Kenya - Economic Diversification, Challenges and Opportunities

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Abstract
International economic theory states that a country should specialize in the production of goods and services that it can produce at a lower relative opportunity cost and import those goods and services that it can produce at a higher relative opportunity cost. It will also produce and offer for export those goods that it can produce with its most abundant factor. This has led most low income countries to specialize in commodity and primary products based on their resource endowments. These countries have also concentrated on trading with only a few partners and especially the former colonial masters and this has subjected these countries to fluctuations in economic growth and volatility in commodity prices due to lack of diversification. Economic growth in Kenya is currently being driven by traditional sectors such as agriculture and services and it still relies on a few export products for export and a few export destinations. Gender inequality is also high and Kenya's human resource development index is also very low compared to other countries in Africa and other developing countries. Labor force participation is also skewed against women and industries are located in only a few major towns exacerbating the levels of inequality and in effect leading to low levels of economic diversification. It is therefore imperative that Kenya diversifies its economy in order to increase the sources of income and growth. This paper uses desk research to investigate Kenya's experience in economic diversification, factors that derail or facilitate its endeavor to diversify its economy and the opportunities that are available for Kenya to take advantage of in order to diversify its economy

Keywords: *Economic diversification, export diversification, production diversification, vertical diversification, horizontal diversification.*

I. INTRODUCTION

Kenya's Growth Performance

Following two decades of stagnation in per capita income and high volatility of economic activity, Kenya's economy moved to a path of accelerating growth after 2002. Gross Domestic product (GDP) growth increased steadily from below 1% in 2002 to 7% in 2007. This was the only episode of five-year accelerating growth in independent Kenya's history, and it was the also the first time since 1986 that GDP growth reached 7%. Since 2007, the economy has been hit by several shocks, starting with the post-election violence in January 2008, which brought GDP growth to a halt, followed by a slow recovery in 2009. Economic growth has started to rebound since 2010 and has stabilized since, although at rates lower than before 2008 as shown in Figure 1

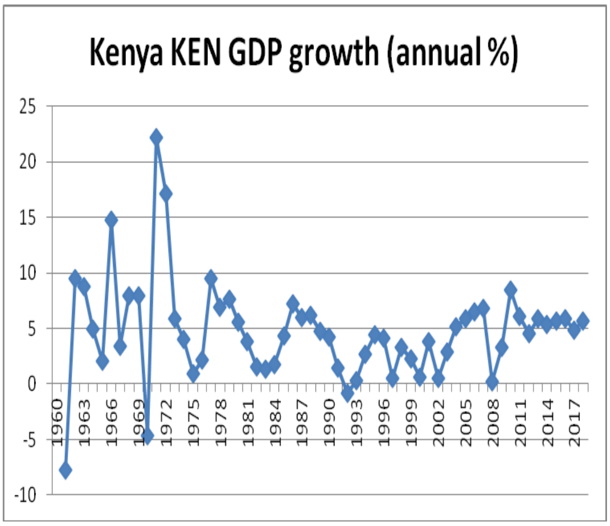

Figure 1: Kenya's GDP Growth 1961-2018

Source: World Bank Development Indicators

Growth volatility remained high in the recovery phase. This fluctuation in growth was caused by various factors, such as political shocks (elections years have been associated with lower growth since the 1990s), exogenous shocks (drought, oil prices, and global crisis), and macroeconomic policy shocks (relatively high inflation).

Economic growth decelerated to a 5-year low of an estimated 4.8% in 2017 from 5.8% in 2016 as shown in Table 1. Poor rains, slowdown in credit growth to the private sector and election-induced uncertainty weighed down on economic activity in 2017. However, a rebound in tourism, strong public investment, and resilient Diaspora remittance inflows partially mitigated some of the shocks the economy faced in 2017. There were also improved rains and easing of political tensions following the conclusion of the Presidential elections, bringing a rebound in economic activity at the beginning of 2018.

II. DRIVERS OF ECONOMIC GROWTH IN KENYA

The growth in the various sectors that contribute to economic growth has mainly been in the services sectors such as transport and storage, information and communication, construction, real estate and financial services as shown in Table 1 with agriculture and manufacturing growing very slowly. Table 1 shows that in 2014, the services sector grew at 47% compared to agriculture which grew at 4.4% and manufacturing at on 2.5%.

Table 1: Growth of Drivers of Economic Growth in Kenya

% Growth of Sources of GDP									
Year	**Agri. Forest and Fish**	**Manufacture**	**Transport and Storage**	**Info and Communication**	**Construct**	**Real estate**	**Finance service**	**Total Growth in Service**	**GDP**
2012	2.8	-0.6	2.6	2.6	11.3	4.0	6.0	26.5	4.6
2013	5.4	5.6	1.3	12.5	6.1	4.1	8.2	32.2	5.9
2014	4.4	2.5	5.5	14.5	13.1	5.6	8.3	47	5.4
2015	5.3	3.6	8.0	7.4	13.8	7.2	9.4	45.8	5.7
2016	4.7	3.1	6.5	9.9	9.9	8.8	6.9	42	5.9
2017	1.9	0.5	7.2	11.0	8.5	6.1	2.8	35.6	4.9
2018	6.4	4.2	8.8	11.4	6.6	4.1	5.6	36.5	6.3

Source: Kenya National Bureau of Statistics, https://www.knbs.or.ke/download/economic-survey-2019/

In 2018, manufacturing sector grew at only 4.2%, agriculture at 6.4% while services grew at 36.5%. After the general elections in 2017, the Jubilee government came up with a plan of development known as the Big 4 Agenda with a lot of importance attached to manufacturing, food security, affordable housing, and universal health coverage. The Kenya Association of Manufacturers (2018) argues that very few countries in the world have managed to achieve high economic growth rates without the manufacturing sector playing a critical role since manufacturing is important for sustaining economic growth, job creation and poverty alleviation.

The economy of Kenya is mainly dominated by the services sector. Services have been the main engine of Kenya's economy over the past decade. Expansion of the services sector accounted for almost two-thirds of the increase in output between 2012 and 2017 with manufacture contributing insignificant proportions to GDP as shown in Table 2.

Table 2: Percentage Contribution to GDP

Percentage Contribution to GDP									
Year	**Agri. Forest and Fish**	**Manufacture**	**Transport and Storage**	**Info and Communication**	**Construction**	**Real estate**	**Finance service**	**Total contribution by Services**	**GDP**
2012	14.3	-1.4	4.1	1.8	10.6	7.4	7.4	31.3	4.6
2013	26.4	10.7	8.0	1.4	4.5	7.9	6.6	28.4	5.9
2014	27.5	10.0	8.6	1.2	4.9	7.7	6.8	29.2	5.4
2015	30.2	9.4	8.1	1.5	4.9	7.5	6.7	28.7	5.7
2016	31.1	9.3	8.1	1.5	5.1	7.6	7.1	38.7	5.9
2017	34.8	8.0	7.5	1.3	5.6	7.1	6.1	27.6	4.9
2018	34.2	7.7	8.0	1.3	5.4	7.0	6.0	27.7	6.3

Source: Kenya National Bureau of Statistics, https://www.knbs.or.ke/download/economic-survey-2019/

Over time the manufacturing sector's contribution to Kenya's GDP has stagnated at around 10% and was about 8.0% in 2017 and fell to 7.7 in 2018. There is renewed interest in the manufacturing sector through the Big 4 Agenda which seeks to increase the manufacturing sector's contribution to GDP to 15% by 2022 (Kenya manufacturers Association, 2018). Activity in the manufacturing sector was impacted by: (1) a prolonged electioneering period (2017-2018) which dampened business sentiment and trade with neighboring countries; (2) poor agricultural harvests which weakened agribusiness activity; (3) challenges in credit access which limited working capital and the ability of firms to expand; and (4) high cost of energy due to drought. Contribution of the agricultural sector to GDP growth in 2017 dropped from 34.8% in 2017 to just 34.2% in 2018. The weakness in the sector's performance was a result of the contraction in output of key agricultural exports such as tea and coffee, and staple foods such as maize, kale, and potatoes.

The services sector has been the main engine of the economy contributing 38.7% in 2016 from a low of 31.3 in 2012. The service sector has remained resilient, albeit with differences across sub-sectors. However, the robust performance in the services sector was uneven. There is ongoing rebound in transport, the financial services sectors which recorded robust growth. Growth was also recorded in the information and communication sub sector and the real estate sub sector. However, the services sector remains highly informal and is dominated by a large number of low-productivity small firms.

Kenya is an open economy and engages in both exports and imports of goods and services. Kenya's most valuable exported good is tea. Other top Kenyan exports are fresh or dried flowers for bouquets or ornamental purposes, refined petroleum oils, coffee, titanium ores and concentrates, and then medication mixes in dosage as shown in Table 3.

Table 3: Kenya's Top 10 Exports, Earnings and Share of Total Exports 2017

	2017			2018	
Product	**Earning in US$**	**%of Total Exports**	**No.**	**Earning in US$**	**Share of Total Exports (%)**
Coffee, tea, spices	1.7 b	29	1	1.4b	24.7
Live trees, plants, cut flowers	595.6m	10.4	2	817.1m	16.1
Mineral fuels including oil	353.7m	6.2			
Vegetables	209.2m	3.6	3	269.1m	5.3
Clothing, accessories	190.3m	3.3	4	260.8m	5.1
Fruits, nuts	180.7m	3.1	5	246.8m	4.9
Ores, slag, ash	177.3m	3.1	6	194.9m	3.8
Knit or crochet clothing, accessories:			7	172.5m	3.4
Tobacco, manufactured substitutes	134.2m	2.3			
Vegetable/ fruit/nut preparations			8	121.5m	2.4
Plastics, plastic articles	129.5m	2.3			
Gems, precious metals			9	81.5m	1.6
Pharmaceuticals	124.2m	2.2	10	79.7m	1.5

http://www.worldstopexports.com/kenyas-top-10-exports/

In 2017, Kenya's top 10 exports accounted for about two-thirds (65.5%) of the overall value of its global shipments compared to 71.5% in 2018 indicating a very high level of concentration and lack of diversification. Coffee, tea and spices were the highest earners (US$1.7b) which was 29% of total export earnings in 2017 compared to 1.4US$ in 2018 (24.7%). This was followed by live trees, plants, cut flowers (US$595.6m and US$817.1m) accounting for 10.4% and 16.1% respectively of total exports earnings. Since 2012 the exports of Kenya have increased at an annualized rate of 4.4%, from US$4.89 b in 2012 to US$6.17 b in 2017. The most recent exports are led by tea which represents 22.3% and 12.2% of the total exports of Kenya in 2017 and 2018 respectively.

III. TRADE BALANCE AND TERMS OF TRADE

Kenya typically has a substantial trade deficit. The trade balance fluctuates widely because Kenya's main exports are primary commodities subject to the effects of both world prices and weather (Figure 2). KIPPRA (2017) contends that majority of Kenya's exports are raw materials and primary products compared to imports that are high value capital and finished products and this sustains the persistent trade deficit. As of 2017 Kenya had a negative trade balance of US$11b in net imports compared to the trade balance in 1995 when Kenya had a negative trade balance of US$656m in net imports. Between 2012 and 2017 Kenya's imports increased at an annualized rate of 3.7%, from US$14.2billion in 2012 to US$17.1billion in 2017.

Kenya's terms of trade (TOT) have also been deteriorating over the years as the value of Kenya's imports has been higher than the value of exports. Terms of trade are calculated as the value of exports as percent of the value of imports. An increase in the terms of trade means that the value of exports is increasing relative to the value of imports. Republic of Kenya (2019) argues that Kenya's TOT deteriorated by 7.5% in 2018 compared to a decline of 3.3% in 2017. The deteriorating terms of trade are as a result of agricultural commodity prices falling relative to manufactured products, relatively inelastic demand, lack of differentiation among producers, development of synthetic substitutes which displace agricultural commodities as intermediate inputs and reducing the growth in demand; low income elasticity of demand in primary commodities, and the loss of competitiveness in Kenya's manufactured export goods. The unfavorable net exports have been persistent over time due to low value addition, low diversification of exports and increased demand for imports.

KIPPRA (2017) argues that Kenya exports 70% of its total exports to only a 15 countries making its exports destination very narrow as shown in Table 4 which shows the top 15 countries that Kenya exports its products to. Concentration on a few export destinations shows lack of diversification.

Table 4: Leading export destinations for Kenyan products, 2016-2017

Country	**% share of total exports**	
	2016	**2017**
Pakistan	7	10.8
Uganda	10.8	10.4
United States	7.5	8
Netherlands	7.5	7.4
United Kingdom	6.5	6.5

United Republic of Tanzania	6	4.8
United Arab Emirates	5.4	4.4
Somalia	3.1	3.3
Egypt	3.6	3.2
DRC	3.5	3.2
Rwanda	3	2.9
South Sudan	2.8	2.8
Germany	2.1	2
China	1.7	1.7
France	1.2	1.4
Saudi Arabia	1.2	1.3
Russia Federation	1.2	1.3
Ethiopia	1.4	1.2

Source: https://oec.world/en/profile/country/ken/

IV. CASE FOR ECONOMIC DIVERSIFICATION

From the information and data presented and discussed in the preceding sections it is clear that economic growth in Kenya is currently being driven by traditional sectors such as agriculture and services sectors and it still relies on a few export products for export and a few export destinations. It is imperative that Kenya diversifies its economy in order to increase the sources of income and growth.

The theory of Comparative Advantage by David Ricardo states that countries should specialize in the production of goods and services they can produce at a lower relative opportunity cost and import those goods and services that they can produce at a higher relative opportunity cost. The Heckscher-Ohlin theorem states that a country will produce and offer for export those goods that it can produce with its most abundant factor. This has led most low income countries to specialize in commodity and primary products based on their resource endowments. They have also concentrated on trading with only a few partners and especially the former colonial masters. This has subjected these countries to fluctuations in economic growth and volatility in commodity prices due to lack of diversification.

On the other hand, Rabih, et. al. (2008) define a diversified economy as one that does not rely on a few sectors but on a wide range of profitable sectors; an economy that is not overly dependent on a single commodity but one that has a strong external as well as internal focus. The authors contend that economic diversification is key to sustainable development as this can reduce economic volatility and improve the economic performance and activity.

United Nations Framework Convention on Climate Change (UNFCCC) (2019) defines economic diversification as the process of shifting an economy away from a single income source towards multiple sources and to a growing range of sectors and markets. It is a strategy to encourage positive economic growth and development and to transform the economy into being inclusive by involving huge sections of the population. The main aim of economic diversification is to improve and sustain economic performance and growth, reduce poverty, build resilience against income, price and product volatility and create job opportunities (Nourse, 1968; UNFCCC, 2016). Kenya needs to diversify not only its export destinations but also its import sources, be inclusive among the participants in productive activities, diversify export products and not just rely on a few products, add value to export products and so on in order to contribute positively to its economic growth and development.

Exports diversification has the potential to positively contribute to growth and development through several channels. The higher and the more diversified a country's exports, the lower its volatility. A country will only become effectively diversified when it successfully creates a robust quantity and variety of exports and worldwide purchasers of its exports (Rabih, et, el. 2008).

Diversification of exports is also associated with reduced fluctuations in foreign exchange earnings, increases in GDP and employment, higher value addition and improvements in the quality of manufactured products. A larger, more diversified basket of commodities exported would mitigate the potentially elastic and unstable demand associated with a single or fewer commodities. Export diversification favorably influences the pattern of growth and structural transformation that countries and regions experience while increasing a country's ability to meet such goals as job creation and improvements in income distribution. Export diversification also tends to reduce export earnings instability and volatilities in imports and capital, which most times tend to be growth-inhibiting. Exports diversification entails Kenya to not only increase the variety of goods exported but also moving into goods of higher quality and new markets. At the same time, export diversification can provide Kenya with a hedge against exogenous price shocks that are mostly associated with primary commodity markets. Finally, export diversification would make Kenya to have a more rapid, inclusive and sustained economic growth and development.

If Kenya increased its investment in a broad range of activities and sectors, this would enhance its sources of income and contribute to mitigating the adverse effects of export instability and fluctuations in the terms of trade. Diversification can serve as a distributional instrument to channel revenues from mineral and resource-based sectors to other sectors of the economy, thus building the foundation for a stable inflow of revenues while accounting for intergenerational equity.

More sophisticated exports basket and higher technology intensity are more likely to act as catalysts for broad-based economic growth. Sectors that observe high sophistication or high-technology intensity are likely to act as engines of growth and promote inter-sectoral and extra-sectoral linkages, rather than isolated enclaves, provided the right macroeconomic conditions and structural factors are in place (Osakwe, Santos-Paulino, and Dogan, 2018). Diversification into new production and export activities, as well as improving the quality and sophistication of the export basket, determine economic growth across countries.

To mitigate the challenges of relative instabilities associated with concentrating in commodity exports, Kenya should consider diversifying exports both in terms of markets and types of products.

Market diversification refers to entering new markets not previously covered with existing commodities, while product diversification means adding new products or services to the range of existing ones in existing markets. On the other hand, export diversification reflects the degree to which a country's exports are spread across a large number of products and/or trading partners. This contrasts with export concentration where a greater focus of trade is on a small number of commodities and/or trading partners (UNDP, 2011).

An export portfolio can be perfectly concentrated when a country exports one product to only one trading partner. On the other hand, when a country's exports include a larger number of products and trading partners, it is said to be more diversified. Export diversification is the changing structure resulting from widening the range of a country's exports. The diversification is achieved through increasingly changing the basket of commodities being exported, or improving the existing exports by adding value, or enhancing them through technology and innovation (Dennis and Shepherd, 2007; UNCTAD, 2018).

Export diversification can be vertical, horizontal or diagonal. Vertical diversification refers to the transformation in a country's export basket from primary products to manufactures through increased value addition (Herzer and Nowak- Lehnmann 2006, and Samen 2010). Vertical diversification is associated with backward linkages advantages and technology transfer. Kenya concentrates on the export of primary products with little or no value addition. Horizontal diversification entails geographical diversification or diversification at the extensive margin which seeks to change the export structure by increasing the mix of primary commodities being exported by the country. However, Kenya concentrates more on five agricultural exports of tea, coffee, horticulture, vegetable oils and articles of apparels hence lacking horizontal diversification in its exports.

Other types of diversification include, intermediate goods diversification, quality diversification, and goods-to-services diversification (UNCTAD, 2018). Hence, diversification is a prerequisite to achieving positive growth in Kenya.

V. MEASUREMENT OF ECONOMIC DIVERSIFICATION

One of the methods of measuring economic diversification is by determining the concentration ratio and the diversification quotient by looking at the distribution of a country's GDP across the various sectors such as agriculture, manufacturing, services, mining, and so on. The concentration ratio measures a country's concentration in a given sector by taking the sum of squares of percent contribution to GDP. The diversification quotient is the inverse of the concentration ratio. The lower the concentration ratio and the higher the diversification quotient, the more diversified a country's economy. Countries that have high concentration ratios and low diversification quotient could be having pervasive structural gaps, such as inefficiencies in labor, capital, and knowledge and technology. High economic concentration leads to volatile growth and fluctuating economic cycles as it makes an economy vulnerable to external events, such as changes in the price of the dominant commodity (Rabih, et, el., 2008).

Another way to measure economic diversification is to measure the distribution of labor categories for example in services, agriculture, mining, manufacturing and so on. Generally, employment distribution across sectors reflects and shapes GDP distribution across sectors.

VI. DETERMINANTS OF ECONOMIC DIVERSIFICATION

IMF (2014; 2013); Bal-Gunduz, et. al. (2015) and Aghion and Howitt (2006) document a number of country characteristics and policies associated with diversification. These are the level of development, institutional quality, stronger infrastructure, a higher degree of globalization, a well-educated workforce especially at tertiary level. These studies argue that increasing human capital accumulation fosters economic diversification by promoting the development of skill-intensive industries and new technologies and by facilitating technological diffusion between firms. High levels of gender inequality, as measured by an extended version of the United Nations' Gender Inequality Index, are associated with lower levels of export diversification while they are negatively related with output diversification (Kazandjian, et. al., (2016). The authors found that gender inequality decreases the variety of goods countries produce and export and especially in low-income and developing countries. This is because gender gaps in opportunity and in the labor market harm diversification by constraining the potential pool of human capital available in an economy and impede the development of new ideas by decreasing the efficiency of the labor force. Kazandjian, et. al. (2016), found that gender inequality using Gender inequality index (GII) (female labor force participation, gender gaps in education, female representation in parliament, and indicators of female health (maternal mortality and adolescent fertility) in low-income and developing countries is negatively associated with output diversification reflecting the fact that low gender inequality may result in greater participation of women in the service sector, in which countries tend to re-concentrate production as they develop. The authors found that higher female-to-male enrollment ratio, higher female labor force participation rates, better health outcomes, in terms of lower maternal mortality ratios and adolescent fertility rates were significantly and positively related to export diversification. Their results also showed that gender inequality, both in outcomes and in opportunities, negatively impacts export and output diversification in low-income and developing countries implying that inequality constrains the level of human capital which limits diversification.

VII. EVOLUTION OF KENYA'S TRADE DIVERSIFICATION POLICY

There have been few but less effective trade policies by the Government of Kenya due mainly to the continuous reforms in the public sector and the impact of negative economic shocks that were occasioned by high concentration on non-value yielding export commodities i.e. coffee, tea and horticulture, whose prices and quality specifications are regulated by international commodity exchange boards in Europe and North America.

Kenya's first trade policy after independence had an import substitution strategy, as expressed in the first Republic of Kenya (1965) Sessional Paper No. 10 of 1965, aimed at improving international trade imbalances by stimulating the domestic market. The Government of Kenya used this policy to protect the domestic market and spur the production of imported goods by local industries, thereby stimulating rapid trade growth, easing balance of payment pressure, increasing domestic control of the economy and generating employment. However, this policy failed miserably in achieving the desired results.

The second major phase in the evolution of the trade policy in Kenya was through the Structural Adjustment Programs (SAPs) introduced in the mid 1980's by Republic of Kenya (1986) Sessional Paper No.1 of 1986 on Economic Management for Renewed Growth. The SAPs were targeted at domestic trade liberalization and this policy replaced the import-substitution model. The SAPs focused on promoting non-traditional exports, liberalized markets and reforms of trade regulations (Republic of Kenya, 1990).

The main thrust of the adjustment programs was to produce a shift from a highly protected domestic market to a more competitive environment that would facilitate increased use of local resources, outward oriented policies that would promote employment creation and export expansion. However, structural adjustment led to neglect of agriculture and food production since Kenya had invested very little in promotion and enhancement of the important ingredients for agricultural development, including rural infrastructure and services, agricultural research and extension, and in the institutions that shape the governance of agriculture. Structural adjustment and the resulting trade liberalization led to an increase in import of foodstuffs and a reduction in government support to agriculture (Gitu, 2006).

In the 1990s, Kenya adopted export promotion strategies which proposed incentives that aimed at encouraging industries to provide for exports. Kenya's trade regime started being guided by market-driven principles of liberalization under the World Trade Organization (WTO), which came into effect in 1995. The liberalization phase led to lowering of tariffs and reduction of non-tariff barriers in Kenya's export markets thereby improving market access to Kenya's products.

In 2007, Kenya launched an ambitious development program called Vision 2030 whose main objective is to help transform Kenya into a newly industrializing, middle-income country providing a high quality of life to all its citizens by 2030 in a clean and secure environment (Republic of Kenya, 2007).

The policy seeks to make the country globally competitive and prosperous through massive investments in critical international trade infrastructures, expansion of the quality of exportable commodities (i.e. Tea, Horticulture, Coffee, Articles of Apparels and Clothing and Vegetable oils), political and economic service reforms and the deployment of technology to stimulate growth and development. It places emphasis on structural transformation of the economy in terms of increasing the share of manufacturing and industrial sectors and increasing the share of manufactured exports to GDP as a strategy to generate employment and higher economic growth and to ensure a sustainable Balance of Payments position (Republic of Kenya, 2007).

VIII. VISION 2030 AND KENYA'S ECONOMIC DIVERSIFICATION

Kenya's Vision 2030, the most recent trade policy is deemed to have been successful, with total global exports increasing by over 64% from Ksh344.9 billion in Year 2008 to Ksh537.2 billion in 2014. However, export growth rate reduced between 2012 and 2013 by 3%, i.e. a sharp decline of Ksh15.5 billion in 2013 and a weaker economic growth rate of 5.7% (KNBS, 2014), which was mainly due to negative concerns about the outcome of the 2013 general elections, and investment anxieties due to the devolved system of government. On the other hand, between 2007 and 2017, the value of Kenya's exports increased by US$1.6 billion compared to US$7.6 billion worth of imports implying deteriorating terms of trade.

In terms of export market diversification, United Kingdom receives 13.06% of Kenya's global exports followed by Uganda at 12%, Netherlands at 9.1% as at June 2018 implying that although exports increased, market concentration still remains a big issue.

On the other hand, Kenya imports 17.8% of its imports from the United Arab Emirates, followed by India at 12.8% and China at 7.5% implying a highly concentrated import market concentration.

In terms of product diversification, Figure 3 shows that coffee, tea, spices and cut flowers still dominate Kenya's exports commanding 29% of Kenya's exports implying that Kenya is still far from diversifying its exports even with Vision 2030.

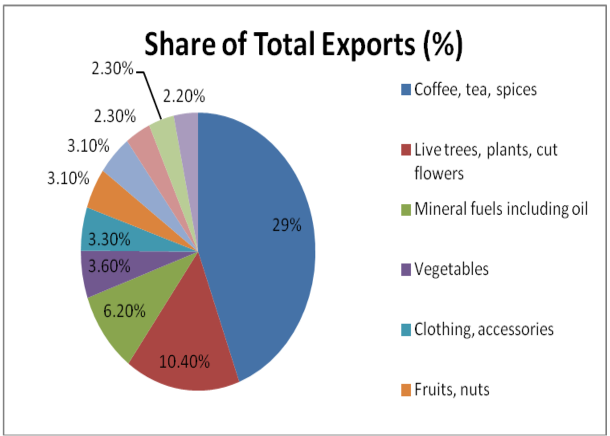

Figure 2: Share and Values of Principal Domestic Exports by Kenya: 2017

In terms of diversification of import products, industrial supplies took the first place in the value of Kenya's total imports in 2016 taking 36.23% of Kenya's total imports as shown in Figure 4. This was followed by machinery and other capital equipment at 21.8% and fuel and lubricants at 14.53%.

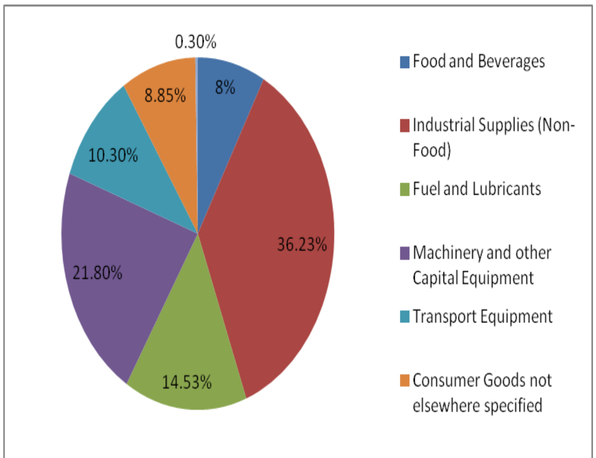

Figure 3: Share and Values of Principal Domestic Imports by Kenya: 2016

From the foregoing, it is clear that Kenya has not managed to diversify its exports, imports, markets, value addition and so on even with an export oriented trade policy implying certain structural challenges that could be posing as major constraints towards diversification.

IX. KENYA'S CHALLENGES IN DIVERSIFICATION

Kenya faces certain challenges such as a low-skilled labour force i.e. the level of physical and human capital is so small that it falls below the threshold needed to start modern production process. There is also a marked absence of a leading industry that may lead the other industries in the country.

Unfavorable economic policies such as tariffs and non-tariff barriers on Kenya's exports to the OECD countries and poor macroeconomic management and institutional constraints make it difficult for Kenya to diversify its export base.

The Trade diversification strategy adopted by Kenya within the EAC is the horizontal model, where the country exports mostly agricultural commodities, e.g. tea, Arabica coffee, horticulture, and low quality machinery and transportation services, but imports refined food and beverages, industrial supplies, machinery, and oil & gas petroleum products from Europe, Asia and Africa (Amondi, 2015).

Vertical integration activities or the value-added export oriented activities that have driven many dynamic developing economies are conspicuously absent in Kenya. Linkage between local industries remains minimal and mostly superficial. There is a very low diffusion of technology from abroad. The technological level of the existing industrial activities remains generally low due to low levels of human capital, low levels of income, small scale nature of industrial enterprises and so on.

Kenya has a very high level of unequal income distribution with a Gini coefficient of 47.7. Uneven distribution of income in turn has perpetuated poverty and exclusion. Unequal distribution in Kenya is caused by concentration of the handful economic establishments including those few industrial plants and modern infrastructure in one or two urban conglomerations such as Nairobi and Mombasa. However, inequality exists not only along regional lines, class, and ethnicity, but also along gender lines and hence modern formal sector employment in Kenya continued to be a largely male domain. Kenya suffers from high levels of gender inequality. The gender wage gap shows that for every Ksh.100 a male earns, a female earns Ksh.55. The WEF (2017) puts Kenya's GII at 0.549 indicating high levels of inequality in terms of labor force participation rates which was 74.4% in 2016 and out of these, the male labor force participation rate was 77.5% compared to 71.5% for females. The male youth labor force participation rate in the same year was 46.7% and

43.4% for females[1]. Gross enrollment ratio in 2016 was 77.43 for males and 75.65 for females[2] Republic of Kenya (2014) and Kenya Demographic and Heath Survey (2014) show the adolescent fertility rates in Kenya stood at 23% but rose to 80.5% in 2017[3].

The maternal mortality rate for Kenya in 2015 was 510 for every maternal deaths per 100,000 live births, while the share of seats in parliament held by women was 23.3%[4]. The low rate of GII signifies low human resource development and contributes negatively to diversification of Kenya's economy.

X. OPPORTUNITIES FOR DIVERSIFICATION

Despite the challenges, Kenya is trying hard to build its existing capacities and institutions such as the East African Community (EAC), Common Market for East and Southern African (COMESA), the tripartite agreement that brings together the South African Development Community (SADC), COMESA and EAC, the African Continental Free Trade Area (AfCFTA) in order to accelerate economic diversification within an integrated regional economy. Regional integration provides opportunities for the expanding sectors such as the services sector in Kenya.

As mentioned earlier, Kenya's services sector accounted for 27.7% of its GDP—largely boosted by the booming digital sector. Digital technologies are empowering new small and medium entrepreneurs, creating jobs, diversifying the economy, improving productivity, and facilitating Kenyans to enter into new markets. The AfCFTA will provide the vehicle for going to scale through a pooled African market (Songwe, 2020).

Kenya is also well positioned geographically since in the East, it has the Indian Ocean facing Asia and Australia with access to key shipping lanes between the Mediterranean and Indian Oceans and it can also take advantage of this geographic advantage to work towards greater diversification of its economy and taking advantage of international opportunities such as the fiber optic connection to conduct e-commerce. The Lamu Port South Sudan Ethiopia Transport corridor (LAPSSET) infrastructure project who funding has now been taken over by the African Union will accelerate the inter-linkage between Kenya and other African countries leading to more trade between Kenya and the rest of the African continent.

[1] https://www.ilo.org/ilostatcp/CPDesktop/?list=true&lang=en&country=GBR

[2] http://uis.unesco.org/en/country/ke.

[3] https://databank.worldbank.org/views/reports/reportwidget.aspx?Report_Name=CountryProfile&Id=b450fd57&tbar=y&dd=y&inf=n&zm=n&country=KEN

[4] http://hdr.undp.org/en/composite/GII

XI. CONCLUSION AND POLICY RECOMMENDATIONS

Kenya's economy lacks diversification in terms of exports, imports, markets and low value addition to its products hence relying on exporting primary commodities and importing high value goods. This scenario exposes it to high volatility in prices due to the elastic demand of its products in the international markets and deteriorating terms of trade over the years. This lack of diversification is as a result of various challenges. Kenya needs to address the challenges that it has faced over the years in its endeavor to diversify its economy in order to achieve higher economic growth and eventually achieve economic development.

To address the challenge of low-skilled labour force i.e. the level of physical and human capital is so small that it falls below the threshold needed to start modern production process the Kenya government needs to invest in improving its human resource index which stands at 57.54 compared to countries such as South Africa (60.50), Mauritius (66.66), Malaysia (70.24), Singapore (78.15) (World Economic Forum, 2017). Supporting education and more so education for girls will help increase the level of human and physical capital needed to diversify the economy. The Government of Kenya is on the right track in this aspect because since 2017, it has emphasized on 100% transition from primary to secondary school, enhanced the provision of bursaries and higher education loans to both universities and technical, vocational education and trainings (TVET) institutions.

There is also a marked absence of a leading industry that may lead the other industries in the country with many small and medium enterprises dominating the Kenyan manufacturing sector and therefore there is need to encourage the growth, amalgamation or merger of these small and medium enterprises to a big conglomerate to be a market leader.

Kenya needs to reform the unfavorable economic policies such as high taxes that make its products non competitive in the Organization for Economic Cooperation and Development (OECD) and to use its foreign policy to negotiate for reduction or eradication of tariffs and non-tariff barriers on it exports to the OECD countries in order to diversify its export base.

The trade diversification strategy adopted by Kenya within the EAC is the horizontal model and it therefore needs to adopt a vertical model of diversification which would entail value-added export oriented activities on agricultural export commodities such as tea, coffee and so on hence linking the small and medium enterprises with large industries through value chains and by encouraging diffusion of technology between industries.

Kenya needs to reform its industrialization policy in order to disperse location of industries to all corners of the country. This will reduce the concentration of the handful economic establishments including those few industrial plants and modern infrastructure in one or two urban conglomerations such as Nairobi and Mombasa.

The Kenya government also needs to reform its employment policy especially in the modern formal sector employment which is largely male dominated to ensure that females are also considered in formal employment. This will also lead to an increase in both male and female labour force participation rate leading to increased productivity in the economy. There should also be equal pay for equal work to eradicate the gender wage gap.

Kenya also need to improve its gender inequality index and in the process it will be able to improve its human resource development and contribute positively to diversification of Kenya's economy.

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