

**Kenya's Radical Licensing Reforms, 2005-2007:**

**Design, Results, and Lessons Learned**

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## **Executive Summary**

In 2005, the government of Kenya launched an innovative reform to reduce its growing number of business licenses and fees, and the corruption connected to those instruments. With the support of FIAS/World Bank, private sector leaders, and a leading international consultancy, the government moved beyond previous strategies based on reforming licenses one at a time, and adapted a broad “guillotine approach” to rapidly identify, review, and streamline all business licenses and associated fees in Kenya.

A central reform committee was created under authority of the Ministry of Finance, and a government-wide program began. The first task was to assemble Kenya’s first complete inventory of licenses and fees. Ultimately, 1,325 licenses were identified by the committee, far more than originally expected. Over two years, the committee worked with more than 240 regulators across the public sector to help them comply with the circular issued by the Government, and brought additional expertise into the reform process by involving sector and other experts to carry out more detailed reviews of licenses in certain sectors.

Many licenses were found to be unneeded, illegal, or unnecessarily costly. Recommendations of the committee for large-scale changes were accepted by the Government, and the process of legal implementation is underway. As of October 2007, 315 licenses have been eliminated and 379 simplified. A total of 294 licenses were retained. Out the remaining licenses, approximately 300 licenses have been deferred due to new Bills under preparation or new Laws already passed, and 25 were re-classified and not counted as a license. Results from the licensing reform were a key contributor to Kenya’s status as a top reformer in the World Bank’s 2008 Doing Business Report.

The broad approach, core competencies, and support in the political economy that were developed in the licensing reform have been instrumental in expanding the reform from one focused on instruments (licenses) to an even broader one focused on improving the capacities of regulatory institutions to continue to regulate better in future. The Government announced the development of a broad-based Regulatory Reform Strategy that will build up skills for regulatory impact analysis, regulatory quality control, and, among other goals, attempt to reduce costs of government “red tape” by a further 25% by 2010.

This paper reports on the design, development and evolution of the reform over its two-year history, identifies its strengths and weaknesses, and concludes with lessons that might be useful for countries wishing to initiate broader and faster reforms to inefficient and pervasive regulatory regimes that are highly resistant to change.

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**I. Context of reform in Kenya: political economy, challenges and goals**

1. Reforming the business environment is a broad agenda, but at its core is legal or regulatory reform aimed at reducing regulatory costs, barriers to entry, legal risks and uncertainties, and associated costs of corruption. At the same time, such reform must safeguard or enhance the capacities of the government to protect legitimate public interests such as health, safety, and the environment.

2. Regulatory systems in many countries have grown beyond quality control or even measurement. Kenya is a case in point. A study done a few years ago identified around 300 licensing requirements. Yet the true scope of licensing regulation was far larger. The comprehensive inventory done under this reform found that Kenya's businesses face well over 1,300 business licenses and associated fees imposed by more than 60 government agencies and 175 local governments, and regulators were continually producing new licenses.

3. The result was that businesses were overwhelmed with licenses, fees, and compliance costs. Many diagnostics had concluded that the bureaucratic procedures associated with licenses had increased the cost of doing business and contributed to making the private sector less competitive, and were, in fact, the single most important regulatory constraint to doing business.

4. One reason for the growing problem was that the ministries and regulatory bodies, including at local levels, had a direct financial interest in creating new licenses and business fees because these revenues support staff salaries and increased opportunities for corruption. FIAS had concluded in its review of administrative barriers in Kenya that one of the most burdensome licenses, the single business permit, was "a tax by nature, not a real license.... the local government is solely interested in the collection of revenues, since the SBP is their main source of income."

5. Some reforms to specific licenses had been carried out over ten years, but businesses felt no improvement. In fact, some reforms made things worse. After years of effort to improve the single business permit, the 2004 Index of Economic Freedom concluded, "Businesses complain that they sometimes have to "pay more for a single business permit than they have paid before for many trading licences."

6. By 2004, there was a growing consensus among reformers that it was time to consider bolder and more aggressive reforms. This was partly a consequence of changes in the political environment created by Kenya's first president in almost 25 years, and partly due to growing fears of Kenya's declining competitiveness, not only globally but also in Africa. There were concerns that Uganda and Tanzania had moved ahead of Kenya on business environment reforms. The time was ripe in Kenya for more radical reform.

## II. Principles and design of the licensing reform

7. Many countries have launched regulatory reforms targeted at a few priority regulatory constraints, partly in hopes that small reforms will build a momentum for bigger reform, and partly due to the belief that big reforms aren't possible in regulatory systems that are highly captured and resistant to change. Yet small reforms to big and expanding regulatory systems will not substantially nor sustainably improve the business environment. Reforms aimed at single processes and rules will never catch up with the productive capacities and incentives of governments to create regulations and controls. The issue is clearly a systemic one.

8. For that reason, the licensing reform in Kenya was based on ambitious and broad reforms that would produce large short-term pay-offs, but also create systemic improvements to how the government regulates into the future. The principles of the reform were adapted by Jacobs and Associates and FIAS from the guillotine approach that has been used in other countries since the 1980s.<sup>2</sup>

9. The reform was designed around several principles:

- A complete picture of the licensing system was needed to understand impacts on businesses and to structure the reform process. This required that an orderly and transparent process of counting licenses be implemented across all public bodies with licensing authority.
- Once counted, the licenses should be rapidly reviewed against clear criteria by a neutral body to ensure consistency and review quality across the government.
- The burden of proof would not be on reformers to show why change is needed, but on regulators to show why a license should be maintained. The role of the neutral body would be to determine that the burden of proof had been met. This reversal of the burden of proof appropriately requires regulators themselves to demonstrate that they are acting in the public interest as a condition of maintaining their regulations.
- Complete transparency and extensive stakeholder participation would help to ensure that the reviews were credible, realistic and factual, and would create new allies for reform and a public momentum to sustain progress.
- At the end of the process, any license that is not successfully justified as legal and needed for future policy needs for market-led development would be eliminated, and any license that is needed but not business-friendly will be

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<sup>2</sup> The guillotine approach was pioneered by Sweden in the 1980s, and also used successfully by Korea and Mexico in the 1990s. Jacobs and Associates used these experiences to develop a systematic, practical guillotine process that can be widely applied in different countries. Regulatory Guillotine™ is an international trademark of Jacobs and Associates.

simplified to the extent possible. The careful process of vetting licenses would ensure that licenses needed for public protection would be maintained, and even improved.

- The first review would be followed by institutionalizing these controls and quality standards into the policy process so that new licenses adopted in the future would be justified as necessary, legal, and business friendly.

### **III. Process of the reform: difficulties and evolution**

10. The Kenyan Ministry of Finance issued on 24 February 2005 a circular to 178 ministries and public bodies throughout the public sector. The circular, titled “Streamlining the regulatory environment for business activity”, launched the licensing reform and established the Working Committee on Regulatory Reforms for Business Activity in Kenya to carry it out.<sup>3</sup> There was substantial preparation for the circular at the political level. The two key players -- the Permanent Secretaries of the Ministry of Trade and Industry and the Ministry of Finance – were supported by a reform coalition made up of high-level representatives of the Attorney General’s Office, the Kenya Law Reform Commission, and the Investment Promotion Agency.

11. The mandate of the Committee work was to carry out a comprehensive review of all business licenses and fees in Kenya, and to develop recommendations on how to assure that the results of the licensing reform would not be undermined by a wave of new licenses. The Government mandate directed the Committee to:

- focus on licences as a particularly damaging form of government regulation;
- use the guillotine strategy to identify all business licences in Kenya;
- select 50 licences for review in the first phase; and
- submit the first set of recommendations by 22 April 2005.

12. The Committee immediately set to work, and it quickly became apparent that the reform would be driven mostly by the Committee itself, working with a wide range of stakeholders with various incentives. Over two years, the Committee carried out most of the research needed to identify and analyze 1,325 licenses. It worked with more than 240 regulators to help them comply with the circular issued by the Government, and brought substantial additional expertise into the reform process by involving sector and

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<sup>3</sup> The Committee comprised of a team led by Ben Musau (Senior Partner, B M & Co.), Hezekiah Okeyo (MoTI), Christine Agimba (Deputy Solicitor-General, State Law Office), Josephine Kanyi (MoF), Valeria Onyango (Commissioner, KLRC), Catherine Munyao (KLRC), Gad Awuonda (State Law Office), Jacob Gumba (MoF), Joshua Kimulu (MoTI), Micah Kilonzo (MoLG) and Peter Ng’ang’a (MoLG). Morris Kimuli (B M & Co.), Andrew Mwaura (B M & Co.), Peter Biwott (MoTI), Robert Nyaga (MoF) and Richard Gakunya (MoF) provided assistance to the Committee.

other experts to carry out more detailed reviews of licenses in certain sectors (tourism, agriculture, local government and environment).

13. The Committee conducted the reforms in three phases. In phase I, which required 4 months, the Committee reviewed and made recommendations on 86 high priority licenses. In phase II, which required 9 months, the Committee reviewed the remaining licenses, about 1,300. In phase III, which required 12 months, the Committee carried out several related activities, namely:

- Completing the business licensing review carry over from phase I and II by preparing the legal materials for formal adoption, and liaison with the budget team in the Ministry of Finance to ensure that revenue impacts were fully taken into account in the budgeting process;
- Preparing and implementing a medium term regulatory reform strategy to:
  - Create an Electronic Consolidated Regulatory Registry for all business licenses;
  - Establish a permanent Business Regulatory Reform Unit to vet future business licenses as well as implementing a Regulatory Impact Assessment policy for existing and future business licenses; and
  - Draft a Business Regulation Bill to give the electronic registry “positive legal security,” meaning that registration of a license would be necessary before it could be enforced against businesses.

14. Importantly, the work of the Committee was based on an extensive consultative process with stakeholders from the public and private sectors, including public hearings that attracted much attention from the media. Special efforts were devoted to address the licenses which the private sector found particularly burdensome. At the request of the Committee, the private sector established a list of the 26 most burdensome business licenses in Kenya. The specific concerns of the private sector were addressed through intensive dialogue and several iterations specifically aimed at the “top 26 list”.

15. In the initial stages, there was much resistance to the reform from public bodies and regulators who feared the reforms would reduce rent-seeking opportunities and reduce licensing revenues. This resistance was partly reduced by the fact that, as part of its thorough, transparent, and independent review, the Committee actively invited information and explanations from the responsible bodies before reaching a decision.

#### **IV. Role of donors in supporting the reform**

16. Donor support added substantial value in Kenya to several of the key success factors for regulatory reform: (i) strong commitment to reform at a high political level; (ii) development and adoption of a comprehensive reform strategy shared by a broad range of local stakeholders; and (iii) availability of sufficient technical expertise, knowledge, and skills to conduct regulatory reviews of existing regulatory stock and improve the quality of regulatory flows.

17. The donor support to Kenya's Licensing Reform has been characterized by a long-term, coordinated support from two World Bank Group units: the Foreign Investment Advisory Service (FIAS) provided and coordinated technical assistance, and the World Bank used traditional tools and policy leverage to encourage the reform. In addition, the reform has been co-funded by the British Department for International Development (DFID) since 2005. DFID and possibly other donors are expected to co-fund the expansion of the licensing reform into the broader and deeper regulatory reforms needed to sustain and expand the gains made from the guillotine phase.

18. A 2004-2005 Administrative Barriers Study by FIAS identified business licenses as a key regulatory constraint for businesses and brought the issue of licensing to the attention of senior policy makers and donors. A World Bank Poverty Reduction Support Credit (PRSC) prepared in 2005 picked up on the FIAS report. The PRSC conditioned that 50 business licenses be identified and reviewed in preparation of the credit. Funds from a Japanese Policy and Human and Human Resource Development (PHRD) grant were then made available to support the licensing reform. Although the PRSC credit was subsequently put on hold and cancelled, and only required 50 licenses to be reviewed, the World Bank conditionality was instrumental in obtaining the attention and support of Ministers for the reform.

19. FIAS, in close cooperation with the World Bank, led the technical support to licensing reform since 2005 with input from external consultants, including Jacobs and Associates. Support has included policy advice to the Ministry of Finance and Trade and Industry; around a dozen reports to the Licensing Committee; and day-to-day technical support to the Licensing Committee and the Ministry of Finance.

20. The licensing reform and subsequent spin-offs have been incorporated in Kenya's Private Sector Development Strategy (PSDS). The PSDS, officially finalized and launched in 2007, has been strongly supported by PSD supporting donors with presence in Kenya.

## **VI. Results of the licensing reform**

21. On 5 March 2007, the Committee tabled its final report to the Minister for Finance, the Minister for Trade & Industry, and the Attorney General. The report marked the end of almost two years of work identifying and reviewing business licenses, and including recommendations for an appropriate institutional framework to support the sustainability of the reforms. Many of the recommendations of the Committee were then politically endorsed and implemented through the Minister for Finance's Budget Speech in June 2007.<sup>4</sup>

22. As of October 2007, results of the licensing reform are:

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<sup>4</sup> The Minister for Finance's Budget Speech in 2005 and 2006 were also used to implement or announce preliminary results and recommendations of the Licensing Committee in the two previous years.

- A first-ever identification and review of all of business licenses in Kenya (a total of 1,325)
- 315 licenses eliminated
- 379 licenses simplified

23. A total of 294 licenses were retained. Out of the remaining licenses, approximately 300 licenses have been deferred due to new bills under preparation or new laws already passed, and 25 were re-classified and not counted as a licenses.

24. The costs to businesses of these reforms have not been quantitatively assessed. While some of the licenses impose trivial burdens, a number of recommendations of the Committee will significantly reduce regulatory costs and risks for businesses and investors:

- In agreement with the Immigration Department, and to allow for a more flexible system for approval of entry permit, the Committee proposed the creation of an interim work permit for certain permit classes;
- In agreement with representatives for the local authorities and the Ministry for Local Government, and to address numerous complaints and concerns of businesses stemming from harassment by local inspectors, all local government advertising licenses (with the exception of billboards) were proposed to be eliminated and replaced by standards.
- To address massive duplication of licenses in the transport sector, the Committee proposed to consolidate the road service license with the public service vehicle license.

25. In addition to the review and reform of pre-existing licenses, the following institutional initiatives, following the OECD agenda of good regulatory practices, have been announced or are in advanced stages of development:

- A permanent Business Regulatory Reform Unit in the Ministry of Finance charged with vetting new business regulation and developing and implementing a Regulatory Reform Strategy;
- An Electronic Regulatory Register in the Ministry of Finance functioning as a depository for all legal business licenses

**The Electronic Regulatory Registry**

Kenya's Electronic Regulatory Registry will host all valid business licenses. Licenses not in the registry cannot be enforced (positive security). The registry will:

- Serve as the national repository for license requirements in Kenya (single point of information);
- Provide easy access to information for the business community (facilitate transparency);
- Provide timely, correct and complete information about license requirements (what is not in the registry is not enforceable);
- Be a tool for sharing information among regulatory authorities (the public-public communication);
- Serve statistical purposes by sorting information by business code and geographical codes.

- Formalised mechanisms for the review of new business regulation – a system for Regulatory Impact Assessment (RIA)
- Development of a Regulatory Reform Strategy setting out key priorities and targets for regulatory reform over the next 3-5 years

26. A Business Regulation Bill scheduled to be tabled for Parliament late 2007 or early 2008 will provide the legal underpinnings for the Review Unit in the Ministry of Finance, for the E-Registry and for the RIA system.

## VII. Lessons learned about implementing radical licensing reforms

27. Conventional wisdom would warrant caution in trying to generalize lessons from one particular reform in a very country-specific context beyond the case in question. However in the view of the authors, who have helped design and implement similar reforms in more than 50 countries, the following lessons from Kenya captures a number of general learning points for regulatory reforms in all constituencies:

- **Getting the scope right.** Businesses do not face one or even a dozen licenses. They face hundreds or thousands. Effective reform of the regulatory function of government means understanding the scope of the problem and designing the reform to meaningfully affect the business environment. Effective reform usually should encompass a much broader scope in terms of institutions and instruments than is usually seen.
- **Measuring the problem.** It is impossible to address a problem unless it is accurately measured. One of the reasons that the guillotine in Kenya worked so well is that a comprehensive inventory, never before done, revealed a problem far larger and more serious than originally understood. This stimulated political and public support for the reform, and help to resist pressures to exempt pieces of the regulatory environment. The comprehensive inventory not only helped track the progress of the reform and improve overall transparency in performance, it also created the basis for further reforms such as the electronic registry, and quality controls on any new licenses.
- **Getting incentives right – reversal of the burden of proof.** How does one assure that reluctant regulatory agencies “play along” with the reform, and contribute to reducing the traditional information asymmetry between regulators and reformers? One way is for the reformers to credibly declare that all regulation will be repealed and eliminated, unless the “owners” of the regulation – the regulatory agency – can *prove* that the regulation in question is consistent with, for example, government principles for good regulation. This principle (a.k.a. “a regulatory guillotine”) was also at the core of the original design of the licensing reform in Kenya. Although there was no legal underpinning of the guillotine approach, the principle of staged repeals played an important role in activating reluctant reformers.

- **There is no autopilot for reform.** Regardless the design and the institutional set-up supporting reform, successful implementation relies on strong and consistent political support *as well as* the constant availability of technical capacities to champion and drive reforms on a daily basis.
- **Centre-of-government leadership is essential, such as from the Ministry of Finance and with a link to Budget process.** In 2006, the leading role in Kenya’s licensing reform was smoothly transitioned from the Ministry of Trade and Industry to the Ministry of Finance. The leading role of the Ministry of Finance seems to have increased the leverage of Licensing Committee, and facilitated the subsequent political vetting of the Committee’s recommendations. Possible (and likely) delays in Parliamentary process were avoided by using the Budget Speech and legislation linked to the passing of the Budget as the main political and legislative vehicle for implementing the reform;<sup>5</sup>
- **Early and visible results create appetite for more reform.** The early and visible results of the licensing reform delivered in the spring of 2005 were relatively insignificant in terms of impact and controversy. However it is likely that they generated the political attention and capital required to extend and expand the mandate of the Licensing Committee in the autumn of 2005.

### VIII. Conclusions: What role for radical reforms?

28. The regulatory guillotine is only one example of the kinds of reforms that can simultaneously produce both short-term results, and lay a foundation for sustainable change. The results in Kenya that are presented in this paper, and seen in other developing countries,<sup>6</sup> show that, given the right conditions such as administrative and legal strategies combined with political commitment, the guillotine can be adapted and work well. This is a tool that merits further attention, assessment, and implementation.

29. Broad solutions, even “radical” solutions to improving the regulatory environment can work better than small reforms, contrary to established wisdom. It should by now be clear to reformers that narrow and one-off reforms to reduce regulatory and administrative costs do not generally produce sustainable and visible results in better business environments (results here mean meaningful changes to the costs and risks facing businesses in domestic markets sufficient to change commercial incentives and business behaviour). It is also clear that unsystematic and ad hoc reforms, such as

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<sup>5</sup> Similar conclusions are made in the World Bank Group’s recent review of the Dutch Government’s program to reduce administrative burdens, cf. Ladegaard, Djankov, McLiesh (2007)

<sup>6</sup> Scott Jacobs and Irina Astrakhan (2006)

attacking a few selected reforms, and reforms that are bottom-up and driven by insider interests, are likely to fail in producing visible benefits.

30. Yet governments and donors continue to find narrow and one-off reforms to be very appealing because such reforms seem to promise rapid results and provide quick fixes to highly visible regulatory problems. This pressure for the “quick fix,” rather than investment in sustainable institutions and capacities, is unlikely to abate, particularly given the emphasis today on short-term and process-specific indicators of the business environment. This is not a criticism of those indicators, but the conclusion is that an effective regulatory reform strategy cannot be based solely on improving relative performance in indicators of a few regulatory interventions.

31. The solution seems to be to develop a strategy in which short-term quick fixes feed into a sustainable reform strategy, that is, are contained within and contribute to a longer-term strategy of reform. The OECD has found that there are no exceptions to the rule that, to keep reform on track, a clear medium-term map for regulatory reform must be developed. The business environment can be improved only with a determined, coordinated and strategic approach based on market principles and reform authority applicable across the whole of the administration. This is not an argument for a “Big Bang” approach. Tactically, the government might start with small, manageable reforms that can be accomplished rapidly, but the big picture over a few years is important to keep reform moving in the right direction and to reassure investors.

## References

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## **Annex 1: Authors of this paper**

**Scott H. Jacobs** helped design the reform of licenses and fees in Kenya, as a consultant for the World Bank. Mr. Jacobs is among the leading international experts on regulatory reform. Over 22 years, he has worked with 75 countries in Europe, Asia, Africa, and the Americas in designing and implementing regulatory reforms. He has written 20 books and many articles, and spoken at conferences worldwide. Working with 30 countries, he developed and directed the Program on Regulatory Reform in the Paris-based Organisation for Economic Co-Operation and Development (OECD) from 1995 to 2001. At the OECD, he wrote the first international standard on regulatory quality. He is currently the Managing Director of Jacobs and Associates, an international consulting firm specializing in regulatory reform and good business environments. Jacobs and Associates is based in Washington, D.C., Dublin, and Seoul, and serves government and corporate clients (see its website at [www.regulatoryreform.com](http://www.regulatoryreform.com)).

**Peter Ladegaard** has led FIAS' technical assistance and policy advice on regulatory reform to the Government of Kenya since May 2005. In cooperation with Chair of the Working Committee on Regulatory Reforms for Business Activity in Kenya, Mr. Ladegaard has helped design and continuously adapt the licensing reform to changing circumstances. At FIAS of the World Bank Group, Mr. Ladegaard is a senior investment policy officer, and specializes in policy advice and technical assistance on regulatory management and reform. In addition to directly client-related activities, he leads a number of research and knowledge management projects within the World Bank Group. Until joining the Bank in April 2005, Mr. Ladegaard worked for OECD's Regulatory Reform Program. At the OECD, he coordinated and drafted a series of regulatory reform country reviews as well as comparative studies on regulatory governance, administrative simplification, and institutional design of sectoral regulators. Mr. Ladegaard has also worked as a management consultant and for the Danish Ministry of Finance. He holds an MA in Political Science. He currently lives in Washington DC.

**Ben Musau** served as Chair of the Working Committee on Regulatory Reforms for Business Activity in Kenya. An Advocate and Senior Partner of B.M. Musau & Co. Advocates in Nairobi, Mr. Musau is a Kenyan lawyer who has worked in Kenyan law reform, law-drafting, corporate governance, and business-oriented regulatory reforms. Mr. Musau's work encompasses the structure of business entities, joint ventures, acquisitions, banking, foreign investment and other general corporate areas. He has acted as a consultant for KIPPRA and the Kenya Law Reform Commission in facilitating investment in Kenya. As a FIAS/World Bank consultant, Mr Musau has been instrumental in the improvement of the Kenya Doing Business Indicators. He is also involved in the regulatory reforms taking place in Sudan, Tanzania and Madagascar.