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Restarting and Sustaining Growth in Kenya

Proceedings of a conference

26 January 2000 – Nairobi, Kenya

Kenya Institute of Public Policy Research and Analysis
Institute of Policy Analysis and Research
Mwaniki Associates
Harvard Institute for International Development

THE CONFERENCE SPONSORS

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The technical proposal for the Kenya EAGER research study was prepared by Mr. Ngure Mwaniki, the Managing Director of MA Consulting, who also coordinated the study. He was assisted by Mr. Aidan Eyakuze, also of MA Consulting.

Research by the following individuals was presented at the conference:

Njuguna Ndung'u - macroeconomic management
Aidan Eyakuze - productivity and competitiveness
Njuguna Ng'ethe - political and institutional dimensions of economic growth
Jay K. Rosengard - microfinance development in Kenya
Ashok S. Rai - microfinance development in Kenya
Aleke Dondo - microfinance development in Kenya
Henry O. Oketch - microfinance development in Kenya
E. Siggel - policy reforms, competitiveness and prospects of Kenya's manufacturing industries
G.K. Ikiara - policy reforms, competitiveness and prospects of Kenya's manufacturing industries
B.M. Nganda - policy reforms, competitiveness and prospects of Kenya's manufacturing industries
Germina Ssemogerere - policy reforms, competitiveness and prospects of Kenya's manufacturing industries
Hezron O. Nyangito - revitalizing agricultural productivity
James Nyoro - revitalizing agricultural productivity
Gem Argwings-Kodhek - revitalizing agricultural productivity
Richard Evans - revitalizing agricultural productivity
J. Omiti - revitalizing agricultural productivity
Graham Glenday - growth, exports, trade liberalization and customs revenue
T.C.I. Ryan - trade liberalization and growth in Kenya
David Ndii - export platforms in Kenya

This report was a joint effort by staff of the following institutions: Kenya Institute for Public Policy Research and Analysis, Institute of Policy Analysis and Research, and the MA Consulting Group. Ms. Esther Kimathi of MA Consulting ably processed the transcripts and multiple drafts, and Ms. Margaret Crouch edited the final document.

"When I was in school in the 1980s I was told that the 1980s were the lost decade for Africa. On New Year's day this year, we were told the 1990s were a lost decade for Kenyans. So I have lost two decades of my life, which is more than half of my life. I can't afford to think that by 2023 we are going to be sitting like this trying to figure a way out. So can we please use the resources that we have to rethink our own development, the role of development, the kind of Kenya we want to see in 2023."

- Conference participant

CHAPTER 1

CONFERENCE OVERVIEW

Restarting and Sustaining Growth in Kenya was the topic of consideration that drew nearly 350 concerned individuals from the public and private sectors to a thought-provoking and highly participatory conference focused on Kenya's economic future. Held in Nairobi on 26 January 2000, the conference attracted a wide cross-section of participants. Among them were senior officers from various government ministries and departments, private sector firms and industry associations, members of academic institutions in Kenya and neighbouring countries, representatives of non-government organizations (NGOs) and Kenya's bilateral and multilateral development partners, and local representatives from several diplomatic missions. A list of the participants may be found in Annex A of this report, and the conference programme is included in Annex B.

BACKGROUND - THE EAGER PROJECT

The conference was the culmination of two years of a countrywide study of pertinent issues relating to Kenya's economic growth—or the absence of it! Commissioned by the Harvard Institute for International Development (HIID), the study was undertaken by leading Kenyan researchers under the auspices of the MA Consulting Group and other Kenyan institutions, with the collaboration of international researchers. Issues covered by the study were macroeconomic management, productivity and competitiveness, political and institutional dimensions of restarting growth, trade and exchange regimes, microfinance development, revitalizing agricultural productivity, trade liberalization and customs revenue, and export platforms in Kenya.

Pursuant to the Kenya study subcontract, the MA Consulting Group reported to a local research supervision committee (RSC). The committee comprised Mr. Harris Mule, a renowned Kenyan economist, former Permanent Secretary and now an independent consultant; Mr. Jimnah Mbaru, an independent Kenyan businessman and chair of the Nairobi Stock Exchange; and Dr. Graham Glenday, HIID Fellow and Director of the HIID Public Finance Group, who is currently an adviser to the Ministry of Finance and Planning, Kenya.

The Kenya study was itself part of an Africa-wide research project known as Equity and Growth through Economic Research (EAGER). Sponsored by the US Agency for International Development (USAID), the project had two components. The first component, Public Strategies for Growth and Equity (PSGE), had as its main theme restarting and sustaining growth. The second component was Trade Regimes and Growth; its main theme was trade liberalization and growth. Research work done by the MA Consulting Group fell under both components.

Nearly 350 concerned individuals participated in the Growth conference.

The EAGER project involved country-specific studies in 11 countries with the goal of accelerating sustainable economic growth with equity in sub-Saharan Africa by applying research to public policy. The idea was to increase decision makers' use of the results of economic and social research in formulating policies on key

issues relating to economic growth. The project also intended to enhance local ownership of research outcomes and strengthen local capacity for policy analysis by promoting collaboration between local and international research and consulting organizations.

Output from the Africa-wide research project was presented at five conferences. The first four were held in Accra, Ghana (5–8 February 1997), Dar es Salaam, Tanzania (13–15 August 1997), Muldersdrift, South Africa (4–6 February 1998) and Dakar, Senegal (4–6 November 1998). The fifth and final event, an All-Africa Conference on "Africa in the Third Millennium: Trade and Growth with Equity," took place in Gaborone, Botswana, on 18–20 October 1999. The Kenyan delegation to the Gaborone meeting consulted on the possibility of holding a national conference to enable Kenyan researchers to disseminate their findings to a largely local audience.

The EAGER project intended to enhance local ownership of research outcomes and strengthen local capacity for policy analysis.

Soon thereafter, Kenya's EAGER RSC appointed a subcommittee of local research organizations to deliberate and, if found desirable, organize a national conference. The subcommittee comprised the Kenya Institute for Public Policy Research and Analysis (KIPPRA), the Institute of Policy Analysis and Research (IPAR), the Institute of Economic Affairs (IEA), and the MA Consulting Group. These four organizations eventually co-sponsored the Conference on Restarting and Sustaining Growth in Kenya.

The Kenya Restarting Growth research project produced a total of ten papers, nine of which were presented for discussion during the Nairobi conference. Executive summaries of the research papers presented are included in Annex C. (The full text of the research papers is being published separately.)

THE CONFERENCE OBJECTIVES

The conference had two major objectives. The first was to disseminate the results of the Kenya country research study. The second objective was to exchange views and ideas on a new strategy for restarting and sustaining growth in Kenya, including an agenda for both public and private sector researchers and policy makers.

The theme of the conference, *Restarting and Sustaining Growth*, was both appropriate and timely, coming as it did at the start of a new century. By the end of the 20th century, the performance of the Kenyan economy had sunk to its lowest levels since independence. Annual GDP growth rate declined from 6.5% during 1964–1972 to 2.6% in 1991–1996, and 1.8% and 1.5% in 1998/1999. During 1972–1982, agricultural GDP growth averaged 3.9% per annum. In 1997, 1998 and 1999, it was measured at 1%, 1.5% and 1.4%, respectively. In the rural areas, the population living below the poverty line increased from 40.2% in 1982 to 46.4% in 1992 and 47% in 1997. Urban unemployment rose from 11% in 1977 to 16% in 1986 and 22% in 1992. The number of poor Kenyans increased from an estimated 3.7 million in 1972/73 to 11.5 million in 1994. It increased to 12.5 million by 1997 and exceeded 15 million (half the total population) by the end of 1999!

The last five years of the century were particularly bleak. Gross domestic investment witnessed a steady decline, from 21.8% of GDP in 1995 to 16.9% in 1999. Likewise, gross domestic savings dropped from 17.4% of GDP in 1995 to 12.9% in 1999. In the external sector, the country's current account deficit grew steadily throughout the five-year period.

At the dawn of the 21st century, therefore, the fundamental economic challenge facing Kenya, like most other countries of sub-Saharan Africa, is that of finding effective means to foster rapid, equitable and sustainable growth. In short, Kenya

needs to achieve quick, substantial gains in her people's living standards, to distribute those gains among the greatest numbers so as to check the alarming poverty levels, and, finally, to ensure that these gains extend far into the future.

The EAGER project set out to answer three questions in the context of sub-Saharan Africa: How and why did growth fail? How could it be restarted? And having been restarted, how could it be sustained? These are the three questions that the Restarting Growth Conference sought to answer in the Kenyan context.

ORGANIZATION OF THE CONFERENCE

The conference began with welcoming and introductory remarks by Prof. Mwangi Kimenyi of KIPPRA. Mr. Harris Mule, the Conference Chair, then presented its objectives, after which the conference was formally opened by Hon. Charles D. arap Kirui, Deputy Minister for Finance, on behalf of the Minister for Finance, Hon. Chrisanthus Okemo. This was followed by a keynote address by Prof. Shem Migot-Adholla, Permanent Secretary in the Ministry of Agriculture and Rural Development. About one quarter of the conference was spent on plenary discussions following the opening session.

To analyse the main issues and research findings, the conference was divided into the following four breakout sessions, each of which had a session chair, authors of the respective papers as resource persons and a rapporteur:

1. Trade, business and competitiveness
2. Managing for growth
3. Revitalizing agricultural productivity
4. Globalization and regionalism – Challenges to growth in Kenya

In the afternoon, the four rapporteurs briefed the plenary on major points raised in the breakout sessions. This was followed by a panel discussion led by five panellists: Prof. Peter Anyang' Nyong'o, Member of Parliament and Director of IEA; Mr. Jimnah Mbaru, Chair, Nairobi Stock Exchange; Mr. Vimal Shah, Chair, Tax Committee, Kenya Association of Manufacturers; Ms. Betty Maina, Chief Executive, IEA; and Dr. Njuguna N'gethe, a consultant. Hon. Gideon Ndambuki, Minister for Planning, closed the conference.

In the event, the Restarting and Sustaining Growth conference was a catalyst for a wide-ranging discussion that involved both members of the private sector and representatives of the government in developing a strategy for the way forward. The conference thus served as an important forum for solidifying the collaborative efforts of the research institutes involved, and the link between their research results and government policy makers. In that sense, particularly, the conference addressed an important mandate of the EAGER project, which was to "enhance local ownership of research outcomes."

Besides the discussions on research findings, the conference produced various recommendations for action by the government, the private sector and research institutions. These outputs are contained in the reports of the breakout sessions, which are presented in Chapter 3, and summarized in Chapter 7, Summary of Issues and Proposed Interventions.

The conference served as an important forum for solidifying the collaborative efforts of the research institutes involved, and the link between their research results and government policy makers.

CHAPTER 2

OPENING SESSION

The opening session featured welcoming remarks by Prof. Mwangi Kimenyi and Mr. Harris Mule, as well as the opening speech by the Minister of Finance and the keynote address by Prof. Shem Migot-Adholla. Following these formal presentations the session was opened to comments from the floor. The speeches are presented here in their entirety; the floor comments have been edited to reduce repetition while retaining a sense of spontaneity and the personal perspective.

WELCOME - PROF. MWANGI KIMENYI, KIPPRA

Our distinguished guests, representatives of the government, permanent secretaries and other officials, ladies and gentlemen.

My name is Mwangi Kimenyi. I am the Executive Director of the Kenya Institute for Public Policy Research and Analysis, which is one of the partner organizations involved in organizing this occasion. I take this opportunity to welcome you all and thank you for your participation.

This is a time when issues of economic policy are very important to us. But may I also let you know that the timing of this conference has nothing to do with the International Monetary Fund! The conference was organized last November, and it is a coincidence that the IMF mission is in the country at this time. There are some implications of this coincidence that will be apparent as we go on, particularly in the participation of key government officials.

What you will find today is a broader treatment of the issues, including topics that were not covered fully in the initial EAGER project, but were thought pertinent to restarting growth in Kenya.

This conference is a result of an Africa-wide research programme called Equity and Growth through Economic Research, or EAGER, which was sponsored by USAID and implemented by the Harvard Institute for International Development. The results of this Africa-wide research programme were presented in a major conference in Gaborone late last year. It was decided then that the Kenyan group of researchers should organize a conference focusing on the Kenyan economy. As we began putting together the research papers that had been presented in Gaborone, we realized that several omissions needed to be addressed. Thus, what you will find today is a much broader treatment of the issues, including topics that were not covered fully in the initial EAGER project, but were thought pertinent to restarting growth in Kenya.

At this point I would like to introduce some of the key players, organizers and sponsors who have brought us here today. The first is my organization, the Kenya Institute for Public Policy and Research Analysis. Then we have the Institute for Policy Analysis and Research (IPAR), whose Acting Director, Prof. Kimuyu, is here with us. Next is the Institute of Economic Affairs; IEA Chief Executive Betty Maina is an associate in co-organizing this conference. Finally, there is Mwaniki Associates, the implementing agency for the EAGER project in Kenya. Mr. Ngure Mwaniki of MA Consulting is here with us today.

I would also like to take this opportunity to introduce the EAGER Research Supervision Committee: Mr. Harris Mule, Mr. Jimnah Mbaru and Dr. Graham Glenday.

Next, I would like to acknowledge the support of USAID—Dr. Lee Ann Ross of USAID, could you please stand—and to recognize Dr. Clive Gray of HIID, the EAGER project chief of party. There are as well three observers from our neighbouring countries: Prof. Germina Ssemogerere, from Makerere University, Dr. Ammon Chaligha, from the University of Dar es Salaam, and Dr. Servicius Likwelile, of the Research and Poverty Alleviation Institute of Tanzania. Finally, I would like to acknowledge the support of various officials in the Kenyan government who will be participating with us throughout the day.

And now, I wish to introduce the Chair of the Conference, Mr. Harris Mule. Mr. Mule is a former Permanent Secretary in the Ministry of Finance and Planning, and for the last 14 years he has been a consultant to several international organizations such as the World Bank, The African Development Bank (AfDB) and the International Fund for Agricultural Development. Mr. Mule is also the Chair of the Board of IPAR, one of the organizing institutions here. He will tell you about the objectives of this Conference. Again, we welcome you all and hope you will be with us throughout the day. We look forward to your participation.

The performance of the agricultural sector, which was very respectable at around 4% per year in the 1960s and 1970s, decelerated to around 1–1.5% during the last five years.

OPENING REMARKS - MR. HARRIS MULE, CONFERENCE CHAIR

Thank you very much, Professor Kimenyi. Dr. Migot-Adholla, distinguished participants, and attendees of this conference, ladies and gentlemen. It is a big honour and a privilege for me to be invited to come and chair this session of this conference. It is a very important conference. Important in the sense that it is addressing a very important issue. Important because it is a conference that is based on serious research and analysis undertaken by Kenyan researchers over the last two years. It is particularly important because we have representatives from the private sector, from the public sector, from civil society and from the donor community. Finally, it is important because it is taking place in the first month of the Year 2000 as we go into the new millennium. So I am happy to be here to chair this session and to take a few minutes to give you the objectives of the conference.

We all know that our country, Kenya, has gone through a very difficult time during the last five years or so. The statistics tell it all: 30 years ago, our economy was growing at around 7% per year in real terms. That growth rate decelerated to 3–3.5% in the 1970s and 1980s, and during the last five years of the 1990s it was about 1–1.5% per year. With the population growing at 2.5–3% per year, we actually have been getting poorer on the average at a rate of 1.5% per year during the last five years. More worrying is the agricultural sector, which provides livelihood to 70–80% of our population. The performance of the agricultural sector, which was very respectable at around 4% per year in the 1960s and 1970s, decelerated to around 1–1.5% during the last five years. In real terms, therefore, agricultural production has in fact been going down on a per capita basis in the last five years. Now these are statistics. Beyond these statistics are the suffering and deprivation of a lot of Kenyans. Those statistics reflect increasing under-and unemployment. The rate of urban unemployment has gone up from about 16% in 1986 to about 22% in 1992 and we suspect that it has been going higher since that time, as poverty has increased and the Kenyans living below the poverty line now account for almost half of our population. That is the background against which we must look at Kenya's economy as we enter the new millennium. What then are the main issues we shall be addressing today?

Beyond the statistics are the suffering and deprivation of a lot of Kenyans.

The main issue and major questions are the following: How and why has the growth rate in Kenya deteriorated? How can growth be restarted? How can the

growth be sustained? If we can provide answers to those three questions then we see this conference as a very important forum to disseminate the research findings and analysis that have been derived as a result of the research that has been undertaken during the last two years. Secondly, on the basis of that research and research findings, we will exchange views on how we can address our economic problems and how we can get growth restarted.

How and why has the growth rate in Kenya deteriorated? How can growth be restarted? How can growth be sustained?

We hope that during the course of our deliberations we shall be able to address the following specific issues:

- How to generate, how to engender, how to bring about, homegrown solutions to Kenya's problems and how we can bring to bear and use the research findings to generate and develop these homegrown solutions.
- How we can link policy analysis and research to policy formulation and policy making, including decision making in both the government and the private sector.
- The critical role of agriculture as a basis for growth and especially as an indispensable starting point for poverty alleviation and industrialization.
- The importance of the cross-cutting issues of productivity and competitiveness in Kenya's manufacturing sector, how we can make our industrial sector more efficient and more competitive, and how we can make industry in the medium and long term function as an important engine for growth in this country.
- The crucial need for an enhanced investment climate so as to forestall complete stagnation in the light of current levels of new investments. Additionally, we shall look at the implications for Kenya of the new and existing trade arrangements and agreements, especially the World Trade Organization, COMESA, East African Cooperation and so forth.
- Finally, the pertinent issues in management for growth that must be addressed.

Six months ago, the government brought in what they call the recovery team, the newspapers call them "dream team."

The research organizations who convened this conference—IPAR, KIPPRA, IEA and Mwaniki Associates—have been working closely together and with the private sector, civil society and government. And the government is becoming increasingly open to new ideas, especially if those ideas are based on objective and serious empirical evidence. Six months ago, the government brought in what they call the recovery team, the newspapers call them "dream team." We will be seeing some members of that dream team here today, which is an indication that there is interaction and there is receptivity to ideas. Our expectation is that because of this forum and those attending this conference, we shall bring the findings of the research to the research users and hope that we shall have the beginnings of linking policy research and analysis, policy formulation, and policy implementation. When I was in school many years ago, one of our professors used to tell us the important thing about life is to think, to decide and to act. This morning and this afternoon we shall be thinking, we hope that after thinking we shall decide and that from tomorrow we shall act.

The person who was going to open this conference is the honourable Minister for Finance, Mr. Chris Okemo. I suspect that he has been held up by discussions and negotiations with the IMF. In the meantime, he has sent his Assistant Minister, Hon. Charles D. Kirui, to come and open the conference on his behalf. All of us know Hon. Kirui; I have the pleasure of inviting him to come and open the conference.

OPENING SPEECH - HON. CHRISANTHUS OKEMO, EGH, MP, MINISTER FOR FINANCE ***(delivered on his behalf by Hon. Charles D. arap Kirui, Assistant Minister)***

Mr. Chairman, distinguished guests, ladies and gentlemen. First I should apologize for coming late and hope, Mr. Chairman, that my quick introduction will not put me at any serious disadvantage. Mr. Chairman, as you had put it, my Minister is unable to be with you this morning and he sends his apologies and has asked me to represent him. Without much ado, I'll go into the Minister's opening address.

Mr. Chairman,
Distinguished guests
Ladies and gentlemen,

It is with great pleasure that I join you on this important occasion, the Conference on Restarting and Sustaining Growth in Kenya. The timing of this conference could not have been at a better time than now, when the government and indeed all Kenyans are in search of permanent solutions for the economic difficulties the country has faced over the past few years. I would like, therefore, to thank the organizers for bringing together a diversity of experts and interest groups in a research oriented policy discussion.

The much talked about and long awaited 21st century is here with us, and with it comes a reminder that many of our development objectives and targets are yet to be realized. The performance of the economy has been disappointingly low and growth targets have not been met. The income per capita of Kenyans has decreased from US$350 in the 1980s to US$280 in 1999 in nominal terms. Many Kenyans remain poor due to shortage of opportunities for gainful employment. About 50% of the population or more than 13 million people live below the poverty line. Many do not have adequate access to basic needs such as food, education, medical services, clean water and shelter. We are therefore starting the new millennium with a disappointing performance on a number of fronts.

Ladies and gentlemen, it is important to remember that since independence, the country has undergone major structural changes. The country went through a turbulent period in the 1970s characterized by commodity price shocks dominated by the huge oil price changes of the early 1970s and the coffee boom in the latter part of that decade. Given the circumstances then, an import substitution industrialization strategy was adopted as a means of realizing our industrialization goals. Unfortunately, this did not happen, because of high protection of the industries. The industries were inefficient and could not effectively compete in the international market. As a result, our economy was ill prepared as we approached the 1980s. By the mid 1980s important structural weaknesses were evident and became the object of policy attention for the rest of that decade.

You will recall that the government outlined measures to address structural weaknesses in the economy through Sessional Paper No. 1 of 1986. The Sessional Paper provided measures for a more market-based economy. The adjustment programmes were, however, not easy to implement as they had unanticipated side effects. It was not until the early part of the last decade that structural adjustments were accelerated, especially after 1993.

Some of the major reforms implemented in the last decade focused on removal of price controls and import restrictions, and the liberalization of the money market and the financial sector. In addition, liberalization of foreign exchange controls by repealing the Foreign Exchange Act and delineating functions of the Central Bank

The long awaited 21st century is here with us, and with it comes a reminder that many of our development objectives and targets are yet to be realized. We are starting the new millennium with a disappointing performance on a number of fronts.

from those of Treasury have greatly improved the money market and the performance of the financial sector. The period also witnessed the introduction of major political reforms occasioned by incidences of insecurity that undermined the tourism industry and eroded both domestic and foreign investor confidence in the country.

Liberalization of foreign exchange controls by repealing the Foreign Exchange Act and delineating functions of the Central Bank from those of Treasury have greatly improved the money market and the performance of the financial sector.

Ladies and gentlemen, allow me to outline some of the major challenges facing the economy that demand urgent policy attention. First, arising from the slow rate of economic growth experienced over the last several years, the country faces severe budgetary financing problems. Consequently, the government has had to rely on domestic debt financing in order to meet its expenditure obligations. Reliance on debt financing to meet government expenditure requirements continues to have secondary negative effects such as high interest rates and crowding-out of private investment.

Second is the problem associated with poor infrastructure, especially roads. The current poor state of infrastructure in the urban areas and inadequate rural roads add significant costs to our production process, thereby undermining our competitive advantage.

The third challenge is related to public sector reform. This entails reforming the civil service to become client oriented and facilitative, with low tolerance for corruption. Furthermore, reduction of direct government involvement in economic activities by accelerating the participation of the private sector through aggressive parastatal reform is a key aspect of public sector reform.

Fourth is the challenge to upgrade investment and export support institutions to international best practices. In this regard, the private sector has experienced low investment levels and the efficiency of investment has experienced significant declines.

Fifth, we are faced with the challenges posed by HIV/AIDS. Currently, about 1 in every 11 adults is infected with HIV. Many of those infected fall in the economically productive age group of 20–45 years. The cost associated with HIV/AIDS in terms of the lives lost, resources required to care for the infected and loss of productive capacity is extremely high.

The cost associated with HIV/AIDS in terms of the lives lost, resources required to care for the infected and loss of productive capacity is extremely high.

I am, therefore, encouraged to learn that these challenges are some of the issues that you will be deliberating on during this conference. It will be difficult, however, to achieve high and sustainable economic growth and to significantly reduce the high levels of poverty if we do not simultaneously tackle these problems in a sustainable manner.

Ladies and gentlemen, as we address ourselves to the challenges facing the Kenyan economy, we must recognize changes in the global economy characterized by globalization of trade and financial markets, advances in information technology, and pressures on the national economies to redress their national policies in the context of the changed environment. In view of these, there is need for concerted efforts by all of us to transform the economy to become more competitive and to take advantage of the opportunities that globalization and regionalism provide.

It will be important to evaluate trends in some of our core sectors. For example, the country is experiencing problems with our traditional exports such as tea and coffee and there is urgent need to revive these sectors. Likewise, there is need to re-evaluate our policies in regard to textiles, fishing and sugar and how to sustain the performance of horticulture in our traditional markets as well as in the emerging markets of COMESA and the Eastern Africa region. We must expand the potential in these sectors in order to generate additional employment and income and thus be able to have impact on poverty reduction efforts.

Over the recent past, the government has undertaken several key steps to jumpstart the economy. The reduction of the number of ministries to 15 was a

deliberate effort towards right-sizing the public sector. It was also the initial step towards reducing the wage bill, which currently consumes more than half of the total government revenues. This was followed by ministerial rationalization in which government ministries and departments redefined their mission and core functions with a view to matching functions with the right type of personnel. The goal is to move towards a small and efficient public sector with high quality service delivery.

Ladies and gentlemen, one of the major missing links in the history of our economic development has been the lack of clear linkage among policy, planning and budgeting. The outcome has been poor prioritization and inefficient utilization of public investments. It also contributed to low impact of public spending on development. It is in view of this that the government has undertaken steps to instil financial discipline in the public sector. To achieve this objective, the government has introduced the medium-term expenditure framework (MTEF) in the budgetary process. The process links policy, planning and budgeting and uses an appropriate macroeconomic framework and sectoral priorities as its key pillars. It is expected to create the necessary environment required for fiscal discipline and ensuring efficiency in policy planning and budgeting.

We believe that this process will ensure that planning functions are closely tied together with the budgetary process and that resource allocation will be based on sectoral priorities. Within the MTEF, several institutions have been put in place. These include the establishment of an MTEF secretariat, the macroeconomics working group and sector working groups.

The primary task of the MTEF secretariat and the macroeconomics working group is to undertake regular forecasting and establishing of macro targets for the country. The process encourages greater consultation among the key stakeholders and therefore has the potential of creating greater ownership in policy formulation and resource allocation. For example, the macroeconomic working group and sectoral working groups are working together to formulate a budget that will not only include achievable targets but will clearly rationalize resource allocations.

The government is keen to ensure that economic policy making involves a wider spectrum of society and is done in consultative process. The Ministry of Finance and Planning is presently engaged in the process of formulating a Poverty Reduction Strategy Paper (PRSP) that will form the basis of medium-term economic policy. Extensive but internal consultations have been going on with the line ministries in preparing this paper. The draft PRSP will be tabled for discussion by private sector organizations, professional associations, and NGOs working with rural and poor communities in order to improve its content. It is our goal that economic policies address problems facing the entire nation. Consultative forums such as the Joint Industrial Commercial Consultative Committee (JICCC), which brings together private sector stakeholders, are already yielding dividends. I would like to encourage NGO umbrella organizations such as the NGO Council to start actively participating in such forums.

Before I conclude, let me on behalf of the government and on my own behalf take this opportunity to thank the USAID EAGER project for the initiative and foresight that has enabled this conference to take place. I would also like to commend the collaborative efforts of KIPPRA, IPAR, IEA and MA Consulting, as well as the researchers who have invested a significant amount of time towards the success of this conference.

Ladies and gentlemen, we need to act fast to fix the economic problems facing the nation today. We need to restore the growth rates that we recorded immediately after independence and sustain them over a long period of time. I am convinced that together we can do it and therefore look forward to practical and realistic suggestions that will enable us to restart and sustain economic growth.

There is need for concerted efforts by all of us to transform the economy to become more competitive and to take advantage of the opportunities that globalization and regionalism provide.

One of the major missing links in the history of our economic development has been the lack of clear linkage among policy, planning and budgeting.

The government is keen to ensure that economic policy making involves a wider spectrum of society and is done in consultative process.

Let me assure all of you one more time of my Ministry's commitment to revamping the economy and that we are very keen on the proceedings of this conference. Several of our senior officers will be here with you throughout the conference. As you are aware, our friends from the IMF are in the country and it will therefore not be possible for me and some of the senior officers to be with you throughout the day. Please accept my apologies in this regard.

With these remarks, it is now my pleasure to declare this important conference officially open. Thank you very much.

We need to act fast to fix the economic problems facing the nation today.

Mr. Mule: Thank you very much, Hon. Kirui, for that very informative and inspiring statement. Your statement will be taken as a very important input in our deliberations today.

I would now like to present Prof. Shem Edwin Migot-Adholla. Prof. Migot-Adholla is well known to many of us, the Permanent Secretary in the Ministry of Agriculture and Rural Development. He is a lead specialist in the Agriculture and Rural Development Department, Africa Region of the World Bank. Before that he was Associate Professor of Sociology at the University of Nairobi and member of the Institute of Development Studies, again of the University of Nairobi. He is a renowned researcher, teacher and scholar.

KEYNOTE ADDRESS - PROFESSOR SHEM MIGOT-ADHOLLA, PERMANENT SECRETARY, MINISTRY OF AGRICULTURE AND RURAL DEVELOPMENT

Hon. Minister, distinguished guests, ladies and gentlemen:

I am pleased to have been invited to deliver the keynote address at this conference. The topic of this conference—restarting and sustaining economic growth—is in fact the preoccupation of most of us. It therefore gives me great pleasure to share with you some of my thoughts as to how we can restart and sustain economic growth in the country.

Kenya has a history of good economic performance.

Kenya has a history of good economic performance and therefore the title "restarting economic growth" is actually appropriate. During the 1960s, Kenya's rate of economic growth averaged above 6% per year. We could not have achieved that rate of growth unless we had in place policies that promoted growth. It was not an accident that we achieved the high rates of economic growth during our first years of independence.

During those "glorious" years, our policies were based on a simple vision of eradicating poverty, ignorance and disease. All these are measurable objectives for which clear and achievable targets can be set. For example, it is possible to measure the degree of poverty and set targets by which to reduce poverty levels. Likewise, it is possible to set targets of literacy among children and adults and to talk about reducing the incidence of certain diseases. In essence, during the first years of independence, we set out to pursue clearly defined goals such as increasing literacy and reducing malnutrition and disease.

The clearly defined policies of the day focused on land redistribution, provision of public health, infrastructure, primary education and other economic services to the majority of the poor living in the rural areas. Cooperatives were started to cater for the interests of the majority low-income population. The result was dramatic improvement in well-being, reduction in levels of disease, increased school enrolment and literacy rates, and increased productivity. Our focus on a simple vision translated into positive results in terms of economic welfare. There is no question that these

policies that focused on rural development and small-scale agriculture were responsible for the impressive growth during the 1960s and early 1970s.

Sometime during the late 1970s, we stumbled. Our focus changed and instead of focusing on small-scale agriculture, we turned our attention to large-scale farmers. The bias against small-scale agriculture is evident if you look at the benefits that went to the large farms. For example, over 80% of AFC loans were directed to large-scale producers. The result was that the policies resulted in making a few people richer and the majority poor. Worse still, a significant percentage of those loans were never repaid. The policies were therefore transferring benefits from the poor to the wealthy, thereby exacerbating the state of income distribution. Our economic performance suffered in the process.

Our early focus on a simple vision translated into positive results in terms of economic welfare.

As already mentioned, the policies that produced economic growth involved improved access to productive assets and social services for the majority of our population. This is not unique for Kenya. The history of South Korea, Taiwan and Japan shows that these countries adopted re-distribution policies such as land reform coupled with provision of economic services. International evidence shows that where income distribution is lopsided there are serious problems in sustaining economic growth. Very few countries with grossly skewed income distribution have been able to sustain economic growth.

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What then is the connection between income distribution and economic growth? It is evident that peace and stability are absolutely necessary for economic growth. But with extreme income inequality, social tension and civil disturbances are a must. These conditions are not conducive to investor confidence. They tend to militate against long-term capital investment. Again we have good examples from history. Latin America, where income distribution is lopsided and the majority of the population is impoverished, has been marked by over 50 years of civil wars, guerrilla movements and government-sponsored military juntas. Economic growth in these countries has also been sluggish until very recently.

Today, Kenya is marked by extreme inequality in the distribution of income as a result of the policies that became prominent after the late 1970s favouring a few large-scale producers at the expense of small-scale farmers. As a matter of fact, the state of income distribution in Kenya today may be comparable to that of Brazil or of South Africa during the height of apartheid.

This is not the path that we started on. Furthermore, this is not to say that we have not designed good policies. There are many extremely good policy documents such as the 1986 Policy Framework Paper. The problem is that we have often lacked the resolve to implement good policies.

This is not to say that we have not designed good policies. The problem is that we have often lacked the resolve to implement good policies.

The results of our neglect of rural and small-scale agriculture have been a deterioration of the quality of life experienced by the majority of the population. For example, if you look at the social indicators in most of the districts what you find is that the population has become worse off on every measure. In many districts that were doing relatively well in the 1960s and the early 1970s, what you find today is that all measures of well-being have declined: income per capita has fallen, nutrition status is worse and levels of illiteracy are rising.

As if all this is not enough, the decline in well-being has also been accompanied since the 1980s by the incidence of HIV/AIDS, particularly among women. The evidence shows that where the majority of women are not empowered, where the population is generally poor but there are a few men with disposable income who are mobile, the incidence of HIV/AIDS especially among women tends to be high.

While many districts in Western Kenya have high incidences of people infected with HIV/AIDS, this menace is spreading fast. Likewise, infection rates are high among commercial agricultural workers in tea, sugar and coffee growing areas. The same is happening among workers in horticultural establishments.

The results of our neglect of rural and small-scale agriculture have been a deterioration of the quality of life experienced by the majority of the population.

The seriousness of this disease should not be underestimated. Kenya has now entered the third phase of HIV/AIDS. The first phase is one where those infected are primarily illicit drug users, homosexuals and commercial sex workers. In the second phase infection includes heterosexual adults. In the third phase, the disease spreads among adolescents. In Kisumu municipality, for example, more than 15% of girls aged 15–20 years are said to be HIV positive. In my Ministry some preliminary estimates, though not scientific, suggest that 50% of our workers who have died over the last five years have died of causes that could be related to HIV/AIDS.

The implications of HIV/AIDS for economic growth cannot be overestimated. In particular, we have to ask ourselves what the implication is for agricultural productivity. First, of course, is that spread of the disease will have significant impact on the labour force and hence overall production. It is therefore not possible to achieve our development targets unless this disease is arrested.

Some estimates suggest that the cost of treating one HIV/AIDS patient is equivalent to educating ten primary school children. Over 1 million Kenyans have died due to AIDS related illness. Clearly, we must wake up to the fact that some of the growth projections that we are making today may not be achievable.

The implications of HIV/AIDS for economic growth cannot be overestimated.

It is increasingly evident that the negative implication of this disease will extend to generations to come. As mothers and fathers succumb to the disease, many orphaned young people have to drop out of school in order to feed and clothe themselves. It will be difficult to fight poverty under the circumstances.

Now let me turn to the issue of broad economic growth strategy. I suggest that we must go back to basics. From our history when our economy performed well and also the experience of other countries, it is clear that we must refocus our attention on small-scale agriculture. Evidence shows that small-scale agriculture is efficient in terms of its labour absorption capacity and therefore poverty alleviation. Since we know from our history that land distribution was instrumental to our growth, then we must adopt a policy of providing access to land by the majority of our population. There is substantial evidence from our historical experience that small-scale farms were more productive than large-scale farms.

Such a strategy entails provision of services such as infrastructure that would reduce the cost of production and also the avoidance of excessive taxation of small-scale farmers. But as experience worldwide now shows, and our own history now bears out, such services are better managed in a totally decentralized manner where the rural populations enjoy significant participation. During our early years of independence, District Councils performed this role. They maintained local roads, supported schools and health dispensaries, and ran local courts and tribunals. Following independence, one would have thought that we should have enhanced the performance of local authorities by improving their revenue base and making their management more participatory and transparent. But by the end of the 1960s, we had chosen the path of increased centralization of both fiscal power and administrative responsibility. Over the years, decision making on matters of public policy became the exclusive domain of bureaucrats as the number of state corporations proliferated.

Clearly, we must wake up to the fact that some of the growth projections we are making today may not be achievable.

In addition to equitable access to productive assets and economic services, sustained economic growth requires empowerment of the people. Our history again shows that economic institutions, such as cooperatives, worked well where the leadership was dedicated to serving their communities and did not seek to use the cooperatives as a stepping stone to national politics. During the early years of our independence, decisions concerning economic well-being were made at the local level by the people themselves. In essence, local decentralization provided the people with the opportunity to participate directly in the decision making process.

Some roads were maintained by the communities, villages employed teachers and there were even native courts, and so on. Thus the period in which this country recorded high rates of economic growth was the period when there was effective local decentralization.

Contemporary evidence also suggests that those countries whose people are empowered through decentralization are also performing much better. China, for example, is one of the most decentralized countries in terms of local administration. It is now also one of the best performers in terms of rural economic growth. Likewise, the best performers in Africa, such as Botswana, are also highly decentralized.

Kenya has in the past attempted decentralization. For example, the District Focus was such an attempt. However, the central government still dominated policy making. What we may need is honest and durable decentralization. Such decentralization requires political devolution so that communities are able to raise their own revenues and make decisions that serve their own interests.

Even under a decentralized system, grants should be made from the centre to the local communities based on their fiscal capacity. But local communities would be responsible for designing the implementing programmes.

In this talk, I have focused on three main policy themes that in my opinion are key to restarting and sustaining economic growth. The first is a return to basics. Here I have emphasized prioritizing small-scale agriculture and equitable access to productive resources, especially land. But this would also be achieved by development of neutral arrangements rather than simple land distribution. Second, I have emphasized the fact that we must take seriously the HIV/AIDS epidemic. International evidence again shows that top-down, centralized national AIDS programmes are unlikely to succeed. Already there are community groups that are helping AIDS victims and it is such groups that are best suited to deal with these problems. Such local efforts need assistance through provision of drugs, equipment and services to support widows and orphans. Finally, I have discussed the importance of political empowerment in association with decentralization.

These themes are not incompatible and are in fact complementary. Their relationships are, however, much more complex and require keener research grounded in Kenya's particular national and regional context. Since this conference also focuses on research and policy, it helps to mention that we should be clear on what type of research we are doing. For example, the development of Ruiru II coffee was a very successful solution to an agronomic problem. Ruiru II is disease resistant and thus has been welcomed by our farmers. However, coffee tasters and liquorers tell me that the product from Ruiru II is not as great as the traditional Kenya Arabica that has given our coffee a special place in the world market. The point is that our research must also focus on our consumer and export markets.

In conclusion, as we again focus our efforts on poverty alleviation, I am convinced that we can only succeed if we return to basics, primarily supporting and promoting small-scale agriculture and empowering the people through decentralization and deliberate broadening of access to productive assets.

Our history shows that economic institutions, such as cooperatives, worked well where the leadership was dedicated to serving their communities and did not seek to use the cooperatives as a stepping stone to national politics.

PLENARY SESSION DISCUSSION ON OPENING AND KEYNOTE SPEECHES

Following the keynote address, Mr. Mule opened the session to questions and comments from the floor. Those making interventions were asked to state their name for the record; their comments have been edited for clarity.

As we focus our efforts on poverty alleviation, I am convinced that we can only succeed if we return to basics, primarily supporting and promoting small-scale agriculture and empowering the people through decentralization and deliberate broadening of access to productive assets.

The key issue is infrastructure—our roads, energy, water, posts and telecommunications.

The reason agricultural growth has been declining is because we do not have the proper infrastructure.

Simon Ndirangu, Africa Development Initiatives: My first question is for Dr. Gitu. You in Government are developing a poverty strategy paper and you have also developed MTEF. In the past you had programme review and forward budget and you had PFP (the Policy Framework Paper) and since 1965 you have had sessional papers. Don't you think there are too many papers? Does it not look like we are just writing papers?

The second question is on HIV/AIDS. There is too much on the impact HIV/AIDS has had on the economy. There is too little on solutions to HIV/AIDS.

Kang'ethe Gitu, Permanent Secretary, Ministry of Human Resources Development: I would like first of all to make a statement here. The key issue is infrastructure—our roads, energy, water, posts and telecommunications. In addition, and obviously, we have to have social stability and political stability. I believe the reason agricultural growth has been declining is because we do not have the proper infrastructure. How can you actually do marketing with the types of roads that we have? How do you do business if you cannot communicate? Another important issue is business confidence; unless investors are confident that policies will be more or less permanent, they will not invest in Kenya. The issue of too many papers is valid. We have written very good papers but we have not implemented them. I think the reason growth has not taken place is that we do not implement what we say we will do. We have a tendency, I think, to talk too much. We also have a tendency to not manage financial resources, physical resources and even human resources well. I think it is high time we started implementing what we have set ourselves to implement. The writing of many papers on HIV, poverty reduction, sessional papers is okay, but only if we can implement what we have actually said in those papers. Finally, the issue of AIDS: I am not an expert in this, but I believe what Migot-Adholla said is very true, that this will have a very great impact on our economic development—that is, today, most of the health budget has actually been consumed by AIDS so it is important to understand its implications for growth.

Finally, going back to basics. The world has changed and we must move with the world. We are talking about a global economy and we have to move out. I believe if we can add value to our agricultural products, we can develop. I believe we also do not need to produce all of our agriculture products, even to process; we can import raw materials and process them in this country and export. That is all the comments I would like to make, but let me say this: there is one animal that has stopped us from growing and this is corruption. Kenyans are very corrupt, we are actually very corrupt. Look around. The business sector is corrupt, so is the public sector. If we want to develop we have to reduce the incidences of corruption. I hope this topic will appear again because I believe that it is one area where we have done very well, in terms of killing the economy.

Titus Muya, Managing Director, Family Finance Building Society: I would like to thank the people who organized this conference because, like the Minister said, the conference was long overdue. I also thank them for presenting very good papers, but there is something they left out, and this is an enabling environment. What do we mean by an enabling environment? One of the issues is the improvement of the infrastructure, and this must be done all over the country, not discriminately. If I am in Kisumu and I have to get my products to Mombasa, even if the road from Kisumu to Kericho is done, I will still not reach Mombasa and if I do, it will be very costly to me. That is one. What else do I mean by enabling environment? I mean security and when I talk about security, I would like to remind all of us here that this country is like the body of everyone

here: if your small finger is aching, it is very difficult for the rest of the body to function that day. Similarly, when there are political clashes in Mombasa, when there are tribal clashes in Kisumu, or like the one we had in Meru, or there is famine in Lake Turkana, this country will be hurting and hurting very badly and therefore the economy will not perform. Security means that property rights must be respected. Third, and this is the one I thought that the speakers forgot to mention, there has got to be political reform for us to be able to move forward. If there is no political reform, everybody will be doubtful as to whether they should continue doing business and doing it well.

There is one animal that has stopped us from growing and this is corruption.

Chris Kirubi, Chair, Kenya Association of Manufacturers: I would like to request that there should be somewhere that we can discuss and make some recommendations on the issue of the impact of *mitumba* on the economy. We have got where we are basically not because of policy issues, because we know them very well, but the issue of the leadership of some of these sectors. So I believe we must discuss, otherwise we will not succeed. And two, I believe we must come out at the end of the day with some recommendations and issues for us to demand to be performed, in order to move forward.

If we want to develop we have to reduce the incidences of corruption.

Speaker: May I take this opportunity like others to congratulate you and your team on organizing this workshop, I also would like to thank the Minister and Prof. Shem Migot-Adholla for their excellent exposition on the issues affecting us. I want to be very clear about basics. We need to stress what we stressed at independence—that is elimination of poverty, elimination of disease, and also of ignorance. The issue I want to raise is that in 1997, Kenya came up with Sessional Paper No. 2 of 1997 on Industrial Transformation by the Year 2020. On page 86 of that paper, there was a macroeconomic policy framework that specified action to be taken, who should have been responsible and the timeframe. Now we are in the year 2000, has anything been done in actual implementation of that paper so that we do not have to waste more time carrying out further analysis on issues we had already analysed and for which we had specific recommendations and action plans? Has anything been done?

Walter Oyugi, Department of Government (Political Science), University of Nairobi: There is one point Prof. Migot-Adholla raised that rather tickled me and this is when he said that over the years this country has developed some very good policies. The problem has been one of results. I think he was avoiding the use of the word, the problem of the will to do what is required. This statement begs the question, because you can't have a good policy and at the same time say it cannot be implemented. If you have a policy that cannot be implemented, that means the policy makers did not dissect the problems before coming up with that particular policy. Reference was made to Sessional Paper No. 1 of 1996 as a very good policy document, but that document was designed to address issues that the authors wanted to address and therefore it did not appreciate the political economy of this country. My second concern has to do with this romanticism about decentralization—that we have to decentralize and that we have to give the local authority the power of taxation. Local authorities have had the power to tax. And what has been the experience over the years? Look at what is happening to Nairobi City Council. It is a mess. We have to address the question of what is the problem with this society because local authorities reflect the wider problems in society. There is no guarantee that they will behave differently without fundamentally addressing the larger problems. Let the Omamo Commission report be released and let the public discuss it and pave the way forward.

We must come out at the end of the day with some recommendations and issues for us to demand to be performed, in order to move forward.

Local authorities reflect the wider problems in society. There is no guarantee that they will behave differently without fundamentally addressing the larger problems.

Speaker: I want to mention that there is hope. I think the government is trying a new way of doing business; the medium-term expenditure framework aims to link the planning process, the budget process and the process of setting priorities. I think there was good budgeting earlier and good policy papers, but you could not say that resources were always there to deal with them. I think what will happen with this MTEF approach is that when you budget for something, you set your targets or at least priorities, and you make sure that you are doing only what you have the resources to do it with.

Dr. Gitu: Thank you, Mr. Chairman. First I want to be honest about Sessional Paper No. 2 of 1997. We have not actually gone very far and I do agree that maybe we have written too much. We do have people here from the Ministry of Industry and maybe they can brief us on how far they have gone, but I think we have not done very much. My friend, Walter Oyugi, I would like to assure you that Sessional Paper No. 1 of 1996 was not produced because of donors. To mention one man, Professor Ryan is here; I think he was the chief architect of that one. Harris Mule was also an architect. I was also there. I do not know what the allusion is to. It was really Kenyan driven, and obviously not everything that comes from donors is bad. I think donors are also partners in development and we should not always over attack them. If it is good, we should use it. Even if it comes from IMF, if it is good we actually adapt it to our situation. The way we have been doing business really has changed. When I joined government in 1983, we were afraid of the private sector. The dialogue between government and private sector was not there. Today, look at the forum here, this forum is very important. We have academicians here, we have businessmen, we have the Federation of Kenya Employers and many others. I think this is the way we have failed in the past, that we did not dialogue, we did not consult. I think this is wonderful, I think Kenya is changing, although the speed may be slow. Let us hope. I believe there is hope for Kenya.

The way we have been doing business really has changed. In the past, we did not dialogue, we did not consult.

Jimnah Mbaru, Chair, Nairobi Stock Exchange: The Minister talked about the need to look at the relationship between research, policy formulation and implementation. I want to go a little bit further and say that we need to look at whether there is any real linkage for the political leadership of a country and the economic growth of a nation. When you look at the history of the development of South Korea, for example, you can clearly see that the political leadership in that country particularly between 1963 and 1977 was really focused on the economic relationship of South Korea with Japan, so Japan was the standard. If you look at the economic growth of Singapore, the focus was that Singapore would be like Switzerland. If you look at the political leadership in Malaysia, you can see there is a very clear linkage with economic development. So the question that people should ask themselves is whether there is any linkage between political leadership and economic development in Kenya, because this is one of the fundamental issues that people have to deal with if they are going to face up to reality. When people are talking about economic reform, political reform, they have to address this issue seriously and explicitly.

The other point I want to make is this: Prof. Migot-Adholla said that what Kenyans did not have is resolve to implement the good policies, the good papers they have come up with. My question is this, where will this resolve come from? If in the past it was not there, and it is not there today, where will it come from? I think the speeches by the two speakers did not address one very fundamental issue about people, leaders, entrepreneurs. These are the people who drive government. These are the people who drive economies. These are the people who drive organizations.

People, people, people. If you put mediocre people in charge of organizations, then the organizations will authomatically become mediocre. What is the vision of this nation? Can we marshall everybody to really focus on the vision and ask what is my contribution towards the national vision, that national goal?

Today I think the Minister has said that the economy has declined from 1980 up to now by 20% in terms of GDP per capita; he said from US$350 to US$280, that is exactly a 20% decline in the economy. Okay, let us say that is our starting point and we decide that within the next ten years, we want the income per capita to be $1,000, which means that we have to have a growth rate of about 10% per annum. Then on that basis you can come up with appropriate policies, whether it is the agricultural sector, whether it is the educational sector, but all of them will be marshalled towards achieving an income per capita of $1,000 within the next ten years or so. I think it is important to be very clear about this vision, about the goal, about where we are going, because if a country does not know where it is going, no road will get them there. What is going to be the Kenyan vision? I think in Kenya, comparison is very important. What do we want Kenya to be like? We want it to be like Britain, and we ask ourselves, is that achievable? Do we want to be like South Africa in terms of economic development? We ask ourselves is that achievable. Whom do we want to be like? Whom do we want to catch up with? On the basis of that vision, a lot of very good fundamental policies can come up and then we can ask ourselves, are we appointing people on the basis of merit or ability to drive us to the goal? Are we giving positions to people simply because of patronage, or are we really choosing people simply because they are the best, they are the ones who can drive us to where we want. Until we address those fundamental issues, I think we may have a long way to go.

What is going to be the Kenyan vision? What do we want Kenya to be like? Whom do we want to catch up with?

Mr. Mule: Thank you, Jimnah, and as I said you are going to be the last speaker. We are running twenty minutes behind, so we now bring to a close this session of our conference.

Are we giving positions to people simply because of patronage, or are we really choosing people simply because they are the best, they are the ones who can drive us to where we want.

CHAPTER 3

THE BREAKOUT SESSIONS

The next phase of the programme consisted of discussions in four concurrent breakout sessions. The first group, on Trade, Business and Competitiveness, and the second session, on Managing Growth, discussed actual results from the EAGER research project. The third group, focused on Agriculture, featured a panel of agricultural researchers and economists who had also participated in the EAGER project. The final session was a panel presentation and open discussion on globalization; this was not a presentation of EAGER research, but was included because of its timeliness and pertinence to the challenges of restarting and sustaining growth.

The groups reported their discussions to the Plenary. The main elements of the reports were highlights of the research and from the discussion, and recommendations for the Government, the public sector and the policy researchers.

SESSION 1: TRADE, BUSINESS AND COMPETITIVENESS

Session Chair:	*Kang'ethe Gitu, Permanent Secretary, Ministry of Human Resource Development*
Presenters:	*Graham Glenday, HIID/Ministry of Finance*
	Aleke Dondo, Kenya Rural Enterprise Programme
Resource Person:	*Peter Kimuyu, Institute of Policy Analysis and Research*
Rapporteur:	*Wasunna Owino, Institute of Policy Analysis and Research*

Presentations and Floor Comments

Kenya has had three export platforms since the 1980s: manufacturing under bond (MUB); export processing zones (EPZ); and the Export Projects Promotion Office (EPPO). The first two targeted export dedicated businesses while the last is more general and flexible. These platforms were supplemented by preferential regional trade arrangements and liberalization.

The EPPO programme has been used extensively by major local manufacturers to expand and extend into the regional markets. The impacts of the dedicated platforms (MUB and EPZ) are marginal, but that of the more flexible EPPO platform has been more significant.

Use of the EPPO programme is also declining, however, due to loss of competitiveness as a result of increases in the real wage, an over-valued exchange rate for the Kenya shilling and regional strategies for phasing out export incentives. In the recent past, further complications resulted from the collapse of currencies and reduction in labour costs in the Southeast Asian countries following financial crises in the region. For these reasons, macroeconomic conditions, rather than export platforms, have proved to be the more important determinant of whatever labour intensive manufactures were competitive as exports. Despite the constraints, EPPO remains an important support for exports outside the regional markets.

A large proportion of Kenya's large skilled and semi-skilled labour force is engaged in the competitive and highly dynamic informal sector. Unfortunately, the country is unable to translate this labour force into labour intensive export processing because of entry barriers imposed on informal enterprises by physical controls and high transaction costs in administering the export platforms. There has been a growing gap between informal and formal sector wages, as formal sector wages have outpaced those in the informal sector, becoming more uncompetitive, while competitive informal labour has not been used by formal export platforms. Because only formal enterprises have access to export markets, the wage gap does not permit export platforms to become springboards for job creation through labour intensive manufacturing. There are also problems with the quality of labour related to poor quality of education.

Kenyan industries have been facing increasing international competitiveness following structural adjustment and progression towards a globalized economy.

Trade liberalization, which began in 1987 and peaked in 1993/94, has increased access to important regional markets for manufactured and processed products. It has also increased aggregate imports, including imports of raw materials and intermediate goods crucial for the success of export drives. Liberalization has also reduced market distortions.

Because imports increased substantially following trade liberalization, Kenya was able to increase its customs duty yields while lowering average duty rates. Duty exemptions decreased through a reduction in the exemption categories and reduction in legislative discretion to grant exemptions and tighter administration of the exemption approvals. There has also been a reduction in the number of duty-free items and an increase in effective duty rates on some products. There were, as well, shifts among imports that are subject to *ad valorem* rates toward imports on the high duty rates. Increased revenues therefore resulted from a combination of enhanced customs administration and improved voluntary compliance.

But industrial growth was rather slow despite dreams of industrialization by 2020. Kenyan industries have been facing increasing international competitiveness following structural adjustment and progression towards a globalized economy. Only a few industries showed comparative advantage and were internationally competitive in the 1980s.

Trade liberalization has increased access to important regional markets for manufactured and processed products. It has also increased aggregate imports and reduced market distortions.

Although there is no direct link between growth performance and trade reforms, there are some indirect links through increased access to regional markets. Private investment is the most important contributor to growth, so that such investment is the major engine of growth. Public investment is also supported by components of private investment. Nevertheless, the small size of the economy means that Kenya can only attract "foot-loose" export dedicated investment by offering a cost structure below that of alternative destinations. As long as Kenya is not cost competitive, export dedicated platforms are not useful.

Trade liberalization alone is not sufficient to remove price distortions; new forms of cost distortions stemming from the cost of public service and other deficiencies related to deteriorating infrastructure have emerged. However, the biggest cost is imposed by inefficiencies in the financial sector that have made the cost of borrowing for investment prohibitive.

Further concern regards the extent to which existing policies support the growth of micro and small-scale enterprises, which dominate the business sector and have proven useful in creating employment and wealth.

Microfinance institutions such as the Kenya Rural Enterprise Programme (K-REP) are important for increasing access by the poor to productive resources. K-REP emphasizes results, cost effectiveness, outreach and impact on the poor, and its conversion into a permanent institution that use local resources is important for sustainability. This is the basis for K-REP's conversion to a bank as a means for mobilizing local resources. K-REP also encourages the development of financial

service associations at the village level to meet grassroots needs for these services. Without such capacity, even the most effective microfinance institutions are unlikely to address the credit needs of the poorest of the poor.

It is necessary to enhance the efficiency and expand the volume of public sector investment to complement and support private investment.

Recommendations

In order to improve the business environment and make domestic production regionally and globally competitive, the session concluded that it is necessary to:

- Privatize excess capacity in the EPZs as regular industrial parks.
- Develop more flexible export platforms by generalizing export incentives and improve the macroeconomic environment, which is more important than the export platforms for sustaining labour intensive manufacturing of exports.
- Obviate high real interest rates by shifting to a sound budget surplus strategy that lowers the domestic debt burden. Low real interest rates encourage real private sector investment, which has greatest impact on growth, and discourage speculative foreign capital flows.
- Strengthen infrastructure and align exchange rates to reduce costs and make domestic production export competitive.
- Review the labour market laws and institutions to shield the labour market against movements in macro prices and reduce the gap between formal and informal real wage rates. Additionally, overhaul laws that control the resolution of labour disputes to make them more supportive of a flexible labour market.
- Improve cargo control systems in the ports through electronic data interchange and enhance transit and export controls through electronic exchanges in the regional economies.
- Cautiously proceed with trade liberalization and develop an industrial strategy that appreciates the importance of the pace of adjustment to a rapidly changing environment by cautiously approaching currency depreciation to obviate inflationary pressure and secure gains from competitiveness.
- Insist on stringent quality controls and enforcement of standards, especially in the food industry.
- When possible, give support to industries that are able to exploit natural competitive advantages.
- Enhance the efficiency and expand the volume of public sector investment to complement and support private investment.
- Use customs duties not as revenue raising measures but as mechanisms for strengthening industries. Also simplify trade documentation and shift from general to specialized trade shows.
- Demonstrate political will and commitment to reforms and move towards improved governance.

SESSION 2: MANAGING FOR GROWTH: MACROECONOMIC MANAGEMENT AND INDUSTRIAL COMPETITIVENESS

Session chair: *Jimnah Mbaru, Chair, Nairobi Stock Exchange*
Resource person: *Njuguna Ndung'u, University of Nairobi and KIPPRA*
Rapporteur: *Stephen Njuguna Karingi, KIPPRA*

The Key Findings of the Studies

This session summarized the findings of three research studies conducted under the EAGER project:

1. Industrial Competitiveness, Trade Prospects and Growth in Kenya: A Review of Macroeconomic and Policy Background, by E. Siggel, G.K. Ikiara, B.M. Nganda and G. Ssemogerere
2. The Productivity and Competitiveness of Kenya's Economy: A Survey of Selected Literature, by Aidan Eyakuze
3. Restarting and Sustaining Growth and Development in Africa: Kenya Case Study in Macroeconomic Management, by Njuguna S. Ndung'u

The basic questions in the three studies were:

- What has led to the growth and investment pause in Kenya?
- What determines growth in Kenya?
- What channels affect growth—from macro management to micro decisions?
- What has led to falling international competitiveness in Kenyan industries?
- What has been the outcome of policies implemented so far?
- Should policies be changed or reforms deepened to restart and sustain growth?

The key findings of the studies can be presented in the following stylized facts:

- ***Kenya's economic performance after economic reforms:*** Economic recovery has been rather disappointing—real per capita GDP growth has only marginally improved. This has not been helped by the tendency for economic management to be short-term focused with conflicting goals and outcomes characteristic of a policy dilemma. A key factor behind the poor economic performance and precarious recovery is the slow response of private investment to stabilization and the realignment of prices. This is made worse by high domestic interest rates and a shift into trading in lucrative government securities, which have made it difficult for money to be available for lending for productive investments in the private sector. Even when interest rates have been brought down, other fundamentals have not been re-aligned. This has meant that low interest rates cannot be sustained, creating uncertainty among private sector managers who must make decisions about their firms' future investment positions.

- ***A large external and domestic debt:*** The large public debt that Kenya holds has given rise to the debt overhang problem, with adverse effects on investment and growth. In particular, the studies found that domestic debt influences the domestic interest rate structure, which militates against fiscal adjustment, financial development and investment, and negatively affects output growth.

- ***Evidence of falling industrial competitiveness:*** An important result of the study by Siggel et al. on industrial competitiveness was that price distortions have diminished considerably with liberalization. Unfortunately, a new form of

A key factor behind the poor economic performance and precarious recovery is the slow response of private investment to stabilization and the realignment of prices.

cost distortion has arisen, which includes public service deficiencies, poor infrastructure, and shortfalls in energy and water supply.

Financial sector inefficiency is a key contributor to the fall in industrial competitiveness, and it is important in the short run to find ways and means to reduce the cost of borrowing for firms.

- ***Other distortions:*** Other distortions that have led to a fall in industrial competitiveness are those that are within the realms of institutional structures that should be supportive of the industrial sector. These include financial sector inefficiency. Exchange rate instability—which affects sustained competitiveness and future returns—is the other distortion within the financial sector. Moreover, the current incentive structure is also distorted and this is worsened by the lack of policy credibility and the inability of the judicial system to oversee fair contract enforcement. Lastly, the socio-political uncertainty prevailing in the country at the moment is another distortion facing the industrial sector, especially in the area of raising credit and winning and sustaining markets.

Policy Lessons for Restarting and Sustaining Growth

Findings from the three studies present important lessons with implications for how growth could be restarted and sustained in the economy. These can be divided into three areas: short-run and long-run policy lessons, and institutional reforms.

The Short-Run Policy Lessons

In the short run, one important policy lesson is the need to reduce risks in the financial sector and encourage long-term financial instruments, as argued in the paper by Ndung'u. This should be accompanied by a sustainable commitment to reduce and finally eliminate domestic debt. In terms of the institutional environment within which business is undertaken in the country, there is need to create certainty by removing the current socio-political and economic uncertainties. In this regard, the credibility of the government and its policies is crucial.

Financial sector inefficiency is a key contributor to the fall in industrial competitiveness, and it is important in the short run to find ways and means to reduce the cost of borrowing for firms. This calls for a reduction in interest rates, but should be accompanied by fiscal adjustment, as the fiscal stance taken by the government is a major determinant of the prevailing interest rates.

Moreover, a stable and well-aligned exchange rate is necessary in the short run as it will create the necessary certain environment for importers and exporters. Such an exchange rate will not be achievable, however, unless interest rates are stable and at lower levels than currently. The importance of a supportive monetary and fiscal policy in the short run cannot be gainsaid. This means removing the existing conflict between fiscal policy and monetary policy.

The Long-Run Policy Lessons

Among the questions addressed by the researchers, especially in the papers by Siggel et al., and Eyakuze, was the role of liberalization in determining the current performance in the industrial sector. One conclusion is that liberalization is positive and beneficial to firms, but that it is insufficient to achieve competitiveness and industrial growth goals. Therefore, what is required is cautious progression of the trade liberalization process combined with an industrial strategy.

The importance of the pace of the industrial sector's adjustment to the changing environment must also be recognized in the liberalization process. This notwithstanding, the industrial strategy must incorporate the development in the long run of a sound infrastructure, especially in transport, communications, energy and water supply. Moreover, the necessary business environment that would lead to a competitive domestic industrial production requires an institutional framework

that ensures fair enforcement of contracts and an effective enforcement of the trade regime. This in the long run would lead to the creation of a level playing field for competing firms, one where laws are enforced and standards and quality controls are observed.

Another factor that will promote investment and future growth in the long run is support for regional cooperation, as domestic firms will exploit their natural comparative advantage. Lastly, the studies pointed at the crucial nature of the quality of investment. Public investment is needed in the long run to provide the required complementarity to private investment. In this respect, the emphasis should be on productive investment and human capital development.

Liberalization is positive and beneficial to firms, but it is insufficient to achieve competitiveness and industrial growth goals.

Institutional Reform Lessons

The institutional structure was found in the three studies to be an important determinant of the economic performance in the country. Hence, in a more specific way, there are policy lessons to be learned from the studies with implications for the institutions in the country. As a start, it needs to be recognized that growth-friendly institutions will stimulate growth and define the incentive structure. Such growth-friendly institutions can only be built if simple and uniform rules, rather than selective and differentiated ones, are applied in dealing with existing institutions. Moreover, it is necessary to endow bureaucrats with few discretionary powers to make decisions affecting the efficiency of the institutions. For the credibility of these institutions it is important to have safeguards against frequent, unpredictable alteration of the rules that govern their operations. This partly calls for the need to keep firms and interest groups at arm's length from the policy formulation and implementation process.

Growth-friendly institutions will stimulate growth and define the incentive structure.

Conclusions and Recommendations

Following the presentation by Dr. Ndung'u, discussion dwelt largely on the vexing issue of the competitiveness of the Kenyan industrial sector and on the prevailing economic environment.

The point was repeatedly made that government lacks credibility. Investors have given up believing in government promises on policy, primarily because of the consistent lack of commitment on the part of government to implement the policies. The situation is worsened by the unaccountable nature of the agencies of government, which are meant to be supportive of the firms that would restart growth by making investments. To this end it was observed from the floor that checks and balances are not working in government, which means that the agencies meant to provide services to the private sector could not be made to perform even if they were efficient. This non-performance of the government in providing services cannot be assuaged, as there is a clear lack of dialogue between policy makers and the governed. The situation is exacerbated to some extent by the passive and fragmented private sector Kenya seems to have.

Checks and balances are not working in government, which means that the agencies meant to provide services to the private sector could not be made to perform even if they were efficient.

Main Recommendations to the Private Sector

It was acknowledged during the debate that the private sector has a role to play by undertaking specific actions to restart and sustain growth that would complement actions by the government. To this end, the following recommendations were made for measures to be taken by the private sector:

- Take a more assertive advocacy role in order to overcome the current passiveness, which may have led to the emergence of complacent and unaccountable government agencies.
- Form a Private Sector Economic Consultative Forum. This forum would

The private sector should take a more assertive advocacy role in order to overcome the current passiveness, which may have led to the emergence of complacent and unaccountable government agencies.

coordinate and follow up on issues pertaining to performance of government agencies in providing services to the private sector.

- Put economy-wide political and institutional pressure on government to remind the government that it is there to provide specific services that the private sector has already paid for through taxes.
- Demand a status report from the recovery team headed by Dr. Richard Leakey, in order to press upon the government the need for transparency on issues that have a direct effect on the private sector.
- Become involved in constitutional reform, as some of the current problems facing the economy are structural.
- In order to keep the government accountable, issue regular statements on the private sector perspective on the status of the economy and make appropriate recommendations.
- Perhaps as a last resort, stemming from the frustration arising from lack of services and infrastructure from the government, consider withholding payment of taxes to government. This is if the private sector does not get what is promised and expected of a government that is collecting taxes.

Main Recommendations to the Government

The specific measures recommended for government action to contribute to the restarting and sustaining of growth in the short run and in the long run were:

- At the outset, recognize that industry (read private sector) is not asking for protection, but a level playing ground in its quest for a better operating and predictable economic environment. It was noted that various costs in Kenya are higher than those in competing countries in the region and overseas.
- Be responsible to the people. This responsibility would be enhanced if a merit-based recruitment and reward system was practiced in government.
- In order to improve efficiency in the delivery of services to the public and private sector, set performance targets for public corporations and remove heads of such corporations who do not perform.
- Given the ongoing liberalization and opening up of sectors that were formerly mainly controlled by the public sector, especially in the utilities sectors, mandate regulators such as the Communications Commission of Kenya to consult with the private sector.
- As a way of improving performance within the public sector, introduce quarterly operations reports from government agencies. In addition, there should be frequent hearings before parliamentary committees by chief executives of government organizations.
- Recognize that speed in policy making is required as a measure to restart growth. Parliament should make economic issues a priority, as opposed to the current situation where despite the recession, economic issues take a back seat to the extent that bills that would hasten recovery take too long to be debated and passed. A case in point is the bill for establishment of the Central Depository System with the Nairobi Stock Exchange.
- Lastly, deal urgently with the new form of cost distortion that has arisen in addition to the public service deficiencies—the non-provision of adequate infrastructure, energy and water supply. Hand-in-hand with this recommendation, it was argued strongly that insecurity as exhibited in the recent clashes in Laikipia should be something of the past in Kenya.

The government should recognize that industry (read private sector) is not asking for protection, but a level playing ground in its quest for a better operating and predictable economic environment.

SESSION 3: REVITALIZING AGRICULTURAL PRODUCTIVITY

Session Chair: *Mwangi S. Kimenyi, Executive Director, KIPPRA*
Resource: *Hezron Nyangito, KIPPRA, J. Omiti, IPAR, J. Nyoro, Tegemeo, Gem Argwings-Kodhek, Tegemeo, Dick Evans, Homegrown, KIPPRA, FPEAK*
Rapporteur: *Gem Argwings-Kodhek, Tegemeo*

Discussion Highlights

Agriculture plays a leading role in Kenya's economic development, contributing about 25% of GDP. It employs about 75% of the labour force and is the major foreign exchange earner. The sector is dominated by the primary production of a few commodities, six of which (tea, coffee, horticulture, maize, dairy and beef) account for 68% of the agriculture GDP and 17% of the total GDP.

Despite the important role of agriculture the sector's profile in policy documents such as the Sessional Paper on Industrialization by 2020 and the National Poverty Eradication Plan has been fairly low—certainly not commensurate with the contribution of the sector to the country's economy. The objectives of poverty alleviation and industrialization will only be realized if the policy marginalization of the sector ends. Funding has decreased drastically, from 10% of total government expenditure in the 1980s to 4% in the 1990s. Most of this allocation is more to the recurrent budget than to development.

The performance of the sector in the 1990s has been dismal, with annual growth in GDP averaging 2% compared with an average of 4% in the 1980s and 6% in the first decade of independence. The production of most commodities showed a general decline, with the worst affected being coffee, cereals (maize, wheat and rice), industrial crops such as cotton, and milk in the livestock sector.

The horticulture exports subsector has performed fairly well over the years, but the decline in production in the late 1990s is an indication of constraints that need to be removed. The increase in production in tea is due to expansion in area rather than increase in productivity.

The reasons behind the general decline in the agricultural sector are varied and are discussed hereunder:

- ***Policy:*** The major agricultural development policies of the period before 1990, which were based on government controls, led to wastage of public funds and stifled the role of individuals and the private sector in agricultural development. The liberalization policy pursued in the 1980s and 1990s has not borne fruit because of:
  - Illogical sequencing of liberalized market policies.
  - Improper timing of policies, which kept them at a pace much higher than the available institutional capacity.
  - Instability in policies, which reduced investor confidence.
  - Privatization of public institutions, which was too radical and rapid to allow for adjustments.
  - Lack of harmony and coordination in implementation of the policies.

- ***Governance:*** The shift towards liberalization has not been accompanied by a corresponding review of the various laws that govern the sector. Thus an unsupportive legislative framework obtains in the sector.

Insecurity as exhibited in the recent clashes in Laikipia should be something of the past in Kenya.

The objectives of poverty alleviation and industrialization will only be realized if the policy marginalization of the agricultural sector ends.

A clear, comprehensive definition of the role of government in the agricultural sector is still lacking.

- ***Role of government:*** A clear, comprehensive definition of the role of government in the agricultural sector is still lacking.

- ***High input costs:*** These are occasioned by high transport costs, poorly developed market systems and tariffs on imports that have reduced levels of use of purchasable inputs.

- ***Marketing:*** Abrupt withdrawal of public agencies from marketing arrangements for products and lack of appropriate regulations for new institutions, coupled with the slow development of the private sector and farmer based institutions, has left marketing of most commodities in disarray.

Recommendations

The session recommended that the government should:

- Review the laws governing the agricultural sector to make them converge with the policy statements; this is a prerequisite to the revival of production in the agricultural sector.
- Restrict its role to:
  - Formulation and enforcement of laws that protect property rights and ensure dispute resolution.
  - Development of incentive structures and safety nets (e.g., taxation, contracting delivery of services, tariffs, financing).
  - Infrastructure development.
  - Inspectorate of quality and standards.
  - Facilitation of functional markets and protection against rent-seeking tendencies and monopolies.
  - Development of disaster management mechanisms.

SESSION 4: GLOBALIZATION AND REGIONALISM: CHALLENGES TO GROWTH IN KENYA

Session Chair:	*Harris Mule; Chair, IPAR*
Resource Persons:	*Mbui Wagacha, IPAR, Dorothy McCormick, IDS-UON, David Nalo, Ministry of Finance and Planning*
Rapporteur:	*Eric Ronge, KIPPRA*

This session featured a panel discussion based on a brief issues paper prepared by the resource persons. The highlights of the discussion are presented here.

Discussion Highlights

During the 21st century and beyond, global competition for investments and markets will intensify. To survive, Kenya must enhance its position within the East African Community and focus beyond COMESA. This requires that international trade relations be examined critically.

Foremost in receiving attention should be the renegotiated Lomé Convention, which comes up for discussion in the first quarter of 2000. Although there was little Kenyan participation in this treaty, there is need in future to ensure that the Kenyan perspective is taken into account in the writing of such treaties through increased

participation by the government and the private sector. Equally crucial is the need to ensure that the treaties do not perpetuate relationships that characterize developing countries as mere producers of agricultural and unprocessed goods.

Secondly, the role of the World Trade Organization (WTO) in the regulation/direction of trade in both goods and services should be better understood. This will enable the country to assert its rights vis-à-vis other members in situations of unfair practices such as the dumping of goods and unfair competition due to covert subsidies, and in the application of the mechanisms of arbitration in disputes. Having internalized the modes of operation of WTO rules, the country may then properly make decisions about such initiatives as the African Growth and Opportunity Act (AGOA) and the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS).

In sum, the global market presents opportunities Kenya must tap into, but the competition requires that the technology applied for industrial production and delivery within the services industry be on the cutting edge. Otherwise, the fast pace of movement of capital, expertise and products of research may aggravate the gap between Kenya and the rest of the developed world, thereby affecting the country's ability to grow.

According to Dr. Wagacha, globalization has led to the integration of economies and cultures as well as increased interdependence of peoples across the globe. As such, a crisis in one part of the globe quickly affects other parts of the world—as recently exemplified by the speed with which the currency crisis in Thailand translated into a regional financial crisis. This growing interdependence has been facilitated by the interwined telecommunications and computer revolutions, which have produced such tools of global communication and commerce as the Internet and the cellular phone. Consequently, there is a global flow of goods and capital as evidenced by the global 24-hour international financial markets with a daily turnover of up to 1.5 trillion dollars and the international annual trade of up to 20% of global GDP.

The fast pace of movement of capital, expertise and products of research may aggravate the gap between Kenya and the rest of the developed world, thereby affecting the country's ability to grow.

The benefits of globalization have not been evenly distributed among industrialized and developing countries, however. Industrialized countries—particularly the G7 countries—dominate global exchange and the institutions charged with its management such as the WTO, IMF and the World Bank. Further, the top 20% of industrial countries control 86% of world GDP while the bottom 20% of developing countries control only 1%. Most global capital flows are private and between industrial countries; developing countries depend predominantly on flows from the IMF and the World Bank, which constitute only about 8% of total global capital flows, and receive only 1% of private flows. These private capital flows are concentrated in a few, mostly middle-income, developing countries. Global private capital flows largely eschew low-income countries like Kenya because of their perceived riskiness.

Dr. McCormick highlighted Kenya's regional and global trade flows as an indicator of the country's position in the present global economy. Kenya's export trade is primarily with African countries, which take up to 47% of the total exports, and the European Union, which is the destination of 30% of the exports.

Kenya's traditional exports are predominantly agricultural and account for about 83% of the total. The four main traditional exports—coffee (22.2% of the total traditional exports), tea (11.9%), crude vegetable materials (3.2%) and petroleum re-exports (33.3%)—have very little value added. The two major traditional exports—coffee and tea—are primarily sold in the European Union and currently face declining prices. Non-traditional exports account for about 17% of total exports. These 28 or so exports include fish, processed fruits and vegetables, and certain manufactured

goods. Of these about three-quarters go to the European Union, where they are subject to significant tariff and non-tariff barriers. Although the adoption of WTO rules on the replacement of non-tariff barriers with lower tariff equivalents may increase access for Kenyan exports, the same rules will lead to the removal of the most favoured nation (MFN) status presently enjoyed by Kenyan non-traditional exports to the European Union. Prospects for non-traditional exports generally look bright, despite setbacks suffered by fish (due to the ban on fish exports to the European Union) and textiles (due to the uncompetitiveness of the local textile industry). Imports—which include manufactured goods—come from Europe (the source of 33% of all imports), the Far East (24%), Africa (12%) and other countries (31%).

Global private capital flows largely eschew low-income countries like Kenya because of their perceived riskiness.

Manufactured exports dominate Kenyan intra-African trade. For example, the share of non-food manufactured exports to the Africa region has increased from 12% in 1986 to 31% in 1995—almost 60% of which goes to Tanzania and Uganda. If we take account of informal cross-border trade, these trade flows would be even higher. South Africa is the primary source of imports from the region, constituting up to 80% of these imports. This phenomenon began in 1994 when trade relations were restored. Since then, South Africa has become a major competitor at home as well as in regional export markets. The importance of regional trade to Kenya is exemplified by Kenya's participation in a number of regional organizations such as COMESA, the East African Cooperation and the Cross-Border Initiative.

WTO rules will lead to the removal of the most favoured nation (MFN) status presently enjoyed by Kenyan non-traditional exports to the European Union.

The discussant, Mr. Nalo of the Ministry of Finance and Planning, said that the structural adjustment policies pursued by the government, which had served to reintegrate the Kenyan economy with the rest of the world, were part and parcel of the process of globalization and the two could not be de-linked. Further, to ensure that Kenya is not left behind in the fast changing global conditions, the Ministry of Finance and Planning is undertaking new negotiations in the ACP/EU forum that is due for conclusion in the next 18 months. However, it is important to note that despite being a major exporter to the EU, Kenya does not have a unique position to defend as other countries will demand reciprocal treatment for any concessions made to Kenya.

The structural adjustment policies pursued by the government, which had served to reintegrate the Kenyan economy with the rest of the world, were part and parcel of the process of globalization and the two could not be de-linked.

Recommendations

The presenters and the floor participants in the ensuing discussions made a number of recommendations for both the private sector and the government.

The session recommended that the private sector:

- Diversify into non-traditional exports and destinations, as traditional exports and their present markets limited growth opportunities. For example, we should export manufactured goods to other emerging markets in Asia.
- Fully exploit trade opportunities available in the region.
- Play its part in increasing Kenya's competitiveness by vetoing, through their professional organizations, any of their members involved in corrupt infrastructure construction projects, which inflate costs or provide inferior facilities.

For its part, the session suggested that the government:

- Protect people from the negative effects of globalization through poverty reduction programmes and investment in the social sector especially in education and skill development.
- Be proactive in negotiating trade quotas ahead of time and using these quotas as the basis of industrial planning.
- Focus export promotion increasingly on expanding Kenya's market share in

the region, which is becoming an important export destination.

- Reduce the number of organizations that are charged with export promotion, as these presently have minimal impact.
- Create an infrastructure that will facilitate private/public sector interactions to strengthen the Kenyan negotiating position during trade negotiations like the current WTO trade negotiations.
- Speed up regional integration initiatives as a means of expanding the size of the market.
- Take account of some of the global shifts in commodity trade through an increase in the value added of Kenyan exports so as to take up some of the market share in coffee and flowers from some developed countries like Germany and Netherlands, respectively.
- Try to attract some of the 92% of global capital that is presently confined to developed countries by, among other things: lowering tariffs, removing exchange rate distortions, trimming fiscal deficits, providing incentives for foreign investments such as improved macroeconomic conditions, building good physical and social infrastructure, and instituting strong governance of economic institutions.
- Centralize trade information so as to minimize the search costs that presently inhibit trade flows within the region.
- Support growth of national markets for SMEs prior to encouraging them to export to the region.
- Make an audit of the country's strengths and weaknesses, which may lead us to encourage the export of skilled labour to the countries in the region.
- Manage the resource squeeze resulting from trade reform and globalization by finding new forms of taxes such as land tax, VAT and income taxes; simplifying tax laws; and reducing and restructuring government expenditure.
- Widen the focus of policy to include implementation by routinely undertaking evaluation and impact assessment of its policies.

Government should create an infrastructure that will facilitate private/public sector interactions to strengthen the Kenyan negotiating position during trade negotiations.

CHAPTER 4

PLENARY DISCUSSION OF BREAKOUT SESSION REPORTS

Mr. Ngure Mwaniki, of MA Consulting Group, chaired this session, which commented on the presentations from the breakout groups. Those making comments or posing questions were asked to state their name and affiliation.

Catherine Masinde, Development Adviser, DFID: If I understand the objective of the conference correctly, the workshop is a culmination of a research programme that has been going on for some time. I am impressed with the quality and calibre of the research. I am also impressed very much with the presentations and the analysis behind some of the conclusions. But I am still anxious about one thing. If this indeed is a programme to restart growth in Kenya, I am not seeing it yet as a strategic plan to get from the point of research to actual implementation. We now know what we need to do, but I am still not clear about who is going to do it, when it is going to be done, how, and how much money we will need or what kinds of resources we will need, and who is going to provide those resources. In addition, I detect a little bit of government bashing again, and much more blame being put at the door of government without necessarily giving us the key to the implementation process. Where is the work plan? Who is going to initiate that work plan? Who are the people and the institutions who are going to implement it, and who is it that should be telling us this? I know that every long journey starts with one step, but I am not sure who is going to make that first step and whether that person has the courage and the resolve to do that right at the end of this workshop.

Where is the work plan? Who is going to initiate that work plan? Who are the people and the institutions who are going to implement it, and who is it that should be telling us this?

My second comment is, we have talked a lot about manufacturing and trade but I am concerned that the services sector has been omitted somewhat. I do not know whether this is deliberate or just that it is not important for the Kenyan economy.

Raphael Mwai, Management Consultant, Fama Resources Ltd.: My concern is that if you are to talk about restarting growth, the issue of the macroeconomic situation is still the most critical. It has its genesis in the structure of government revenue and expenditures. The issue of productivity of our resources, including what is being paid in the civil service, must now form the focus of restarting our economy. I am suggesting therefore that the issue of productivity be given a critical emphasis in whatever we do because the few resources we have should go into the priority sectors for productivity where we can have major impact.

David Ndetei, Professor of Psychiatry, University of Nairobi: Listening to the economists talking here, it looks like we are heading to a kind of a crisis unless we do something. I can tell you that some of the medical problems that we have right now, AIDS and drugs, are things that we talked about a long time ago and are on record. We talked about AIDS in 1985; we prescribed things then that we thought could be done and unless those things were done, a situation would come sooner than later where we would have rampant infection of AIDS at all levels in Kenya. That is exactly what is happening: the authorities did not listen at all. I can say the

same as far as drugs are concerned—in fact in 1994 we warned of a looming disaster. The question I would want to ask is this, why is it that we Kenyans tend to manage situations by crisis? We wait until we have a crisis and that is when we wake up. Is it because if a professional says something he cannot be listened to, unless he is a politician? What is the problem?

Chris Kirubi, KAM: I think what you have done here, Mr. Chairman, and your group is something that is very good and is going to give us some basis of issues to discuss with IMF and the World Bank. So I think it is not all lost. The issue the doctor is talking about—AIDS—is a very, very major issue. It is a new factor in our economy, one we must factor in, in whatever else we do. I think we need all of us to agree that we should have a committee to follow up on these issues with the government so that maybe in six months time, we can have another meeting to say what impact this meeting has achieved in guiding the government. We need to involve the government, which is not here—you can see we are talking to ourselves. Dr. Gitu is here, but his voice is marginal; so few out of these few hundreds of people. I think we need, not what a colleague said, bashing the government, but we need to tell the government that things are very serious, they must listen to experts, these recommendations must be taken to them. And we professionals must look at our role in perpetuating and promoting the art of corruption in this country. If you go to any corruption in road making, in building government institutions, in buying government equipment, there is always a professional, as an engineer, a contractor, a businessperson, advising the poor civil servants how to fiddle some money from the economy. Can we create a code of conduct ourselves to give this country a moratorium from corruption so that we can all survive again?

We professionals must look at our role in perpetuating and promoting the art of corruption in this country.

Can we create a code of conduct ourselves to give this country a moratorium from corruption so that we can all survive again?

Ngure Mwaniki: It is important to mention the presence of government here. As of two days ago, we had confirmations of close to a hundred members from government who were going to be with us today, and someone said this morning, why is it that whenever the IMF is in town, everyone seems to go in to some kind of panic? Is this an indication of a culture of dependence?

Robert Shaw, Economist: I would like to fully endorse the comments of the first speaker from the floor. I have attended a number of these sessions and I personally find them very useful, very interesting and I try to move some of the issues on. But we are largely talking to ourselves here and I think what we need to be doing, and the challenge of this conference, is to say, right, how do we move this forward? Where do we go? And when we come to the particular issues that have been raised from the breakout sessions, I think the important thing is, with each one we say how? when? what? And put a programme there. It may not work fully, but at least there will be a way forward. What we have got at the moment is really a dream list, and that's fine but I think now we have moved forward we need to take up the challenges ourselves and broaden the approach, and marry the research and the brains that are here with the realities and the forces, whether they are in government, whether they are in the private sector, or whether they are the stakeholders.

Why is it that whenever the IMF is in town, everyone seems to go into some kind of panic?

Dinguri Nicholas Mwaniki, CGIAR, Washington, D.C., and Coda Corporation: My concern is very basic. Are we asking the relevant questions? And if we are not, how are we going to get the relevant answers? Are we relying a lot on the traditional conventional wisdom, or are we on the frontier of some of the basic issues that are going to be of the greatest concern to the viability of growth and development of Kenya? Let me give some examples: Is it not possible to raise a question, can

Kenya grow and develop within the context of an individual sovereign state without being fully integrated within the region? Secondly, is it possible that some of the issues that we are raising, for example, the access of traditional export crops to EU and other industrial countries, are going to be bypassed by some of the incoming technologies in terms of product mixtures and so on. Perhaps we should start by questioning the traditional conventional wisdom and find out whether we are really asking the right questions.

If we do not participate in reforming ourselves then we will be ignored and become irrelevant.

Josphat Mwaura, KPMG, public sector reform and privatization: One of the things I was looking for in the presentation on globalization is a follow up on some of the issues Mr. Mwaniki has just talked about. How can we as Kenyans or Africans—because perhaps Kenya is very quickly going to become irrelevant—take advantage of the opportunities that arise from globalization. One of the things that is happening is the openness: no borders and no differences in time; and anything that is happening out there is quickly going to be felt here in Kenya. Now, a recommendation I found missing, is how can we reform ourselves to participate in globalization, in particular by introducing fundamental political and economic reforms that make Kenya attractive to the international community. If we do not participate in reforming ourselves, we will be ignored and become irrelevant. Secondly, can Kenya lead again in contributing to the development of an African solution, expanding the regional programme beyond the East African Community to an African Initiative?

Is it not time to be concerned about the content of the solutions we are providing to the government, and therefore being able to design a programme of action that provides specific solutions?

David Nalo, Ministry of Planning: Listening to the presentations and comments, one wonders who constitutes the government. I personally believe very strongly that a large number of people who are sitting in this floor are coming from government, even though they may not be holding the portfolio. When we got the topic of this seminar, restarting economic growth and sustaining it, we were very anxious about what we were going to hear and get from this conference. I think at this point in the history of Kenya, we do not need to deliver the problems that face the country. We know the state of the economy, we know the specific difficulties we are going through. We are also aware that the government is trying varying initiatives. Unfortunately, as the first speaker mentioned, there is more of the government standing on the other side and we are clean on this side, and yet I thought this was a consultative process that should bring synergy between the initiatives for restarting growth. Is it only when we have all the permanent secretaries here that we can deliver the comments on economic growth in this country? Is it that we don't have mechanisms for delivering specific recommendations, especially those that are tailored towards restarting economic growth given the knowledge of the problems that we have at hand? Is it not time to be concerned about the content of the solutions we are providing to the government, and therefore being able to design a programme of action that provides specific solutions? That approach can be used to challenge the government that this way is wrong and here are our options. What I see coming out of the conference is more of a wish list, things that should be done. But how they should be done, who should do them, the resources to do them with, and how they should actually be executed are not coming out strongly. From the Ministry of Planning point of view we are looking for specific solutions to complement the initiatives taking place. I think the collaboration between KIPPRA and the government and the institutions that are here is providing that forum. What we need is to get to the contents and the quality contribution to restarting growth of the economy.

CHAPTER 5

PANEL DISCUSSION ON THE CHALLENGES OF RESTARTING GROWTH

Chaired by Dr. Kang'ethe Gitu, the panel consisted of Prof. Peter Anyang' Nyong'o, MP and Director of IEA; Mr. Jimnah Mbaru, Chair of the Nairobi Stock Exchange; Mr. Vimal Shah, Tax Committee, Kenya Association of Manufacturers; Ms. Betty Maina, Chief Executive, IEA; and Prof. Njuguna Ng'ethe, consultant and member of IDS, University of Nairobi. Each of the panel members made a brief presentation, following which questions and comments were invited from the floor.

PANEL PRESENTATIONS

Peter Anyang' Nyong'o: The Need for Personal Commitment to Change

Thank you very much, Mr. Chairman. First of all I would like to thank the organizers of this seminar for something well done and well attended, and something that I think was long overdue. But as I was sitting there I was wondering why nobody was sitting to my left. I hope it is not by design! I think I am going to be very brief because I think we need to allow more interaction with the audience.

At the end of the day today, we are supposed to look at the challenges of restarting and sustaining growth. When I look around I think that we who are here today share one common thing among us. We all sit in a zone of comfort. We are all members of the middle class. And we all want to respond to Shem Migot-Adholla's challenge this morning to return to the basics if we want to restart economic growth and sustain it in Kenya. We are also a part of the Kenyan population, 49% of which is wasted: they are not part of the market; they cannot even help themselves because they live below the poverty line. The other 51%—which you might call the useful Kenyan—a good part of it is not fully engaged in productive activities. A good part of that 51% is ill-equipped for the job of restarting economic growth and sustaining it, and a good part of that 51% is actually abused by society, abused by the government, abused by the leadership, abused by a retrogressive culture faced with economic backwardness that seems to find solace in sexual chauvinism and ethnic xenophobia. That is the society in which we as members of the middle class find ourselves sitting in a zone of comfort, and pontificating on an afternoon on how we are going to restart the economy and sustain it. We are also addressing a government that according to statistics produced by the Centre for Governance and Development usually wastes 56% of the budget or engages that 56% in unproductive activities, uncompleted projects, corruption and mismanagement. So for every one shilling that we pay in taxes, you can as well kiss good-bye to 56 cents.

Now what do we do? For quite sometime now various people have described and analysed the ills and inequities of Kenya. The point, however, is to change it. So the challenge is—if you are going to talk about this situation, the only useful thing you should do today is to change it.

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How are we going to change Kenya? This is the subject of my address this afternoon. Change is always painful, sometimes even unplanned. But the truth about change is that it either takes you forward or sinks you into an abyss from which you will never rise again. There are two types of change that human beings know. Whether you like it or not you must go through them. One is birth. Birth is a positive change that brings you to life. Otherwise you would not be here.

The other change is death. Death is a negative change that sinks you into the abyss of the unknown; nobody knows what happens after death in spite of religion promising us that we shall go to heaven or hell. We have data from the bureau of statistics on what happens after birth. We have no data from the bureau of statistics for what happens after death. So our challenge here today is how we are going to manage change for the better; how we are going to avoid sinking into the abyss of the unknown. The problem today, however, as I see Kenya, is that apparently those of us sitting here in the zone of comfort are incapable of avoiding the abyss, because we do not want to take the challenge of modelling change towards the better. We continue pontificating, producing figures, saying we must stop the government, but today—I will stand on my words—very few of us are prepared to take the challenge for managing change for the better.

The problem today is that apparently those of us sitting here in the zone of comfort are incapable of avoiding the abyss, because we do not want to take the challenge of modelling change towards the better.

Why do I say so? John F. Kennedy once said (and it is a saying that has been repeated over and over again), "Ask not what your country can do for you, ask what you can do for your country." How many of you have asked yourselves what you can do for your country?

At one point, Nicodemus, who was a tax collector, went to Jesus very worried about the sins he had committed—consuming 56% of the budget of Israel! Nicodemus asked Jesus, "Lord, you tell me that I can only inherit the kingdom of heaven if I am born again. What can I do to be born again? Do I have to go back into my mother's womb?" Jesus told him, "You foolish man, that is not what I meant. To be born again you must be able to take up your cross and follow me."

How many of you are prepared to take up your cross and follow change for the better? You always create excuses, "No, to be born again I must go back to my mother's womb." You foolish fellows, that is not what I am saying. What I am saying is that to be born again you must take up your cross and pursue change. I'll give an example; I have lived in Latin America where middle class intellectuals like you also live, and when they want change, they take up their cross and follow change. If that was not the case, Fernado Enrigne D'Oso, the well known sociologist, would not today be the president of Brazil and would not have superintended the kind of changes that Brazil has been going through over the past eight years. Intellectuals, economists, professionals got together and said, "We are fed up with military rule and authoritarianism. We want somebody with a head above his shoulders who can lead this country positively." And they organized for it and made sure it happened. In Mexico today as I talk Canteno Cardenas and Profurus Munyosledos are two individuals who have challenged the authoritarian regime with the backing and support of the professionals and intellectuals. People who have asked what they can do for their country. People who are prepared to take up their cross and follow change.

In Kenya they do not do that. They sit in their offices, send hot e-mails around the world, but say, "You people are doing very well out there in politics, we support you, we support you." If you ask them how do you support us, the answer is not forthcoming.

What I am saying is not for you to support politicians out there in the countryside or in Parliament, but to ask yourself what you can do for your country. If you think reform is important, form yourselves today into a reform lobby, have a face, have an agenda, have a programme, take up your cross and follow change.

Jimnah Mbaru: Changes in the Capital Markets

I think when we look at the process of restarting economic growth and sustaining it, we must ask ourselves what is going to be the role of the private sector in this area, and it is very important to know that we are going through both political reform and economic reform. It is very clear from examples around the world that if change is not properly managed, we may end up with chaos. I think the process of managing the change has to be left to the managers.

Let me talk about the changes that are taking place within the capital market in order to show you what we think happens if the economy starts taking off, how shall we look for finances and ways and means of financing that economic growth so that it becomes sustainable. When you look at this country as a whole, and many countries in Africa, you find that the financial infrastructure is extremely weak. The commercial banks are still very dominant as sources of finances and, unfortunately, commercial banks tend to provide short-term finance. When you look at the banking sector in this country, you see that there is a fundamental need to restructure the sector so that it starts to serve the needs of the people in this country. That is precisely what Malaysia did in 1967/68. It went into the banking sector, restructured it so that it could serve the Malaysian people. Now an ingredient of that restructuring was the development of several local financial institutions and banks to support the local push in that respect. I think when you look at our banking infrastructure landscape today, you feel very, very sad, that this is the only country in the world where the banking sector is foreign controlled and dominated.

What I am saying is not for you to support politicians out there in the countryside or in Parliament, but to ask yourself what you can do for your country.

Similarly, when you look at the whole infrastructure side you find that the insurance industry is not fully developed, and insurance and pension fund industries are the major sources of long-term finance for industrial development and for funding government on long-term basis. These two sectors—which are crucial to the future of financing of any growth, any development we are anticipating in this country—are fundamentally undeveloped. It is very important for us to restructure these two sectors, to support them and to encourage them to move forward fast. What bothers me generally is that when I look at Kenya itself, I wonder about the pace at which it is moving. One wonders whether Kenya is conscious about what is developing within the region, within the whole continent and within the whole world.

One wonders whether Kenya is conscious about what is developing within the region, within the whole continent and within the whole world.

We have looked at the development of the stock market from 1954 when the stock exchange was set up. There were about 58 companies when the stock exchange was started. That was during the colonial times. Today we have 56 companies. So for a period of about 50 years, we have always had a plus or minus one or two or three companies. We have started asking ourselves, did the stock exchange in this country start on a wrong footing? Can the capital market of this country support the expected contribution of the capital market towards financing the industrial development of the future? We have started wondering whether we should not revisit the whole concept totally from scratch because we think the whole stock market and capital market were started on the wrong footing. It was set up for purposes of enabling a few settlers to sell off some of their assets and later to enable the government to privatize and indigenize or Africanize some companies. Today its major purpose is to ensure that privatization takes place. So I believe the thinking has started and it is very important that we go back to the basics.

For this country to move forward, as for many countries in Africa except South Africa, the most important thing is to look at what we call the "over-the-counter market." The origin of a stock market is in the over-the-counter market where we do not have too much regulation. Even more importantly, the domestic savings of this country are not enough, so we have to find mechanisms of tapping the international

capital market. You cannot move into the international capital market unless you have very strong companies, very well capitalized and well managed companies. What we want now, and I can speak here in my capacity as the chair of African Stock Exchanges Association, is to have a cross-border listing between the Nairobi Stock Exchange and the Johannesburg Stock Exchange. This will enable Kenyan companies to be listed in the Johannesburg Stock Exchange, to raise capital and funding from the bigger and deeper South African capital market. This is the challenge we have as a stock market in this country. I think regionalization is very important for us, but for Kenya to benefit fully, it has to break into the South African market. To do this, we have to ask ourselves some of the questions that are not being asked by politicians. When we stand on a platform and condemn South Africa, are we really conscious of our intertwined linkage, our joint interest in development? I think it is important when we conduct our foreign policy to realize that Kenya needs South Africa; we are partners and we need to work together.

The port of Mombasa can become the regional port of entry for Uganda, Rwanda, Burundi, Eastern Zaire, Southern Sudan. It can be, but we have to nurse it.

I want to make two other comments before I sit down. I think Dr. Mwaniki of Coda said something very important, that we need to revisit the whole concept of our economic growth and our development. I do remember the German ambassador sometime back said that we have all the ingredients of success in Kenya. Let us look at the services sector; the world today is being driven by technology and services and knowledge-based types of industries. In the context of the services sector look at where Kenya is located, look at the location of Nairobi. Can we make Kenya a regional capital market centre? Can we get all companies from Uganda and Tanzania and Eastern Zaire, Southern Sudan, all listed in Nairobi as well as in their own countries? Can we make it a regional market centre? Can we make Nairobi a regional insurance centre? Can we develop this concept and see how we can benefit? Can we make Kenya, Nairobi, a regional or a global educational services centre, whereby we can set up schools here, and parents in UK, Germany, Sweden, can send children here to learn, and the schools can have their academic systems. Can we focus on these? Can we focus on the services sector as a way forward? The port of Mombasa can become the regional port of entry for Uganda, Rwanda, Burundi, Eastern Zaire, Southern Sudan. It can be, but we have to nurse it. Kenya has to think very, very seriously because it is not the only one that is thinking this way. Others are asking, can Durban become the continental eastern and central African port of entry? They also ask, what type of railway system, communication network system, can be developed so that goods entering the port of Durban can reach Kampala at a cheaper rate than if they entered through Mombasa? All these are areas we Kenyans need to concern ourselves with, and we need to think about if we are going to move forward. It is important to understand that some of the traditional ways of looking at things need to be questioned.

The second point I want to make is what you might call our very local way of looking at development. If you look at the economy of Nairobi, and the economy of Kenya as a whole, Nairobi and its environment constitutes about 40–50% of the GDP of this country. Suppose, instead, that the city council of Nairobi, the town councils of Kiambu, Kajiado, Machakos, Athi River, Tala and Thika all met under the auspices of our government, and decided to develop dual carriageways to all these other urban areas. What would happen is that instead of a lot of people being really congested in the city centre, in the slums, a lot of pieces of land in those areas would emerge as places where people could put up good houses, educational institutions, and we could de-congest Nairobi. The traffic would be less and people would have space in which to live.

Vimal Shah: A Strategy for Kenya

The topic, the challenges of restarting and sustaining growth in Kenya, is a very, very important and timely issue. We need to look at this issue in terms of both short-term and longer-term challenges. I think we need to separate the issue into those areas because there are certain things that need urgent, important and immediate remedies to restart growth. And there are certain things that are longer term and we need to look at them with a vision and a clear-cut idea of how to make them sustainable.

First and foremost, what has come up in all papers today on every front is what I think we would call the credibility gap. This is where we come from; this is where it may sound like government bashing, but it's not. It's an issue that I think the government has also addressed. There is a credibility gap that needs to be filled first. This issue is one of trust—mistrust—and of not failing on promises made; you must keep to them. I think this comes up from a lot of the old baggage. I call it the old baggage; a lot of stuff that we carry from the past. How can we get out of this?

I would like to propose a solution. We have just started a new millennium, a fresh new beginning. Kenya has made it this long. We have to make it work and I think the group here can become a think tank and say let's do this and let's move forward. Let's not carry our mistakes and say we should crucify 10, 50, 100 people to sort things out. Instead of that, let's say, put a stop to it from today. From today onwards there should be nothing else that goes wrong. Let's have prudent management being put in. Let's have your catchwords, good governance, being put in, and deterring sentences for anybody not toeing the line. I think if this approach means an amnesty, it should be done. We cannot change the past. What has happened, happened. But we can make sure that in future nothing really goes wrong.

I would like to propose a fresh new beginning. If this means an amnesty, it should be done. But we can make sure that in future nothing really goes wrong.

We also have to live within our means, prioritize expenditure, which everybody else has said, and radically try to eradicate AIDS. Now I am ***not*** talking about HIV/AIDS, I am talking about AIDS, which means the Always In Debt Syndrome. We have gone into this always-in-debt-syndrome and I think we need to get out of it. This conference here has been facilitated by some NGO or somebody somewhere, and it is still part of aid. Can we not do it ourselves? Can Kenyans say "we will do it, let's do it together?" I think it's high time. If it's not done in the past, let's try to do it now. This is basically removing all dependency on aid. Can we try to remove all the wastage? All things that we don't need to do. There are a lot of things that we are doing that the country need not do. Can we identify and remove them? Non-productive outputs: whatever is non-productive, can we actually eliminate them? Every industry tries to do this. Can we do this as a country?

We must promote competitiveness. Can we promote competitiveness of Kenyan industries? Can we rationalize the duty structures? We discussed earlier the COMESA rates that raw materials are being charged in this country. We brought down all our duty rates to 20% on finished products coming in from COMESA countries, whereas manufacturers here have to pay anything from 5 or 10% to 40% on raw materials. This is being used by the government as a source of revenue to fund its fiscal budget. Can this policy change? Can we say customs duties on imported raw materials are not going to be used as a revenue source, but to strategically industrialize our country and give protection—just enough protection, not too much protection, say 10–20%. We are advocating a 20% maximum tariff for local production. This in my opinion would radically improve the pathetic situation we have today, because a lot of industries today would rather relocate from Kenya and produce in our neighbouring countries or any other COMESA country and still export to Kenya and be very competitive.

Let's decide on a strategy for Kenya. Are we going to be a trading nation or are we going to be a manufacturing nation? This needs to be very clear among the policy makers, the policy implementers and the stakeholders. Let's look at core competency. What is the key competency of Kenya? I think it's been addressed so many times this morning. I am very proud that it's basically agriculture. We are an agro-based economy. Can we build on this core competency and take it to the limits? Actually it's been—in my own word—murdered. I think agriculture has been murdered in this country. We need to revive it and say, fine let's take it places. This needs a vision again. Can we as a think tank say let's achieve self-sufficiency in food by the year 2002? Is this possible? If a mission is set as "self-sufficiency in food by the year 2002," and thereafter whatever needs to be done, policy changes, whatever changes in government, in the private sector, will all take place.

We need a very clear vision for our country. This has to be a shared vision. Every single Kenyan has got to share it.

This is where I think we need a very clear vision for our country. This has to be a shared vision. Every single Kenyan has got to share it. Is it possible in two years? That's the big question. I have discussed it with a few people and they say, yes it is possible. But the question is, what are the buts? The buts are: Can we manage our resources? Will our government change? And I think Prof. Anyang' Nyong'o said very clearly that change is something that everyone of you in this room, everyone in this country, has to undertake. And there's a saying that the only permanent thing in life is change, so I think we have got to look at it in that perspective and say, yes, let's make it possible. We have all the water, we have a lot of idle land, we have all the sun that we need for agriculture. We have the human resources. So we don't see what is lacking. It's just the will to say, fine, let's go and do it.

The other important point is adding value to local raw materials, primary products. We are exporting primary products from this country and they are just going across in primary form, helping the industrialized nations serve their industries. Can we not do that here? A lot of industries like coffee, cotton, leather, other primary products, can be done here. Once we support them and give them all the incentries, they will not need any more protection. There will be a lot of effects of this because as we improve competitiveness and embrace liberalization, we also have to be prepared for a borderless and a tariff-free economy. If not now, in the next five years. Are we prepared for it? As we speak, no. But can we now look at it in the next two or three years and get prepared for it? The effect of this will be rationalization of some industries. We have to accept this. Some industries that are not competitive will not survive. Others will. The other thing is, Kenya has a strategic or logistical advantage in this region. Have we exploited it? This is the big question that we need to ask. Can we become a servicing country, or a servicing area for our neighbours who are landlocked?

Kenya has a strategic or logistical advantage in this region. Have we exploited it? Can we become a servicing country, or a servicing area for our neighbours who are landlocked?

There was a comment this morning by somebody that manufacturers in this country are not pro-liberalization. I'd like to correct this, and I am speaking for KAM. The Kenya Association of Manufacturers actually has changed its mission statement. We are now saying we are promoting competitive local manufacturing in a liberalized market. We are embracing liberalization as the manufacturers, and saying make manufacturing competitive. We are not worried about COMESA as manufacturers. What we are worried about is a level playing field. This is an important issue—I think all the researchers need to know this, that manufacturers here are capable of manufacturing to global standards provided there are no inequalities or inequities in tariffs.

The other point that I want to share is that we need some more paradigm shifts in this country. We can say we go back to basics. I agree with going back to the basics as far as agriculture is concerned because that is one of our core competencies. But can we look at the information age—have we even done any

impact analysis of it, of the information age on our economy? How it can transform us? The latest *Business Week* talks about the new economy. The new economy is the Internet, the information technology age. Has Kenya done anything about this? We are still struggling with our band widths and we are trying to protect our airwaves and saying, let's make money out of it. I think we must ruthlessly open up our airwaves. Let players come in. Can Kenya be the African Silicon Valley? Is it not possible? The only asset is people. We have the people. If this was to be done, we can wire up, and say wire up the whole country totally with fibre optic cable or wireless. Within one year this is possible. Government does not need to do anything about it. Government needs us to say, yes open up, no more regulation. You will see private companies coming in and wiring up the whole economy. Now, the impact of that on each and every one of your businesses, it would be dramatic. This, the value addition in that industry is so tremendous, it is unbelievable. It could give us not only sustainable but tremendous growth, and we can do a lot more. Let Kenya become the hub in the Africa region for communications. Why are we still trying to control this and keep it in some quarters only? This is where I think we need to radically look at new ways, new things that we can do, not only the old traditional way of doing things. And I think a lot will change.

We need some paradigm shifts in this country. Can we look at the information age? Have we even done any impact analysis of it, of the information age on our economy? Can Kenya be the African Silicon Valley?

Finally, I just want to make one very important point, that we need to look at expanding our markets. We have to be part of the global village, we have to be part of the East African community, we have to be part of COMESA, and we have got to open up. Our market size needs to improve immediately. What would this do? It would improve our economies of scale. It would improve our entire economy. We could have large-scale industries locating here because of logistical advantages to serve the entire East and Central African region. But only if markets are open.

Betty Maina: Four Scenarios for the Future

What will Kenya be like in the year 2010? What about in the year 2020? What kind of place would you like it to be. We look into the future, trying our best to make wise decisions, only to find ourselves staring into the teeth of ferocious and widespread uncertainty. If only everything didn't depend on everything else! How do we, or better still our children, decide what kind of career path to pursue when it is not clear what industries will exist in 10 or 15 years' time. Will they be agriculture, will they be service? What will they be? What kind of skills will they require? How do we plan our children's education when we cannot know what kind of society they will be living in?

We have to be part of the global village, we have to be part of the East African community, we have to be part of COMESA, and we have got to open up.

More to the point, what kind of society do we want them to live in? Can we in any way shape the society they will be living in? Are we already doing this in some ways even if we may not be aware? I have been asked to focus my remarks on key learning points from a recent project on scenarios for Kenya. Over the last 15 months, a colleague and I have had the privilege of coordinating and managing research, analysis, workshops, meetings and continuous conversations that brought together more than 70 young Kenyans. The main objective of this work was to develop a shared understanding of possible scenarios or futures for Kenya for the next 10–20 years. The result of this work is being prepared for wide dissemination.

What are scenarios, you might ask. Scenarios describe alternative pathways into the future. Scenarios are not predictions of what will happen, but they identify what might happen. They are a powerful way to explore our thinking around issues of mutual concern and ways of facing them. Scenarios will help us think about the future and prepare us for futures we might face. They are a tool for ordering our perception and an understanding of the environment in which the decisions we

Scenarios help us think about the future and prepare us for futures we might face.

make today may be played out. We can use scenarios to rehearse and develop difficult decisions we might have to make. We can also use these scenarios to identify what has to be done in order to secure a desired outcome. Having described that in the context of the project, I really cannot, in these very few remarks and very few minutes, convey the richness that this experience brought to those who are a part of it. And the sharpened sense of perception they now possess. There are very many messages from that project and I am sure I cannot do justice to them all.

However, I'd like to highlight two of the main messages. The first is that in Kenya today we have pretty much reached the limits of our present economic and institutional model and foundation. It is time to learn very fast. It is time for change and those changes must be fundamental—no more small fixes or small turn-arounds. During our research the team analysed Kenya's social, political and economic crises and compiled a list of driving forces that have shaped the past. Out of this research and the major findings, the team concluded that political, economic and social elements of the current crisis are all locked into a very downward spiral of mutual causes and effects. We need simultaneous interventions on all these fronts.

In Kenya today, we have pretty much reached the limits of our present economic and institutional model and foundation.

We all point to the glorious days of past growth of nearly 10% for several consecutive years. Almost all the research reviewed this morning argued that the key to addressing the challenges raised was institutional reorganization and development of more responsive institutions and delivery mechanisms. For the scenario team, some of whom are present, these are further signs that we have reached the limit on those chosen fundamentals. These two deep structural crises mean that Kenya would face a succession of small crises and emergencies in the coming years. In trying to meet these new challenges up until now a rapid succession of quick fixes has been applied, but such responses can no longer cope. As with classic quick fixes that failed, the more of these kind of interventions, the less the results are from what was anticipated, and over time, the cumulative results are the opposite of the original intervention. To meet the challenges of these crises is beyond the resources of any single individual or whole group or regional grouping. Our situation is unprecedented. There are no blueprints for handling it, therefore we are very likely to make mistakes. There will be many mistakes, but we must be willing to make them. There is need for a willingness to learn and there is need for willingness and space to make mistakes as we reorganize our institutions and the foundations of our economy.

But what will we learn? Will we respond to the upcoming emergencies with blaming, conflict and violence? Or will we learn to work together in order to survive? Will we re-engineer the economy to invent new ways of feeding ourselves and earning a living, or will we try to return to law simplicities. What were we all debating about when we discussed going back to basics this morning? Were we wanting to return to war simplicities or value time? How will we feed on each other's distinctive features? When we have reached this sense of limits, what are we going to do about it and how are we going to respond?

The second main message from the project is that a successful and prosperous outcome for Kenya is still possible, though it will require radical reorganization and great sacrifice by all Kenyans. Changes will not come without pain or at no cost. Failure to undertake fundamental reforms of the economy, as well as political and institutional reorganization, will not yield the desired results and is extremely dangerous. Attempts to sort out one and not the other fundamentally are like building a house with a strong foundation on one side and a weak one on the other. In time, the strains will appear and the house could come tumbling down. It is imperative that sufficient attention be paid to reorganize the economy for growth and the institutions of governance for greater responsibility and participation.

In short, the problems Kenya faces need to be understood and addressed from a systematic point of view. If Kenya is to arrest the spiral and reverse the decay and decline, government policies and actions may have to examine modules and engines of development in the country. We do not speak only about government, but also about us in the private sector and the rest of us as researchers. We all need to examine the fundamental modules and engines of development in the country and its people, and we must also examine the structures and institutions they have established and the practices surrounding these institutions.

What futures could Kenya face and what are the challenges for the theme of today's meeting? The future depends very much on the decisions made by major actors such as yourselves in regard to the two fundamental issues that I have highlighted. The team came up with four possible outcomes depending on the answers to four crucial questions. The first question was, Will the confusion and inertia of recent times thwart efforts both to transform the economic modules and to reorganize the politics and institutions of governance in Kenya? The outcome of maintaining the status quo is likely to be a very highly polarized and criminalized society in a continuous decline. The second question was, Will the transformation concentrate on reordering the economy only and postpone agreements or needed changes on the fundamental institutional structures and environment? If that is the case, the gains of the economic transformation will be hobbled and will require sorting out if they are not to be lost when we are only half-way through the process. This is a scenario of rapid initial gains but it is full of inequalities and instabilities. The third one was, Will that transformation be long drawn, lasting for most of the decade and focusing on institutional reorganization and creation of the most democratic and locally accountable institutions? We do not know. If so, though responsive institutions will emerge, Kenya may not achieve far-reaching economic transformation and poverty might increase. And the fourth question, Will there be a radical transformation of the economy to spur growth and improve distribution, accompanied by a reorganization of institutions to improve representation and participation that reflect the diversity of Kenya's people and improve governance? This scenario would be a definite departure from the disruptive politics of the past, and will require hard political choices to be made.

The message of the four scenarios is that we are standing at the point in time where we all need to shape the future and act as primary actors. We stand at the threshold of radical change in the life of Kenya. What choices will we make? What choices would we like others to make? What will we do to assist them in making those choices?

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Njuguna Ng'ethe: The Challenge of Change

I'll take up where Peter Anyang' Nyong'o left off this afternoon. This business of all of us taking up our own crosses: I would like to suggest that when Jesus was speaking he was using "yours" in singular and not in plural. Which essentially means that we all have different crosses to carry. And "ours" as academicians and policy researchers is a very, very specific cross; that is to shed light on some of the issues that we have been discussing this afternoon, and which no doubt we shall continue to discuss. I want to summarize these issues around five very quick points.

One is indigenizing the policy debate. This is something that has become apparent to us especially since the early 1980s when this country started implementing structural adjustment. And one of the motivating factors between putting together the policy research institutes that you see represented here this afternoon, plus of course those that existed before like the Institute of Development

Studies at the University of Nairobi, was precisely to try to put together a critical mass of thinkers who would then domesticate and therefore indigenize the policy debate. One of the concerns here is that perhaps we did not do our work well as policy researchers. Perhaps if we had started thinking about some of these issues, let's say around 1975, we would have come up with our own domestic regime of structural adjustment. And that probably would have been a very appropriate time, right before or during the coffee boom that we experienced at that time. But we didn't, and when the new development orthodoxy came up, we were caught by surprise and tended to react like ordinary citizens instead of informed citizens. Therefore when we complain that the debate has been hijacked, perhaps we have only ourselves to blame, because the hijackers of this debate went to school with us and we know some of them personally and we did as well as they did in school.

When we complain that the policy debate has been hijacked, perhaps we have only ourselves to blame, because the hijackers of this debate went to school with us and we know some of them personally and we did as well as they did in school.

Challenge number two, if we are going to indigenize this debate, is what do we do with it? And I would like to suggest that one of the biggest challenges facing researchers is to reorient the country so that it synthesizes its own thinking in order to come up with a new social development philosophy. In the 1960s the country's philosophy was guided by the notion of African Socialism around Sessional Paper No. 10. We have attempted since that time to produce different papers, but my own submission this afternoon is that we need to look at those documents again—over and over again—in order to see what kind of collective social philosophy can evolve out of that. I will tell you we have been remiss in this one; we have in the past, especially in the recent past, allowed the debate to be hijacked by one discipline, and that is the discipline of economics, perhaps following on the heels of suggestions coming from international development agencies such as the World Bank and the International Monetary Fund. Now, one is not underestimating the importance of economics. But what I am saying is that we have to bring the various disciplines together—and this is obvious to every Kenyan—economics, philosophy, sociology, political science, public administration, management, in order to come up with this collective social philosophy about the direction we want to go. In this respect, I think the biggest challenge facing us is to figure out how we balance the various societal demands as suggested by these disciplines. How do we balance political demands and economic demands? How do we balance social demands and economic demands? Clearly these demands are not going to go away so that they can respect economics and leave the ground for the economics discipline. There will always be political demands, social demands, whether these are community, tribal or other. How do you balance those? Let's not wish some aspects of society away, because they won't go away. Let's synthesize and see how we come up with the correct balance.

Three, one of the challenges facing the EAGER research project was to try to say something about institutions. Following from what I have said before, our interest has been to persuade the economics discipline in particular to take into account the problem of institutions and institutional management. And I am glad to report that the discipline has responded very well. Now there is a lot of dialogue between economics and other disciplines. Well, we might not like, for example, the way economics is trying to do political science by trying to quantify everything including some things that are not quantifiable, but at least there is room for some dialogue on some of these issues. And here, what I would like to suggest to this distinguished gathering is that we are beginning to come of age. Let us institutionalize this kind of gathering. Maybe once a year we could bring this forum together—the private sector, government, policy researchers—so that we can start evolving this social economic philosophy that I am calling for this afternoon.

I would like to suggest that the biggest challenge facing this country is that we have failed greatly in the area of institutional and political management, particularly institutional management. What we therefore need is to give some thought to the problem of institutions. Can we, for example, develop a new philosophy towards institution? Can we see them as public investments that need to be nourished, that need to retain their visions so that they perform what they are supposed to perform. We all know what has happened to institutions. We can therefore argue that restarting growth requires restarting institutions to make sure they function the way they are supposed to function. And here I am touching the issues that were touched upon this morning, corporate and public institutions, how they are managed.

The fourth issue that we need to throw some light on as policy researchers, and which we have not done enough of in the past, is the question of the appropriate leadership for a certain stage in a country's social and economic development. This is an issue that you find discussed in the literature, but there is very little scientific research about what this whole notion consists of. I think we were challenged as researchers working with the private sector, for example, to ask ourselves the question, What is that critical interface between society and leadership? Does a certain society always throw up a certain type of leadership? Does a certain corporation, because it is structured the way it is, throw up a certain type of corporate leadership? We need it to develop knowledge on these things and this is something that I would like to challenge my academic colleagues to start thinking about.

Finally, let me touch very briefly on an issue that came up this morning, that is the question of vision. When we talk about vision, we are usually predicating this notion on leadership, but I would like to suggest that this is a much wider notion than simply leadership vision and here I am revisiting this whole question of what society expects of itself. Therefore, as we transform our economy and as we transform our institutions and our society, the challenge to all of us is what future vision do we have for ourselves? What kind of society do we want to see in the future? And here I am suggesting a sequence of things. First of all I believe that when we put our institutions in order as we shall do, then perhaps our biggest challenge, to our surprise, will be the increase of visionary thinkers. I agree with Dr. Gitu when he says that he does not apologize for being visionary. For policy makers, being visionary probably counts in the long run more than anything else. To conclude, I would like to say that it is all right to dream, it is all right to have a vision, so long as you dream with your eyes open.

Let us institutionalize this kind of gathering so that we can start evolving this social economic philosophy that I am calling for this afternoon.

What is that critical interface between society and leadership? Does a certain society always throw up a certain type of leadership? Does a certain corporation, because it is structured the way it is, throw up a certain type of corporate leadership?

COMMENTS AND QUESTIONS FROM THE FLOOR

Following the presentations, Dr. Gitu announced that the Minister for Planning would be joining the group later. He opened the floor to comment and urged people to feel free, noting that the government was present and listening to the debate.

Amos Kimunya, Matrix Development Consultants and Chair of the Institute of Certified Public Accountants of Kenya: Since morning we have been talking about government bashing, we have been talking about leadership, governance or lack of it. But I have not heard anything on the other two killers of accountability and checks and balances, about Parliament, about the Judiciary. I do not know how many members of Parliament are here, except Professor Anyang' Nyong'o, who is here in a different capacity, and why they are not here because these are the people who approve the budget annually. We talked about withholding taxes because we

pay the government. The Parliament gives the money to the government, on an annual basis; they pass the law to tax us, they receive the reports from the Public Accounts Committee and do nothing with it. I do not know how we can integrate them into this whole process so that they either develop or are empowered in some way to create those checks and balance on the government and ensure that all those policy papers that are lying somewhere actually are implemented.

I have not heard anything on the other two killers of accountability and checks and balances, about Parliament, about the Judiciary.

Hirji Shah, Federation of Kenya Employers: Restarting and sustaining growth in Kenya requires continued investment in the economy. I want to pick up one viewpoint, which was presented by Mr. Jimnah Mbaru, about developing the insurance and pension industry in this country in order to create wealth, national wealth, then get the national wealth available for development. Consider that we cannot progress and develop this economy and restart the economy unless the climate and the means of investment are made available. I wonder whether Mr. Mbaru would expand either now or later on this particular issue because unless we have national wealth accumulated and available for investment, we will again have to go overseas to donors and beg for development funds. This will not lead us where we want, so we must indigenize our development fund. I would like to suggest that this would be one of the important issues we must take up further to see how it can be done.

Anok Shah: In this meeting and a lot of other meetings that we attend with the government and other institutions, I am really amazed by the resources and the brains that we have in this country and I am really amazed at all the answers that we have and I would like to just leave with one little thought in my mind. I would like to talk about Martin Luther King, Jr., who said "I have a dream." He dreamt with his eyes open and I think this is what we need to do. Let us have a dream with our eyes open and let us do something about it this time.

We have a vast array of intellectual power in this country and one of the competitive advantages we will have in Kenya will be human resources.

Kitili Mbathi, Stanbic Bank: One of the things that was troubling me was a question raised earlier; that is, what about the service sector? We spent a lot of time discussing agriculture, we spent some time on manufacturing. An example was given of the development in India of a new Silicon Valley because not only have they looked at the industrial age, they have looked at the post industrial age and at the service sector. We have a vast array of intellectual power in this country and my view is that one of the competitive advantages we will have in Kenya will be human resources. Even though our education system is much maligned by us, by and large it does produce people who do have an above average intellectual capacity and I think one of our challenges will be to harness this and to go beyond the industrial age to become the service centre in this region and even beyond. Not only in the capital markets, in insurance, in banking, in processing and going even further to make Kenya the Silicon Valley of Africa.

Raphael Mwai: My concern has been triggered by the issue of indigenization of the policy debate, re-orientation of the country's philosophy, and of course the issue of the challenges of institutional development. I think I agree with the basic theme, that the critical linkage between politics and institutional management in the country is the genesis of our problem. For some reason our public service got paralysed, indeed the public sector failed to do what it was meant to do. For some reason, and someone said this is because of the powerful presidency and so forth, that linkage has constrained the capacity of our civil service and public institutions. What I would want to know from those who work in those systems, and those who understand this issue, is there a way where we can circumvent the political hullabaloo that is

drowning us? Is there such a mechanism? The second thing I would like to know is whether we have evaluated the role of donor support in our economic decline. To what extent have donor support and donor policy advice contributed to the problems we see today?

Laban Onditi Rao, Small and Medium Enterprise Committee, Kenya National Chamber of Commerce and Industry: So many donors complain that Kenya's resources are going to waste, but today you can see professors, consultants, industrialists and others gathered here. I want to talk about something that we have to address as a private sector. There is a disease that we must get medicine for first, then we come up with a workable policy that will make us restart and sustain growth in Kenya. That disease is corruption. Corruption is here, existing, whereby the private sector is the manager of the corruption, and the public sector is the implementor. So, for us as the private sector, what are the machineries we are putting in place to discipline ourselves from the corruption so that we can achieve what we are talking about here?

Is there a way where we can circumvent the political hullabaloo that is drowning us?

Erastus Omolo, practicing public accountant: We have missed the role of NGOs from the beginning, although the Minister commented, with a casual touch, that NGOs will be involved in the poverty eradication strategy. I wanted to request that the report you make of this meeting indicate that the NGO sector, which generated for this country 44 billion shillings in 1997 and 1998 and contributed heavily to the exchequer, is being missed out. We need to find a niche in this report to put something forward in discussions with the government that the NGO sector has been treated unfairly. From 1993 right up to 1999, in virtually every budget speech, 90% of what is mentioned about NGOs is negative, yet the facts are that NGOs bring in capital to this country. What policies do we have in place to attract social investors to this country? Can we not do something, beyond what we have done, like tax exemptions. Tax exemption has not only been withdrawn, but right now we hear there is a working committee in Treasury working on removing it completely come the budget speech. We find it extremely painful that the government does not appreciate the role of NGOs except in famine relief.

My second point is, how do we start? And I am going to re-shout, how do we start? I agree with the speaker who said, can we even have a day of forgiveness and say from this date, we are going to start afresh, we are going to forgive each other, we are going to terminate all these cases. But from this date, friends, as a Kenyan, return what you have stolen, come and speak to us, come in a truth commission and tell us. In the place of KACA let us have an economic crimes commission. We will be able to go places and even shorten the constitution debate that is disturbing us today.

There is a disease that we must get medicine for first, then we come up with a workable policy that will make us restart and sustain growth in Kenya. That disease is corruption. The private sector is the manager of the corruption, and the public sector is the implementor.

Prof. Anyang' Nyong'o: Prof. Njuguna Ng'ethe was right about the crosses, as he was addressing a single person, but I am also right in the sense that I would like you singly to come together to be plural; the example I have is as follows: Yes, it is okay for researchers to analyse these issues, but please feed it into a pro-reform lobby that has a face, constituency and agenda. You know, change is not just a consultancy programme, which I am afraid, notwithstanding my dear friend's comments, a lot of NGOs are falling into: the mentality that change is just haphazard consultancy from one programme to the other. The donor community is also falling into that; they define priorities and look for people to implement those priorities without due attention to the cumulative effect of change in our country. As Betty said, all indicators—economic indicators, social indicators, political indicators—show

that we are at the brink of disaster. Nobody should be sitting on a zone of comfort, nobody. In a war everybody becomes a soldier, everybody becomes mobilized. I think we in Kenya today must be mobilized, all of us must wear the uniform for fighting for change. It does not matter whether your role is to analyse and throw light, that light is not going to be useful unless it is programmed into a pro-reform lobby with a face, constituency and agenda. Kenya is not going to be a service centre if Kirinyaga Road stays the way it is. It is not going to be a service centre if you pass Korogocho and you turn your back to it and you think Korogocho does not concern you. It is not going to be a service centre if you drive in Westlands and just next to the Municipal Market there is a huge mountain of shit (sorry to use the word). If we were mobilized, as in Singapore, if somebody dropped a piece of paper on the road, you as a citizen would have the right to arrest that person. Everybody is a soldier for cleanliness in Singapore and I think this is the attitude we Kenyans must take.

Change is not just a consultancy programme. In a war everybody becomes a soldier, everybody becomes mobilized. I think we in Kenya today must be mobilized, all of us must wear the uniform for fighting for change.

I have always used the example of corruption, that somehow Kenyans do not feel an iota of consciousness, an iota of feeling bad when their father or brother is corrupt or when their clansman is corrupt. As Kang'ethe was saying today, you steal a billion and go to Rumuruti and donate and become a development conscious leader. I think we have to internalize a sense of guilt. The other thing is that we condemn tribalism but you go into an office of a professor in the university, who is your fellow tribesman, and he engages you in a lecture, telling you how you must be a great Luo or a great Kikuyu or whatever and you know it is wrong in your intellect but you do not have the moral courage to say no to this fellow and say that speaking like an ordinary villager when you are a professor does not make you a soldier for change. So I really think that out of this seminar, let us not have another seminar before you people here organize yourselves together with us into a pro-reform lobby for change with a face, constituency and an agenda.

My plea is that we decide as part of our future agenda to meet once a year and eventually this forum will evolve into a reform advocacy group, a people's forum

Prof. Ng'ethe: My whole point about suggesting that we institutionalize this kind of forum is precisely the concern that you have, that research should not end on our desk and not be read by anyone As I noted in my remarks, a few years ago it was virtually impossible to hold this kind of forum, particularly the representation of the private sector, that I am seeing here this afternoon and my plea is that we decide as part of our future agenda to meet once a year and eventually this forum will evolve into a reform advocacy group, very different from the officially constituted economic forum, because this really is a people's forum.

Mr. Mbaru: Let me deal with the issue of the role of the insurance industry and pension funds and what should be done to them. I argued in my presentation that commercial banks, although they also need to be reorganized, restructured, re-capitalized, and modernized, will still deal with short-term funding for industries, private sector, government, etc. The long-term finances for the domestic economy will come from the insurance companies and the pension funds. Yet what we have in this country is a very weak insurance sector; we have about 40 insurance companies, all of them very poorly capitalized, most of them are not properly managed, all of them dealing with very small sectors. I suggest that they should merge and create bigger insurance companies that will be able to develop new products and provide new services. But I think the more important thing is that they must understand what is happening in the global marketplaces for insurance industries. Insurance industries are also providing almost the same services as banking institutions and even in the global marketplace insurance companies and banks are merging to create stronger institutions. Kenyan insurance companies

are not going to withstand the competition that is going to emerge from the international insurance companies, which are well organized, well managed, competitive and highly innovative. So the insurance companies in Kenya need to look for strategic partners, whether they are American insurance companies, South African insurance companies, or British or German companies. They will bring in capital, they will bring in additional management, and above all they will also instil discipline.

As far as the pension funds industry is concerned, the first thing that needs to be done is to restructure the National Social Security Fund. We are talking about an institution holding about 60 billion shillings in this country, that is almost going bankrupt, that is carrying assets that are liquid, and we do not even know whether the pensioners will be able to get something. I think that is very wrong. The NSSF needs to look at the employees pension fund of Singapore. That fund has played a crucial role in providing cheap housing for the whole of the population of Singapore. There is a lesson we can look at there. First of all, to start moving the pension industry, we must restructure NSSF. We must also create compulsory retirement benefits, whether for individuals, in private sector, in NGOs, or operating on their own. Everyone should have a compulsory retirement fund from which to draw some funding at old age. I am worried about the way the Retirement Benefits Authority and the Ministry of Finance are dilly-dallying as far as the operation of the Retirement Benefits Authority is concerned. If they appreciate the role the pension funds industry is going to play, particularly in mobilizing funds, in allocating them, in giving those funds for industrial development, I think they need to move a little bit faster.

I also wish to comment on the role of the donors in an economy like ours. The most important thing about appreciating the role of the donors, in an economy like Kenya, is to look at the politics of Kenya. In Kenya we practice what we call the politics of distribution of resources. We distribute plots, we distribute jobs, we distribute opportunities, we distribute government revenue. When those resources are limited, then it is very important for us to get somebody to provide us with something to distribute. That is where the donors come in. We cannot do without them, because the fundamental strategy is distribution and we need funding from donors in order to distribute. Now, to deal with this situation we have to adopt what we call the politics of creation of wealth. When we talk about creation of wealth, then we ask ourselves, how do we create wealth? We start to ask what is the role of industrialists, business people, of farmers. That is when you start understanding where you are.

One other comment that I missed. If you look at the structure of our domestic debt, it is short-term money. If we look at our investments, we are looking at very short term. This perspective probably needs to be changed to longer-term thinking, which means beyond ten years, twenty years. That way we can restructure our debt to go longer term; we restructure our deposits to go longer term and investments for the longer term. In order to do that, the basic issue will be business confidence, sustaining business confidence in people, and saying yes, this is investable in the longer term. I think that is the obvious question that we need to all address.

In Kenya we practice what we call the politics of distribution of resources. We distribute plots, we distribute jobs, we distribute opportunities, we distribute government revenue. When those resources are limited, then it is very important for us to get somebody to provide us with something to distribute. That is where the donors come in.

Sam Mwale, independent consultant and occasional writer in the *East African:* I really hope that this workshop is not going to be one of those things that end here. There is going to be some kind of forum and some kind of lobby that has an agenda, that has commitment, that has an identity, and that will be taken as an equal partner by the government in negotiating for economic and other changes. To speak a bit emotionally, 75% of us, Kenyans, were born after 1963. When I was in school in the 1980s I was told that the 1980s were the lost decade for Africa. On New Year's day

this year, we were told the 1990s were a lost decade for Kenyans. So I have lost two decades of my life, which is more than half of my life, and I just can't bear to think that I will lose another decade and another decade—because statistically Kenya's life expectancy is 59 years and so by around 2023 I should be expiring. I can't afford to think that by 2023 we are going to be sitting like this trying to figure a way out. So can we please use the resources that we have to rethink our own development, the role of development, the kind of Kenya we want to see in 2023. Let us not leave without some commitment to further action from here.

The main constraint to growth in Kenya at the moment can be stated in one or two words: political risk. So in my mind, the main challenge of restarting growth is to stop doing some of the things that we are doing that are sabotaging growth.

David Ndii, economist, co-author of one of the conference papers: The other side of saving and mobilizing saving is the rate of return to that investment. You are not going to be able to mobilize savings even if you put pension fund infrastructure in place unless you raise the rate of return in the economy. There is an issue of cost with an open economy, as savings will go to markets with higher rates of return.

Secondly, I want to reflect on the agenda, which talks about restarting and sustaining growth. I think a lot of things we have been saying are about sustaining growth in the long term. I think we have neglected the subject of restarting growth, how do we restart from where we are now and then sustain it with all the previous ideas, like a knowledge economy. To do that we have to ask what is stopping growth, what are the constraints? I would like to submit that the main constraint to growth in Kenya at the moment can be stated in one or two words: political risk. So in my mind, the main challenge of restarting growth is to stop doing some of the things that we are doing that are sabotaging growth. And I think we have to come up with an agenda in which there is a very clear link in this transition between resolving the political risk that is holding growth hostage and then restarting growth.

Beyond that, I would like to throw some challenges to the private sector. I think the private sector—and I will be very blunt here—has to stop playing zero-sum games, with everybody fighting in their own corner. To give an example, in the East African Cooperation, which is a very strategic market for our exports, everybody in the private sector in Kenya is fighting their own corner not trying to compete with other goods from COMESA. Can our private sector actually go to the government with a plan on how Kenya can take leadership, given that we are actually beneficiaries of COMESA, especially our immediate neighbours. Could we, for instance, propose to the government that we liberalize our economy to Uganda and Tanzania unilaterally, in terms of taking leadership, and allow Uganda and Tanzania to liberalize gradually, allow free movement of goods as well as labour. I think these are proposals the government would be willing to listen to. To give another example, recently we had a big fight between the insurance industry and the lawyers, on how to keep as much of the claims compensation as possible. One solution that would have solved the problem for both parties, which they were not willing to contemplate, is that both could have agreed on third party custody of that money, for instance by a custodian bank, but everybody is fighting their own corner and not looking for real win solutions. It does not need to wait for petitioning government; even if we do so, then we are petitioning government to create the regulatory framework for what we all want to do for the economic sector.

Once we have chosen our vision and our mission, we must be committed to it and all must be committed to the development process we have chosen. The private sector must be committed, the government must be committed, NGOs and obviously the civil society.

Finally, the issue we have not addressed very much in making all these recommendations to the government is the institutional capacity of government. I will illustrate. When I left university, not too many years ago, I was in a class of 40 or so students of economics, of whom about two-thirds joined the government. None of those people are still in government. That, I think, is a critical issue in restarting growth, if the government does not have the institutional capacity to design and implement these policies.

Dr. Gitu: I would now like to conclude this session by making just a few remarks, then turn the session to the Minister for Planning, who has joined us and is listening intently.

I think we have to understand that development is not a matter of chance, it is a matter of choice. We have to choose to develop. Once we have chosen our vision and our mission, we must be committed to it and all must be committed to the development process we have chosen. The private sector must be committed, the government must be committed, NGOs and obviously the civil society. All must understand the vision and mission and therefore must be committed to it. There are prerequisites for development: you have to have proper infrastructure, stable microeconomics, high levels of investment. You must have energy because, as you have witnessed this morning, how can you develop with electricity stoppage in this country, how can we develop with the type of roads we have in the industrial area, how can you develop without water? How can you develop without social and political stability? How can you develop if you do not use your human resource, which to me is abandoned in this country? I would like to say that it is high time we became committed to our development process.

Let us become proactive, let us implement those policies that we have set and let us be bold.

We know what is wrong with the Kenyan economy, we have been talking about it the whole day. We keep repeating ourselves. We went to Mbagathi—we told the public that we know what is ailing the economy, we know! And yet we do not see. Let us ask what we can do for our country, not the other way round, and let us dream with our eyes open. I am going to stop by saying let us become proactive, let us implement those policies that we have set and let us be bold. You cannot develop if you are afraid of implementing some of these policies. Let me also stop here and introduce Honourable Gideon Ndambuki, Minister for Planning in the Ministry of Finance and Planning. He has held other ministries; he has been at the Office of the President, and also has been the Minister for Lands and Settlement. Thank you very much for coming and sitting there and participating out of your very busy schedule, that is very encouraging.

Hon. Ndambuki: I wish I had come here early in the morning, I would be more rich in terms of the discussion you have been carrying on. I thought it was going very well, what I saw, and what I heard people contributing and exactly what they think we should be doing and which way we should be going. In fact, the basic, to me, is first to change our attitudes, and if we change our attitudes, I am sure we will get a lot of things done. And when I talk of changing attitudes, it is like not all the time expecting the government to do but also other people who are in a position to do so and also support the government. The other thing is that we Kenyans are very much known for writing very good papers on policies and everything but our weakness is implementation. When it comes to implementation we find that is where we go wrong and I think the government since last year has been addressing this. It has realized that we have to work with these stakeholders and that is why we are involving everybody in every discussion. Even now in preparation of the budget, you talk of trade, you talk of tourism, also inviting other people to hear their opinion and assist us in order to come up with better policies; policies that really can be implemented and be of use to people. So I think this was a very good forum and I am sure quite a number of you have really learned quite a bit. I hope what you have discussed can be disseminated to those who did not take part and see whether we can fix some things that can be incorporated into some of the departments and also the Ministries. Those are my private considerations.

I wish I had come here early in the morning, I would be more rich in terms of the discussion you have been carrying on.

CHAPTER 6

CLOSURE

The conference debate and discussion were brought to a close by the Minister for Planning, followed by a vote of thanks to all participants by Prof. Francis Gichaga. The Minister's closing speech is presented here in full.

CLOSING SPEECH - HON. GIDEON NDAMBUKI, EGH, MP, MINISTER FOR PLANNING

This conference has provided a unique opportunity for top policy researchers to reflect on what has been happening in the economy over the recent past and to chart out the way forward

Mr. Chairman,
Distinguished participants,
Ladies and gentlemen:

It gives me great pleasure to be with you this evening to officially close this very important conference on Restarting and Sustaining Growth in Kenya.

Let me begin by thanking USAID and the Harvard Institute for International Development for supporting this Africa-wide research, which has been executed under the auspices of Equity and Growth through Economic Research (EAGER). This research work comes at a time when the continent is facing a number of development challenges, including the debt burden, declining economic growth, deteriorating terms of trade, rising poverty and unemployment, dwindling foreign direct investment and official development assistance, challenges posed by globalization and liberalization, advances in information technology, and the spread of HIV/AIDS. It also comes at a time when African Heads of State and Government jointly with World Bank and IMF have just concluded a summit on options for Growth and Poverty Reduction for sub-Saharan Africa.

I would therefore like to commend our leading policy research institutes, KIPPRA, IPAR, Institute of Economic Affairs (IEA) and MA Associates, together with other researchers and consultants, for making invaluable contributions towards this conference. My sincere thanks also goes to the session chairs, resource persons, discussants and all other participants for their hard work in steering the deliberations.

Ladies and gentlemen, I wish to remind participants that the Kenya government is committed to private–public sector partnership in economic development through consultative processes such as the one exhibited in this conference.

I am convinced that this conference has provided a unique opportunity for top policy researchers to reflect on what has been happening in the economy over the recent past and to chart out the way forward for restarting and sustaining economic growth. I commend the organizers of the conference for accurate timing and choosing topical issues relevant to Kenya's economic recovery.

I notice with appreciation the careful selection of the topics for this conference: trade, business and competitiveness, managing growth, revitalizing agricultural productivity, and the challenges of globalization and regionalism to growth in Kenya. In a rapidly changing world in which globalization has created the need for efficiency

in production, competitiveness and best practices in management, we must as a country reposition ourselves and see how best we can fit into the changing economic environment and exploit opportunities that come with this change.

Ladies and gentlemen, the 21st century is one characterized by globalization of trade, financial and capital markets, stiff competition, and technological advancement. For Kenya to survive the competition and be fully integrated into the global village, policy researchers must as a matter of urgency formulate policies that will improve Kenya's competitiveness in the global market. We have to come up with policy recommendations to improve product quality, ensure that products are price competitive locally, regionally and internationally. More importantly, we cannot afford to lose any of our export market share. Indeed, we should strive to retain what we have and at best expand export opportunities.

In view of this, our industrialists and researchers should swiftly tackle the challenges posed by the World Trade Organization (WTO) and seek ways and means of quickly defining alternative trade arrangements for the benefit of the country and our people.

It would equally be beneficial, within the ACP/EU cooperation framework, that we start preparing a strategic plan that will enable us to negotiate a new trade regime with EU after the eight-year transition period. We need to be aggressive and think of how we can secure export quotas with our major trading partners such as the Europeans, and ensure that we use such opportunities efficiently. It is my hope that you have dealt with these issues in greater detail during your deliberations.

Ladies and gentlemen, from a planning standpoint, Kenya is on record in terms of preparing excellent policy documents. One only needs to refer to policy documents such as Sessional Paper No. 10 of 1965 on African Socialism and its Application to Planning in Kenya, Sessional Paper No. 1 of 1986, and the current Sessional Paper on Industrial Transformation.

We have always set desired levels of growth targets required to enable us to achieve both growth and poverty reduction. For example, the current National Development Plan for 1997–2001 set growth targets of about 6% per annum over the plan period. Indeed, if Kenya is to significantly reduce poverty at the levels recommended at the Social Summit in Copenhagen, and which are contained in the National Poverty Eradication Plan, the desired growth should be at 7% per annum. Unfortunately, the attainment of the growth targets has not been possible especially in the past few years. The main problem stems from the missing link between policy, planning and budgeting.

It is in this context that the government is reforming its budgetary system by adopting the medium-term expenditure framework (MTEF) to link policy, planning and budgeting with scarce resources to be invested in key priority areas to achieve growth and poverty reduction.

In this regard, I would like to acknowledge the key role played by the Kenya Institute for Public Policy Research and Analysis (KIPPRA) by providing technical support in macroeconomic modelling and forecasting to establish the resource envelope and determine sector resource allocations with the MTEF process.

Since the exercise is continuous and participatory in nature, I expect other leading research institutes and universities to be involved in such analytical work, as this is the only effective way of making contributions to informed decision making by the government and thus contribute to economic recovery. I would also like to encourage competition in research geared towards providing practical solutions to our economic problems to enable the government to have a wide base of choices. In countries like South Korea, modelling and forecasting macroeconomic targets is

In a rapidly changing world in which globalization has created the need for efficiency in production, competitiveness and best practices in management, we must as a country reposition ourselves and see how best we can fit into the changing economic environment and exploit opportunities that come with this change.

The conference coordinators should ensure wide circulation of their recommendations and make adequate follow up so that there can be effective implementation.

not undertaken only by the government; public research institutes as well as company based research centres also participate in such processes. It is high time that our researchers started thinking along these lines. It is the government's intention to ensure broad ownership of the reforms by consulting widely with all stakeholders.

Ladies and gentlemen, let me reiterate once again the government's commitment to private sector–public sector partnership and assure you that recommendations from this conference will be considered for integration into the current economic reform initiatives by the government. The conference coordinators should therefore ensure wide circulation of their recommendations to relevant agencies, private or public, and make adequate follow up so that there can be effective implementation.

With these few remarks, it is now my pleasant duty to declare this conference officially closed. Thank you.

Chapter 7

Summary of Issues and Proposed Interventions

What were the main issues addressed, the findings of the research that led to the presentations and the proposals made from this unique consultation? These are summarized here in a matrix that begins by identifying the broad issues, then spells out the specific policy concerns and overall strategies for addressing the concerns, and finally presents a menu of specific proposed interventions.

Main issue	Detailed policy concerns	Overall strategy	Specific interventions
Poor export performance	Export dedicated platforms have not been helpful because: • They made more sense before liberalization • Their usefulness was further eroded by preferential regional arrangements and the growing gap between formal and informal wage rates • Only formal enterprises have access to outside markets • Wage gap means export platforms cannot become springboards for job creation through export-oriented labour-intensive manufacturing	• Make the export platforms more flexible • Reduce excess capacity at the EPZs • Promote labour-intensive export-oriented production	• Privatize the EPZs to reduce excess capacity • Establish regular industrial parks • Generalize export incentives • Review labour laws to create links between formal and informal production • Make resolution of labour disputes more supportive of a flexible labour market
	Kenyan exports are no longer competitive.	• Reduce real cost of domestic production	• Reform bankruptcy laws to reduce negative impact on labour markets • Hedge labour costs against undesirable movements in exchange rates • Reduce government deficit to reduce upward pressure on interest rates • Improve all aspects of infrastructure • Use customs duties to strengthen industries rather than to raise revenue

Poor growth performance	Link between trade reforms and overall growth is weak and indirect. Private investment is the most important growth factor.	• Promote private investment as major engine for growth	• Improve the business environment by: • Shifting financial resources to the private sector • Reducing insecurity • Improving enforcement of contracts • Simplifying mechanisms for resolution of corporate disputes • Putting in place sound fiscal policies to reduce upward pressure on interest rates
		• Make public sector more supportive of private sector	• Promote interactions between public and private sectors • Enhance the efficiency of public Investment
		• Improve governance	• Remove corruption • Enforce standards
MSEs dominate the business sector, but suffer from inadequate access to financial resources	Financial markets discriminate against micro and small-scale enterprises because of the negative correlation between credit costs and perceived risk with enterprise size.	• Develop innovative ways of extending financial services to MSEs	• Reduce domestic government borrowing to allow flow of more resources to the productive sector • Encourage development of networks to make group lending more profitable • Reduce entry barriers in the financial markets to improve their outcomes • Approach financial reforms in ways that take into account the needs of MSEs • Support microfinance programmes by facilitating their operations • Broaden the range of services available to the small enterprise sector
	Access to credit by informal activities that have unclear legal status is more complicated.		

Poor growth performance			
a. Short term	Inefficiency in the financial sector is the main villain in the fall in industrial competitiveness.	• Reduce risks in the financial sector	• Improve property rights to reduce the debt/collateral ratio • Rationalize government expenditure to government reduce borrowing
b. Long term	Liberalization is not adequate. It should be complemented with other strategies and should be progressive.	• Stay the liberalization course • Develop a clear industrial strategy	• Enforce trade regimes to progressively create a level playing ground • Ensure efficient enforcement of contracts • Support regional cooperation • Selectively increase public investments to support industrial development • Establish a Private Sector Economic Forum
c. Institutional reforms	Growth-friendly institutions are necessary for stimulating growth and defining the incentive structure for growth.	• Strengthen existing institutional arrangements	• Develop and apply uniform rules • Reduce discretionary powers • Base civil service recruitment and promotion on merit • Set clear and enforceable performance targets for state corporations • Insist on submission of quarterly reports by state corporations • Encourage intensive interaction between the public and private sectors • Punish sloppy management and reward managerial foresight • Encourage Parliament to put priority on economic issues

Dismal performance of the agricultural sector	Although the agricultural sector is the bedrock of the Kenyan economy, it has suffered from: • Reduced funding by government • Improper timing and sequencing of policies • Unclear division of labour between government and private sector • Unclear policy on land distribution and use • Poor coordination of policy implementation • Institutional weaknesses • Increasing rural insecurity	• Raise agricultural productivity to increase food security, generate raw materials needed in the manfacturing sectors and increase export earnings	• Secure the funding of research and extension • Develop mechanisms for funding small-scale agricultural production • Make labour intensive arrangements for improving and extending access to roads • Inject further competition into the marketing of inputs and produce • Rationalize use of tariffs in food imports • Encourage the formation of outgrowers' associations to enable farmers to take charge of their destiny • Pay special attention to industrial crops • Encourage greater private sector participation in seed bulking • Explore ways of expanding domestic processing and value addition • Monitor the quality of seeds available in the markets • Facilitate enforcement of contracts to encourage interaction among different segments of the agricultural sector

Marginal benefits from globalization	This can be characterized by: • Limited input in global negotiations • Limited appreciation of the role of the WTO • Effects of unfair trade and competition • Reliance on a narrow range of primary products • Technological limitations • Stiff competition from South Africa	• Ensure that Kenya derives maximum benefits from the irreversible processes of globalization and regionalism	• Fully exploit existing regional trade opportunities • Encourage diversification into non-traditional exports • Improve infrastructure to reduce domestic costs of production • Continue to develop the country's human capital to tip the skills/ resource ratio in favour of exports of manufactures • Address insecurity in the semi-arid areas where most livestock is raised • Decriminalize milk hawking • Take a more proactive role in trade negotiations • Rationalize organizations involved in export promotion • Facilitate private sector and government interactions as part of the groundwork for better trade negotiations • Create an environment for attracting a greater share of global capital • Centralize trade information to make it less costly to acquire • Pay special attention to the financing needs of micro and small-scale enterprises to facilitate their participation in regional markets

Annexes

A. List of Participants

B. Conference Programme

C. Executive Summaries of EAGER Research Papers

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ANNEX A

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ANNEX B

CONFERENCE PROGRAMME

Time	Event
8.00	**Arrival and Registration** *Betty Maina, IEA; Ngure Mwaniki, MA Consulting*
8.30-10.30 **Opening Session and Keynote Address**	**Welcome and Introduction:** *Prof. Mwangi Kimenyi, KIPPRA* **Objectives of the conference:** *Harris Mule, Chair, TIMS Consultants & IPAR* **Opening of the Conference:** *Hon. Chrisanthus Okemo, Minister for Finance* **Keynote Address:** *Prof. Shem Migot-Adholla, PS, Ministry of Agriculture, Livestock and Rural Development* **Plenary Discussion** ***Session chair:*** *Harris Mule, TIMS Consultants & IPAR*
10.30-11.00	**Coffee Break**
11-12.30 **Four Concurrent Breakout Sessions**	**1: Trade, Business and Competitiveness** ***Session chair:*** *Dr. Kang'ethe Gitu, PS, Ministry of Human Resource Development* ***Resource persons and discussants:*** *Graham Glenday, HIID; Gerrishon Ikiara, UON; Prof. Kimuyu, IPAR; Aleke Dondo, K-REP* ***Rapporteur:*** *Dr. Wasunna Owino, IPAR* **2: Managing for Growth** ***Session chair:*** *Mwaghazi Mwachofi, Financial Secretary, Ministry of Finance (Commentary)* ***Resource persons and discussants:*** *Dr. Njuguna Ndung'u, KIPPRA; M. Kanga, Central Bank; J. Kinyua, Central Bank* ***Rapporteur:*** *Dr. Stephen Karingi, KIPPRA* **3: Revitalizing Agricultural Productivity - Panel Review** ***Session chair:*** *Prof. Mwangi Muthaka, Director of Agriculture, Ministry of Agriculture* ***Resource persons and discussants:*** *Dr. H. Nyangito, KIPPRA; J. Omiti, KIPPRA; J. Nyoro and Gem Argwings-Kodhek, Tegemeo; Dick Evans, FPEAK* ***Rapporteur:*** *Gem Argwings-Kodhek, Tegemeo* **4: Globalization and Regionalism - Challenges to Growth in Kenya** (Panel Discussion on Global Trade Regimes and Regional Integration) ***Session chair:*** *Harris Mule, TIMS Consultants & IPAR* ***Resource persons:*** *Dr. Mbui Wagacha, IPAR; Dr. Otieno Odek, UON; Dr. Dorothy McCormick, IDS-UON; David Nalo, Ministry of Finance and Planning* ***Rapporteur:*** *Eric Ronge, KIPPRA*

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12.30-1.45	Lunch
2:00-3:00 **Group Reports**	Report back from the groups and plenary discussion ***Session chair:*** *Ngure Mwaniki, MA Consulting Group* ***Commentary:*** *Dr. Kang'ethe Gitu, PS, Ministry of Human Resource Development/Vocational Training*
3.05-4.30 **Panel Discussion in Plenary**	**The Challenges for Restarting and Sustaining Growth - A Panel Discussion** ***Panel chair:*** *Dr. Richard Leakey, PS and Head of Civil Service, Secretary to the Cabinet* Panelists: 1. *Prof Peter Anyang' Nyong'o, MP, Director-IEA* 2. *Jimnah Mbaru, Chair, Nairobi Stock Exchange* 3. *Vimal Shah, Chair, Tax Committee, Kenya Association of Manufacturers* 4. *Betty Maina, Chief Executive, Institute of Economic Affairs*
4.40- 5.10	Tea
5.15-6.00 **Wrap-up**	**Session chair:** *Harris Mule, TIMS Consultants & IPAR* **Closing Speech:** *Hon. Gideon Ndambuki, Minister for Planning* **Vote of Thanks:** *Prof. Francis Gichaga, chair-KIPPRA*
6.15	Reception

ANNEX C
EXECUTIVE SUMMARIES OF EAGER RESEARCH PAPERS

1. Kenya's Macroeconomic Management
   Njuguna Ndung'u

2. The Productivity and Competitiveness of Kenya's Economy: A Survey of Selected Literature
   Aidan Eyakuze

3. Revitalizing Agricultural Productivity
   H.O. Nyangito, G. Argwings-Kodhek, J. Omiti and J. Nyoro

4. Trade Liberalization and Growth in Kenya
   Graham Glenday and T.C.I. Ryan

5. Industry Competitiveness, Trade Prospects and Growth in Kenya and Uganda
   E. Siggel, G.K. Ikiara, B. Nganda and G. Ssemogerère

6. Export Platforms in Kenya
   Graham Glenday and David Ndii

7. Microfinance Development in Kenya: K-REP's Transition from NGO to Diversified Holding Company and Commercial Bank
   Jay K. Rosengard, Ashok S. Rai, Aleke Dondo and Henry O. Oketch

8. Trade Liberalization and Customs Revenues: Does Trade Liberalization Lead to Lower Customs Revenues? The Case of Kenya
   Graham Glenday

KENYA'S MACROECONOMIC MANAGEMENT

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EXECUTIVE SUMMARY

The paper discusses growth and sources of growth in Kenya. This is achieved by borrowing from the available literature that sheds light on the strong factors that drive growth in Kenya. Furthermore, the literature is used to argue on the pre-conditions necessary to restart and sustain growth. The questions addressed in the paper are:

- What are the factors that have led to the growth pause in Kenya, and by extension what has led to an investment pause?
- What are the determinants of growth and what are the links to growth from the literature and are they applicable to the Kenyan case?
- What are the mechanisms or channels through which short-run macroeconomic management affects growth in Kenya?
- How have the policies succeeded or failed in the past to promote growth and what do economic performance indicators show?
- How should current policies be changed or reforms deepened to restart and sustain growth in the future?

In order to assess these issues, the paper first starts from what is known, by reviewing some background materials about the economy. Specifically, the paper looks at Kenya's history of structural adjustment policies and the weaknesses found in managing and conforming to the required reforms. Second, it parades the performance indicators in an attempt to assess what has happened over the years. Third, it reviews the literature and shows the corroborating evidence in Kenya's growth decline. Finally, with these "facts" at hand the paper focuses the discussion on what is required to reverse the decline and sustain a high growth path in the future and thus bring together long-run structural and short-run macroeconomic management issues. Key to this discussion is a highlight of institutional reforms to support growth-friendly policies.

Stylized Facts

There are several important stylized facts about Kenya's economic performance after more than a decade of economic reforms:

- Economic recovery has been rather disappointing, with real per capita GDP growth improving only marginally.
- Economic management has tended to be extremely short term, with conflicting goals and outcomes characteristic of a policy dilemma. For example, in the liberalization period (1993–1997), a phenomenon that has arisen is that of short-run speculative capital flows responding to an interest rate differential. In this period, the authorities have encountered a policy dilemma arising from targeting a competitive exchange rate and low inflation in a floating exchange rate regime. In order to pursue these goals, the authorities have intervened in the foreign exchange market to stabilize (and sometimes defend) the exchange rate because of the volatile capital flows. They have then had to follow this action with sterilization of these capital flows in the money market by raising domestic interest rates. The result has been that the exchange rate has been stabilized in the short run but at high interest rates, thus jeopardizing the goals of increased domestic investment and chances of economic recovery.
- In 1998, the government acknowledged that its borrowing kept interest rates artificially high. Through the Central Bank, it decided to sell fewer treasury bills than those demanded by the financial sector (the main dealers in treasury bills). Excess liquidity in the financial sector and low demand for credit for investment squeezed the profit margins of weaker banks. The result was a banking crisis. This further depressed private investments.
- One of the key factors behind this poor performance and precarious recovery is the slow response of private investment to macroeconomic stabilization and the realignment of prices. This has been worsened by high domestic interest rates and a shift into trading in lucrative financial instruments and tradeable government

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securities. Even when interest rates have declined, given the uncertainty in the socio-political environment, investors have tended to hold back on investing in fixed irreversible assets.

- The existence of a large external and domestic debt has given rise to the debt overhang problem with adverse effects on investment and growth. This is because investors expect current and future taxes to be increased to effect the transfer of resources to pay for the external and domestic debt. In addition, there are the usual crowding-out and liquidity effects. The result, again, is that private investors exercise a waiting option in their investment decisions as in the risky environment noted above.
- Domestic debt has also influenced the domestic interest rate structure, enlarged the fiscal deficit, and affected financial development, investment and savings responses, resulting in a negative effect on output growth.

The challenge of the paper is to show how structural long-run factors are linked with short-run macroeconomic management to affect overall economic growth and to show the avenues through which growth can be re-started and sustained. The short-run macroeconomic issues relate to stabilization of basic prices necessary to give adequate signals for long-term growth. These are reviewed in relation to:

- Inflation rate, which reflects the outcome of macroeconomic management.
- Interest rate, which is the price of capital and also reflects inflationary expectations.
- Real and nominal exchange rate, which is a relative price that ensures a healthy balance of import and export returns. Furthermore, it is an indirect tool of monetary policy.
- Fiscal deficit, where fiscal policy should maintain internal balance and foster investment and thus appropriate signals for investors and fewer crowding-out effects of private loanable funds

Lessons from the Kenya Case Study

Short-run macro management issues

The profile of performance indicators shows the movements of inflation, money supply, real exchange rate, capital flows and the interest rates. They collectively show a period of turbulence consistent with the policy dilemma argued earlier. The outcome of economic management in Kenya has thus been disappointing but that does not mean that the appropriate policy formulation has not taken place. These have not been in short supply. Several policy framework papers and sessional papers have dwelt on policy out-turns in the short and medium term.

Short-term lessons highlight the pitfalls of economic management and can be summarized as follows:

- The financial sector has not responded appropriately and effectively to financial liberalization. The sector seems to have moved from financial repression to liberalization and to secondary financial repression. "Political banks" have increased the risk in the sector. Financial instruments have become more profitable to invest in. In addition, the government's heavy domestic borrowing has discouraged financial intermediation.
- The institutional structure, the legal and payments system, and the enforcement of contracts have been eroded.
- The trade regime (liberalization and the tariffication of quantitative restrictions) seems to encourage commercial activities promising quick and guaranteed returns rather than production that has a long gestation period and is risky. Importation of sugar, for example, undermines domestic production and encourages illegal rent extraction.
- As growth has decelerated, poverty has become rampant. Aggregate demand has fallen, checking future expansion of local industries.
- The capacity to implement and monitor the reform programmes and the ability of the government to implement these programmes seem to be lacking or political will has been absent.
- Corruption has emerged as a major factor. A number of studies have tried to estimate the degree of corruption and a weighted average of this index is used to rank countries. These studies ranked Kenya third worst in 1996 and the situation seems to have worsened since then.
- Social spending has been reduced drastically. This has devastating consequences on the development of human capital necessary for future growth.

Long-run and structural issues

The lessons from the analysis indicate that:

- To stimulate and sustain growth it is necessary to invest now to achieve growth in future and to sustain it. This can only happen if the current environment that discourages long-term investments is reversed. This requires other complementary policies to enhance institutional reforms and create certainty in the future. We borrow from Rodrik (1994), who states that an adequate institutional structure should "apply simple and uniform rules,

rather than selective and differentiated ones; endow bureaucrats with few discretionary powers; contain safeguards against frequent, unpredictable alteration of the rules; keep firms and other organizational interests at arm's length from the policy formulation and implementation process."

- Investment by the public sector encompasses both human capital and physical infrastructure to allow the private sector to respond and reduce transaction costs. These are structural factors that enhance the productivity and profitability of private investments.
- To reverse the private investment pause and stimulate growth, it is necessary to create an environment of certainty in the economy. Social and political certainty and the feeling of long-lived government and government policies is crucial.
- For this to be achieved, short-run macroeconomic policies should be in line with long-run growth targets. To achieve the stated goal of export-led industrialization by the year 2020, there should be an interest rate structure that supports investment in the export sector as well as being in line with the exchange rate policy. The real exchange rate is a relative price that determines the profitability of exports, yet as we have shown in our analysis it is influenced strongly by short-term capital flows responding to an interest rate differential. Thus an appropriate policy response for capital flows is required.
- The short-run economic management issues reviewed include the domestic debt, which influences domestic interest rates, inflationary expectations, short-term capital flows and the real exchange rate. Domestic debt is a distortion in the economy and needs to be drastically reduced. One of the quickest remedies is to change the maturity profile of domestic debt instruments and to create a fund that will service the domestic debt and reduce the principal, accompanied with reduction in future domestic government borrowing.
- The domestic interest rate structure currently encourages investment in short-term financial assets, the main one being tradeable government securities. The consequence has been to reorient the financial sector into short-term deposits and lending, thus limiting its intermediation role and slowing the development of the financial sector. These effects spill over into the exchange rate and interest rate, and encourage speculative investment and commercial activities.
- For macroeconomic policies to provide the required short-run supply response and lead to future growth, institutional reforms are necessary to support and complement the economic reforms so far undertaken. Political and social certainty and credible government policies are crucial.

The existing political climate, issues of governance and corruption in the public sector all currently combine to create a very uncertain future, which affects:

- Private investment currently and in the future
- Tourism sector and investmet related activities
- Future potential for growth
- Economic mangement
- fiscal discipline

With these dampening effects, hopes for future growth are seriously compromised.

THE PRODUCTIVITY AND COMPETITIVENESS OF KENYA'S ECONOMY: A SURVEY OF SELECTED LITERATURE

Aidan Eyakuze
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EXECUTIVE SUMMARY

This paper briefly reviews selected theoretical, empirical and survey literature examining the productivity and competitiveness of Kenya's economy.

Productivity describes the static level and dynamic rate of change in a nation's output per worker, or output per unit of a composite input combining labour, capital and intermediate inputs (Hall and Jones, 1996). Porter (1998) also suggests that the productivity of a nation's economy is linked directly to that of its firms by asserting that "unless companies become more productive, an economy cannot become more productive." Firm-level productivity rests on two interrelated areas: "the sophistication of company operations and strategy, and the quality of the microeconomic business environment (suppliers, human resources, marketing channels, customer sophistication). In addition, a sound legal and political structure and macroeconomic policies create the potential for productivity increase. Harberger (1998) examines the growth residual (Solow's residual), which represents technical change, or total factor productivity (TFP) improvement, and is the source of productivity growth. He recasts technical change as real cost reduction in order to give the residual an address (the firm), and a face (the entrepreneur, the CEO, the production manager, etc.). He agrees with Porter in suggesting that because three of the five key elements of growth (rate of investment, rate of return and real cost reduction) are also the critical elements in decision making at the firm level, "one cannot escape the conclusion that the great bulk of the action associated with the growth process takes place at the level of the firm."

While the concept of competitiveness is quite well understood at the firm level, it has been rather controversial when applied to national economies. Competitiveness has been defined variously as "the ability of a country to realize central economic goals, especially growth in income and employment without running into balance of payments difficulties" (Fagerberg, 1988) and "the degree to which [a nation] can, under free and fair market conditions, produce goods and services that meet the test of international markets while simultaneously expanding the real incomes of its citizens" (Castells 1996). Competitiveness "depends on the capacity of [a nation's] industry to innovate and upgrade" (Porter, 1990). The World Competitiveness Report (1994) suggests that competitiveness derives from the combination of a country's assets, either inherited (e.g., natural resources) or created (e.g., infrastructure, human capital) and the processes (e.g., manufacturing) that transform them into economic results and meet the test of the international market.

The importance of competitiveness for a nation's economic health and standard of living has been vigorously debated. In at least one article, Krugman (1994) argued that the concern with competitiveness was misplaced, essentially because countries were not in competition with each other in the same manner as firms are. This view has been hotly contested by, among others, Prestowitz, Thurow and Cohen (1994).

The literature also reveals an interesting tension between comparative and competitive advantage in explaining the economic performance of nations. Under the theory of comparative advantage, "the success of nations in particular industries is based on so-called factors of production such as land, labour and natural resources" (Porter 1990). In this view, "a country is tied to what it has, not to what it can create. In contrast, competitive advantage is based on the ability of the people of a country to add value to the available resources" (Doryan, 1993). The two views result in radically different implications for economic policy, as Collier (1998) suggests in his analysis of the implications of globalization for Africa. Collier proposes a transaction cost argument to explain Africa's low level of manufactured exports relative to natural resource exports, as an alternative to Woods' (1997) natural resource endowment thesis. According to Collier,

> On Woods' thesis, Africa can forget about manufactures. There is nothing to be done. On the transactions costs thesis, there is everything to be done. *Policymakers can, by reducing transactions costs to world levels, make Africa into the most competitive region in the world for labour-intensive manufactures because of Africa's low and relatively declining real incomes.*

The economic success of such natural resource poor countries as Japan, Hong Kong and Singapore and the prevailing context of an increasingly knowledge-based, globalizing economy, tilt the argument in favour of a created competitive advantage.

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The Productivity and Competitiveness of Kenya's Economy

Four studies of Kenya's productivity and competitiveness are reviewed. Gerdin (1997) offers a comprehensive historical analysis of Kenya's productivity. Siggel (1997) examines the competitiveness of Kenya's manufacturing sector in 1984, which is broadly supported by more recent analysis by Kimuyu (1998). Ndung'u and Mwega (1998) look at the impact of exchange rates on Kenya's manufactured exports.

Gerdin (1997) focuses on the determinants of growth following the neo-classical growth accounting tradition originated by Solow (1957) in which total factor productivity (TFP) growth is measured as a residual. Productivity growth is measured at the sectoral level based on sectoral production functions in the 1964–1994 period, an approach that allows for an investigation of whether the observed behaviour is common across all sectors or whether it is sector specific. The sectors analysed were agriculture, mining, manufacturing, wholesale and transport. Output growth in the five sectors was allocated between growth in inputs and change in productivity. Average annual growth rate in overall output was 3.98% between 1964 and 1994, declining from 6.05% in the first decade to 2.12% in the 1984–1994 period. Annual productivity growth rates increased over time from 0.19% in 1964–1973 to 0.47% in 1984–1994. Productivity growth gave on average a small boost to output growth of 0.37% each year.

Overall results show productivity growth to have been the least significant source of output growth in Kenya. It accounted for about 9.30% of overall output growth compared with labour's 10.05%, capital's 30.65% and intermediate inputs' contribution of 50.25%. The analysis estimated a mean rate of technical change (technological upgrading and innovation) of –0.18% and a mean total factor productivity (TFP) growth rate of –0.12%. This study suggests that over a period of 30 years, Kenya's aggregate productivity growth and rate of technological advancement seems to have been almost negligible.

Siggel (1998) used data of 78 Kenyan firms in 24 industries from 1984 to learn about the competitiveness of Kenya's manufacturers in the mid 1980s. The analysis found that unit costs at shadow prices exceeded international prices by 15%. This suggests that Kenya had no comparative advantage in manufacturing in 1984. Unit costs at market prices also exceeded international prices by 10%, so that Kenya's manufacturing sector as a whole also lacked a competitive advantage during that year.

Lundvall et al. (forthcoming) undertake a detailed analysis of productivity and technical efficiency in four manufacturing sectors (textiles, wood, food and metal) based on data from a three-year (1993–1995) survey of 266 firms (interviewed at least once) as part of the World Bank supported Regional Programme on Enterprise Development (RPED) exercise. Productivity was defined as the ratio of output to inputs, and technical efficiency as the ratio of actual output to the maximum feasible output, given inputs.

The inter-firm (within the same sectors) comparison of technical efficiency showed a strongly positive size efficiency relationship up to and including firms with 75–149 workers. Efficiency declines for firms larger than this. Informal firms are less efficient than formal firms due to their small size and very low capital–labour ratio. Comparisons across industry sectors were interpreted as productivity differences, rather than differences in technical efficiency. The results showed the food sector to be between 40% and 120% more productive than the wood and textile sectors. The metal sector was between 20% and 85% more productive than the wood and textile sectors. The most significant determinants of productivity for the food and metal sectors were investment, the quality of the firm's human capital and access to credit.

The analysis of Kenya's manufacturing firms showed export participation increasing from 26% to 36% of surveyed firms. The share of total production that was exported also increased from 24% to 28%, with the metal and textile sectors doubling their mean export share. Technical efficiency was higher for exporters (compared with non-exporters) in all sectors except for textiles, but was statistically significant only for the food and wood sectors. Exporting firms were almost six times larger (using output volume as a proxy for size) than non-exporters and generally had higher capital and labour productivity and capital–labour ratios. Both the probability of exporting and the proportion of output exported were strongly influenced by labour. Kimuyu's (1998) analysis "confirms that labour intensive activities are not only more likely to export but also export a greater share of their production than other enterprises. This probably suggests that Kenya's comparative advantages presently lie in labour intensive manufacturing activities." These conclusions echo Siggel's findings, using earlier data, on Kenya's apparent comparative advantage in labour-intensive manufactured goods.

Horticulture: Kenya's Most Competitive Sector

While the productivity growth of Kenya's economy as a whole has been shown to have stagnated for three decades, and competitiveness seems to elude the manufacturing sector, the performance of horticultural exports has been encouraging and revealing of a success story in international competitiveness.

Over the past two decades, the horticultural export subsector has developed into an important component of

the Kenyan economy, providing a major source of foreign exchange earnings as well as substantial employment and farm income opportunities. During this period when Kenya's exports of many traditional commodities either declined (sisal, meat, pyrethrum) or fluctuated greatly from year to year (coffee, tea), the aggregate volume and value of horticultural exports increased substantially and virtually continuously, mounting into double-digit rates most years. Horticultural exports more than doubled in volume and increased by over 24 times in shilling value terms between 1984 and 1998.

The expansion of Kenya's fresh produce trade has been accompanied by, and is in many ways dependent on, the entry of many new participants, especially at the production level. In the case of vegetables, this expanded production came in response to a rapid increase in foreign demand during the 1970s and was stimulated by competitive pressures within Kenya, which led exporters to extend and diversify their sources of supply.

The production and trade of cut flowers has been one of the most dynamic components of Kenyan agriculture over the past two decades. This industry has experienced several new medium- to large-scale investments, a secondary yet substantial growth in smallholder production, and a considerable diversification in the mix of crops produced and marketed. Since 1973, participation in Kenya's horticultural export subsector has broadened considerably, with growing numbers of smallholder and other producers providing commodities and raw materials and with increased entry into trade, especially for fresh produce exports.

Lessons from Horticulture's Success

With the possible exception of South Africa, Kenya has developed the most diversified and successful horticultural export trade within sub-Saharan Africa. For African countries and entrepreneurs seeking to replicate aspects of Kenya's horticultural development experience, three lessons can be drawn. First, while many African countries share with Kenya some ecological, locational and labour cost advantages in the production of certain horticultural crops, few such countries are well endowed with the additional technical, financial, infrastructural and managerial assets that are critical for developing a competitive horticultural trade. In the absence of foreign investment or a considerable initial investment by government and/or the local private sector in horticultural research, training and marketing infrastructure, the development of horticultural exports will be a very slow process in Africa, with a high incidence of failure among individual firms.

Second, and relatedly, the development of African trade in many horticultural commodities will require the attraction of foreign investment or at least the development of long-term technical and marketing contracts between domestic and foreign firms. This may be especially important in commodity lines requiring highly specialized knowledge and inputs, featuring rapid technical and market changes, and having highly concentrated international markets. Governments need to improve the incentives for foreign investment and the legal and informational basis for the development of complex contractual relations between local and foreign companies.

Third, "learning-by-doing" may no longer be a viable means of developing a horticultural export trade in light of the intensification of competition in European and other markets and the increased requirements for quality, supply continuity and product variety in these markets. Prospective exporters would be advised to gain experience first in the domestic market, perhaps by developing crop procurement and distribution arrangements to supply high-quality produce to restaurants, hotels and up-market retail outlets. In encouraging new entry into horticultural exports, attention should focus on private firms and cooperatives currently active in domestic fresh produce wholesaling, large individual growers, and firms or individuals that currently export other agricultural or manufactured products and thus have market contacts and an understanding of the risks and mechanics of international trade.

While Kenya's institutional framework and macroeconomic climate will remain critical, improving the productivity and competitiveness of Kenya's industrial sector also depends to a significant extent on enterprises learning from the experience of the horticultural exporters and applying the lessons to their activities in the domestic and international marketplace.

REVITALIZING AGRICULTURAL PRODUCTIVITY IN KENYA

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EXECUTIVE SUMMARY

Agriculture plays a leading role in Kenya's economic development. It directly contributes about 25% of the gross domestic product (GDP), employs about 75% of the labour force, is the major foreign exchange earner for the country and provides most of the food requirements for the nation. The sector is dominated by the primary production of a few commodities, six of which account for 68% of the agricultural GDP and 17% of total GDP. Agricultural related transportation, trading and processing activities are responsible for another 20–30% of economic activity, meaning that agriculture and related activities are responsible for up to half of all economic activity in the country.

Indeed, success of Kenya's current major development concerns—industrialization in the year 2020 and poverty alleviation—will depend heavily on the development of the agricultural sector. Unfortunately, the sector is not given the prominence it deserves in the documents that outline the policies for industrialization and poverty alleviation. This is a reflection of the policy marginalization of the sector, while it is expected to play a leading role in economic development.

Performance of the sector in the 1990s was dismal. Annual growth in GDP averaged 2% compared with an average of 4% in the 1980s and 6% in the first decade of independence. Production of most commodities had mixed trends, with a general decline for all of them. The worst affected were coffee, cereals (maize, wheat and rice), industrial crops, particularly cotton, and milk production in the livestock sector.

The export horticulture subsector continued to perform fairly well for most of the years but there was a decline in production in the late 1990s and indications are that the good performance may not be sustained unless the constraints hindering growth are removed. Further, although some commodities like tea show a general increasing trend in production, this is attributed to an increase in hectarage rather than an increase in productivity. In all cases, productivity for all the commodities is low, and in some cases declining.

A number of factors are responsible for the decline in production and low productivity, The most common excuse is climatic (drought), but the major culprits are policy related. In particular, since the government's commitment to implementation of liberalized market policies in 1993, the agricultural sector has faced problems with respect to sequencing, timing, instability and poor adjustment to the policies. This has been made worse by lack of an appropriate legal framework to support operation of the emerging policies and lack of a clearly defined role of the government in agricultural development. The other broad problems include low investments, poor delivery of services to farmers, high input costs, marketing problems, weak extension and research systems, poor access to credit, unclear policy on land use, poor promotion of exports, insecurity in rural areas and therefore loss of investor confidence, and uncontrolled imports.

In the cereals subsector, production is lagging behind demand, meaning that even in normal production years the country must import. The subsector is characterized by high costs of production, subsistence production for maize, high costs of fertilizers and machinery, injudicious use of taxes on imports, low use of improved technologies, inefficiencies in production, and policy bias towards large producers. Kenya should make best efforts to become a low-cost producer of cereals, particularly maize. The mechanisms of doing this are known, but call for radical rethinking of the policy instruments chosen. These include:

- Rationalizing the way in which services like research, extension and credit, and marketing functions like storage, are funded and delivered
- Shifting the way government raises tax revenue
- Injecting competitiveness into input supply and output marketing, agricultural credit, infrastructure provision
- Running Kenya's agricultural sector

A vision of a low-cost, efficient and globally competitive agricultural sector must accompany moves toward more open borders if these arrangements are not to kill our agricultural industries. Protection through high tariffs

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cannot make this happen. The problems of high-cost domestic production, and protection through prohibitive tariffs also apply in the wheat and rice sectors.

For the sugar industry, severe cost overruns and other problems have led government to invest in no new production capacity apart from efforts to improve throughput at existing schemes. For the foreseeable future Kenya will import sugar as investments in new production schemes, such as those proposed for Busia and Siaya, lag behind growing domestic demand. Diversion of sugar imports intended for other countries and inefficiencies in domestic production have aggravated the problem. Efforts to restart the industry include:

- Investments in research into high sucrose content cane varieties.
- Strong outgrower farmer organizations to ensure efficient delivery of services to farmers by factories.
- Cane purchase on the basis of sucrose content, and privatizing factories to enhance on-farm efficiency.
- Clear policy on import competition, in light of WTO agreements that will reduce maximum levels of duty on imports.
- Investment in cost-reducing efficiency measures and research.

The cotton industry had all but collapsed when the government began to liberalize it in 1991. Some of the reasons for this were cash flow problems in the industry, delayed payments to farmers, poorly planned liberalization and privatization programmes, poor seed quality, inadequate funding for research, and minimal extension services. For the cotton industry to survive it must compete at international prices. The only way in which Kenyan cotton can be made competitive is through investment in seed bulking and multiplication that makes extra insecticide spraying worthwhile on current varieties, or on new varieties.

In the livestock subsector, there have been liberalization policies since the mid 1980s. The impact of these policies has been mixed. Currently, there are surpluses in production of pig, poultry and rabbit products. Dairy production is on the balance, while meat production shows a deficit balance. Non-conventional livestock production is expanding in crocodile farming, ostrich farming and game cropping. The major issues in the desire to modernize the livestock sector and improve the livelihoods of those dependent on livestock farming include insecurity and the cattle rustling menace; the poor state of infrastructure (stock routes, transportation, water facilities); market access; poor breeding stock; high feed costs and feed quality problems; high cost of inputs (chemicals, fuel, etc.); access to credit and veterinary services; inadequate breeding services (artificial insemination and bull schemes); and anti-competitive practices (dumping of imports, cartel-like purchasing tendencies).

To overcome these constraints, Kenya must improve its meat export capability while consolidating its hold on its niche markets through innovative marketing and quality control. Other strategies should include efforts to diversify and expand domestic consumption, improve security and stop cattle rustling, enhance competitive input manufacture and product processing, revise various legal provisions to permit efficient and legal operations in the industry, and involve stakeholders in enhancing growth of the subsector.

Performance of the coffee, tea and horticulture subsectors is vital for the resuscitation of the economy because of their role in raising farm income both local and foreign, employment, and food security. But in recent times, this has not been the case. Coffee and pyrethrum production has declined. Tea factories are congested, and horticulture faces increased competition and threats of losing its traditional markets.

In the coffee industry, major problems include low world market prices, high transaction costs due to widespread mismanagement, corruption, lack of transparency, high political patronage of many organizations involved in delivery of services to farmers, high handling and marketing costs, high cost of production, and poor regulatory framework. The critical requirements for the coffee industry are to involve stakeholders to determine changes in the industry, provide farmers with rehabilitation funds, introduce cost reducing technologies, reduce transaction costs and install a better regulatory framework.

Major steps to develop the tea industry are:

- Diversify market through value adding activities, and exploit potential markets in the Middle East, Africa and some parts of the Pacific Rim.
- Encourage private sector and cooperative participation in putting up new factories.
- Encourage rather than hamper private sector investment in tea factories, and not by the proposed restructuring of KTDA.
- Improve roads in tea growing areas.

TRADE LIBERALIZATION AND GROWTH IN KENYA

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EXECUTIVE SUMMARY

Trade liberalization and openness are advocated as a key prescription to attain high economic growth. The opening up of trade in the developed world began in the 1950s under the General Agreement on Tariffs and Trade (GATT). By contrast, in developing countries, particularly most African countries, this process of opening up economies came later, starting in the 1980s under the structural adjustment programmes, but with effective implementation of policies often only in the 1990s. This paper looks at the case of Kenya to check whether changes in trade policy and exchange rate regime have made any significant impacts on growth performance.

Since independence, Kenya has been through a process of protecting and controlling its markets, which went through a buildup that peaked in the early 1980s. In parallel, Kenya lost its major regional markets through the 1970s. This left Kenya as a closed economy through the 1980s, but the country began opening up its economy again through trade liberalization and price decontrols starting in 1987, with liberalization reaching a peak in 1993–1994. These changes in policy regime had major and very obvious impacts on the patterns of international trade. Were these changes in policy regime and trade sufficient to lead to similarly significant changes in economic growth?

This paper lays out in some detail the changes in market policy regime since independence, and explores which of the policy levers were critical to changing the Kenyan international trade experience. It attempts to identify any significant relationship between these changes in trade patterns and economic growth by exploring a broad range of factors that affect growth and investment. Based on this analysis, conclusions can be reached about the relative importance of trade and exchange rate policies relative to other elements of the overall policy environment on Kenyan growth performance and prospects.

The study generated many significant findings:

1. Trade and exchange rate policy has had major impacts on the trade performance and experience of Kenya. The two major impacts on trade have been:

    - ***The loss and regaining of the East African markets for exports:*** Tanzania closed its border in 1977 and Ugandan imports demand declined from the late 1970s through the 1980s with internal civil instability. These markets began to recover through the late 1980s and early 1990s. Access to the East African and regional markets has been extremely important for exports of manufactured and processed goods. Hence, regional trade policy has significant consequences for manufacturing investment prospects.

    - ***The imposition of foreign exchange allocations by the Central Bank for all imports in 1983 and its removal in 1993:*** This had the most dramatic effect on aggregate trade performance. These comprehensive import controls effectively constrained import demand to significantly lower levels than existed either prior to their imposition or after their lifting. Imports of goods dropped by some 6% of GDP during the period from 1981 to 1992 compared with both earlier and later performance Aside from the imposition of other market controls, the comprehensive foreign exchange allocation mechanism for imports made the 1981–1992 period the most distinctive policy regime period in terms of its major and clear impact on restricting trade.

3. The imposition of comprehensive foreign exchange controls not only adversely affected imports, it also adversely affected export performance, particularly in manufactured and processed goods. When imports dropped by some 6% of GDP, exports dropped over the same period by a similar share of GDP. It is also evident that the East African market was lost before 1983 and was opened again before 1993. The significant shifts in exports came, however, with the changes in foreign exchange allocation restrictions to imports, particularly in 1993 and

thereafter with a dramatic increase in exports of manufactured and processed goods to Uganda, Tanzania and other COMESA countries. Particularly in manufactures, low-cost and flexible access to imported raw materials and industrial intermediate goods is critical to export success—increased imports are essential to achieve increased exports of manufactures or merely expanded re-export trade.

4. Up to 1993, Kenya had used a large range of policies to restrict imports (including tariffs, deposit requirements, licensing and no objection certificates) and protect domestic industry. Post 1993, effective trade protection has largely come from relatively modest tariff rates. While these import protection devices clearly caused market distortions and resource misallocations, these policies were generally partial and often ineffective, so that trade could continue at reasonably high levels. It is notable that in the early period of the East African Community, trade was open within this community, but not with the rest of the world.

5. No *direct* link could be established between the growth performance of Kenya and the changes in trade policy regime or trade performance. This does not imply that trade and exchange rate policy are not important, for three reasons:

   - Kenya has only experienced a truly open trade and exchange rate policy since the major liberalization of 1993/1994. Hence, the time period for the effects of an open trade policy to evidence themselves has been limited. The dramatic increases in manufactured exports since liberalization points to growth potential in the manufacturing and processing sectors over the longer term.
   - Kenya has had a poor performance in creating all the other complementary supportive factors that would allow the economy to fully exploit the benefits of more open trade and international competition. Kenya has underperformed in the provision of economic infrastructure and a competitive macroeconomic environment. High growth generally is the result of a number of favourable factors combining in a multiplicative manner to achieve significant surplus generation. *Openness in trade is not sufficient to overcome other adverse factors.*
   - *Indirect* relationships between trade and growth are found. Access to regional trade markets does appear to promote private investment significantly by over 13%, which is estimated to have added 1.2 percentage points to growth.

6. The period of low openness to trade (1981–1992) contains a period from 1985 to 1990 of significant economic growth at an average rate of 5%. This was generally driven by inward looking investments, except for a major expansion in the tourism sector. Imports increased significantly during this period while exports of goods were at their lowest levels since independence. The foreign exchange requirements of this growth spell were financed by higher service sector earnings from tourism and a significant increase in net official development assistance starting in 1987 with the various economic adjustment programmes for the development of export and other markets.

7. Private investment is the strongest and most significant contributor to growth. Private sector investment has been the only major engine of growth.

8. Public investment by central and local government and parastatals shows up as a weak contributor to growth, but positively related to private investment. Out of public investment, *parastatal investment has a weak direct impact on growth, but a stronger indirect impact through supporting private sector investment.* This is consistent with the economic support role of the major utilities, which, until recently, were all parastatals. *Government investment has a stronger, but still weak, direct effect on growth.* This effect can act through investments in roads, for example.

9. *Private sector investment can be increased through improved market incentives, particularly lower real interest rates,* which can be achieved primarily by reducing the domestic debt burden of the government. *Enhancing the efficiency of public sector investments and expanding the volume of government investments* will also have significant direct and indirect effects on growth.

10. Measures of operating and maintenance expenditures per employee by the central government show a significant, if not large, impact on investment and growth on a lagged basis. The large drop in government real wage rates, particularly in the managerial and professional cadres, has no doubt also undermined the efficiency of the use of operating and maintenance funds in effective public sector service delivery.

11. Formal sector employment (private and public) has a weak and inconsistent relationship to growth.

INDUSTRY COMPETITIVENESS, TRADE PROSPECTS AND GROWTH IN KENYA AND UGANDA

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EXECUTIVE SUMMARY

The main objective of this study is to examine the competitiveness and comparative advantage of manufacturing industries in Kenya and Uganda in view of recent trade policy changes, as well as present and future measures of regional integration in East Africa. A further objective is to evaluate the impact of certain policies on the costs, and thereby on the competitiveness, of the manufacturing sector, in particular the impact of trade policy changes, management of the exchange rate and measures that influence the cost of capital.

Policy Environment

In Kenya, the government has pursued policies that emphasize markets and freer trade since the mid 1980s, and in particular since 1992. Quantitative restrictions on trade were phased out, the tariff structure has been made more uniform with lower rates and the exchange rate has become market determined. At the same time, the Government of Kenya has set an ambitious target for the country: to accelerate industrialization and become a newly industrialized economy by the year 2020.

In Uganda, unlike Kenya where industrialization was continuous, the industrial base of the 1960s disintegrated during the years of political instability and civil war. Since the early 1990s, the Government of Uganda has adopted a fairly liberal trade regime with absence of quantitative restrictions, a market-based exchange rate and relatively uniform tariff structure with low rates. Many Ugandan manufacturers are therefore back at the infant industry stage and, at the same time, face strong international competition.

Method of Analysis

The method of analysis chosen for this study is based on the concept of *cost competitiveness* and its close link with that of *comparative advantage*. It is derived from basic trade theory principles, combined with principles of social cost–benefit analysis. The method consists of the computation of three indicators of competitiveness and their decomposition into cost components representing the factors of production (tradeable and non-tradeable inputs, labour, and capital), all at shadow prices, as well as a number of distortions. The latter are mainly policy-induced price distortions, but some distortions in costs are also caused by deficiencies in the quality of services such as utilities. The price distortions are measured as divergence from shadow prices.

The three indicators are unit cost ratios obtained by dividing total costs of production through the value of output, using three different sets of prices. This definition of unit costs is particular and diverges from the usual definition of unit costs as costs per physical unit of output. Its purpose is twofold: to overcome differences in product mix and quality between competitors, and to make the analysis independent of data from international competitors. The analysis does not exclude, however, bilateral international comparisons when data are available. We assume that the international free trade price (cif) of traded goods equals the lowest cost of international competitors. The unit cost ratio then compares the unit cost of African firms with the free trade or border price of comparable imports. If their cost is inferior or equal to the border price, we consider a firm internationally or export competitive. This indicator is called UCx; the criterion for *export competitiveness* is $UCx \leq 1$.

The second indicator, measuring *domestic competitiveness*, is the unit cost ratio at domestic prices (UCd), i.e., based on market prices that include all kinds of cost and output price distortions. The principal distortions are those of the tariff on output, the tariff on traded inputs, the potential misallocation of the exchange rate, and distortions of

the interest and wage rates, as well as distortions in energy, transport and communications costs. The indicator UCd is obtained by dividing total costs at market prices by the domestic value of output at ex-factory prices. It differs from UCx only in the denominator, which includes the tariff on output.

The third indicator is the one of *comparative advantage*, which excludes all distortions on the cost and revenue sides. It is based on the theory of comparative advantage, which requires that unit costs at equilibrium prices must be inferior to the cost of international competitors. The separation of distortions from the equilibrium values of output and all inputs is made by calculating shadow prices for all products and factors that are likely to be distorted.

Data Sources and Research Procedure

The study is based on three data sets. Kenyan enterprise data of 1984 are taken from a sample of 78 firms, collected for the Ministry of Planning in 1985. The second set of data pertains to 42 Kenyan firms in 16 industries, which are a subset of the earlier sample, with a few additions. The third set consists of a sample of 21 Ugandan firms in 12 industries. The data of the latter two sets are for 1997, with a few firms reporting 1996 or 1998, and were collected by the team members of the present project. All data are quite detailed cost and revenue data and were obtained by help of a questionnaire and interviews. They also include qualitative answers to various questions concerning obstacles and sources of competitiveness. Additional data sources were documents of the IMF, central banks, ministries and studies of other organizations, in particular the manufacturers associations of both countries.

The research procedure consisted of the design of the questionnaire and a programme for the computation of the indicators and their decomposition, the collection of data by firm visits and interviews, the computation and interpretation of the indicators, and the reconciliation of the findings with those of other studies.

Results of the Analysis

The findings of the study are quite disturbing in the case of Kenya, but relatively comfortable in the case of Uganda. For Kenya, the main finding is based on the comparison of industry performance of 1997 with that of 1984, i.e., during a 13-year period of policy changes in the direction of freer trade and market orientation. Based on the three indicators, it appears that on the one hand, industries have gained somewhat in terms of comparative advantage, as one would expect, but have lost in terms of competitiveness, due to increased distortions.

Starting with the situation in the mid 1980s, the average (across 78 firms) unit cost ratios were UCx = 1.25, UCd = 1.13 and UCs = 1.17. This means that the manufacturing sector as a whole, to the extent that the sample of 78 firms is representative, was neither export competitive nor endowed with comparative advantage. Nor was it competitive in the protected domestic market. Since UCd was the lowest of the three ratios and lower than UCs, the sum of all distortions was negative, meaning that on the whole, the distortions acted as implicit subsidies. In other words, the combined net effect of the tariff and non-tariff barriers helped the firms to compete against imports by raising their profitability. Export competitiveness was weakest, as protection at the level of inputs raises unit costs and is not compensated by the protection of output prices, since exports pay only world prices.

The comparison between 1984 and 1997 can be summarized by the following sample average unit cost ratios:

	UCs		UCd		UCx
1984	1.17	>	1.13	<	1.25
1997	1.06	<	1.22	<	1.42

The important point shown in this table is that in 1997, the inequality between UCs and UCd runs in the opposite direction from that of 1984. The sum of all distortions (equal to UCd – UCs) is now significantly positive rather than negative as in 1984. Distortions, on average, act as penalty rather than as implicit subsidy.

The most important distortion, measured as a proportion of output value, is the interest rate distortion, which accounts for 19.3% of output value, while it had been –2.8% in 1984. The reason for this reversal is that in 1997 the average lending rate was 30%, some 10% higher than the shadow interest rate, whereas in 1984 it had been estimated as slightly below the shadow interest rate.

The second factor weighing most heavily on unit costs in market prices vis-à-vis those in shadow prices is the exchange rate distortion, which had been absent in 1984. The Kenya shilling was found to have been well aligned in that year, but over-valued by 10% in 1997. The combined effect of over-valuation on output and input prices in 1997 was 7.5% of the output value.

The net effect of protection on output and inputs was -13.3% in 1997, while it had been only -4.7% in 1984. This is surprising, because it means that, on average, the effect of protection on unit costs, which is unit-cost reducing if

the nominal rate of protection (NRP) on output is higher than that on inputs, has increased. Since both NRPs have gone down as a consequence of trade liberalization, the explanation of this outcome is that the average NRP on inputs was reduced more strongly than that of output prices.

Finally, the energy, transport and communications cost distortions have increased. For this finding we have qualitative evidence in the form of verbal and written responses to the 1997 questionnaire, but we have no comparable data for 1984. In 1997 all firms reported excess cost in these three areas, which account for 1.5% (energy) and 1.3% (transport and communications) of output value. While these proportions don't appear to be large, in comparison with the ones discussed before, they are important factors that have contributed much to the deterioration of the business climate, or the "enabling environment." Electricity blackouts, unreliable telephone lines, unreliable rail transport and a strongly deteriorated road infrastructure are accounting for these distortions.

Our analysis of the sources of competitiveness is based on the relative size of the cost components in total output value. This method is valid for the distortions, although most of them are obstacles to, rather than sources of, competitiveness. Concerning the *sources of comparative advantage*, however, which we consider as the *real sources of competitiveness* (as opposed to the temporary and nominal character of the price distortions), the method of decomposition cannot be applied rigorously. Excess costs of one factor may be compensated for by savings of another factor. In other words, the possibility of substitution between factors of production must be taken into account. Since our method of analysis would become too complex if we added a cost function analysis, we have resorted to a much simpler statistical test. We argue that when one factor's proportion in unit cost (at shadow prices) is particularly high (meaning higher than average) whenever the total unit cost is higher than average, then it can be considered a source of comparative disadvantage. Conversely, when extensive use of a factor is correlated with lower than average unit costs, that factor is regarded as a source of comparative advantage. We have therefore regressed the coefficients of all four cost components—tradeable and non-tradeable inputs, labour, and capital—over the unit cost ratio UCs, and found a significant intercept only for capital in 1984, and it is negative. This is interpreted as capital having contributed to comparative disadvantage. In other words, firms seem to have over-used capital in the mid 1980s, which contributed most significantly to their lack of comparative advantage. This conclusion is supported by the evidence of low capacity utilization rates, which were widespread in Kenya in that period. In the 1997 sample this bias is less significant, which is consistent with our observation of higher rates of capacity utilization in 1997.

Our comparison with Uganda is also carried out at the level of firms in the industry case studies, and at the level of industries. For the latter purpose, the data of 42 firms in Kenya are aggregated into 16 industries at the three-and four-digit level of ISIC. In Uganda, the data of 21 firms are aggregated into 12 industries with the same or very similar output mix. In 11 of these 12 industries comparisons are possible, while in one of the Ugandan industries (animal feed) no Kenyan competitor could be persuaded to collaborate in our study. The comparison results in the following average (across 11 and 16 industries for Uganda and Kenya, respectively) for our indicators of competitiveness and comparative advantage:

	UCx		UCd		UCs
Kenya	1.42	>	1.22	>	1.06
Uganda	1.33	>	1.09	>	1.12

First, the inequalities run in the same direction in both countries. This means that in Uganda, as in Kenya, the sum of all distortions penalizes the manufacturers, in spite of the cost-reducing effect of net protection. While Kenya has a competitive edge on export markets, however, Ugandan firms are relatively more competitive domestically. In other words, the Ugandan firms are, at present levels of protection and other distortions, more profitable than the Kenyan firms in our sample. As to comparative advantage, in both countries, manufacturing as a whole (to the extent that the samples are representative, has a comparative disadvantage, but Kenya's disadvantage is less pronounced.

The industries that have greatest comparative advantage in Kenya are fish and fruit processing, followed by grain mills and the beverage and tobacco industries. In Uganda, fish processing has also comparative advantage, but it comes second after the unexpected leader in the automotive parts industry producing auto batteries. Footwear comes third. The inter-country comparison of UCs, irrespective of its absolute value, shows that Kenya has an advantage in dairy products, grain mills, bakery products, textiles and clothing, paints, cement, and metal products, whereas Uganda has an advantage in fish processing, footwear, paper products and batteries. These conclusions, especially when confronted with the reality of present trade flows between the two countries, lead us to the following cautioning remarks.

First, the industries are not always equivalent in the two countries, in terms of output mix. The paper products industry, for instance, is represented by only one producer of stationery in our Uganda sample, but by two paper mills in Kenya, which export raw paper to Uganda. Although being in the same industry in our aggregation, they are

at different levels of transformation, and one buys from the other, rather than competing with each other. Furthermore, the paper industry is very capital intensive, and we have shown in the study that our indicators are biased against capital intensive industries. This bias comes from the fact that unit costs include the full opportunity cost of capital. Firms that are fully owned and not in need of substantial borrowing may be more competitive than the indicators suggest. Third, and more generally, all our figures are prone to special-case biases. Since we have obtained data for only one year, the performance of the firms in that year may have been exceptionally good or bad, and since the sample of every industry is very small, such biases attach to whole industries.

Policy Conclusions

In spite of these words of caution, we believe that policy conclusions can be drawn from the analysis. They differ slightly for the two countries, but let us start with one conclusion that is valid for both. We conclude that the opening of the countries' borders to trade, both regionally and internationally, is a necessary but not sufficient condition for the growth and development of the industrial sector. Liberal trade policies must be cautiously monitored and complemented by other policies that are consistent with the former and can be seen as part of an industrial strategy. Such policies must include cautious fiscal and financial policies that keep the cost of capital from being excessive. They must also include a cautious approach to monetary and exchange rate policy, avoiding the competitiveness reducing effect of over-valuation. Third, and equally important, an industrial strategy can only work if the transport and communications infrastructures are maintained in good condition and expanded according to the needs of industries and their markets. The utilities must also provide reliable services at competitive prices. And last but not least, the government bureaucracy must reduce regulatory inefficiency (red tape) as much as possible and avoid corruption.

For Kenya, these conclusions are particularly imperative, since its industrial sector seems to be on a downward slide that makes the ambitious goals of the government appear to be unrealistic. The indicators we have generated show that more liberal trade policies do seem to move resources more towards activities with comparative advantage, but also that they do not guarantee international competitiveness. To reach this goal, the important other distortions of the cost structure have to be avoided or minimized, and that requires much more discipline in the policy areas singled out above.

For Uganda, the general conclusions also apply, but the sector is still on a positive slope. It can easily reverse this trend, however, if the conditions of the sector are not carefully monitored and the discipline and consistency of various policies are not observed. The indicators proposed in this study provide a useful tool, in our view, for monitoring the impact of various policies on the competitiveness not only of manufacturing, but of all economic activities.

EXPORT PLATFORMS IN KENYA

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EXECUTIVE SUMMARY

The paper analyses the structure and performance of export platforms in Kenya over the past decade. Kenya has three types of export platform. Two are targeted at export-dedicated businesses: manufacturing under bond (MUB) and export processing zones (EPZ). The third is the so called EPPO programme, a generalized and flexible export support programme providing import duty exemptions for imported inputs into the production of exports and duty free goods for the domestic market. A stylized theoretical framework is presented to explore the structural features of different platform designs. The actual use of the three platforms in Kenya is analysed using administrative and customs data. The changes in the macroeconomic policy environment are also analysed in terms of the impact on export *competitiveness* and the composition and direction of exports.

Kenya embarked on trade liberalization and export promotion programmes in 1987 in response to a deterioration of export performance over the preceding decade. Merchandise export earnings as a percentage of GDP declined from 19.6% in the 1970s, to 16.97% over 1980–1984 and a further 13.6% over 1985–1989 (reaching an all time low of 11.5% in 1987). Export promotion efforts included introducing the export platforms in the late 1980s and early 1990s, the development of regional markets through preferential trade arrangements, the liberalization of trade through the removal of quantitative restrictions, the reduction and rationalization of duty rates, the lifting of import licensing, and the removal of foreign exchange controls. The most significant of all these policy changes was the lifting of the comprehensive import licensing and foreign exchange allocation system in May 1993. Following this opening of trade, both exports and imports of goods jumped by some 7 percentage points of GDP.

Despite the specific export promotion platforms and other policies, *macroeconomic reforms, trade liberalization measures and regional integration have been the key factors behind fluctuations in Kenya's manufactured exports.* The export surge recorded in 1993–1995 coincided with a sharp depreciation of the Kenya shilling (a 25% real depreciation of the Ksh/US$ exchange rate from 1990 to 1993), a significant fall in the real average wage (by 39% over the same period), and a major shift in the trade regime following the abolition of trade licensing and foreign exchange allocations in 1993. These favourable export conditions were not sustained, however, as both the real Ksh/US$ exchange rate and the average wage rate in US dollar terms by 1997 had reverted to pre-1990 levels and then, in the case of the exchange rate, exceeded them. *The combined effect was that the real average wage rate expressed in US dollars in the manufacturing sector rose by 92% over 1994 to 1998. Over* the same period, world trade prices dropped by some 12%. Export performance deteriorated significantly after 1996, dropping from 22.4% of GDP in 1996 to only 17.1% of GDP by 1998. The preferential regional market, primarily Uganda and Tanzania, followed by the wider Common Market for Eastern and Southern Africa (COMESA), accounted for the dominant share of the increase in Kenya's exports after 1993, especially manufactured exports. In fact, the preferential regional market absorbed over 100% of the cumulative increase in processed exports over 1993–1998, reflecting diversion of trade away from the rest of the world. Non-COMESA markets accounted for 95% of the increase in primary goods exports over the same period. Overall, recorded exports to COMESA increased from a 1990–1992 average of 15% of the total, to 34% in 1996–1998. Uganda's share alone increased from 6% of the total to 15% and Tanzania's from 3% to 12%, in effect, to a combined share of close to a third of Kenya's total exports. Besides the regional economic integration initiative, this trend is also a reflection of economic recovery and trade liberalization in the region; the overall increase in import demand, alongside a downturn in the Kenyan economy, was an added impetus for Kenyan firms to seek external markets.

Given these trends in exports, and not surprisingly, the impact of MUB and EPZ platforms, designed to target dedicated export processors for overseas markets, has by and large been inconspicous among exports. The combined cumulative share of exports originating from MUB/EPZ enterprises over 1993–1998 amounts to just over 1% of total exports. By contrast, exporters using the more flexible EPPO programme have averaged 35% of total exports, which we estimate to be over 50% of the processed and packaged exports eligible for EPPO, and over 75% of exports of manufactures. The EPPO programme has been extensively used by the major local manufacturing

and processing companies (beer, cigarettes, cement, paper, corrugated iron sheeting, vegetable cooking oils, soaps, etc.) to extend or expand their production for the domestic markets into the regional markets. However, use of the EPPO programme has been declining, from a peak share of 38% in 1994 to 31% in 1998, reflecting the decline in exports with the erosion in competitiveness through exchange rate and real wage appreciation as well as the tax value of the programme declining with lower duty rates.

The MUB platform did show considerable potential for a period. The facility became an attractive platform for contract garment manufacturing for the US market, but this suffered a major setback in 1994 when the US trade authorities revoked Kenya's quota for some items (shirts, tee-shirts and pillow cases) citing transhipment of garments originating from India through Kenya. By 1997, only 10 garment factories were in operation, out of over 70 in operation at the time of the quota restriction. But even if the quota had not been revoked, the success might not have been sustained on account of the subsequent appreciation of both the exchange rate and the real wage, and later, the precipitous fall of Southeast Asian currencies and labour costs following the financial crisis. The favourable export conditions, particularly in 1993–1995, resulted in textile and clothing exports increasing, but only from 1.3% of exports in 1990–1992 to 4.9% in 1993–1995, and then falling back again to 2.1% in 1996–1998 as wages increased and the exchange rate strengthened. This indicates the importance of the macroeconomic conditions to sustaining labour-intensive manufacturing for exports.

Kenya has a relatively large skilled and semi-skilled industrial labour force that could be readily engaged to produce labour-intensive manufactures, notably garments and footwear, for the world market. A large proportion of this labour force is engaged in a dynamic and highly competitive informal sector (somewhat analogous to Asia's "sweat shops"), where earnings are significantly lower than formal sector wages. Unlike Asia, Kenya has not been able to translate this dynamism and wage competitiveness into labour-intensive export processing. Reliance on physical, rather than accounting controls and high transactions costs imposed by excessive bureaucracy in the administration of Kenya's export platforms constitute entry barriers for the informal sector, either as direct exporters or through subcontracting arrangements with formal sector exporters. A careful review of labour market laws and institutions is needed to explain the growing gap between formal and informal sector wage rates, as formal sector wage rate increases have outpaced those in the informal sector. Given that it is formal sector companies that access export platforms, this wage gap trend does not augur well for export platforms becoming the springboard for job creation in labour-intensive manufactures in the medium term without restructuring the platforms.

Arguably, the more flexible EPPO programme has contributed to the remarkable growth of manufactured exports to the regional market. It is noted, however, that the East African Cooperation and COMESA trading partners have committed to phase out export incentives from regional trade within five years. Tariff reduction has substantially eroded EPPO incentives, and the attraction of the programme will continue to diminish as further tariff reductions are implemented. Given its flexibility, however, EPPO-like programmes will continue to have a role in (a) supporting direct and indirect exports outside the region, and (b) removing negative protection from the duty free or exempt goods produced for the local market. This flexibility arises from the programme's ability to deal with businesses producing for both local and foreign markets simultaneously, from its lack of special income tax or other capital investment incentives, and from its accessibility to producers outside the strict limits of the manufacturing sector, such as mining and agriculture, which are typically excluded from export-dedicated platforms. In the Kenyan case, packaging is a critical input in fresh horticultural produce exports, and the EPPO programme has played an important role in this leading export sector for both direct imports and locally produced packaging material.

Attracting significant export-dedicated investment requires the domestic investment environment to be extremely attractive, with low cost and high productivity labour; dependable and cost effective transport, utilities and other infrastructure services; and comparatively low business risk. On a wide range of these competitive factors, many African economies are not sufficiently attractive. Evidently, tax incentive based export platforms have not been sufficient to overcome these constraints in Kenya. Given the small size of the local market, African countries will only attract "foot-loose" export-dedicated investment by offering a cost structure well below alternative locations. In the light of this outlook, the dedicated platforms, the EPZ programme in particular, are unlikely to make a significant impact. The excess capacity in Kenya's public EPZ should be privatized to save costs, and parts of it deregistered and established as regular industrial parks. The focus has to be on developing more flexible platforms, generalizing investment incentives and improving macroeconomic conditions.

Given the obvious importance of getting the macroeconomic conditions right to support export-oriented investment, macroeconomic reforms are urgently required. This will require a shift away from the high interest rates that have persisted since 1993. Over 1994–1998, inflation-adjusted lending rates by commercial banks have generally been in the range of 15% to 30%. This will primarily require a shift in government fiscal policy to budget surpluses to lower the current heavy domestic debt load. Lower interest rates will both encourage real private investment and discourage speculative foreign capital inflows. This will sustain a more competitive, export-promoting exchange rate. If the right macroeconomic environment (lower real interest rates, weaker exchange rate, and lower wages in US dollar terms) is combined with moves to increase the flexibility of export platforms and the labour markets, and efforts to strengthen economic infrastructure, then Kenya's export prospects in labour-intensive manufactures could brighten considerably.

MICROFINANCE DEVELOPMENT IN KENYA: K-REP'S TRANSITION FROM NGO TO DIVERSIFIED HOLDING COMPANY AND COMMERCIAL BANK

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EXECUTIVE SUMMARY

K-REP (Kenya Rural Enterprise Programme), established in 1984, is one of the most innovative and successful microfinance schemes in Africa. It provides financial services to microenterprises excluded from the formal financial sector, thereby generating income and employment opportunities for low income microentrepreneurs.

K-REP has successfully managed the process of institutional reorganization and diversification, and has:

- separated commercial banking operations from its research and consultancy services, creating the K-REP Bank;
- received a banking license in March 1999; and
- secured share capital in K-REP Bank.

Establishment and Evolution of K-REP

K-REP's programme strategies have evolved with time and experience. In its first phase of development (inception in 1984 to 1990) the strategy was to develop micro and small enterprises (MSE) through local non-government organizations (NGOs) with support programmes for MSEs. Support to these institutions comprised grants, training and technical assistance, with the objective of building their capacity, in order to strengthen their ability to provide services to the MSE sector. In the second phase (1990–1999), K-REP continued its focus on microfinance for MSE development. More emphasis was given to K-REP's own direct lending activities, however, and the development of a financially self-sustaining microenterprise finance institution. This effort resulted in the creation of the K-REP Bank in 1999.

Why a Bank?

To some, it is not very clear why K-REP needs a bank. Could it not continue to offer services in its present corporate status? Will it not abandon its mission once it becomes a bank? Critics frequently raise these and other similar questions.

First, the public generally perceives NGOs—which most microfinance institutions (MFIs) are as social welfare organizations providing relief services and handouts. This perception often undermines the seriousness of clients. We believe that the image and legitimacy of a MFI will be greatly enhanced if it operates as a bank.

The funding sources of NGOs are limited and often dependent on donors. An MFI cannot guarantee its continuity, future and growth when dependent on grants. To gain recognition and legitimacy microfinance services must be mainstreamed into the local financial markets. Thus, an NGO-based MFI cannot legally take deposits (even though some do, it is illegal and risky). This limitation constrains the ability to offer one of the most important microfinance services, savings. It also closes an important funding source for growth, deposits.

K-REP Bank hopes to play a catalytic role by demonstrating that the poor are bankable and that microfinance is commercially viable. This we hope will attract other players into this market segment. We all know that conventional banks shun this sector, yet they profusely accept deposits from low income people, only to lend to the rich. This is socially unjust. The bank intends to correct this by redirecting the resources to the poor communities.

K-REP NGO Programme

The overall strategic objective of K-REP's Microfinance Research and Innovations Programme is to identify, test and develop new microfinance systems, products, mechanisms and instruments for the poor. The focus of our Microfinance Research and Innovations work will be to develop sustainable microfinance services for the poor in the rural areas of Kenya. K-REP will also serve as a catalyst for the development of microfinance systems for poverty alleviation.

The programme intends to increase learning about what works in microfinance through action research projects. The areas of experimentation, currently under various stages of development, include:

- User owned, managed and financed savings and credit schemes (e.g., the FSA model and savings mobilization)
- Health care financing for the poor
- Microfinance project for smallholder dairy farmers
- Renewable energy financing project
- Microfinance project for smallholder crop production
- Low-cost housing finance scheme for the poor

Capacity Development Programme

The main aim of this programme is to contribute to the development of the management capacity of grassroots user-owned and managed microfinance schemes. By "capacity" we mean the skills, tools, frameworks and methodologies necessary for effective and efficient implementation of microfinance projects and programmes.

The microfinance development sector in Africa is still in its nascent phase and still faces significant institutional, operational, legal, financial and political barriers. Strengthening the capacity of grassroots and community-based organizations involved in microfinance to contribute more to the microfinance development process is an important issue for many local NGOs, international NGOs and donor organizations.

K-REP will contribute to capacity building of grassroot microfinance organizations in Kenya by providing training and technical assistance to NGOs and grassroots community-based organizations with microfinance activities, by promoting NGO collaboration, and by participating actively in networks. In its endeavour to increase the capacity for microfinance development, K-REP will also operate a one-year management internship programme for women graduates and a three-month internship for students in institutions of higher learning (the explorer programme).

Other capacity building activities will involve consultancy services (a separate business plan has been prepared for this) in various aspects of microfinance development, the Arifu Microfinance Information Centre and an Exchange Visit Programme.

TRADE LIBERALIZATION AND CUSTOMS REVENUES:
Does trade liberalization lead to lower customs revenues? The case of Kenya

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EXECUTIVE SUMMARY

Developing countries typically raise more than two-thirds of their tax revenues from indirect taxes, of which about half are collected through import duties. Hence, the loss of customs revenues from trade liberalization is often seen as a major stumbling block to trade liberalization, particularly where it implies a reduction in the average tariff rate on imports. The standard remedy is to recommend the imposition of consumption taxes, or raising the rates of an existing consumption tax, such as a value added tax (VAT). Kenya's experience with the trade liberalization initiated in 1987 shows that customs revenue substitution by consumption taxes may not be necessary, at least at early stages of trade liberalization. In fact, from 1994 onwards, Kenya managed to increase its customs duty yield while significantly lowering its average duty rate.

Detailed customs data from 1989 to 1999 are used to analyse the factors that contributed to the change in customs revenue yield. While trade liberalization started in 1987 with rationalizing and reducing quantitative and tariff trade barriers, the results show that a major shift in trade and customs collections occurred over 1993 and 1994, when import licensing and foreign exchange controls were removed and a comprehensive pre-shipment inspection programme was implemented along with other customs management reforms. Over the initial years of 1989/90–1993/94, the simple average import duty rate (SADR) was 40% and the trade weighted average duty rate (TWADR) was 24.1%. These rates yielded average import duty revenues of only 2.9% of GDP and an effective duty rate of 10.6%. Over the later years, 1994/95–1998/99, by contrast, the SADR dropped to 20% and the TWADR to 17%, but on average import duty yields were 4% of GDP and the effective duty rate was 13.9%. The lowest revenue yield was experienced in 1991/92 at 2.1% of GDP when the SADR was 38% and the TWADR was 21%. The lowest duty rates prevailed in 1997/98 with the SADR at 17% and the TWADR at 15%, but the revenue yield from import duties was 3.7% of GDP.

The change in import duty yields from 1989/90–1993/94 to 1994/95–1998/99 can be explained, in part, by a range of observed factors. These include:

- Imports increased significantly following trade liberalization. Imports as a share of GDP increased from 26.2% to 29%. In the years immediately following the removal of import licensing and foreign exchange controls in 1993, both imports and exports increased markedly by 7 percentage points of GDP.
- Duty exemptions on imports decreased through fewer exemption categories and reduced legislative discretion to grant exemptions, and through tighter administration of exemption approvals and import entry controls. Non-exempt imports increased from 68.5% to 76.5% of imports.
- Reduction in the number of items classified as duty free in 1991 reduced the share of duty free imports by about 4 percentage points.
- The effective duty rates on oil products increased from 1993 through a rationalization of the combined duty and tax rates, and the "variable duty" agricultural commodities (wheat, sugar, maize, milk and rice) also increased from 1994 through tighter restrictions on exemptions and increases in the duty rates.

Trade liberalization led to a shift among imports subject to ad *valorem* rates towards imports in the high-duty-rate group from 19.2% to 27.5% of these imports. In addition, there was a relatively larger reduction in exemptions among this high-duty-rate group than imports in the lower rate groups. The share of high-duty imports paying duty increased from 44.3% to 66.6%. The combined effect resulted in a doubling of the share of customs duties (from 26% to 52%) derived from the high-duty-rate import group even though the TWADR on these imports dropped from 43.6% to 33.1%.

Allowing for these changes in the import volumes and composition, and in the exemption and tariff rate structures, the import duty collection effort in 1994/95-1998/99 was enormously higher than in the period of 1989/90-1993/94. If the collections in the latter period are predicted using the collection effort in the former period, then in the second period the effective duty rate is 67% higher and the effective revenue yield relative to GDP is 160% higher than in

the first period. A combination of the enhanced customs administration and improved voluntary compliance explains the increased revenues. A range of customs administration reforms was introduced during the1990s.

First, in mid 1994 a comprehensive pre-shipment inspection (PSI) programme was implemented. Comparison of customs collection efforts in 1994/95 with the prior year suggests that the PSI programme may have generated a 34% improvement in revenue collection performance over and above what can be explained by observed changes in the imports, exemption and rate structure. More recently, in 1998, the import verification programme was introduced to add to the customs controls, enhance PSI company performance and ensure more effective use of the PSI data by customs officials. Second, to deal with customs fraud outside of the regular imports, various controls on transit, exports and bonded warehouses were strengthened to prevent diversion and leakage into the domestic market. Third, the establishment of the Kenya Revenue Authority in 1995 has allowed the systematic upgrading of the management, organization, staffing, computer systems, procedures and coordination of the revenue administrations.

A final important question remains. Can Kenya continue to lower duty rates and still improve, or at least sustain, customs yields? The answer is probably "yes." While improved customs administration has clearly raised the revenue yield from imports, customs administration has many avenues along which significant improvements can still be made in customs enforcement and trade facilitation. Aside from further capacity building in management and customs skills, specific areas for improvement include:

- Improved cargo control systems in the ports can be achieved through electronic data interchange and cooperation with the port authorities and shipping agents. This could eliminate much of the gross or large-scale smuggling such as undeclared containers and other cargo.
- Enhanced transit and export controls can be achieved through electronic and other interchange of computerized customs information with customs authorities in neighbouring countries.
- Introduction of more integrated, online computer systems in the long-rooms to upgrade the existing partial online and backup computer systems would allow enhanced control of cargo arrivals, transit and bonded warehouse transactions, and control of bonds.
- General capacity building in management and customs skills, especially valuation and investigation, can enhance internal capacity. Externally, there is significant scope for more selective and cost-effective use of pre-shipment and post-shipment inspection services

LIST OF ABBREVIATIONS

ACP	Africa - Carribbean - Pacific
AFC	Agricultural Finance Corporation
AGOA	African Growth and Opportunity Act
CEO	Chief executive officer
CGIAR	Consultative Group for International Agricultural Research
COMESA	Common Market for Eastern and Southern Africa
DFID	(British) Department for International Development
EAC	East African Cooperation
EAGER	Equity and Growth through Economic Research
EPPO	Export Projects Promotion Office
EPZ	Export processing zone
EU	European Union
FPEAK	Fresh Produce Exporters Association of Kenya
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
HIID	Harvard Institute for International Development
HIV/AIDS	Human immunodeficiency virus/Acquired immune deficiency syndrome
IDS	Institute of Development Studies
IEA	Institute of Economic Affairs
IMF	International Monetary Fund
IPAR	Institute of Policy Analysis and Research
JICCC	Joint Industrial Commercial Consultative Committee
KAM	Kenya Association of Manufacturers
K-REP	Kenya Rural Enterprise Programme
MA	Mwaniki Associates
MFI	Microfinance institution
MFN	Most favoured nation
MSE	Micro and small enterprises
MTEF	Medium-term expenditure framework
MUB	Manufacturing under bond
NGO	Non-government organization
NRP	Nominal rate of protection
PFP	Policy framework paper
PRSP	Poverty reduction strategy paper
PSI	Pre-shipment inspection
RPED	Regional Programme for Enterprise Development
SADR	Simple average import duty rate
SAP	Structural adjustment programme
SMEs	Small and medium enterprises
TFP	Total factor productivity
TRIPS	Agreement on Trade Related Aspects of Intellectual Property Rights
TWADR	Trade weighted average duty rate
USAID	United States Agency for International Development
VAT	Value added tax
WTO	World Trade Organization