financial matter, it has pride of place in constitutional democracy and its much-vaunted promise of freedom and human dignity.

**Three decades into the transition from an authoritarian one-party state to a multiparty democracy, and well over a decade into a new progressive constitutional dispensation, Kenya's democratic transition is seriously imperiled.**

The democracy deficit in Kenya has manifested itself most glaringly in the electoral sphere, begging the question as to why the stakes in Kenya are evidently so much higher than in other seemingly comparable countries. Of the seven multiparty elections since 1992, only one election is generally acknowledged as free and fair (2003) and four of the remaining six have featured widespread violence (1992, 1997, 2007, 2017), that is, only two have been peaceful. The two peaceful elections were end of term (Moi 2002, Kibaki 2013). Elsewhere, notably Ghana, Nigeria, Senegal, Malawi, incumbents have lost midterm elections without much ado.

Political power is seldom an end in itself. The findings of this paper suggest a nexus between electoral malfeasance and plunder. Money is a big enough motive for people to want to stay in power by hook or crook. This nexus implies that addressing Kenya's electoral malfeasance should not be confined to the legal institutional framework and mechanics of electoral process, but within the broader political economy of corruption.

Electoral failure has consumed two electoral bodies. A third one is mortally wounded. Similarly, anti-corruption discourse and effort that is confined to legal and institutional reforms is just as superfluous. As anti-corruption crusader John Githongo never tires to remind us, Kenya has created some of the most elaborate legal and institutional anti-corruption infrastructures in the world over the last three decades, yet corruption flourishes with impunity. As with election bodies, the country is now on its third generation anti-corruption body, one whose autonomy and independence is properly anchored in the constitution, but it is far from evident that it is faring any better than its precursors.

In conclusion, this paper makes the case for expanding the purview of the state capture discourse beyond corruption, to encompass political accountability broadly defined.



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