



Policy Impacts on Africa's Extractive Sector Kenya, Mineral Wealth, and Legislation Facilitating Inclusive Development

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This paper examines the current state of natural resource development and governance in Kenya, arguing that while the country has taken several meaningful and positive steps towards less dependence on the agriculture sector and towards critical economic diversification from its underexploited mineral resources, significant challenges remain. Kenya is a heavily agriculture-reliant economy' this sector accounts for approximately one quarter of its gross domestic product (GDP). The Government of Kenya recently publicly espoused a position of seeking to reduce its dependence on agriculture in order to diversify its economy. The focus is on the development of its extractives sector which presently accounts for just 1 per cent of GDP and less than 3 per cent of the country's total export revenues (ICES, 2014). A question relevant to this shift is whether Kenya's existing governance and institutional systems are capable of managing this change from agriculture to extractive industry so as to ensure future sustainable outputs and growth overall. As such, this paper examines the current state of natural resource development alongside governance in Kenya. Implications for inclusive economic development are considered, along with the prospects of attaining broadly beneficial administrative reforms conducive to economic growth and the amelioration of Kenya's socioeconomic position. The study underscores the current state of Kenya's fiscal regime, efforts being made to

diversify its economy, and steps being taken to promote linkages between and within its economic sectors from both within the state and with outside partners.

This paper¹ examines the current state of natural resource development and governance in Kenya, arguing that while the country has taken several meaningful and positive steps towards less dependence on the agriculture sector and towards critical economic diversification from its underexploited mineral resources, significant challenges remain. These include the strength of fiscal policy, shifting regulatory landscapes, linkages promotion, infrastructure deficits, and corruption. The paper considers implications for inclusive economic development, along with the prospects of attaining broadly beneficial administrative reforms conducive to economic growth and the amelioration of Kenya's socioeconomic position. The study underscores the current state of Kenya's fiscal regime, efforts being made to diversify its economy, and steps being taken to promote linkages between and within its economic sectors from both within the state and with outside partners. In so doing, it is hoped that the reader is provided with an effective review of the present state of Kenya's extractives sector.

Since the colonial era, Kenya's economy has focused on the development of farming, tourism, manufacturing and service industries (Mayer Brown, 2013). Considered a lower middle-income country by the World Bank, Kenya has a per capita income of US\$1,710.00 (WBG, 2018). It is a constitutional, presidential republic with a bicameral parliament and 47 constituent counties (Constitution of Kenya, 2010). Upon gaining independence from Great Britain in

¹ This paper was informed by interviews conducted in Kenya in August 2016. Semi-structured interviews were conducted with representatives of the World Bank-Private Sector Development, International Finance Corporation, Kenya Ministry of Mining, Kenya Chamber of Mines, Institute for Security Studies and Cardno Emerging Markets. All interviews were conducted in confidentiality, and the names of interviewees are withheld by mutual agreement. The authors would like to thank Joshua Mugambwa for his research assistance on this paper.

1963, Kenya has pursued a mixed economic development strategy crafted to attract foreign direct investment (FDI), with mixed success (Republic of Kenya, 2015). Economic growth witnessed periodic declines, particularly in 2000, that was the result of a contentious constitutional review process (Booth et al., 2014). Despite these recurring challenges, Kenya has managed to sustain an average annual economic growth rate of 3.6 per cent since 1992 (World Bank, 2015), and is now the 9th largest economy in sub-Saharan Africa (Republic of Kenya, 2015). The country's socioeconomic development is relatively low by global comparative benchmarks but remains higher than most sub-Saharan African countries (UNDP, 2015).

Kenya relies heavily on agricultural output, which accounts for approximately one quarter of its gross domestic product (GDP) (World Bank, "Kenya Economic Update," 2019). The sector accounts for 75 per cent of Kenya's rural labour force, more than 65 per cent of merchandise exports (World Bank, "Kenya Economic Update," 2019, USAID, "Agriculture and Food Security," 2020). Only 20 per cent of Kenya's land is suitable for sustained agriculture (USAID, "Agriculture and Food Security," 2020). According to Deloitte, Kenya has also restricted the growth of any genetically modified produce, forcing the development of innovative agricultural technologies and techniques, as well as creating a national specialization in fresh and organic food stuffs (2015, 15). The challenge, however, is that Kenya's agriculture and livestock sectors have been decimated in recent years by the still on-going East African drought, which has led to tea crop losses of between 12-30 per cent, livestock losses of 40-60 per cent and has pushed both inflation and electricity prices to rise quickly (Were, 2017).

As a result, the Government of Kenya is seeking to reduce its dependence on agriculture and diversify its economy by focusing on the development of its extractives sector, which presently accounts for just 1 per cent of GDP and less than 3 per cent of the country's

total export revenues (AfDB, 2020). There are several different ores and commodities in the Rift Valley state and Turkana County that are either currently under production, or believed to be commercially valuable, including soda ash, fluorspar, gold, oil, natural gas, and rare/heavy minerals. The government of East Africa's biggest economy also announced that it has an estimated US\$62.4 billion worth of rare earth elements in its coastal region, which would place it among the top five countries in the world with such deposits.

The extraction of Kenya's mostly untapped mineral resources presents a significant opportunity for economic growth, which could serve as a boon to socioeconomic development if newfound revenues are administered effectively. Kenya's nascent extractives sector requires a policy and regulatory framework that capably facilitates resource exploration, extraction, and beneficiation activities for the good of its people. Currently, Kenya's mining sector is managed by The Mining Act 2016, and The Mining and Minerals Policy 2016 which emerged from The Mining Bill 2004; Precious Metals Act and The Diamond Industry protection Act and the Finance Act 2014.

Diversification of the Economy

The Government of Kenya is committed to diversifying its economic base, as the country continues to rely heavily upon services and agricultural output as a means of wealth creation at a time when Kenya's unemployment rate sat at 9.31%, and with 39% of Kenyan youth unemployed (Statista, "Kenya: Unemployment rate from 1999 to 2019"; Alushula, 2020.) Kenya's mining sector is underdeveloped, constituting less than 1 per cent of GDP at present, but with the potential to contribute to upwards of 10 per cent (Republic of Kenya, 2015). Metallic minerals currently produced include titanium, gold and iron ore, and the Government of Kenya has recently offered generous terms to companies willing to develop these and other minerals (Republic of Kenya, 2015). Enterprises resident in Kenya,

ordinarily pay a corporate income tax rate of 28.2 per cent on revenues sourced in Kenya, while non-resident enterprises are expected to pay a rate of 37.5 per cent on such revenues (BMI Research, 2015). That said, Nairobi awarded the Kwale concession to Australia's Base Resources on the grounds that Base would pay corporate taxes of 15 per cent for 10 years –half the standard rate – along with royalties set at 2.5 per cent as opposed to the 3 per cent rate that prevailed in 2012 when the deal was made (Oxford Business Group, 2014).

It is expected that Kenyan national revenue will be bolstered by the US\$305 million Kwale Mineral Sands Project, which is considered a world class advanced development initiative with an estimated 140 million tonnes of titanium deposits. The deposits are expected to yield 14 per cent of the global supply of rutile, and 10 per cent of the global supply of ilmenite, once fully operational (Oxford Business Group, 2014; Republic of Kenya, 2015). These minerals are employed in the manufacture of titanium metal, plastics, ceramics, and pigments used in paper (Oxford Business Group, 2014). It is believed that output from the Kwale Project could generate up to US\$300 million in revenue for the Government of Kenya over the 13-year life of the mine (Oxford Business Group, 2014). Further exploration and provision of mineral rights could allow Kenya to become the regional mining sector hub for these and other minerals in East Africa in the years ahead (Republic of Kenya, 2015). Campbell noted that it is not clear that government earnings from taxes and royalties connected with large-scale foreign-owned industrial mining maximises the revenues and developmental benefits that could accrue to the country.

Other strategies recommended were: minerals processing, development of the mining services and equipment supply side of the industry, as well as enhanced local ownership of mining and exploration companies in order to appropriate a greater share of profits. These approaches enhance wider economic benefits for mining in

industrial nations and merit serious consideration by relevant policy makers with regard to the Kenyan mining industry (Campbell, Hatcher, Lafortune, and Sarrasin, 2004). Further, Macdonald (2016) observed that considerable resource revenues transmitted to provincial governments in the form of royalties seem to have been rarely converted into social benefits, unless done by resource company intervention under the Infrastructure Tax Credit Scheme. While this was studied in Papua New Guinea it can be true for Kenya.

Complementing the activities currently being undertaken by the Ministry of Mining, the Government of Kenya has committed to several infrastructure development projects that will contribute to the pursuit of Vision 2030, Kenya's development roadmap. The Mombasa Port Efficiency Project, for example, has been undertaken to cope with an increase in traffic at East Africa's largest and busiest port, and will involve the construction of additional berths, container terminals, and the dredging of a large channel. Investments in Mombasa's port operations have resulted in tremendous improvements to its efficiency, as it now only takes 3 days to clear cargo when it formerly took 10. Another project that could be of tremendous benefit to Kenya's mining sector include the construction of a standard gauge railway from Mombasa to Nairobi, which will have 40 stations for loading cargo, and may be expanded through Uganda and into Kigali, Rwanda. It is anticipated that the rail line will be able to transport cargo to and from the Mombasa Port in under four hours on high-speed trains with modern facilities.

As noted in the previous section, Kenya is currently characterized by a shifting regulatory landscape characterized by greater oversight of the mining sector and greater transparency in the licensing process in keeping with industry standards and international best practices. It is believed that this administrative adjustment is being made to avoid the various mistakes associated with poor resource

management.² The Ministry of Mining appears to have tightened enforcement of the sector, having revoked 42 prospecting and mining licenses granted between January and May 2013 on the grounds that proper licensing procedures may not have been respected. An independent task force was also established to review the suspended licenses (Oxford Business Group, 2014). Further to these efforts, the Government of Kenya has indicated that it intends to revoke the various rights awarded to mining companies that have held concessions without undertaking operations for over a decade or more. The administration is currently vested with the authority to do so pursuant to section 56(1)(b) of the Mining Act. As noted above, the Mining Bill presently awaiting senate approval contains several provisions enabling the Cabinet Secretary in charge of the mining portfolio to suspend or revoke mineral rights due to extended periods of inactivity on the part of license or permit holders. Officials from several mining companies have thus expressed concern that the Government of Kenya will leverage the new Mining Bill to compel them to begin investment and mining activity within the next year.³ The Ministry of Mining is also reportedly planning to launch a core strategy to guide the country's mineral policy, which is to be coordinated and chaired by President Uhuru Kenyatta.⁴ Nairobi has also recruited McKinsey & Co. to design a 20-year plan to chart the development of the country's burgeoning mining industry, which the Government of Kenya intends to harmonize with its country mining vision.⁵

Poor governance also threatens Kenya's ability to diversify, as extractives industry executives are warier of political risk and invest-

2 Interview with Cardno Emerging Markets, August 19, 2015.

3 Interview with Kenya Ministry of Mining official, August 18, 2015.

4 Interview with Kenya Ministry of Mining official, August 18, 2015.

5 Interview with Kenya Ministry of Mining official, August 18, 2015.

ment climate challenges under such circumstances (DFID, 2015). Kenya is deemed to pose a greater risk to investors in terms of ease of conducting trade and quality of governance than neighbouring Tanzania. Kenya has also been rated more poorly than its Great Lakes neighbours Uganda and Rwanda according to trade and investment risk, and worse than Uganda and Tanzania based on economic openness (BMI Research, 2015). Moreover, the 2014 Fraser Institute Annual Survey notes that Kenya is not perceived to be a top tier mining country in comparison to Tanzania, Mozambique, or Ghana, and figures among the bottom 10 countries in terms of investment attractiveness in the mining sector. Further complicating the Kenyan extractives investment climate is a new Petroleum Bill under discussion that contains several provisions that are contentious to stakeholders. As regulatory uncertainty often serves as the handmaiden to cronyism and corruption in awarding and managing licenses and PSAs, Kenya's near term ability to attract FDI may face formidable obstacles. Nairobi must be wary of losing out to regional investment competitors in an environment where it does not enjoy a formidable reputation as a mining state, where regulatory uncertainty is fairly high, and where low return on investment is more likely in the near term (DFID, 2015).

Why the Mining Sector?

Despite poor data, studies suggest that Kenya holds a vast array of untapped mineral resource deposits, including soda ash, fluor-spar, titanium, niobium and rare earth elements, gold, coal, iron ore, limestone, manganese, diatomite, gemstones, gypsum and natural carbon dioxide, collectively worth trillions of Kenyan shillings (Okoth, 2016). It is this potential for the mining industry that has Kenya scrambling to update its legislation and governance regime so as to attract foreign investors.

In 2016, the Government of Kenya signed into law a new Mining Act in an attempt to jump start an economic sector that has not seen major legislative development since the 1950s. The mining sector has faced considerable geological data omissions, culminating in a prospective business environment that failed to attract meaningful domestic or FDI (Aglionby, 2016). Indeed, legislations pertaining to Kenya's mining sector did not conform to the country's constitution as they failed to meet international standards and best practices, as well as not covering several mineral types under its remit (Government of Kenya, 2016, 7). In addition to lackluster policy and governance frameworks, the Kenyan mining sector has been impacted by disputes regarding access to land, which have inhibited exploration and prospecting. This has been further complicated through a lack of expertise in mineral marketing and value addition and inadequate funding for infrastructure (2016, 7-9). Environmental protection laws replete with gaps that have been exploited by the private sector, along with gender and labour issues - particularly for artisanal and small scale (ASM) practitioners - and inadequate institutional and human capital lacking specialized skills and the means to teach them with, finally, an absence of policies that reflect a preference towards local sourcing and value addition posed multiple policy challenges to the Kenyan government. Indeed, the global financial firm KPMG (2016: 1). identified the mining sector as the black sheep of Kenyan economic potential, a void within which few dared ventures. The result was, as KPMG indicated, a mining sector that contributed a mere 0.4 per cent of the country's GDP, despite being present in the country for more than 50 years.

To solve these dilemmas and more, the Mining Act of 2016 sought to achieve a number of rapid successes. First, it aims to decentralize decision-making and place further authority in the Mineral Advisory Board, which would be charged with licensing and permit approvals. Decentralization includes county governments who would now be required to provide consent for licensing operations

and surface rights. Second, the Act seeks to establish a state-run mining corporation that will conduct activities on behalf of the government, creating a direct link between royalties, GDP growth, and mineral extraction activities. Third, emphasis is placed on rectifying the significant gaps in geological data by creating both the Directorate of Mines and the Directorate of Geological Survey. Finally, the law establishes new parameters for transparency, requiring publication of mining activity details in the public domain (KPMG 2016, 1-2). Although analysis by KPMG denotes that there remain several continuing gaps and missed opportunities, the Mining Act was the first step towards modernization of Kenya's mining sector as a means of diversifying the country's economy.

The focus of this study, however, is to examine whether Kenya is able to learn from its experience in the agriculture sector to leverage both growth and diversification in its economic output within the new focus on mining. In other words, are Kenya's existing governance and institutional systems capable of managing this transition from agriculture to extractive industry? In line with this focus and investigation into this question, the following section explores the country's fiscal regime as it pertains to the mining sector.

Fiscal Regime

Sound resource governance is integral to realizing the potential of Kenya's mineral resources. In principle, the fiscal regime administering Kenya's minerals sector should maximize rent capture and promote FDI. The Kenyan fiscal environment is based in part on provisions found in the Mining Act 1940 (hereinafter Mining Act), which regulates all of the country's mining activities. The most recently revised edition of the act was published in 2012. Key aspects of the act include the principle that the Government of Kenya is vested with ownership of all the country's mineral deposits as trustee of the Kenyan people (Mayer Brown, 2013; Republic of Kenya,

2015). The Minister of Mines (now Cabinet Secretary) administers the right to explore and develop mineral resources and appoints the Commissioner of Mines and Geology to implement provisions found within the Mining Act (Republic of Kenya, 2015). The Cabinet Secretary is supported by the Principal Secretary, while the Commissioner of Mines and Geology serves as the chief technical advisor to the Cabinet Secretary (Republic of Kenya, 2015). The Commissioner, in turn, carries out the daily operations required to implement the provisions of the Mining Act. Finally, investors must apply to the Commissioner to acquire Prospecting Rights and mining licenses and leases (Mayer Brown, 2013)

The Government currently issues five types of mining licenses and leases under the Mining Act, though applicants must first obtain a Prospecting Right before they can acquire them. Prospecting Rights vest individuals, company agents, body corporates and other partnerships with the ability to acquire licenses and peg locations. The Rights also allow these entities to prospect on any land as authorized by the Kenyan Commissioner of Mines and Geology. Once these rights have been obtained, applicants may proceed with acquiring a mining location: the first type of license. This is mainly granted to small-scale mining entities; up to eight mining locations may be granted to a single entity per district. A single mining location consists of a block of a maximum of ten claims amounting to no more than 20,000 m² for precious metals and stones, and 50,000 m² for all other minerals.

Exclusive prospecting licenses are the second type of license, and are granted for areas exceeding 1,000 km², provided the applicant has deposited the necessary securities and fees, received written consent from local authorities, gained consent from land owners, and garnered other approvals from the Commissioner of Mines and Geology, while simultaneously holding Prospecting Rights. Third, special prospecting licenses are essentially the same as exclusive licenses, though they apply to property that is ordinarily off-limits to

prospectors, such as game and forest reserves. Mining leases are the fourth type of license. They facilitate the exploitation of proven mineral deposits that have been discovered through prospecting and exploration activities provided by the three other types of licenses. It typically takes over one year to complete the various administrative steps needed to obtain a mining lease (Mayer Brown, 2013). Special mining leases are the fifth sort of license awarded by the Government of Kenya. These apply to properties that are normally inaccessible, and there is no limit to the acreage allotted through special leases.

Prospecting licenses are ordinarily valid for one year and are subject to renewal for no more than five years. Mining leases are issued for durations of anywhere from 5 to 21 years and can be renewed for any duration not exceeding 21 years. The Commissioner of Mines is vested with the authority to extend license and lease periods, as necessary. Assessed fees must be paid to renew mining licenses and leases in Kenya and are based on the completion of work programs subject to the Commissioner's approval. There are no restrictions to the duration of special prospecting licences or mining leases in Kenya (Republic of Kenya, 2015).

Mining leases are forfeited if leaseholders completely cease their work "in, on, or under the land" for a continuous period of six months without the consent of Kenya's Commissioner of Mines and Geology, as per clause 56 (1)(b) of the Mining Act (Republic of Kenya Parliament, 2012). The Mining Bill 2014 does not refer to leases. Rather, it differentiates between mining licenses and mining permits; both of which are considered mineral rights. Mining licenses apply to large scale operations, while mining permits apply to small scale activities. Clause 12(3)(b) of the Mining Bill 2014 vests the Kenyan Cabinet Secretary responsible for the country's mining portfolio with the authority to enact regulations governing the revocation or suspension of mineral rights, *inter alia*.

The new Mining Bill imposes deadlines by which license holders must undertake their operations. Clause 67(1)(a) stipulates that reconnaissance license holders must commence operations within three months of the license being granted. Clause 77(1)(a) of the bill stipulates that prospecting license holders must undertake their operations within three months of the license being granted, or according to "the period specified in the approved programme for prospecting operation". Clause 109(a) of the Mining Bill requires mining license holders (i.e. large-scale miners) to begin mining activities within six months, or according to the terms of an approved mining operations program or relevant minerals agreement. There is not a uniform deadline imposed on retention licenses, artisanal mining permits, prospecting permits, or mining permits (which apply to small scale operations).

Clause 147 authorizes the Cabinet Secretary to suspend or revoke any of the aforementioned mineral rights if license holders do not comply with any condition attached to their rights, including the 'use it or lose it' provisions noted above. Clause 147(3) obligates the Cabinet Secretary to provide prospecting or mining permit holders with written notice requiring them to comply with the timeline conditions stipulated in their permit "within a reasonable period of time". Clause 147(3) also allows the Cabinet Secretary to provide prospecting and mining permit holders with the opportunity to show cause as to why their mineral rights should not be suspended or revoked due to non-compliance. The Mining Bill 2014 does not appear to have a clause compelling the Cabinet Secretary to provide other types of mineral rights holders with written notice as to the pending suspension or revocation of their rights.

Under current Kenyan law, prospecting or mining for diamonds requires special authorization from the Commissioner of Mines. Unlike other minerals, diamonds are currently regulated by the Diamond Industry Protection Act, which would be repealed if the Mining Bill enters into force.

With respect to the country's taxation framework, some key features are worth noting. Corporate income tax rates are set at 30 per cent for Kenyan individuals or businesses, and 37.5 per cent for non-resident entities – including branches of foreign companies - with limited exceptions. Importantly, reduced rates of corporate income tax apply if a company has recently been listed on the Kenyan Stock Exchange. The Government will withhold taxes on natural resource income and transfers of shares or property in the extractives sector, with a 20 per cent tax imposed on the gross amount received for the sale of corporate assets. However, Kenyan nationals, involved in the transaction pay a reduced 10 per cent rate. Then, tax losses tied to mining operations can be carried forward indefinitely and deducted from the mining licensee's future income, provided it is derived from the same licence area. Rehabilitation expenditures are deductible by licensees for tax purposes, and, finally, capital gains tax on farm outs, is imposed on the assignment of mining interests at prevailing corporate tax rates (Mayer Brown, 2013; Republic of Kenya, 2015).

Despite these various provisions, the fiscal regime currently governing Kenya's mining sector may be amended in the near future as it has received criticism for being outdated. A new Mining Bill 2014 has been approved by the National Assembly. It was reintroduced in 2016 and was signed into law by President Uhuru Kenyatta in May of that year (National Council for Law Reporting, 2016) It aims was to ameliorate Kenya's mining sector by providing the Ministry of Mining with robust oversight powers while establishing greater transparency in the licensing process and efficient management of the country's natural resources, along with greater benefit sharing and disputes resolution mechanisms (Mayer Brown, 2013; Oxford Business Group, 2014; KPMG, 2016). Clause 183(2) of the Mining Bill vests the Cabinet Secretary with the authority to prescribe the royalty rates payable to the Kenyan Government, while Clause 183(5) stipulates that seventy per cent of royalties are to be

paid to the Kenyan National Government, twenty per cent to the county government, and ten per cent to the community hosting the mining operations. Nevertheless, the bill does not expressly identify the exact amounts or percentages of revenues to be paid by mineral rights holders. Salim (2014) notes that the bill provides for the Cabinet Secretary to determine the royalties to be paid on the various classes of minerals through a regulation published in the Kenya Gazette, which can be amended every two years. These changes have been brought about in a bid to increase the revenue stream gained from Kenya's mining sector (Doya, 2015).

A Kenya Ministry of Mining official indicated that mining companies operating in the country over the years have often paid just 5 cents per ton in royalties. If the bill enters into force, the Government of Kenya will impose royalty rates ranging from 1 per cent of gross sales value for industrial minerals such as gypsum and limestone; 5 per cent for gold; 10 per cent for coal, titanium ores, niobium and rare earth elements; and 12 per cent for diamonds (Doya, 2015). These increases are consistent with those witnessed in other African countries in recent years, and do not represent high royalty rates when compared with those imposed by other states.⁶ Moreover, former Kenyan Mines Cabinet Secretary Najib Balala has gone on record stating that the new Mining Bill will ensure that all mining entities pay their taxes so that the Government of Kenya revenues will increase to an anticipated 1.5 billion Kenyan shillings (US\$15 million), up from an estimated 21 million shillings in 2012 (Doya, 2015).

In addition, capital gains tax was reintroduced to Kenyan law via the Finance Act 2014 after having been suspended as of June 1985. Capital gains are currently taxed where gains have accrued to companies or individuals on the transfer of property situated in

⁶ Interview with Kenya Ministry of Mining official, August 18, 2015.

Kenya. The tax is also levied on net gains made through operations in Kenya's extractives sector. The capital gains tax rate is currently set at five per cent of net gains (KPMG Africa, 2015). In addition, Kenya introduced transfer pricing rules in 2006 to supplement the related provisions found in the country's Income Tax Act. Section 18(3) of the Income Tax Act allows the Commissioner of Domestic Taxes to adjust the profits earned by entities residing in Kenya that were gained through transactions with non-resident entities so that they are reflective of profits that would have been earned if the parties were independent and had completed the transaction at arm's length. Business entities are considered to be resident in Kenya as long as they are incorporated, effectively managed, and controlled by Kenyan laws (TPA Global, 2013). However, entities are deemed related under Kenyan law "if each participates in the capital, control and management of the business of both, be it within or without the Kenyan borders" (TPA Global, 2013, p.2).

Further to strengthening its mining legislation, the Government of Kenya has also received guidance from the International Monetary Fund (IMF) so that it can augment other facets of its fiscal regime. The Kenyan Treasury and Kenya Revenue Authority have received assistance from the IMF since 2013 to craft production sharing agreements (PSAs) under the IMF's topical multi-donor Trust Fund *Managing Natural Resource Wealth*. The work of the programme was incorporated into Kenya's new Finance Act, which was enacted in December 2014. The IMF also provided the Kenya Oil and Gas Association with clarification regarding the taxation of capital gains in the sale of non-resident interests that own Kenyan petroleum rights, as well as the PSA pertaining to the sale. According to the IMF, Kenya's new tax code governing extractives is comparable to what is found in most European countries. The Mining Bill, coupled with the IMF assistance Kenya has received in the extractives sector, should provide the country with a fiscal framework conducive to the development of its petroleum and mining industries over time.

Linkages Promotion

Through analysis, the Government of Kenya's commitment to ensuring improved mineral linkage to the broader economy may be called into question. The government appeared to sound a clarion call for safeguarding local content in the mining sector with the release on October 12, 2012, of Kenya's Mining (Local Equity Participation) Regulations. The document aimed to increase Kenyan participation in mining companies by stipulating that at least 35 per cent of shareholders in mining companies subject to the terms of mining licenses awarded by executives at the Ministry of Mining must be Kenyan nationals (Mayer Brown, 2013). Ensuring local investor participation is not uncommon in the extractives sector; as such laws have been passed in Botswana, Gabon, Ghana, Guinea, Indonesia, Nigeria, Zimbabwe and neighbouring Tanzania (Mayer Brown, 2013; Oxford Business Group, 2014). Botswana's approach to mining sector management particularly ensures a balance between oversight of multinational mining companies, joint management of its mining sector, and reasonable taxation in order to attract continuous FDI to the sector and reinvest resources. The Regulations were repealed in June 2013 (Mayer Brown, 2013), however, as the Government of Kenya determined that the rationale behind the law was not completely sound.⁷ An issue that may have affected this decision is the inadequate financial infrastructure currently available to local investors, which would have affected their ability to raise sufficient capital to gain at least 35 per cent of shares in mining ventures in the East African country (Mayer Brown, 2013).

⁷ Interview with Kenya Ministry of Mining official, August 18, 2015.

Many studies in the literature also focus on the effect of local content policies on producing positive outcomes towards economic development once they are properly implemented and governed by various authorities in resource-abundant economies. For example, Jesse Salah Ovidia (2016) established that legal initiatives which took into account local content measures contributed to the development of petroleum and mining sectors across Sub-Saharan Africa. As addressed in this study, local content policies (LCPs) encourage local and national participation in the extractives sector to shift resource allocation from exporting raw materials to local production and service provision. In an earlier study in 2014, Jesse Salah Ovidia argues that local participation in the extractive industries is another significant factor in achieving sustainable economic development in addition to the investment of the rents and taxes from resource extraction. This is particularly important since there are a limited number of jobs available in oil and gas which can be compensated for by countless employment opportunities in the goods and services industries associated with resource extraction.

However, both studies emphasize the importance of proper implementation of LCPs and how these policy frameworks are being adopted to produce positive developmental outcomes. To this extent, Jesse Salah Ovidia (2016) identifies several factors that are essential in reaching positive developmental benefits from LCPs. The study suggests that to maximize the economic benefits of adopting LCPs, it is necessary that they are implemented in a consistent and transparent manner and are monitored by qualified authorities in the public and private sectors. However, Ovidia (2016) lists the following challenges for local content in practice; corruption, local fronting, foreign labour, access to capital, skills, training and human capacity, and managing expectations. In another study, it was established that there is a relationship between specificity of local content frameworks such as policy, legislation and contracts, and outcomes achieved. Countries with more specific local content frameworks

such as Angola and Algeria tend to produce better outcomes, while those with less specific frame works such as Equatorial Guinea, Tanzania and Uganda produce weaker outcomes. (Mushemeza & Okiira, 2016).

Kenya's mining legal and regulatory framework requires entities undertaking mineral activities to notify affected communities and relevant county governments to obtain their consent prior to the commencement of mineral exploitation. As with the hydrocarbon sector, provisions for local content in the mining sector are negotiated on a project-by-project basis. Notification requirements provide a forum facilitating communication and information exchange between county administrators, community leaders, landowners, lawful occupiers of land and mining license applicants. Applicant notification of community leaders and relevant county governments - along with a meeting between the two sides facilitated by the Ministry of Mining - constitutes the first step of Kenya's mining licensing process. As a means of further supporting local content in the mining sector, foreign investors are permitted to employ expatriate staff in senior management positions only where Kenyan citizens with closely aligned skill sets are not available for hire (Republic of Kenya, 2015). Looking ahead, it is believed that - in close consultation with the Government of Kenya - the McKinsey & Co 20-year Kenya mining sector diagnostic is being crafted to facilitate beneficiation and value addition inclusive of Kenyan citizens and businesses.⁸ Moreover, the Government of Kenya has also demonstrated a strong willingness to collaborate with local partners in policy making, as it undertook broad consultations that resulted in robust public participation and input involving the representatives of civil society organ-

⁸ Interview with Kenya Ministry of Mining official, August 18, 2015.

izations and members of the private sector in drafting its Mining Bill.⁹

The bill unequivocally establishes the legality of artisanal mining, which features a suite of rights and institutions in support of the sub-sector; one which has hitherto been considered an illegal activity in Kenya.¹⁰ The proposed legislation also vests the Cabinet Secretary of Mines with the capacity to declare areas expressly reserved for small-scale and artisanal mining operations. Moreover, section 46 of the Mining Bill requires a mineral rights applicant to provide the Cabinet Secretary of Mines with a detailed program for the recruitment and training of Kenyan citizens for positions in the sector. The ministerial granting of such rights is incumbent upon the submission of the program proposal. In addition, section 46 of the bill also provides the Cabinet Secretary with the lawful authority to draft regulations (i) governing the replacement of expatriate workers in the mining sector, and (ii) administering the number of years they are entitled to serve in their positions.¹¹ It also grants the Cabinet Secretary the capacity to form partnerships with universities and research institutions to enhance the training of Kenyans so that they may better reap the gains of the country's mining sector.

Moreover, section 47 of the Mining Bill stipulates that the holder of a mineral right must give preference of employment to community members and Kenyan citizens.¹² Section 50 of the bill

9 Interview with Cardno Emerging Markets, August 19, 2015.

10 Interview with Cardno Emerging Markets, August 19, 2015.

11 Please note that this sentence is mindful of the modification made to the Cabinet Secretary's administrative authority via the amendment made to sub clause 46(3), as per the Republic of Kenya's Eleventh Parliament (third session) Order Paper produced by The Senate on July 29, 2015.

12 Please note that the sentence above is mindful of the Cabinet Secretary's administrative authority that was modified by the amendment made to sub clause 47(1), as per the Republic of Kenya's Eleventh Parliament (third session) Order Paper produced by The Senate on July 29, 2015.

states that the holders of mineral rights must give preference to materials, products, services, companies, or businesses owned by Kenyan citizens in the conduct of virtually all aspects of their mining operations, while section 128 requires holders of various mineral rights to gain the consent of the communal authority or county government prior to commencing excavation or drilling operations. Notably, the proposed law does not appear to obligate foreign holders of mineral rights to partner with Kenyan entities in the course of their operations. Nevertheless, the provisions found within the Mining Bill promise to encourage robust, balanced local participation in the Kenyan extractives industry once they receive presidential assent. Moreover, they have the potential to connect a growing number of Kenyans to regional supply chains, which could have positive, knock-on effects for economic growth and prosperity.

Challenges for Trade, Investment and Economic Engagement

Of all the challenges facing Kenya today, one of the most pervasive remains that of the near-institutionalization of corruption. According to Transparency International, Kenya ranked 145 of 176 analyzed countries on the 2016 Corruption Perceptions Index, falling from a position of 136 in 2013 (Lindner, 2014, p.3). In 2013, surveys by Transparency International showcased that some 70 per cent of Kenyans had reported paying at least one bribe to access social services in the preceding twelve months, with the police, judiciary, registry and permit services being sites of most frequent examples of corruption (Lindner, 2014, p.3). The latest (2013) survey results from the World Bank's Enterprise Surveys indicated that depending on sector, upwards of one third of businesses expected to pay a bribe or provide a gift in exchange for public services (enterprisesurveys.org, 2013).

Despite having been elected on a largely anti-corruption platform, President Uhuru Kenyatta has struggled to address this issue. In 2015, budget audits showed the Kenyan public that government was only able to account for 1.2 per cent of its total budget allocations for the 2013-2014 fiscal year, with some \$600m being lost altogether (Githongo, 2015). Reports indicate that corruption has been so widespread that it is undermining the government's ability to address terrorism and it has hollowed out public institutions like the judiciary (Githongo, 2015). According to Newsweek, Kenyatta's government could readily be classified as one of the most corrupt in Kenya's history for reasons including a lost \$2.7 billion Eurobond commercial loan for national development; intimidation and deportation of journalists reporting on corruption; embezzlement of some \$1.8 million from the government-run Youth Enterprise and Development Fund; lack of open bidding processes for multimillion dollar government contracts; harassment of political opponents and civil society; misappropriation of \$50 million for maternity care across the country; the loss of 1.8 Kenyan shillings from the National Youth Service; 5.5 billion shillings missing from the Ministry of Health; multi-billion shilling theft from the government's National Irrigation Board by its appointed general manager; among many other examples (Githongo, 2017; Guguyu, 2017; Osiro, 2017). According to the Financial Times, even Kenya's lauded mPesa mobile payment system has been used for institutional corruption and bribery payments (Aglionby, 2016).

While some actions have been taken to attempt a large-scale remedy of engrained corruption in Kenya, including new legislation and international agreements such as the Kenya-US Joint Commitment on Good Governance and Anti-Corruption Activities in Kenya, due to a lack of meaningful actualization of these agreements and graft that may extend all the way to the president himself despite his lofty rhetoric (Mosoku, 2017), progress has been extremely sluggish. As a consequence, the ease of doing business in Kenya remains chal-

lenging; businesses face the rampancy of asset mismanagement, petty and institutionalized fraud, expectation of gifts and bribery, and procurement corruption, among other issues (PwC, 2016, p.5-6).

Besides corruption, there are other concerns about the overall contribution of mining companies to economic development as we take into consideration the payments of taxes and royalties by these companies. Bonnie Campbell (2009), in a study on the development and regulation in the mining sector in Africa, discusses the controversial arguments concerning the economic benefits of the mining sector. It is argued in this study that although the earnings generated from the mining sector are viewed as contributions to national development and poverty reduction, there are a number of factors that lead to the overexploitation of these earnings, thus leaving very little towards national development efforts. Examples of such factors are capital allowances, excessive concessions, and incentives to investors in the mining sector, customs and tariff exemptions on mining-related equipment, and so forth.

The threat of terrorism poses a serious threat to economic engagement in Kenya. Government seemingly has not helped in curbing terrorist activities: 2017 saw police and military begin targeting Kenyan Muslim communities in an effort to root out extremist and terrorist cells, driving up tensions between religious groups in the country (Grant, 2017). As a consequence of this persistent threat of terrorism, Kenya has made a number of moves to attempt an ambitious push back. First, the Kenyatta government has signed into law a number of legislative measures intended to augment national security, including the Prevention of Terrorism Act, the Proceeds of Crime and Anti-Money Laundering Act, and the Security Laws Act of 2014 (state.gov, 2015). The latter in particular included some 20 new amendment provisions to existing law, including the criminalization of participation in terrorism training, augmenting the breadth of applicable evidence in terrorist related prosecutions and strengthening Kenya's National Counter-Terrorism Centre (state.gov, 2015).

Kenya's National Police Service has equally pursued a very public campaign of naming in national publications those organizations, banking institutions, and individuals it has connected to terrorist groups (state.gov, 2015). The result, according to government officials, has been a reduction in causality incidents as of 2016, an increase in available equipment for police services, and a growth in Kenyan participation in AU counter-insurgency operations in Somalia (Allafrica.com, 2017).

Lastly, it is worth noting that political instability is a critical issue area that prospective partners, foreign direct investors, and international private sector actors should be wary of as they consider deeper economic partnerships with Kenya. The country, unfortunately, has had a history of electoral violence: in 2007, after the announcement of results from the then-Presidential elections, resultant violence caused the deaths of some 1,100 people, 40,000 cases of sexual and gender-based violence, and the displacement of more than 650,000 (Elder, Stigant, and Claes, 2014, p.5; Jones, 2014). It was only thanks to large scale institutional reform, including a new constitution, new electoral commission and laws, judiciary and police reform that Kenya would seemingly avoid similar mass violence in 2014; key informant interviews, however, proposed that few saw a genuine long-term commitment to the reduction of political conflict in the country by government actors (Elder, Stigant, and Claes, 2014, p.8-9). As if to reinforce this, Amnesty International reported in mid-2014 that government had systematically neglected its responsibility to investigate and prosecute crimes committed during the 2008 election, with many victims failing to report incidents to authorities out of a continuing fear for their physical and economic security (Jones, 2014).

ACAPS suggests that there are a number of contributing factors which could contribute to electoral violence in Kenya. First, analysis suggests that the withdrawal of the International Criminal Court case against both Kenyatta and Ruto, credited for disincentivizing

violence in 2014, as well as the expulsion of NGO monitoring groups in 2016 and a refusal of new international civil society permits in 2017 will likely provide a fertile ground for violence this year (2017, p.1). Raila Odinga, leading opposition to the current government, has also called for mass protests prior to the August election, largely out of continued dissatisfaction with the judiciary's response to 2013 election irregularities (ACAPS, 2017, p.2). Exacerbating the above are continued widespread perceptions of marginalization in the coastal region, belief among non-Kikuyu ethnic groups that the latter has dominated Kenyan politics since independence, land grievances aggravated by political corruption and patrimonialism, and a perceived lack of credibility amongst opposition parties of the Independent Electoral Boundaries Committee (ACAPS, 2017, p.2). Indeed, the latter has been the source of considerable criticism from civil society and opposition parties, who believe that the IEBC rigged the 2013 election in favour of the incumbent government, and that it accepted bribes as part of a multi-million shilling procurement deal known as the "Chickengate Scandal" (Aling'o and Noor, 2017). As a consequence, the Coalition for Reforms and Democracy has begun leading country-wide demonstrations calling for the disbanding of the IEBC, resulting in a hardening of government positions and increased crackdowns by police on protestors (Aling'o and Noor, 2017). We also envisage the development of the mining sector as a potential risk factor for violence if the returns from it are not well managed. This can easily spur ethnic rivalries and hatred as a result of ethnic favoritism, and political patronage in the mining sector. The current circumstances of corruption and violence cannot support legitimate growth of the mining sector, so they have to be dealt with by government and citizenry. Otherwise corruption breeds misappropriation and undermines the benefits from mining investment.

Conclusion

This study has examined Kenya's institutional systems capability to manage the change from an agricultural-based economy to one being diversified through the extractive sectors. It has argued that while Kenya has taken several meaningful and positive steps towards less dependence on the agriculture sector and towards critical economic diversification from its underexploited mineral resources, significant challenges remain. The untapped mineral resources present enormous opportunity to support Kenya's economic growth. Although they are both still in a nascent stage, Kenya's petroleum and mining sectors have the potential to attract investor interest and contribute to a substantial percentage of the country's economic output. Importantly, while legislation governing the mining sector is perceived as being out of date, the new Mining Bill has tremendous potential to protect and advance the interests of local communities and Kenyan citizens as it is developed. Kenya's prospects for inclusive growth will be realised if the government continues to facilitate FDI. This is urgent as the country's rising youth unemployment rate, and dangerous and unstable security situation, poses obstacles to the business operating environment and investment in the extractive sector (Booth et al., 2014).

Through the drafting of its Mining Bill, the creation of a country mining vision based on the AMV, and by enlisting McKinsey & Co to craft a 20-year diagnostic, Kenya appears to be attempting the implementation of a 'Botswana model' of mining sector management. Botswana's approach to mining sector management is generally well regarded for its ability to balance oversight of multinational mining companies, joint management of its mining sector, and reasonable taxation, along with country's the need to reinvest government resources and attract continuous FDI to the sector. If Kenya's mining and petroleum sectors are therefore to fulfill their potential, the government must continue to reform its historically burdensome bureaucracy and tax regime while pursuing infrastructure develop-

ment to improve the country's business climate over the medium term (BMI Research, 2015). In conclusion, the impending passage of Kenya's Mining Bill has the potential to diversify and strengthen the Kenyan economy if the country manages to continue on its current path of demonstrating respect for constitutionalism and the rule of law.

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