Renewable energy project financing risks in developing countries: Options for Kenya towards the realization of vision 2030

Charles M. Rambo
Department of Extra Mural Studies, University of Nairobi, P.O. Box 30197, Nairobi, Kenya.
E-mail: rambocharles@yahoo.com, crambo@uonbi.ac.ke. Tel: +254 020 318 262.

About 90% of global energy supply comes from carbon-based fuels which are associated with environmental issues such as climate change and global warming, with far-reaching consequences on the ecosystems and humans. Projections show that a dramatic increase in the global energy demand by 2050 is inevitable, especially in developing countries. Although renewable energy sources form the basis of sustainable development, a lot of investments are still directed towards carbon-based energy technologies. The development of renewable energy systems is a capital-intensive process that most developing countries cannot undertake without financial support from development partners. However, endemic investment risks remain key impediments to investors as well as the exploitation of multilateral funding initiatives such as the Green Climate Fund and Clean Development Mechanism. This paper examined secondary literature on the typical investment risks on developing countries and makes recommendations for Kenya and other African countries to create an environment that is not only safe but also promising to investors. The investment risks emerging from the literature include political instability, low-carbon policy and currency value fluctuation, monopolization of energy production, transmission and distribution, as well as community non-involvement. Based on the identified risks, the study recommends the need for the Government to secure a sustainable political stability, strengthen laws and policies promoting foreign investment, establish currency-hedging mechanism, open-up renewable energy market and promote community involvement renewable energy projects.

INTRODUCTION

Kenya’s Vision 2030 is the national development blueprint, initiated to transform the country into a newly industrializing, middle-income economy by the year 2030. The Vision is founded on three pillars of economic, social and political development. The economic pillar is aimed at improving the living standards for all Kenyans through an economic development program, through which the country is expected to achieve an average Gross Domestic Product (GDP) growth rate of 10% by the year 2030 [Government of Kenya (GoK), 2007]. The level of economic development determines the intensity of energy use; as economic systems in developing countries expand, so is the demand for energy to power production activities (Winkler, 2005; UN-Energy/Africa, 2011). The Kenya Vision 2030 identifies energy as one of the key infrastructural enablers, necessary for the realization of its objectives (GoK, 2007; 2012a). In view of this, the economic development program mooted in the Vision is expected to increase demand on Kenya’s energy supply. Currently, energy
shortages and supply disruptions coupled with high cost remain serious obstacles to the manufacturing sector (GoK, 2012a).

In liberalized markets, the cost of energy significantly influences the competitiveness of local products vis-à-vis imported goods. Consequently, a high cost of energy negatively affects domestic wealth creation, balance of payments and employment creation, as consumers opt for cheaper imports (GoK, 2012a; Karekezi and Kimani, 2009). This scenario necessitates the establishment of new projects to step-up energy supply at a lower cost and increase efficiency in energy consumption (GoK, 2012a). Universal access to sustainable, affordable and clean energy is instrumental for the realization of Kenya’s Vision 2030 (GoK, 2012a).

RENEWABLE ENERGY AND DEVELOPMENT

That energy is essential for economic and social development needs no further emphasis. About 90% of the global energy supply comes from carbon-based fuels, but whose emissions are associated with environmental pollution, increase in global temperature and disruption of climatic patterns. Projections show that a dramatic increase in the global energy demand by 2050 is inevitable, especially in developing countries (UNEP, 2012). Nonetheless, the current and future energy demand remains unsustainable, particularly because carbon-based fuels are fast running out (Pegels, 2009). Sustainable economic development in all countries will better be achieved by replacing carbon-based fuels with renewable energy technologies (Pegels, 2009; UNEnergy/Africa, 2011).

The United Nations Framework Convention on Climate Change (UNFCCC) associates renewable energy technologies with clean and sustainable development, as documented in Article 12 of the Kyoto Protocol (UNFCCC, 2008). Renewable energy has the potential to enhance energy security, mitigate climate change, create employment and enable developing countries make substantial foreign exchange savings (Winkler, 2005; UNEP, 2012; Weiss, 2011; GoK, 2012a). However, a lot of public and private sector investments are still directed towards carbon-based energy sources, even where renewable technologies are technically and economically feasible (Pegels, 2009; AfDB, 2010; UNEnergy/Africa, 2011).

In Kenya, renewable energy resources include solar, hydro, geothermal, wind and bagasse, as well as tidal waves and municipal waste (GoK, 2011; 2012a; 2012b). Such resources are regenerative and can therefore provide continuous and unlimited supply of clean energy. In 2011, Kenya’s Economic Survey revealed that renewable energy accounted for 69% of the country’s electricity supply; however, the country relies heavily on hydro-electricity (GoK, 2012a). Other forms of renewable energy, including solar and wind energy have not made as much contribution due to lack of promotion, unavailability of data and the high cost of setting up the necessary infrastructural requirements (GoK, 2012a; 2012b).

Due to climate change, water volume in hydro-electricity generating dams in Kenya has been fluctuating as a result of recurrent and prolonged droughts. Fluctuation in water volume often affects power supply during drought, leading to rationing in most parts of the country, including industrial zones, where continuous supply is necessary (GoK, 2012b). Furthermore, the Economic Survey 2011 indicated that wood fuel accounts for about 70% of the total national energy demand in Kenya, which raises concern about issues such as environmental degradation and desertification (GoK, 2012a; 2012b). Such circumstances may not favour a country that looks forward to becoming a middle class economy by the year 2030; and necessitates diversification to other forms of renewable energy, including wind and solar to bridge the power supply gap.

THE CHALLENGE WITH RENEWABLE ENERGY PROJECTS

The transition process to cleaner renewable energy technologies in developing countries is constrained by a number of challenges, which are of great concern to energy economists and financial management specialists. Renewable energy projects are capital intensive and many developing countries may not have adequate resources and expertise to establish the necessary infrastructure (Winkler, 2005; Pegels, 2009; UNEnergy/Africa, 2011). Among the challenges are market investment risks, which discourage foreign investors, as well as development agencies from financing renewable energy projects. Such challenges should be identified and addressed to pave way for foreign investments in renewable energy projects (UNEP, 2012).

To finance renewable energy projects, most developing countries have to look beyond their borders for foreign investors as well as development agencies. On the other hand, project financiers (whether they are individuals or institutions), often assess and develop a risk profile of countries requesting for funding (Pegels, 2009). It is not a secret that a lot of such projects have failed to take off, simply because of heavy risk profile of the countries requesting for funding (UNEnergy/Africa, 2011; UNEP, 2012). The risk profile analysis is critical for foreign investors and financial institutions; it acts as a filter in many financial decision-making processes and involves a broad assessment of the political, legal and macroeconomic landscape (Pegels, 2009; UNEP, 2012).
Figure 1 shows a typical risk assessment and lending cycle of renewable energy projects in developing countries.

The market for renewable energy technologies in developing countries remains young and undiversified, which affects the returns on capital. Non-diversification has resulted in heavy dependence on carbon-based and particular renewable energy sources such as hydro-electricity, both of which are not suitable for ambitious economies. Besides, if renewable energy projects are anchored on political initiatives such as feed-in-tariff schemes, there will be uncertainty about the effect of legislative change on the economics of renewable energy projects (Pegels, 2009). Because feed-in-tariff schemes are market creations, their introduction in renewable energy projects exacerbates the market risk. Technology risks arise from the fact that renewable energy technology is still in its infancy in most developing countries. Without proper legal and policy backing, renewable energy projects are bound to fail, leading to reputational risks. These factors are considered by investors while making investment decisions for renewable energy projects (Pegels, 2009).

STRATEGIES PROMOTING INVESTMENT IN RENEWABLE ENERGY PROJECTS IN KENYA

Kenya has a huge potential for renewable energy resources; however, their exploitation has been rather slow (Karekezi and Kimani, 2009). To encourage foreign investments, the Government has taken a number of measures, including formulation of the National Energy Policy, as articulated in the Sessional Paper No. 4 of 2004 and operationalized by the Energy Act No. 12 of 2006; a feed-in-tariff policy, as well as establishing a Green Energy Facility to pool local and international resources to finance renewable energy projects (Karekezi and Kimani, 2009; GoK, 2012b). The Feed-in-Tariff policy, which was developed in 2008 and revised in 2010 and 2012, allows renewable energy power producers to sell electricity to the distributor, the Kenya Electricity Transmitting Company (KETRACO) at a pre-determined tariff for a given period of time. Among other objectives, the policy provides for investment security and market stability for investors in electricity generation from renewable energy sources (GoK, 2011).

The Government has also undertaken far-reaching restructuring and reforms in the energy sector, which include the unbundling of a vertically-integrated monopoly in power production, involvement of private power producers, separation of power production, transmission and distribution, commercialization of power distribution, as well as establishment of an independent energy regulator. After the reforms process, key players in the energy sector includes the Ministry of Energy (MoE), Energy Regulatory Commission (ERC), Rural Electrification Authority (REA), Kenya Electricity Generating Company (KenGen), Kenyan Power and Lighting Company (KPLC), Kenya Electricity Transmission Company (KETRACO), Geothermal Development Company (GDC), Independent Power Producers (IPPs), and the Energy Tribunal. The institutional framework is as indicated in Figure 2.
Besides the energy sector reforms, Kenya recently enacted a new constitution, which is expected to expedite the realization of political and macro-economic stability. As noted by Moreira (2009), political instability can significantly curtail the flow of foreign direct investments by increasing uncertainty about cost and profitability of investments. Political instability subsumes events such as antigovernment demonstrations, assassinations, cabinet changes, sudden constitutional changes, coups, government crises, purges, revolutions and riots (Moreira, 2009). The likely results of such events may include currency crashes, double digit inflation and excessive budget deficits, making the investment environment unattractive (Krugell, 2005).

Alongside the new constitution, reforms have targeted the structural organization of specific institutions, including the judiciary, police, anticorruption agency and public service, all of which play a crucial role in the realization of political and macro-economic stability. With regard to investments in renewable energy, whereas the judiciary is responsible for the protection of property rights, the institution of police is crucial in law enforcement, while the anticorruption agency is anticipated to reduce cases of extortion of investors by public servants. The reforms processes have been particularly necessary after the 2007/08 post election violence, which reduced the flow of foreign investments into the country.

STATEMENT OF THE PROBLEM

The bulk of global energy supply comes from carbon-based fuels, but whose emissions threaten the global climate, environment, human health and earth’s very existence (UN-Energy/Africa, 2011; UNEP, 2012). Besides, carbon-based fuel reserves are fast running out and may not effectively cope with the future demand for energy, which is expected to increase dramatically by the year 2050 (Pegels, 2009; UNEP, 2012). The deployment of renewable energy technologies in developing countries on a massive scale remains a key option for addressing challenges associated with carbon-based energy sources.

Renewable energy projects are capital-intensive initiatives that require the involvement of foreign investors and development agencies (UNFCCC, 2008; Pegels, 2009; UNEP, 2012). However, the inflow of direct foreign investments to developing countries is constrained by poor risk profiles, mainly emanating from political and macro-economic instability. As a result, most developing countries lack the capacity to attract financing for renewable energy projects as well as exploit opportunities provided by facilities such as the Green
Climate Fund and Clean Development Mechanism (UN-Energy/Africa, 2011). Identifying and addressing investment risks are fundamental for creating a business environment that is not only safe but also promising to investors (UN-Energy/Africa, 2011; UNEP, 2012).

In view of this, the Government has taken various measures to improve the investment environment, attract financing for renewable energy projects, and support the realization of Kenya’s Vision 2030 objectives. These measures include formulation of energy sector policies, legal and energy sector reforms, enactment of a new constitution and structural reforms targeting key institutions, including the judiciary, the police and the anticorruption agency (Karekezi and Kimani, 2009; GoK, 2011; 2012a; 2012b). In spite of these achievements, there is no documentation of whether Kenya has done enough to ensure a sustainable inflow of foreign investments for renewable energy projects and to improve energy supply for economic development. This paper examines investments risks in developing countries and makes recommendations for Kenya and other African countries, to improve the investment environment as well as ensure the safety and profitability of foreign investments. The paper cites experiences from various developing countries, including South Africa, Argentina, India, Mauritius, Nigeria, Senegal, Somalia, Egypt, Uganda, Mali and Ivory Coast.

The paper is based on a desk review of secondary information, including empirical studies, renewable energy project reports and policy documents. From this review, the paper highlights typical financing risks that are endemic in developing countries, lessons learnt from mitigative measures, and options available for Kenya and other African countries to improve the investment environment and attract foreign investors and development agencies, interested in financing renewable energy projects.

From the review of secondary information, it was observed that the financing of renewable energy projects in developing countries is constrained by a variety of investment risks, including political instability, low-carbon policies, currency value fluctuations, monopolization of energy production, as well as lack of community ownership of renewable energy projects. Details are presented and discussed under the following subsections.

**POLITICAL INSTABILITY RISK**

Political instability negatively influences the economic growth and social well-being of a nation. A review of pertinent literature revealed that in most developing countries, particularly in Africa, democracy is still at the early stages of evolution (Dengerink, 2011). A number of countries are yet to fully embrace the principles of democratic governance; as such, the past three decades have been characterized by transitions from autocratic to democratic governance systems (Asyan and Ersoy, 2007; Dengerink, 2011). For countries such as Uganda, Ivory Coast, Nigeria, Egypt and Mali, just to cite a few, the transition to democratic governance was not a smooth sail. The processes were characterized by intra-state conflicts, which undermined economic development (European Union, 2009; Dengerink, 2011). Similarly, Kenya’s transition from the single-party rule to multi-party democracy in the early 1990s was marred by inter-ethnic violence in certain parts of the country. Nevertheless, young African democracies remain vulnerable to intra-state conflicts due to poor governance and economic mismanagement issues. A case in point is the post election violence that rocked Kenya in 2007/08. Whereas accountable political governance have been associated with economic development, poor governance has been a key recipe for mismanagement of public resources, abuse of office, impunity and political instability (Asyan and Ersoy, 2007).

Political instability risk is more realistic in African countries than in any other parts of the world. The study found that intra-state conflicts have been linked to the destruction of renewable energy infrastructure in Mali, Ivory Coast, Somalia and Egypt, among other countries (AfDB, 2010; Environics, 2010). Furthermore, several studies have revealed a close link between political instability risk, and the level of private as well as foreign investments in the energy sector (Ramcharran, 1999; Asyan and Ersoy, 2007). According to the UN-Energy/Africa Report (2011), political instability ranks highest in the list of investment risks in developing countries, particularly in Africa.

Political instability in developing countries also associates with the risk of breach of contract between governments and project financiers. In extreme cases, renewable energy projects have been expropriated. For instance, in 2010, Malian rebel groups expropriated wind farm projects in the Northern parts of the country to boost their revenues (Government of Mali, 2012; AfDB, 2010). Political interference worsens the risk profile for investment; making the cost of investment too prohibitive and potential investors uncertain about returns on capital. This is particularly detrimental to renewable energy projects given that they are capital-intensive undertakings. Consequently, political instability is considered the primary filter by potential project financiers in their decision-making processes (Baldwin, 2006; UNEP and Partners, 2009; UN-Energy/Africa, 2011). To remain relevant as preferred investment destinations, developing countries have no choice but to build sustainable and accountable democratic structures to minimize the risk of political instability. Countries such as Mauritius and South Africa have been cited as relatively stable and promising democracies in Africa,
with immense potential to attract foreign investments for their renewable energy projects (UNEP, 2012). The success of these democracies is attributed to far-reaching constitutional and institutional reforms, which have seen political power distributed to institutions. In turn, this has enhanced accountability to the citizenry and has minimized cases of abuse of office by political leaders (Moreira, 2009).

LOW-CARBON POLICY RISK

The political instability risk, which characterizes most African countries, interconnects with legal and macro-economic challenges. In such countries, the possibility that policies and legal frameworks governing investments in renewable energy projects being altered or reversed to achieve political interests is real (UN-Energy/Africa, 2011). The review revealed that the vulnerability of renewable energy projects to political manipulation stems from the fact that they are partly anchored on state-owned institutions and mechanisms (Kamese, 2004; UNEP, 2012). In the event that lifeline incentives are discontinued or even reversed retroactively, renewable energy projects suddenly become unviable and investors are left with stranded assets (UNEP, 2012).

Low-carbon policy risk relates to the question of how credible and reliable public policies, regulation and incentives are over a period of time, and how effectively they are implemented by responsible government departments and agencies (Helm and Hepburn, 2003; UN-Energy/Africa, 2011). This type of risk has been documented in countries such as Argentina, South Africa and Senegal where feed-in-tariff levels were suddenly adjusted downwards (Girardin, 2003; Pegels, 2009; Diop, 2009). In Argentina, the main reason for such adjustments was partly due to over-generous design of the feed-in-tariffs in the first place, which allowed investors to pocket high returns (Girardin, 2003; Konttinen, 2010). In Egypt, a tax of 28% on solar photovoltaic revenues was introduced in 2010, with retroactive effect, leading to loss of investor confidence and trust in the national promotion of renewable energy technologies (Environics, 2010).

In many sub-Saharan Africa (SSA) countries, the risk of low-carbon policy is largely attributed to political instability, lack of supportive policies for renewable energy projects, as well as limited enforcement of necessary regulations (UNEP, 2012). The availability and implementation of supportive policies is critical for creating enabling environment to attract investments in renewable energy technologies. Appropriate policies should have necessary clauses to safeguard against sudden and non-consultative policy changes, particularly during regime change. Renewable energy policies and regulations may also be strengthened by establishing regulatory agencies that are independent from the central government to avoid political interference, as evidenced by documentation from Mauritius (Kirkpatrick and Parker, 2005; Mohee et al., 2012).

CURRENCY VALUE FLUCTUATION RISK

The stability of local currency is one of the filter factors informing financing decisions for renewable energy projects. The study found that currency fluctuation risk is corded with the political instability risk, which is a core challenge for young democracies (Pegels, 2009; UN-Energy/Africa, 2011). The financial markets in most developing countries, particularly in Africa, are vulnerable to negative political influence, poor governance and lack of transparency, resulting to intra-state conflicts. Consequently, financial markets in countries with a history of internal conflicts remain relatively weaker compared to conflict-free countries; thus, making them less attractive to foreign investors (Pegels, 2009; UN-Energy/Africa, 2011). Uganda is an example of countries whose currency market remains weak, 30 years after the autocratic regime of the 1970s (Kamese, 2004).

Currency fluctuation risks are particularly of greater concern for projects expected to deliver public good, such as electricity and water; especially because project cash flows are denominated in local currency, while debt service and dividend payments are effected in foreign currency. The success of renewable energy projects in developing countries is influenced by the foreign exchange risk given their novelty in countries with volatile currencies (UN-Energy/Africa, 2011).

For instance, in Argentina, the implementation of the Renewable Energy Project for Rural Electricity Markets (PERMER) was seriously undermined by the financial and economic crisis of 2002, which led to the devaluation of the Argentine Peso (Girardin, 2003). During this time, the project came to complete standstill, as the government and foreign financiers adjusted to the new situation. In view of this, a series of currency value fluctuations is likely to cause the demise of high potential energy projects (Girardin, 2003).

In Ivory Coast, a report compiled by the European Union in 2009 noted that the development of renewable energy was impeded by the high cost of investment capital, which was tied to weak local currency following a series of politically-instigated conflicts over the past two decades (European Union, 2009). Currency exchange risk is exacerbated by lack of currency hedging instruments or mechanisms to safeguard local currencies from international economic shocks (UN-Energy/Africa, 2011).

THE MONOPOLY RISK

Energy supply is one of the key functions of central
governments in developing countries. The study found that in most countries, the energy sector was monopolized by government agencies, shouldering key functions such as energy production, distribution, billing and revenue collection (UN-Energy/Africa, 2011; UNEP, 2012). Although state monopolies are created to guarantee a public service and protect the public from possible exploitation by the private sector (Karekezi and Kimani, 2009), the study found that monopolies in the energy sector were associated with inefficiencies such as inadequate supplies, frequent power outages and high user-fees (Pegels, 2009; European Union, 2009). State-owned monopolies in the energy sector have been associated with poor quality of services in South Africa, Mauritius, Argentina and Ivory Coast (Pegels, 2009; Karekezi and Kimani, 2009; Environics, 2010; Konttinen, 2010; Mohee et al., 2012). In Ivory Coast, for instance, the energy market is monopolized by the Compagnie Ivoirienne d’Electricité (CIE), which is 51% owned by a subsidiary of France’s Bouygues group. CIE handles the management of state-owned production facilities as well as transmission and distribution (European Union, 2009).

As noted by Pegels (2009), state-owned monopolies in the energy sector are often favoured by the government in terms of subsidies, tax exemptions, among other financial and legal incentives to facilitate their operations to deliver national good. However, the result in many countries has not been impressive in terms of financial sustainability, diversification and transition to clean development with renewable energy (Pegels, 2009). For instance, in 2008, the South African state-owned energy agency, Eskom made a record loss of ZAR 9.7 billion despite the incentives initiated to facilitate its operations. Pegels (2009) blamed such poor performance on lack of competition in the energy sector, operational inefficiencies and political interference in the pricing of energy.

As a result, energy prices are neither based on the production cost nor the market demand dynamics, which in turn, affects revenues of state-owned utility firms. This challenge is not unique to South Africa, but also emerged in the literature from Mali, Ivory Coast, Egypt and Nigeria (Pegels, 2009; European Union, 2009; Environics, 2010; Government of Mali, 2012). The inefficiencies associated with monopolies connect to the reason why privatization of state-owned utility firms and liberalization of the market were key components of the economic reforms proposed by the World Bank in the 1980s and 1990s.

Furthermore, the review revealed that in typical monopolies, the playing field is tilted in favour of state-owned firms. Private sector and foreign investors are licensed to operate within specified conditionalities, which discourage investments in the development of renewable energy projects. For instance, in Egypt, the primary direct incentive for renewable energy is the reduction of customs tariff for equipment and components. Under Article 5 of the Presidential Decree 39/2007 concerning customs tariffs, “equipment and components as well as spare parts of new and renewable energies (wind and solar energy) are subject to 2% custom tax of value.” Although the New and Renewable Energy Authority ( spares that enjoy reduced tariff, private importers are charged 5% customs tariff. As noted by Environics (2010), in situations where governments change policies to favour monopolization of the energy sector, renewable energy projects co-run with foreign investors may face serious challenges.

COMMUNITY INVOLVEMENT RISK

Community involvement and ownership are key elements of successful renewable energy projects. The study found that in some countries, the planning, construction and maintenance of renewable energy projects were undertaken by governments and development partners with minimal or no involvement of local communities. Although a few such projects succeeded, most of them sparked-off controversies because they failed to interlock with community values, expectations and circumstances (Fielmua, 2011). Communities that do not feel part of a project are vulnerable to whipping by civil society groups or political leaders, resulting in insecurity challenges to project implementers (Dengerink, 2011).

The backlash-effect of community non-involvement in renewable energy projects poses the risk of delayed completion and discontinuation. In Uganda, for instance, the non-involvement of communities and civil society groups delayed the completion of the 250 MW Bujagali power station along River Nile. The project was heavily criticised for negative social, environmental and economic challenges to the host community (Kamase, 2004). Non-completion of mega projects may have far-reaching financial consequences to project financiers; hence, community involvement from the onset of projects is a key ingredient for building investor confidence (Dengerink, 2011).

Community involvement is important for the sustainability of projects. In this regard, community involvement entails providing opportunities for employment as well as transfer of technical and/or managerial skills from project experts to community members (Dengerink, 2011). Notably, such measures enhance ownership and may play a key role in the maintenance of small-scale renewable energy projects. For instance, although Uganda has had a relatively successful Domestic Biogas Program, various projects have not reached their potential due to poor maintenance; a situation, which Karekezi and Kimani (2009) and Dengerink (2011) attribute to limited transfer.
of knowledge and technical skills to local communities.

CONCLUSION AND RECOMMENDATIONS

This paper has revealed that the investment environment in developing countries is studded with various risks. The political instability, which emerges atop, also instigates other forms of risks such as low carbon policy and currency value fluctuation. To improve the risk profile, various countries have initiated legal, policy and institutional reforms towards a better investment environment. Kenya has taken a number of measures to improve its risk profile; however, a number of issues require further consideration to improve the country’s ability to attract, reward and retain foreign investors.

SECURE A SUSTAINABLE POLITICAL STABILITY

Compared to her neighbours, Kenya has been a relatively peaceful and prosperous country. However, events such as the post-election violence of 2007/08 and ethnic tensions witnessed after the 2013 general elections, suggest that the prevailing calmness may not be sustainable.Securing lasting peace and stability should be prioritized and may be achieved through a number of options. First, the Government should complete the reforms process that was initiated in 2008, as part of the long-term measures to secure political stability in the country. The new constitution should be implemented fully and institutions established to address historical injustices, including the Lands Commission, National Integration and Cohesion Commission as well as the Truth Justice and Reconciliation Commission, strengthened to fulfill their mandate. Historical injustices and ethnicity are important issues that should be addressed to secure the political stability and the investment environment in Kenya.

Implementation of the new constitution and strengthening of governance institutions require a strong political will, genuine dialogue among political leaders as well as sustained pressure from the international community and civil society organizations. At the core of the new constitution is the equitable distribution of national resources and devolution of governance. Consequently, the successful implementation of the new constitution is an important ingredient for Kenya’s future political stability by reducing economic inequalities, pacifying inter-ethnic tension, developing stronger financial markets and encouraging the flow of foreign direct investment.

Secondly, the Government should honour its commitment to international statutes to sustain diplomatic and business ties with the international community to guarantee the inflow of investments for renewable energy projects. Being a signatory of the Rome Statute, the Government must fully cooperate with the International Criminal Court (ICC) regarding the 2007/08 post-election violence. Regardless of the achievements in terms of legal, policy and institutional reforms, suboptimal cooperation with the ICC will have serious consequences on the international perception of Kenya as a secure investment destination.

Thirdly, Kenya should consider fasten its involvement in the East African Community (EAC) and lobby member states to fast-track pending issues to facilitate integration, particularly because regional blocks promote political stability by restricting membership to democratically elected governments (Moreira, 2009). Furthermore, the success of regional integration depends on how well governance policies of member states are coordinated and harmonized. For instance, members may be required to curb corruption, implement sound microeconomic policies and adopt investor-friendly regulatory frameworks. The fear of sanctions associated with non-compliance serves as an incentive for developing countries to implement good policies that promote political stability (Asiedu, 2006).

Strengthen laws and policies promoting foreign investment

Political stability is necessary for the credibility and sustainability of legal and policy frameworks governing investments in renewable energy projects. However, in situations of political instability, laws, policies and institutions perceived to be checking against personal interests are vulnerable to sudden alterations. Based on this, the Government should spearhead the formulation of supportive clauses to safeguard against non-consultative alteration of laws and policies promoting foreign investments in renewable energy. This may also be achieved by raising the threshold required for amendments and ensuring the involvement of citizens in the process, through consultation with civil society organizations. Renewable energy policies and regulations may also be strengthened by establishing autonomous regulatory agencies to bolster the Governments’ commitment to clean development and keep at bay political interference.

ESTABLISH CURRENCY-HEDGING MECHANISMS

A currency risk-hedging mechanism is an insurance policy for foreign investors cushioning against currency fluctuations. Kenya lacks commercial risk-hedging instruments for foreign investor-funded projects. Such instruments are crucial for minimization of losses that may occur as a result of currency fluctuations in foreign markets (UN-Energy/Africa, 2011). The Government...
should consider establishing an insurance policy for renewable energy projects to address the challenge of currency exchange losses, provide foreign investors with security concerning exchange rates over time and make the business environment more appealing.

OPEN-UP THE RENEWABLE ENERGY MARKET

Energy sector reforms paved the way for independent power producers to participate in energy production. However, power transmission and distribution remain closed, albeit with serious capacity issues, resulting to frequent power outages. Eliminating bureaucratic challenges in the incorporation of new companies and initiating appropriate fiscal incentives are key measures that the Government should consider to break monopolistic systems in the energy market.

Compared to countries such as Rwanda, the duration and cost of registering a new company in Kenya remain key impediments to foreign investments. The registration processes and obtaining necessary legal documents such as Personal Identification Number (PIN), Value Added Tax (VAT) and necessary licences take between 30 days and a maximum of 45 days. The costs for stamping Memorandum and Articles of Association, stamp duty, declaration of compliance before a commissioner for oath, filing at the registrar of companies, legal services and acquiring a trade licence cost between KES 40,000 and 70,000. Long, bureaucratic and costly process of registration for business entities is likely push investors to relocate elsewhere or cancel their investment projects (Morisset and Neso, 2002). Hence, the Government should consider reforming the process of company registration to make it faster and cheaper for foreign investors.

Renewable energy equipment and accessories remain expensive and unaffordable to local investors. Even though the Government has shown commitment to abolish import duty and taxes on renewable energy equipment to attract investments, the implementation the incentive has neither been consistent over time nor universal (Karekezi and Kimani, 2009). Investment in renewable energy may also be improved through elimination of trade barriers as well as relaxation of profit repatriation regulations. Zero-rating of imported renewable energy equipment and accessories has been successful in India, Mauritius and Mali (Sambo, 2009). The Government should also consider incentives such as periodical tax reliefs to increase the profitability of renewable energy projects and returns on capital.

PROMOTE COMMUNITY INVOLVEMENT IN RENEWABLE ENERGY PROJECTS

Community involvement in projects ensures the harmonization of their aspirations and project objectives, which is necessary for ownership and sustainability. A mismatch between community aspirations and project activities is a recipe for project failure, irrespective of its expected returns at the national level. Based on this, the Government should develop and implement appropriate investment guidelines, encouraging the involvement of community members in renewable energy projects, as well as making it compulsory for investors to undertake environmental and social impact assessments (ESIA) as part of requirements for licensing. Through ESIA, stakeholders should identify community skills and capabilities, as well as key areas of involvement, cooperation and compensation. Alternatively, the Government should undertake ESIA well in advance and provide data to investors or support the process by providing technical skills or financing, as part of incentives for foreign investors.

REFERENCES


Environics (2010). Prospects of the renewable energy sector in Egypt focus on photovoltaics and wind energy, Cairo: Egyptian-German Private Sector Development Programme.


Karekezi S. & Kimani J. (2009). Have power sector reforms increased access to electricity among the poor in East Africa? Nairobi: AFREPREN.


UNFCCC (2008). Report of the conference of the parties serving as the meeting of the parties to the Kyoto Protocol on its first session.