The allocation for infrastructure projects has been increased with the Minister undertaking to scale up infrastructure investments noting that these are "the building blocks needed to achieve a more lasting and stable growth"

Continued emphasis on infrastructure as a key pillar for growth

Infrastructure related projects allocation increases by 21% to 268.1 billion KES for the 2012/13 period

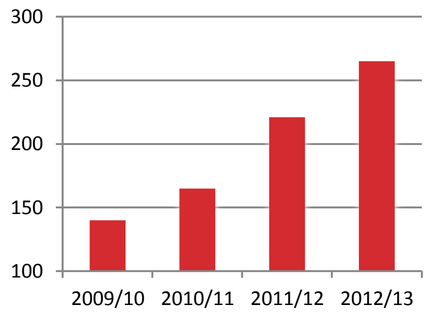
Importance of infrastructure investment for growth re-emphasised

The budget for 2012/13 allocates 268.1 billion KES to infrastructure. This is an increase of 21% over the 2011/12 budget allocation of 221 billion KES and represents 18.3% of total expenditure estimates.

The amounts above do not include 41.5 billion KES and 1.5 billion KES set aside for the water and the Nairobi commuter rail respectively. These are included under the economic affairs and Public Administration dockets respectively. Neither does it include 8 billion KES for irrigation infrastructure contained in the Public Administration. In total therefore, the amount allocated to infrastructure is in excess of 300 billion KES.

In his speech, the Minister undertook to scale up infrastructure investments noting that these are "the building blocks needed to achieve a more lasting and stable growth". Infrastructure investment has a direct impact on other aspects of the economy such as helping to reduce poverty, facilitate trade, generate employment and increase activity in the building and construction sector.

Infrastructure budget allocation over the years in billions KES



The importance attached to improving infrastructure is telling as it was the second economic challenge that the Minister sought to address, after specifying the measures aimed at keeping the global economic crisis at bay.

Over the past two financial years, infrastructure projects expenditure allocation has increased by over 62%. This shows the Government's desire to improve the infrastructure that has often been cited by the private sector as one of the key impediments to country's economic competitiveness.

The energy sector gets the highest increased allocation.

The minister mentioned the sectors requiring specific attention such as roads, energy, railways and ports. This is unsurprising as each of these sub-sectors is seriously underperforming.

Energy Sector

With an allocation of 79.9 billion KES, the energy sector gets the highest increased allocation in financing for the physical infrastructure. Energy costs have been cited as a key obstacle to growth and the allocation would go some way in addressing some of the problems that the sector faces.

In the electricity subsector, the country envisages growing the installed capacity to 17,000 MW by 2030 from current 1,500 MW. There are significant efforts to increase the geothermal and renewable sources of energy and we expect some of the funding to be allocated towards this cause.

The transmission and distribution system also requires significant investment to stabilise the often unstable system. For electricity tariffs to decrease to enhance the country's competitiveness, significant investments would be required over the coming years. We should therefore not expect the cost of energy to decrease significantly over the year as this requires sustained investment over a number of years.

The Minister also mentioned resources being provided for oil infrastructure to facilitate export of services in the oil sector for the region. It is unclear whether these are specific for the existing pipeline, oil storage facilities or the envisaged Lamu-Sudan oil pipeline.

Transport

In his budget statement, the Minister has allocated a significant 123.6 billion KES for rehabilitating and expanding the road network. This is an 18% increment over last year continuing the recent emphasis that the Government has placed on the roads sector improvement projects.

The amount includes a 2.0 billion KES allocation for the Lamu Port South Sudan Ethiopia (LAPSSET) project underpinning the importance the country is placing on this transport corridor.

To improve urban commuter rail transport 1.5 billion KES has been allocated to the Urban Commuter Rail for the completion of the Jomo Kenyatta International Airport (JKIA) link to the Central Rail Station. Once complete, this would ease transport between the City Centre and the Airport, and connect to the Syokimau Station.

The rest of the transport subsector was allocated 18.8 billion KES. The budget statement did not provide additional information on this expenditure, but the Minister emphasised the need to improve rail, ports and air transport.

Among the measures the minister mentioned were rationalisation of goods transportation including reducing and / or relocating weighbridges near the ports of entry. Given the importance of Mombasa port to regional trade and the current inefficiencies and congestion, it would have been good had the Minister elaborated on how the port efficiency could be further improved.

Other infrastructure sub sectors

The budget statement has an allocation of 7.2 billion KES for the Kenya ICT board, 21.5 billion KES to the local government for improving urban infrastructure under the local authorities as well as 8.9 billion KES for other unspecified physical infrastructure projects.

Infrastructure expenditure absorption capacity

The amount of infrastructure allocation over the past few years has been significant, more than doubling over the past few years.

However the ability to absorb the infrastructure spending could be questioned in a number of areas.

The ability for the infrastructure ministries to spend the allocations made to them is dependent on their absorption capacity. The expenditure saturation point can be caused by a number of factors.

First is the capacity to undertake the projects within the time available. This includes both human and other resources required to undertake these projects. Although there is no data available, it is acknowledged that some projects, such as geothermal energy projects are being hampered by the lack geophysicists and geotechnical engineers as well as lack of specialised drilling equipment. There also appears to be limited capacity on some of the core raw materials, such as cement from the limited production.

This has denied the economy the trickledown effect that the spending would have created to spur growth.

The Minister acknowledged that there are implementation challenges for infrastructure projects. A long procurement period is one such challenge. Procurement of infrastructure would ordinarily be undertaken under the *Public Procurement and Disposal Act* that spells onerous procedures needing to be followed.

To address the implementation challenges, the Minister spoke of a framework that will be developed and institutionalised to facilitate efficient planning and management of public sector investment projects. Although no further details were provided, we anticipate part of the framework would include streamlining the Act as well as strengthening the PPP unit to appropriately oversee the PPP investments.

The need for private sector investment

In his speech, the Minister recognised the limited public resources at the disposal of the Government for it carry out the necessary infrastructure investments. As such, the Minister reiterated the need to rely on the private sector to make some of the investments in infrastructure by promoting a "robust public private partnership (PPP) agenda".

This is not new. It is a central theme in Vision 2030 and has received sufficient attention in the previous budget and policy pronouncements since the launch of the Vision 2030 document in 2008.

Four years on, we have seen little actual investment from the private sector. The problems afflicting the global economy have not helped – with investors more wary of investing in risky markets and demanding more premiums in what would have been stable and safe infrastructure projects.

One therefore wonders whether the desire to tap into private sector for infrastructure financing is not a mirage.

To his credit, the Minister sought to address some of the issues that hinder the private sector participation by undertaking reforms that would improve the public service. Specifically, the Minister indicated that the PPP bill would soon be tabled in Parliament. Until this legislation is enacted, we see few PPPs projects on the horizon as uncertainty on their procurement and implementation continues.

The long gestation and procurement of PPPs would still remain a challenge for the country and requires significant attention. For example the Nairobi Road Transport Project procurement was started in 2002 only to be abandoned in 2010.

The PPDA Act, under which most projects are currently procured, is onerous and has often been cited as a key obstacle in faster procurement of the projects. It is welcome that the Minister has indicated that there will be reforms within the PPA.

Further undertaking a PPP project is indeed a political process requiring significant political will. With the looming elections, we do not expect to see many PPPs projects especially for core infrastructure within the fiscal year 2012/13.