Kenya's Experience in Economic Development

PROF. TABITHA KIRITI-NGANGA

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STRUCTURE OF PRESENTATION

- Kenya's experience in economic development
- Attempts at diversifying its economic productive base.
- Main challenges at Diversifying
- Economic policies and reforms undertaken by the Government.

Introduction: Kenya's Human Development Indicators-Trends

Year	Life expectancy at birth	Expected years of schooling	Mean years of schooling	GNI per capita (2011 PPP$)	HDI value
1990	57.5	9.1	3.7	2,297	0.468
1995	53.9	8.7	4.5	2,130	0.456
2000	51.8	8.4	5.3	2,112	0.451
2005	55.8	9.4	5.8	2,223	0.490
2010	62.9	10.7	6.1	2,467	0.543
2015	66.7	11.7	6.3	2,806	0.578
2016	67.0	11.9	6.4	2,898	0.585
2017	67.3	12.1	6.5	2,961	0.590

Introduction: Kenya’s GDI for 2017 relative to selected countries and groups

Country	Life expectancy at birth		Expected years of schooling		Mean years of schooling		GNI per capita		HDI values		F-M ratio
	Female	Male	Female	Male	Female	Male	Female	Male	Female	Male	GDI value
Kenya	69.7	64.9	11.7	12.5	5.7	7.1	2,529	3,398	0.568	0.610	0.931
Cameroon	59.7	57.5	11.3	13.0	4.7	7.6	2,751	3,878	0.513	0.593	0.866
Tanzania (United Republic of)	68.1	64.6	8.6	9.3	5.4	6.2	2,282	3,037	0.517	0.557	0.928
Sub-Saharan Africa	62.4	59.0	9.5	10.6	4.7	6.5	2,763	4,034	0.506	0.567	0.893
Medium HDI	71.1	67.2	12.2	11.8	5.6	7.9	3,673	9,906	0.598	0.680	0.878

Introduction: Kenya's Gender Inequality Index for 2017 relative to selected countries and groups

Country	GII value	GII Rank	Maternal mortality ratio	Adolescent birth rate	Female seats in parliament (%)	Population with at least some secondary education (%)		Labour force participation rate (%)	
						Female	Male	Female	Male
Kenya	0.549	137	510	80.5	23.3	29.2	36.6	62.4	68.5
Cameroon	0.569	141	596	105.8	27.1	32.5	39.2	71.2	81.2
Tanzania (United Republic of)	0.537	130	398	115.1	37.2	11.9	16.9	79.5	87.4
Sub-Saharan Africa	0.569	—	549	101.3	23.5	28.8	39.2	65.2	74.0
Medium HDI	0.489	—	176	41.3	21.8	42.9	59.4	36.8	78.9

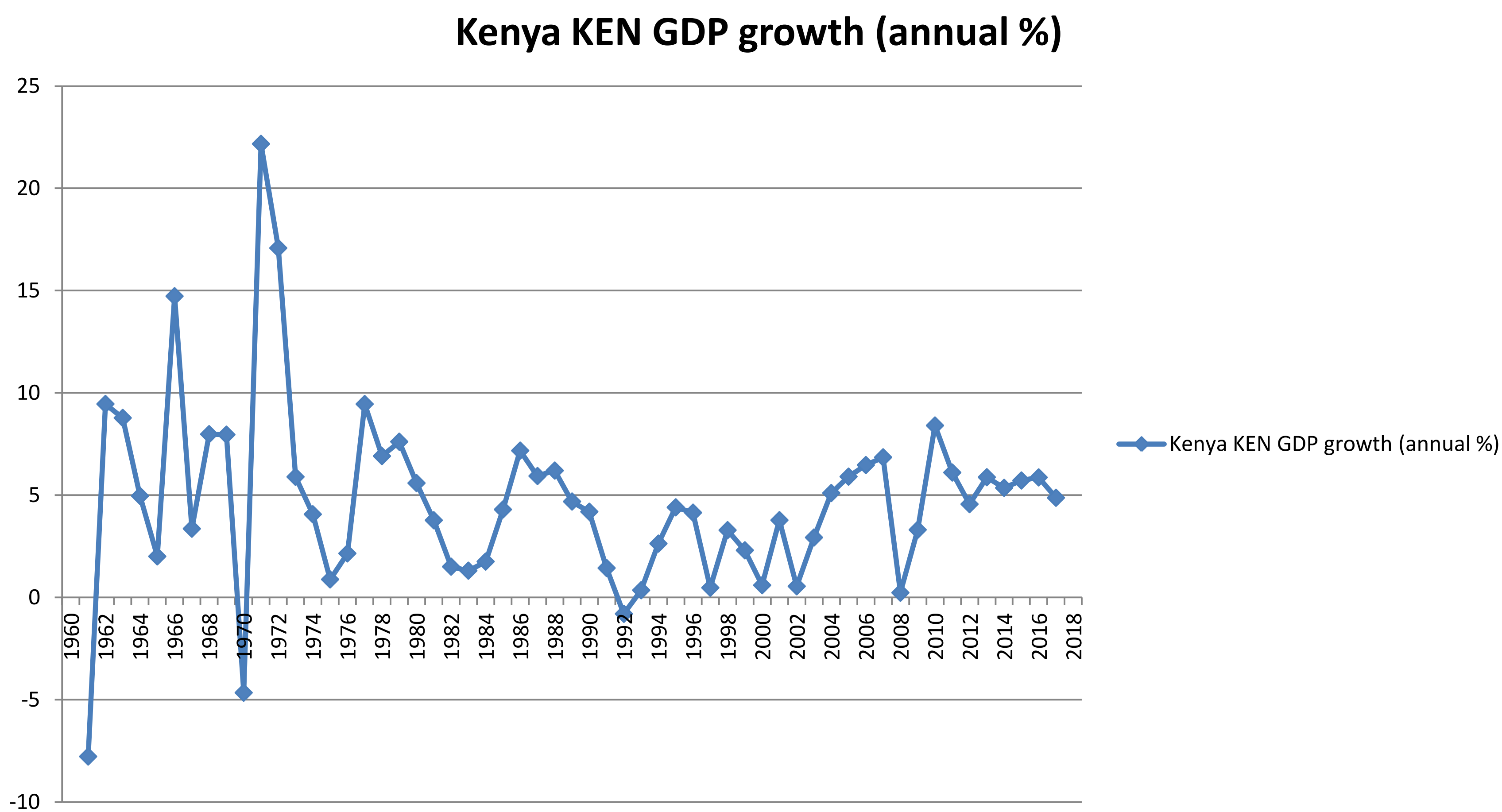
Introduction: Demographics

- Kenya is a 'young' country, with an estimated 61 per cent of its population being either children – age 0 to 14 – or youth – age 15 to 24 (UN 2017).
- The **median age** in Kenya is **19.2 years**.
- The country's youth population is made up of over 9.5 million people, more than 20 per cent of all Kenyans.
- Fertility Rates 3.9 births per woman of child bearing age
- Population growth 2.56% - 2017
- **27.1 %** of the population is **urban** (14,149,974 people in 2019)

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 Jan 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

Kenya GDP Growth 1961–2017



Kenya's Growth Performance

- Growth volatility remained high in the recovery phase.
- In recent years, political turmoil and violence after the political elections in 2007 and the global economic crisis magnified volatility.
- 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).

Kenya's Growth Performance

- 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.

Drivers of Economic Growth in Kenya

- 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 sectors accounted for almost two-thirds of the increase in output between 2012 and 2017 (Table 1).

Drivers of Economic Growth in Kenya

Year	Growth in %			
	Agriculture	Industry	Services	GDP Growth
2012	0.7	0.8	3.1	4.6
2013	1.4	1.4	3.9	5.9
2014	1.2	1.2	2.9	5.4
2015	1.3	1.4	3.0	5.7
2016	1.2	1.1	3.5	5.8
2017	0.2	0.8	3.7	4.8
2018				5.7

Drivers of Economic Growth in Kenya

- Contribution of the agricultural sector to GDP growth in 2017 dropped from an average of about 1.2% in 2016 to just 0.2% in 2017.
- 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 food such as maize, kale, and potatoes.
- The industrial sector which accounts for some 19% of GDP, contributed only 0.8% to GDP growth in 2017 compared to an average of 1.4% in 2015.

Drivers of Economic Growth in Kenya

- Activity in the industrial sector was impacted by:
- (1) a prolonged electioneering period 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,
- (4) high cost of energy due to drought.
- The service sector has remained resilient, albeit with differences across sub-sectors.
- The services sector, which accounts for 58.5 % of GDP, was the main engine of economic growth in 2017, single-handedly accounting for some 80 % of the 4.8 % growth in 2017.

Drivers of Economic Growth in Kenya

- However, the robust performance in the services sector was uneven.
- There is ongoing rebound in tourism, the accommodation and transport sectors recorded robust growth.
- Solid growth was also recorded in the ICT sub sector (thanks to the exponential growth in mobile money and data services) and the real estate sub sector (spurred by the dynamism in commercial real estate market and steady growth in residential real estate market).
- The services sector remains highly informal except for the few large firms in finance, telecommunication, and ICTs and is dominated by a large number of low-productivity small firms.

Kenya’s Exports

Table 2: Kenya’s Top 10 Exports, Earnings and Share of Total Exports 2017			
No.	**Product**	**Earning in US$**	**Share of Total Exports (%)**
1	Coffee, tea, spices	1.7 billion	29
2	Live trees, plants, cut flowers	595.6 million	10.4
3	Mineral fuels including oil	353.7 million	6.2
4	Vegetables	209.2 million	3.6
5	Clothing, accessories	190.3 million	3.3
6	Fruits, nuts	180.7 million	3.1
7	Ores, slag, ash	177.3 million	3.1
8	Tobacco, manufactured substitutes	134.2 million	2.3
9	Plastics, plastic articles	129.5 million	2.3
10	Pharmaceuticals	124.2 million	2.2

Kenya's Exports

- Kenya's top 10 exports accounted for about two-thirds (65.5 per cent) of the overall value of its global shipments indicating a very high level of concentration and lack of diversification.
- Coffee, tea and spices were the highest earners (US$1.7 billion) which was 29% of total export earnings in 2017. This was followed by live trees, plants, cut flowers (US$595.6million) accounting for 10.4% of total exports earnings.
- During the last five years the exports of Kenya have increased at an annualized rate of 4.4%, from US$4.89billion in 2012 to US$6.17billion in 2017.
- The most recent exports are led by tea which represents 22.3% of the total exports of Kenya, followed by cut flowers, which account for 11.2%.
- The top export destinations of Kenya are the United States (US$537million), Pakistan (US$522million), Uganda (US$506million), the Netherlands (US$460million) and the United Kingdom (US$411million).
- Concentration on a few export destinations and lack of diversification

Kenya's Imports

- In 2017 Kenya imported US$17.1billion, making it the 75th largest importer in the world.
- During the last five years the imports of Kenya have increased at an annualized rate of 3.7%, from US$14.2billion in 2012 to US$17.1billion in 2017.
- The most recent imports are led by refined petroleum which represent 14.2% of the total imports of Kenya, followed by palm oil, which account for 3.17%.

Trade Balance

- 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.
- As of 2017 Kenya had a negative trade balance of US$11billion in net imports compared to the trade balance in 1995 when Kenya had a negative trade balance of US$656million in net imports.
- The top import origins are China (US$3.91billion), India (US$1.68billion), the United Arab Emirates (US$1.27billion, Saudi Arabia (US$1.05billion) and Japan (US$791million) showing another concentration on a few import orgins and lack of diversification.

Terms of Trade

- The terms of trade for Kenya are calculated as the value of its exports as % of the value of its imports.
- An increase in the terms of trade means that the value of exports is increasing relative to the value of imports.
- Kenya’s terms of trade have been deteriorating over the years.
- The deteriorating terms of trade are as a result of agricultural commodity prices falling relative to manufactured products, because of the relatively inelastic demand and also because of the lack of differentiation among producers.

Terms of Trade

- Also, the deterioration of the terms of trades could be due to low income elasticity of demand in primary commodities, and also of the loss of competitiveness in Kenya’s manufactured goods.
- From the demand side of the economy, private consumption contributed 79.8 per cent to GDP while investments and government consumption contributed 17.7 per cent and 13.6 per cent, respectively, in 2016.
- Also, the development of synthetic substitutes further displaces agricultural commodities as intermediate inputs, reducing the growth in demand.
- However, the contribution of net exports to GDP was -8.8 per cent, and therefore a key factor in determining growth performance .
- The unfavorable net exports have been persistent over time due to low value addition, low diversification of exports and increased demand for imports.

Need for Diversification

- Exports diversification has the potential to positively contribute to growth and development through several channels.
- First, increased investment in a broad range of activities and sectors enhance the sources of income and contributes to mitigating the adverse effects of export instability and fluctuations in the terms of trade.
- Second, 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.
- Third, the 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.

Need for Diversification

- Fourth, export diversification favorably influences the pattern of growth and structural transformation that countries and regions experience.
- Fifth, export diversification helps to increase a country's ability to meet such goals as job creation and improvements in income distribution.
- Sixth, export diversification tends to reduce export revenue instability and volatilities in imports and capital, which tend to be growth-inhibiting.
- Seven, exports diversification entails not only increasing the variety of goods exported but also moving into goods of higher quality and new markets.
- Eighth, export diversification can provide a hedge against exogenous price shocks usually associated with primary commodity markets.
- Lastly, export diversification promotes more rapid, inclusive and sustained economic growth and development

What is Diversification?

- Market diversification refers to entering new markets not previously covered with existing commodities.
- Product diversification means adding new products or services to the range of existing ones in existing markets.
- 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.

What is Diversification?

- A perfectly concentrated export portfolio exists when a country exports one product to only one trading partner.
- Conversely, a country has more diversified exports when its exports include a larger number of products and trading partners.
- The simplest definition of 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.

What is Diversification?

- 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.
- There are forward and backward linkages advantage and technology transfer potentials associated with vertical diversification.
- Horizontal diversification entails geographical diversification or diversification at the extensive margin which seeks to change export structure by increasing the mix of primary commodities being exported by the country.
- 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 product diversification, intermediate goods diversification, quality diversification, and goods-to-services diversification.
- Hence, diversification is a prerequisite to achieving positive development in Kenya.

Evolution of Kenya's Trade Diversification policy

- **Import Substitution Policy Phase**
- An import substitution policy can be defined as putting various barriers to the importation of foreign goods to reduce a country's foreign dependency and providing these goods by producing them domestically. It is based on the premise that a country should attempt to reduce its foreign dependency through local production of goods, mainly industrial products.
- The import substitution policy is also termed the infant industry argument in that industries in their infancy should be protected till they grow up and are strong to withstand competition.
- Kenya's first trade policy was an import substitution strategy, as expressed in the first 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.
- The import substitution strategy was complemented with state-led economic development through nationalization, subsidization of vital industries and agriculture.
- Kenya used this policy by restricting the importation of goods by use of tariffs, quotas and controlling the amount of foreign exchange that one could buy from the Central Bank to import goods and subsidizing the industrial sector.

Evolution of Kenya's Trade Diversification policy

- **Import Substitution Phase**
- However, the excessive government control mechanism put in place to support the strategy stifled progress to further stages of import substitution.
- This strategy was not achieving its development objectives of creating employment and reducing poverty.
- The ensuing economic distortions resulted in macroeconomic imbalances and slowed overall economic growth.
- The small domestic market (made smaller by the collapse of the East African Community in 1977) resulted in excess capacity, further compounding this problem and making it not viable to undertake further expansion of industrial capacity based on this strategy.
- The only logical option was to seek export markets and thus adopt an export oriented industrialization policy.

Structural Adjustment Programs Phase

- Structural Adjustment Programs policy replaced the import-substitution model.
- SAPs introduced in the early 1980s to address the structural rigidities, price instability and macro-economic imbalances that had become embedded in the economy and led to poor delivery of services by the public sector.
- The SAPs focused on promoting nontraditional exports, liberalized markets and reforms of trade regulations

Structural Adjustment Programs Phase

- It produced 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.
- It emphasized a change from reliance on import substitution and protectionism towards a policy that led to industries being encouraged to manufacture for export with reform programs aimed at improving efficiency, stimulating private investment and increasing the sector's foreign exchange earnings.
- It also meant economic liberalization, bringing to an end the central role of the public sector institutions.
- The SAP phase led to lowering of tariffs and reduction of NTBs in Kenya's export markets thereby improving market access to Kenya's products.

Structural Adjustment Programs Phase

- However, SAPs led to neglect of agriculture and food production.
- 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.
- SAPs and the resulting trade liberalization led to an increase in import of foodstuffs and a reduction in government support to agriculture.

Export Promotion Phase and WTO

- 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.
- The phase also coincided with increased efforts in the regional economic integration initiatives that resulted in the establishment of the EAC, COMESA and IGAD.

Export Promotion Phase and WTO

- The export promotion strategy created a more conducive trading environment for export growth.
- This was to be achieved through
- (1) Institutional reform,
- (2) Reduction and restructuring of tariffs,
- (3) Abolition of export duties,
- (4) Introduction of export retention schemes,
- (5) Improvement of foreign exchange
- (6) Insurance regulations
- (7) Establishment of the National Export Credit Guarantee Corporation (NECGC).

Export Promotion Phase and WTO

- (8) Introduction of a Foreign Exchange Bearer Certificate (Forex-Cs) secondary market and retention schemes in order to liberalize the foreign exchange market.
- (9) Trade licensing requirements were abolished and exporters had control of foreign exchange earnings.
- (10) The tariff structure was harmonized and tariff dispersion lowered substantially.
- (11) Export Processing Zones (EPZs) were established

Kenya's Vision 2030

- In 2007, Kenya launched Vision 2030 – 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.
- Vision 2030 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.

Kenya's Vision 2030

- Vision 2030 is deemed to have been successful, – total global exports increasing by over 64 % from 2008 to 2014.
- However, export growth rate reduced between 2012 and 2013 by 3 % and a weaker economic growth rate of 5.7 % which was mainly due to negative outcomes 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$1.6billion compared to US$7.6billion worth of imports.

Kenya's Vision 2030

- In terms of export market diversification, UK receives 13.06% of Kenya's global exports followed by Uganda at 12%, Netherlands at 9.1% as at June 2018.
- 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% .
- In terms of product diversification, coffee, tea, spices and cut flowers still dominate Kenya's exports.
- In terms of diversification of import products, industrial supplies took the first place in the value of Kenya's total imports in 2016 .
- This was followed by machinery and other capital equipment at 21.8% and fuel and lubricants at 14.53%.

Kenya's Challenges in Exports Diversification

- Challenges such as a low-skilled labour force- 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.

Kenya's Challenges in Exports Diversification

- 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.
- 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.
- A very low diffusion of technology from abroad -The technological level of the existing industrial activities remains generally low.
- 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.

Kenya's Challenges in Exports Diversification

- Unequal distribution of industries 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.
- Unequal distribution of income and development in regions bleeds ethnicity hence fanning the flames of ethnic conflicts.
- Kenya's export concentration on few primary commodities has led to Kenya being more vulnerable to external shocks in addition to the low efficiency and productivity of Kenyan industries.

Recommendations

- Mobilization of domestic savings for investment including human capital and physical infrastructure;
- Large FDI inflow as alternative source of foreign currency and capital formation);
- Shifting resources from less productive sectors to more productive sectors (vertical diversification);
- Emphasis on export-led growth;
- Sound macro-economic management