COUNTRY PROFILE 2015

KENYA

United Nations
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KENYA AT A GLANCE

General Information	
Subregion	Eastern Africa
Official language(s)	English, Kiswahili
Currency	Kenyan shilling
Capital city	Nairobi
REC membership(s)	EAC,COMESA,IGAD,CEN-SAD

Rankings	
Human Development Index (United Nations Development Programme)	145/188 (2014)
Gender inequality index (United Nations Development Programme)	126/155 (2014)
Ibrahim index of African governance (Mo Ibrahim Foundation)	14/54 (2014)
Ease of doing business index (World Bank)	108/189 (2015)
Corruption perceptions index (Transparency International)	139/168 (2015)

ECONOMIC GROWTH

Real gross domestic product (GDP) expanded by 5.3 per cent in 2014, a decline from the 5.7 per cent recorded in 2013. The Government estimates that the economy grew by 5.6 per cent in 2015. In 2014, the fastest-growing sectors of the economy were mining and quarrying, information and communication, and construction – all growing by more than 13 per cent.

FISCAL POLICY

In 2014/15, total government receipts amounted to about 19 per cent of GDP, while total government expenditure reached about 28 per cent of GDP. The budget deficit of the central Government grew from 6.1 per cent of GDP in 2013/14 to 8.6 per cent of GDP in 2014/15.

MONETARY POLICY

Kenya has enjoyed a period of macroeconomic stability in recent years. The consumer price index inflation rate increased from 5.7 per cent in 2013 to 6.9 per cent in 2014. The Central Bank raised its reference interest rate from 8.5 per cent to 10.0 per cent in June 2015, and then to 11.5 per cent in July, in an attempt to stem currency depreciation and anchor inflation expectations.

CURRENT ACCOUNT

The Kenyan current account deficit worsened by 30 per cent in 2014 and now stands at KSh 536 billion (US$ 6.1 billion). This is mainly due to the widening trade deficit. The trade balance deteriorated by 26 per cent as a result of faster growth in the import bill than in exports. The country's merchandise exports increased by 7 per cent in 2014, mainly due to the re-export of petroleum products, while merchandise imports increased by 15 per cent.

CAPITAL AND FINANCIAL ACCOUNTS

The Kenyan financial account surplus increased by 85 per cent in 2014. This remarkable performance largely reflected a very sharp increase in portfolio investment inflows.

DEMOGRAPHY

The Kenyan population is growing rapidly, at an average of 3 per cent per year. The urban population, in particular, is expanding very fast – the share of the population living in urban areas rose from 19 per cent in 1999 to 32 per cent in 2009.

POVERTY

Despite some progress, poverty remains endemic and spatial inequalities very high. The incidence of poverty declined from 53 per cent in 1997 to 47 per cent in 2005/06, with most gains being achieved in urban areas. Kenya has one of the highest levels of income inequality in Eastern Africa – with a Gini coefficient estimated at 0.45 in 2005/06.

EMPLOYMENT

Agriculture accounted for 59 per cent of total employment in 2005, with services (34 per cent) and industry (7 per cent) following behind. The informal sector accounted for 11.8 million jobs (83 per cent of the total), 60 per cent of which were in rural areas.

HEALTH

Estimated HIV prevalence rates have dropped from a peak of 10.3 per cent in 1996 to 3.3 per cent in 2014. In 2014, malaria and pneumonia were the leading causes of death – accounting for 12 and 11 per cent of all reported deaths, respectively.

EDUCATION

The primary net enrolment rate stagnated at 88 per cent between 2010 and 2014. The secondary net enrolment rate increased from 31 per cent in 2010 to 48 per cent in 2014. This is attributed to the introduction of free secondary education in 2008 and the expansion of education facilities.

GENDER SCORECARD OF THE AFRICAN UNION COMMISSION

Gender parity has almost been reached in terms of secondary school enrolment, with 64.5 per cent of women enrolled compared to 69.5 per cent of men. Labour force participation rates are also similar, with 75.7 per cent for women against 87.6 per cent for men. However, just 19.7 per cent of members of the lower house of parliament are women and high inequality persists regarding access to land, with Kenya scoring just 1 out of 10 in this area in the scorecard.

1

OVERVIEW

While economic growth slowed somewhat, from 5.7 per cent in 2013 to 5.3 per cent in 2014, the outlook for the Kenyan economy remains broadly positive. The economy is projected to expand by 5.6 per cent in 2015, mainly owing to public investments in infrastructure and robust consumer spending. In 2014, economic performance was driven by agriculture, construction and several service subsectors, but the accommodation and restaurants sector contracted for the second year in a row as security concerns continued to dampen tourist arrivals and receipts.

The main macroeconomic indicators remained relatively stable in 2014. Despite declines in the prices of fuel, electricity and some food commodities, consumer price inflation rose slightly, but remained within the Central Bank target. Meanwhile, 2015 has brought some risks and uncertainty. In particular, the Kenyan shilling depreciated considerably over the first half of 2015. The Central Bank raised its reference interest rate from 8.5 to 10 per cent in June 2015, and then to 11.5 per cent in July, with a view to stemming currency depreciation and anchoring inflation expectations. The balance of payments position improved in 2014, mainly thanks to the Eurobond sale proceeds that earned US$ 2.75 billion. However, the current account deficit worsened with the deterioration of the trade deficit, owing in particular to a 12 per cent increase in imports and a weak export performance. Fiscal policy focused on scaling up public investment in infrastructure over the period 2014-2015, but lower than expected revenue receipts contributed to a large budget deficit.

There have been important achievements in the social dimension, although the lack of recent household data precludes a timely assessment of living conditions – especially household incomes. The dependency ratio is starting to decline, a possible sign that a demographic dividend is emerging. There have been significant improvements in maternal and child health, while life expectancy continues to recover from the HIV/AIDS pandemic. Enrolment in secondary education has increased considerably, but the quality of teaching remains a challenge.

The Kenyan economy has experienced limited structural transformation over the past few decades. In particular, the structure of output, exports and employment has changed very little. In order to accelerate and sustain economic growth – which is crucial to improving living standards – Kenya will require a much stronger and dynamic industrial sector. Boosting competitiveness, increasing productivity and strengthening local production capacities will be key to revitalizing the manufacturing sector. In this regard, it will be crucial to scale up investments in transport infrastructure and energy, with a view to reducing production costs and facilitating regional trade. Moreover, raising firm productivity will require strong investments in vocational skills, adequate funding for research and development, and technological upgrading.

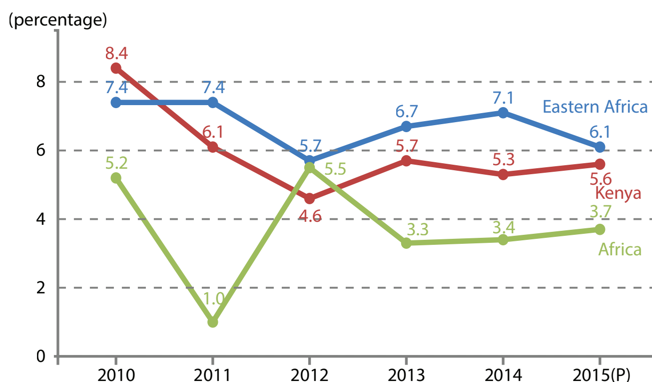
2

NATIONAL AND SUBREGIONAL CONTEXT

Kenya has the largest economy in Eastern Africa. The country benefits from a favourable geographic location, good economic infrastructure, relatively skilled labour force and strong institutions, in particular when compared to its regional peers. Nonetheless, the performance of the economy has not been at par with the country's vast human, physical and natural endowments.

The economy has grown at an average of 6 per cent per year between 2010 and 2014. That said, however, since 2011 the real growth of the country's gross domestic product (GDP) has been lower than the Eastern Africa average, demonstrating the stronger economic dynamism of neighbouring countries.[1] Moreover, the share of agriculture in total output has actually increased over the past five years – at the cost of industry and services – which differs from the experience of most countries in the region. For example, Ethiopia, Uganda and the United Republic of Tanzania have experienced relatively fast levels of structural change since the early 2000s, while Kenya has lagged significantly behind (Martins, 2015, p. 39). Despite a fairly solid economic performance, Kenya has struggled to engender structural transformation, which undermines its competitiveness and economic growth prospects.

Figure 1: Real GDP growth



*Source: KNBS (2015a) and ECA calculations**

** The East Africa region includes: Burundi, Comoros, Democratic Republic of the Congo, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Rwanda, Seychelles, South Sudan, Uganda and United Republic of Tanzania. Data were not available for Somalia.*

The Kenyan economy has recently been affected by a fairly volatile external environment. The Kenyan shilling has been pressured by the strengthening of the United States dollar against other major world currencies, and also by a higher demand for dollars in the domestic market (Central Bank of Kenya, 2015a, p. 3). Export performance has suffered with the decline in the prices of some commodities, such as tea, and weaker external demand – in particular from European trade partners. Despite lower oil prices, the import bill has risen considerably, mainly owing to large imports of transport equipment and a depreciating currency. Foreign investment doubled in 2014, albeit from a low level, while the Eurobond issuance provided vital external resources.

Deeper regional integration is a key priority for Kenya, especially in the context of the East African Community (EAC). The country's efforts and achievements in this regard are shown in box 1. Despite the establishment of a customs union in 2005 and a common market in 2010, there are still

1 In 2014, the economies of Ethiopia, the Democratic Republic of the Congo and the United Republic of Tanzania expanded by 10.3 per cent, 9.5 per cent and 7 per cent, respectively.

impediments to the free movement of persons, capital, goods and services within EAC. For instance, non-tariff barriers are often cited as a key constraint to regional trade. In June 2015, the Tripartite Free Trade Area agreement was signed by 26 countries belonging to three regional economic communities in Africa.[2] It is a free trade agreement that creates a market with more than 600 million people and a combined GDP above US$ 1 trillion. The agreement is expected to boost regional trade and enhance investment opportunities. Meanwhile, EAC signed an economic partnership agreement with the European Union in October 2014. The European Union will continue to grant duty-free and quota-free market access for all EAC imports, while EAC will gradually open its markets to European Union goods. This deal might adversely affect Kenyan industries, however, through increased competition from the European Union. In fact, tariff cuts may undermine structural transformation if they provide greater incentives to export primary products with low value added rather than more sophisticated products – such as manufactured goods.[3] An EAC-United States trade and investment partnership is also under discussion, although progress on that front has been slow. In the meantime, the Africa Growth and Opportunity Act has helped to boost exports of apparel and clothing from Kenya to the United States.

Improving regional infrastructure is crucial to the acceleration and maintenance of economic growth. Kenya is currently planning and implementing several projects to enhance its transport infrastructure – especially railways and ports – as well as expanding power interconnections. Many of these projects are part of the Northern Corridor Integration Projects initiative, which aims to deepen regional integration by lowering trade and production costs.[4] For instance, the standard gauge railway project aims to link Kampala and Kigali to the port of Mombasa. Construction of the Mombasa–Nairobi section has already started and is largely funded by a loan from the Export-Import Bank of China.

Partner States are also considering the construction of pipelines for crude oil and refined petroleum products, with a view to exploiting recent oil discoveries in Kenya and Uganda. In addition, partner States have embarked on a project to improve energy generation, transmission and interconnectivity in order to boost production, reduce prices, and improve reliability. The Lamu Port–Southern Sudan–Ethiopia Transport Corridor project aims to provide an alternative to the Northern Corridor, and facilitate the development of the eastern and north-eastern parts of Kenya. The project comprises the construction of a new port in Lamu, with the aim of decongesting the port of Mombasa, the laying of railways, highways and a crude oil pipeline linking Lamu to South Sudan and Ethiopia, and the building of an oil refinery near Lamu. The Project has an estimated budget of US$ 24.5 billion. In order to avoid excessive budget pressures, Kenya is actively seeking investors to fund these ambitious projects.[5]

Regional security remains an important social and economic concern in Kenya, with terrorist attacks having occurred in 2014 and 2015. Adverse travel advisories from the main sources of tourism have had a negative impact on the sector, resulting in significant declines in tourist arrivals and earnings.[6] Insecurity also affects trade and investment.

2 These are the Common Market for Eastern and Southern Africa (COMESA), the Southern African Development Community (SADC) and the East African Community (EAC).

3 For instance, the EAC Common External Tariff has a 25 per cent tariff on consumer goods, which has benefited Kenyan manufacturers and their ability to export to the rest of EAC.

4 The initiative faces competition, however, from the Tanzanian Central Corridor, which provides a cargo route linking the port of Dar es Salaam to Burundi, the Democratic Republic of the Congo, Rwanda and Uganda. For instance, Uganda has recently signed an agreement with the United Republic of Tanzania for the construction of a crude oil pipeline, mainly relating to security concerns along the Kenyan route.

5 A public-private partnership unit was established within the National Treasury in 2013, with a view to attracting new sources of finance.

6 In fact, international visitor arrivals and tourism earnings have been declining since 2011 (KNBS, 2015a, p. 211). Recent data from the Kenya Tourist Board suggest that tourist arrivals dropped by a further 19 per cent in the first half of 2015.

Insecurity is particularly high along the Lamu Port-Souther Sudan-Ethiopia Corridor, which could deter potential investors. For instance, Lamu is only 100 km from the Somali border and has been the target of attacks. In addition, over recent years Kenya has received record numbers of refugees from Somalia and South Sudan.[7] In response to these challenges, the Government has increased security-related spending, which has placed further pressure on the fiscal budget.

7 The Kakuma camp in Turkana County is estimated to host some 200,000 refugees (mostly from South Sudan), and the Dadaab camp in Garissa County nearly 500,000 refugees (mostly from Somalia).

Box 1: Africa regional integration index: Kenya

The Africa regional integration index is designed to measure the extent to which each country in Africa is meeting its commitments under the various pan-African integration frameworks such as Agenda 2063 and the Abuja Treaty. The index, which is a joint project of the African Development Bank, the African Union Commission and the Economic Commission for Africa, covers the following dimensions: (i) free movement of persons; (ii) trade integration; (iii) productive integration; (iv) infrastructure; (v) financial integration and macroeconomic policy convergence. The following section gives highlights on selected indicators. A technical description of the indicator may be found on the ECA website at www.uneca.org.

Overall rank: First in EAC (score – 0.74), first in COMESA (score – 0.57) *				
Free movement of persons: Joint best performer in EAC with Rwanda (score – 0.8); joint fourth in COMESA (score – 0.44).	Trade integration: First in EAC (score – 1); fourth in COMESA (score – 0.81).	Productive integration: First in EAC (score – 0.84); second in COMESA (score – 0.75).	Infrastructure: Third in EAC (score – 0.44). Best performer in EAC is Burundi with 0.84. Sixth in COMESA (score – 0.48).).	Financial integration and macroeconomic policy convergence: Second in EAC (score – 0.20). Best performer in EAC is Rwanda with 0.50. Tenth in COMESA (score – 0.38).

Free movement of persons: Kenya allows nationals of 33 other African countries to enter visa-free or with a visa on arrival. Kenya has ratified the relevant EAC instruments concerning free movement of persons, rights of establishment and free movement of workers, but has not ratified the COMESA protocol on free movement of persons.

Trade integration: Kenya has an average applied tariff of zero on imports from EAC, and an average applied tariff of just 1 per cent on imports from COMESA. Nevertheless, since COMESA members generally have low average applied tariffs on imports from the bloc, it ranks only fourteenth among COMESA members on this measure. Trade (as a share of GDP) with the rest of the regional economic communities of which it is a member is mixed. Imports from other regional economic community members are relatively low (at or below 1 per cent), while exports are somewhat stronger – 2 per cent to EAC and 3 per cent to COMESA.

Productive integration: Kenya is fairly well integrated into regional value chains. To some extent, its trade

complements that of its partners. The share of Kenya of intermediates in its imports from the regional economic communities was 21 per cent, while the share of intermediates in total exports within the region averaged 46 per cent.

Infrastructure: The internet bandwidth per capita in Kenya of around 21 megabits per second per person is the highest on the continent. Internet bandwidth is important for international communication, both within Africa and beyond, including to support trade in services. Around 71 per cent of international flights to and from Kenya are intra-COMESA, and 63 per cent of such flights intra-EAC.

Information on the performance by Kenya in the area of financial integration and macroeconomic policy convergence can be retrieved from the stand-alone report on the regional integration index and the dedicated companion website.

Conclusion: Overall, Kenya performs relatively strongly across the board, particularly in terms of productive integration. Where specific policy measures that could boost its performance are concerned, Kenya could consider ratifying the COMESA protocol on free movement of persons, waiving visa requirements or granting visas on arrival for nationals of a greater number of African countries, further reducing tariffs on intraregional imports, and looking into other measures to boost intraregional trade in goods.

* A continent-wide ranking, in which all African countries from all regional economic communities will be compared with one another, is currently under development for the Africa regional integration index and will be added to subsequent updates of the ECA country profiles.

3

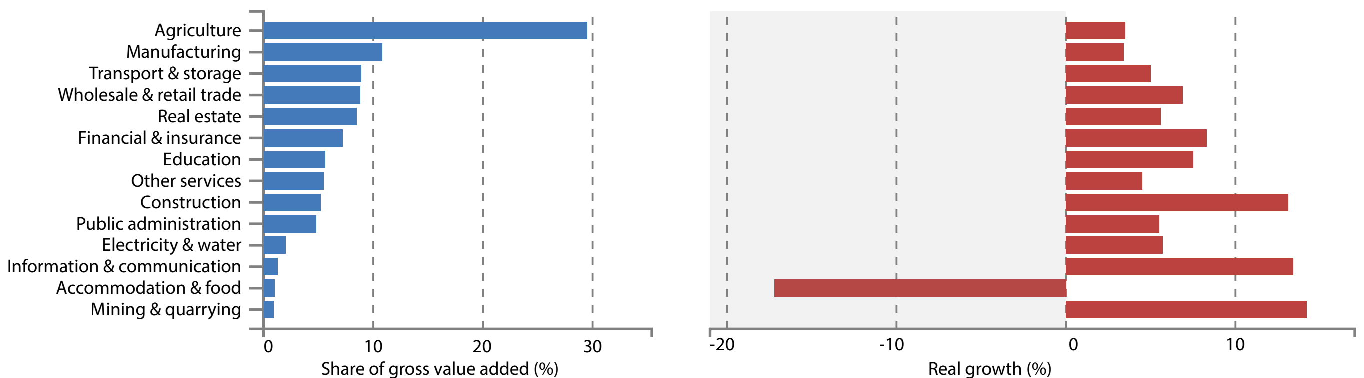
ECONOMIC PERFORMANCE

3.1 Economic growth and sectoral performance

Real GDP in Kenya expanded by 5.3 per cent in 2014, a decline from the 5.7 per cent recorded in 2013.[8] The Government estimates that the economy grew by 5.6 per cent in 2015. The deceleration of growth over the period 2013-2014 was mainly due to the weaker performance of agriculture and manufacturing, which together account for over 40 per cent of gross value added. In fact, the large contribution of the agricultural sector illustrates the lack of structural transformation of the Kenyan economy. The slowdown of growth in agriculture, from 5.2 per cent in 2013 to 3.5 per cent in 2014, was chiefly caused by erratic weather patterns that affected the production of various crops (KNBS, 2015a, p. 25).

In 2014, the fastest-growing sectors of the economy were mining and quarrying, information and communication, and construction – all growing at a rate above 13 per cent.[9] However, these are still relatively small sectors, and therefore unable to boost the overall economic performance of Kenya to any considerable degree. The two major sectors – agriculture and manufacturing – registered the lowest (positive) growth rates. The accommodation and food services sector contracted by 17 per cent, owing to internal and external factors that affected tourism – including security concerns. Bearing in mind the sectoral shares and growth performance, the largest contributions to economic growth came from agriculture, construction, and some services subsectors – in particular, wholesale and retail trade, education, financial and insurance activities, and information and communication.

Figure 2: Sector shares and real growth (2014)



Source: Calculated from KNBS (2015a)

8 Real GDP per capita only grew by 2.5 per cent in 2014, which is insufficient to improve living standards in any substantial way. This underscores the need to achieve a real annual growth rate of 10 per cent, as proposed by Vision 2030.

9 Oil production will not start until at least 2017.

The sectors of agriculture and of transport and storage grew significantly faster in the first half of 2015 than during the same period in 2014, partly as a result of improved climatic conditions and lower fuel prices. By contrast, manufacturing, construction and wholesale trade registered a weaker performance (KNBS, 2015c, p. 11). Although vulnerable to downward revisions, in the light of the increasingly fragile state of the global economy, current expectations are that the economy will continue to grow strongly in 2016. Box 2 summarizes GDP growth forecasts produced by international organizations.

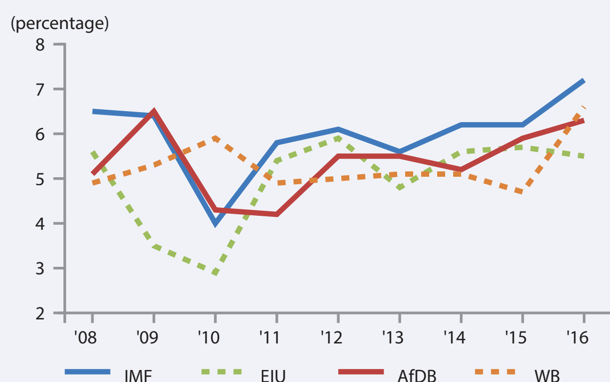
From a demand perspective, private consumption was the main driving force behind economic growth in 2014, owing to its weight in aggregate demand and a healthy growth rate of 5.5 per cent. Investment recorded growth of 11.2 per cent, mainly due to large-scale infrastructure projects, the purchase of new aircrafts by Kenya Airways, and the real estate sector (KNBS, 2015a, p. 29). The share of investment in GDP remains low, however, in particular when compared to other countries in the region.[10] The growth of imports significantly outpaced that of exports, leading to a large deterioration of the trade balance.

Box 2: Forecasts for the Kenyan economy

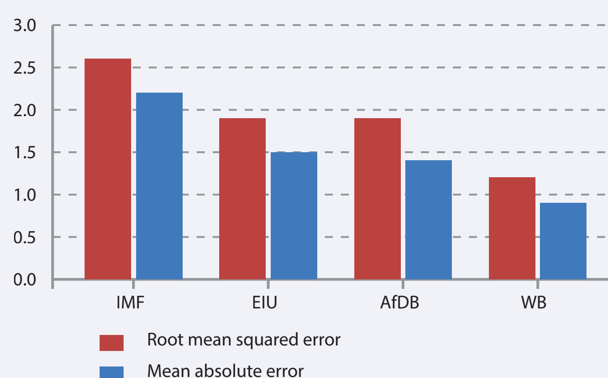
Economic forecasts provide essential information for decision-makers in the public and private sectors. Several international organizations produce forecasts for Kenya, including the African Development Bank (AfDB), the Economist Intelligence Unit (EIU), the International Monetary Fund (IMF) and the World Bank (WB). The growth forecasts produced by these organizations have been within 2 percentage points of one another since 2011. The most optimistic forecast for 2016 is that produced by IMF (7.2 per cent), while EIU is the least optimistic (5.5 per cent).

How accurate are these forecasts? The root mean squared error and the mean absolute error are common measures of the accuracy of forecasts. The higher the value of these errors, the less accurate the forecasts. The analysis suggest that the most accurate forecasts produced for the period 2008–2014 were those made by the World Bank. These were followed by the African Development Bank and the Economist Intelligence Unit, which produced forecasts of similar accuracy.

Forecasted GDP growth rates

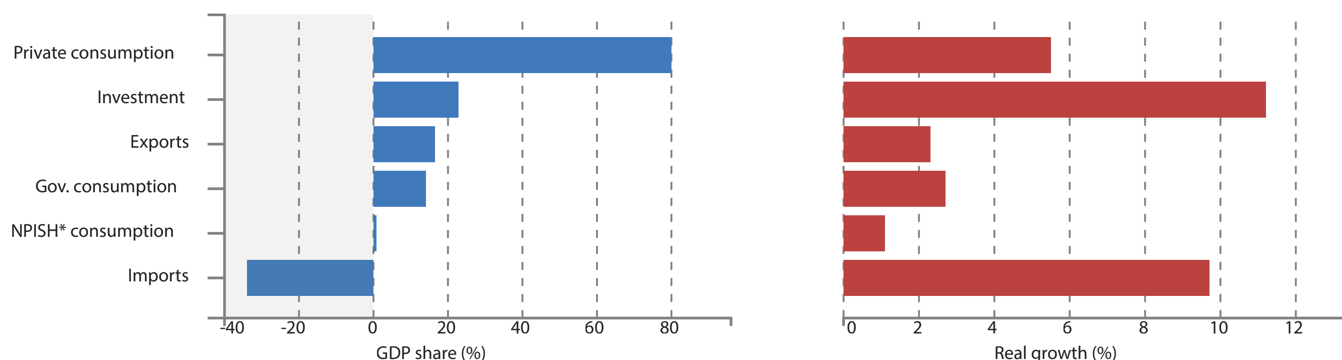


Forecast error



10 In 2014, gross fixed capital formation represented 23 per cent of GDP in Kenya, lower than the 40 per cent recorded in Ethiopia, 33 per cent in the United Republic of Tanzania, and 28 per cent in Uganda.

Figure 3: Demand shares and real growth (2014)



*NPISH: Non-profit Institutions Serving Households

Source: Calculated from KNBS (2015a)

3.2 Fiscal policy

Recent fiscal trends indicate that a much stronger focus is being placed on public investment, especially in infrastructure development, although recurrent expenditures have also increased considerably. Among the key areas of spending are economic infrastructure, education and devolution. The scaling up of public spending, combined with a slow growth in fiscal revenues, contributed to a significant widening of the fiscal deficit in 2014/15.

Total government receipts amounted to KSh 1,109 billion in 2014/15 (about 19 per cent of GDP), which represented an 11 per cent increase in relation to 2013/14. The bulk of these receipts stemmed from tax revenues (86 per cent), while external grants accounted for 3 per cent of total receipts. Income

Table 1: Fiscal accounts (billions of Kenyan shillings)

	2010/11	2011/12	2012/13	2013/14	2014/15
Total revenue and grants	686.3	765.1	869.5	1 001.4	1 109.3
Tax revenue	557.2	619.4	701.3	851.8	958.2
Non-tax revenue and appropriations-in-aid	110.4	130.5	147.6	122.6	123.0
Grants	18.8	15.2	20.5	27.0	28.1
Expenditure and net lending	811.8	945.3	1 111.9	1 297.8	1 616.0
Recurrent expenditure	592.4	650.4	796.1	749.6	873.6
of which: wages and salaries	198.5	218.8	274.4	281.2	293.1
of which: interest payments	76.2	81.9	121.2	132.0	172.0
Development expenditure	219.4	294.9	306.0	319.3	478.0
County transfers	0.0	0.0	9.8	193.4	229.3
Other expenditure	0.0	0.0	0.0	35.4	40.0
Fiscal balance (cash basis)	-118.8	-180.2	-255.6	-309.1	-491.9

Note: Data for central government only.
Source: National Treasury (2015a)

taxes accounted for 53 per cent of total tax revenue, while value added tax generated 27 per cent – the rest was raised through excise and import duties. Total government expenditures reached KSh 1,616 billion in 2014/15 (about 28 per cent of GDP), an increase of 25 per cent over the previous fiscal year. Development expenditures increased by 50 per cent, to KSh 478 billion, currently accounting for 30 per cent of total expense. County transfers represented 14 per cent of total expenditure, while recurrent spending used 54 per cent of the total budget.[11] Wages and salaries accounted for 34 per cent of recurrent expenditures, and interest payments 20 per cent – mainly relating to domestic debt.

The central Government's budget deficit grew from KSh 309 billion in 2013/14 (6.1 per cent of GDP) to KSh 492 billion in 2014/15 (8.6 per cent of GDP). This represents an increase of 59 per cent in nominal terms (National Treasury, 2015a, p. 25).[12] In terms of funding the budget deficit, foreign financing doubled to KSh 218 billion in 2014/15, mainly due to project loans, while domestic financing grew by 25 per cent to KSh 254 billion. The budget for the 2015/16 fiscal year targets total expenditure at KSh 2,002 billion and total revenues at KSh 1,358 billion, amounting to approximately 25 per cent increases when compared to 2014/15 (National Treasury, 2015b, p. 23).[13] In particular, development expenditures will be considerably increased to support the development of key economic infrastructure, such as the railways, roads, ports and energy.

Gross public debt in Kenya increased by 17 per cent in 2014/15, from KSh 2,423 billion in June 2014 to KSh 2,844 billion in June 2015, accounting for about 50 per cent of GDP (National Treasury, 2015a, p. 19). This increase was mainly driven by large loan disbursements from China and rising domestic commercial bank debt, including infrastructure bonds and treasury bills. Foreign and domestic debt had equal shares in the total debt stock. While high public debt levels can threaten macroeconomic stability and thus undermine economic growth, a recent debt sustainability analysis conducted by IMF argues that Kenya remains at low risk of external debt distress (IMF, 2015, p. 15). Nonetheless, the combination of an ambitious spending programme and over-optimistic revenue targets for the 2015/16 fiscal year may lead to a considerable deterioration of the public finances.

3.3 Inflation and monetary policy

Kenya has enjoyed relative macroeconomic stability in recent years. The consumer price index inflation rate increased from 5.7 per cent in 2013 to 6.9 per cent in 2014, mainly driven by food price inflation, which has outweighed declines in fuel and electricity prices (KNBS, 2015a, p. 1).[14] Available data for 2015 suggest that inflation remains within the Central Bank's medium-term target band – the upper band is 7.5 per cent (KNBS, 2015d, p. 9). The Central Bank raised its reference interest rate from 8.5 to 10 per cent in June 2015, and then to 11.5 per cent in July, in an attempt to stem currency depreciation and anchor inflation expectations. Meanwhile, interbank rates increased sharply in 2015 – from 6.8 per cent in February to 18.6 per cent in August – while average yield rates for the 91-day Treasury bills increased from 8.3 in May 2015 to 11.5 in August (KNBS, 2015d, p. 12). Monetary policy might have been effective in stabilizing the currency and managing inflation, but high interest rates can undermine economic growth by discouraging private investment and consumption. Moreover, lower than expected economic growth is likely to

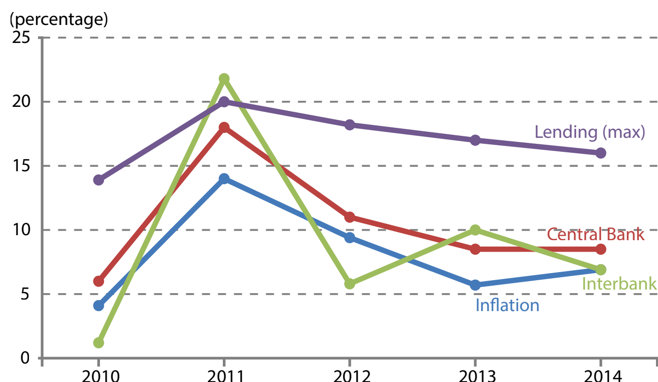
11 Fiscal decentralization is a feature of the devolution process in Kenya. County transfers represented about 21 per cent of total revenue in 2014/15, which is above the 15 per cent stipulated by the Constitution.

12 This includes external grants and an adjustment to cash basis. The fiscal deficit on a commitment basis (including grants) grew from 5.9 per cent of GDP in 2013/14 to 8.9 per cent in 2014/15.

13 This is an ambitious revenue target, especially when considering past performance. It will require measures to expand the tax base and eliminate tax leakages, along with stronger economic growth.

14 Food and non-alcoholic beverages have a large weight in the basket used to determine the consumer price index for Kenya – 42.9 per cent (CBK, 2015a, p. 8).

Figure 4: Inflation and interest rates



Source: KNBS (2015a)

dampen tax revenues and increase debt interest payments, thus aggravating the budget deficit.

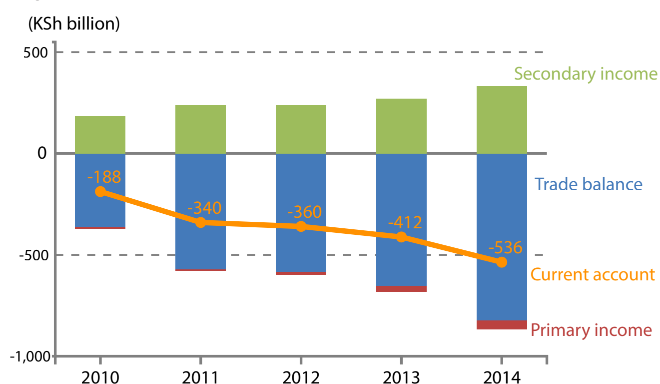
In 2014, the shilling depreciated against the dollar, but appreciated against the euro and the pound sterling – especially in the second half of 2014.[15] The overall trade-weighted index deteriorated slightly, by 0.9 per cent (KNBS, 2015a, p. 143). The Eurobond proceeds and higher remittance inflows provided valuable foreign exchange, while a deteriorating trade deficit and a decline in tourism earnings worked against the Kenyan shilling (KNBS, 2015a, p. 17). Depreciation accelerated in 2015. Between January and August, the shilling lost 15 per cent of its value against the pound, 12 per cent against the dollar, and 7 per cent against the euro (KNBS, 2015d, p. 11). The shilling has recently surpassed the 100 mark against the dollar, raising concerns about the impacts of this depreciation on inflation, production costs and capital flows.

Broad money supply increased by 19 per cent (to KSh 2,330 billion by December 2014), which was close to the policy target (KNBS, 2015a, p. 88). This increase was mainly driven by domestic credit and net foreign assets, despite slower domestic credit growth – which decelerated from 13.5 per cent in December 2013 to 6.5 per cent in December 2014. Domestic credit to the private sector increased by 21 per cent in 2014, while credit to the national Government more than halved over the same period, because of the growing reliance on foreign borrowing (KNBS, 2015a, p. 89). As a consequence, the share of the commercial banks' credit to the private sector increased from 61 to 70 per cent, while the share to the national Government declined from 23 to 10 per cent (KNBS, 2015a, p. 87).

3.4 Current account

The current account deficit in Kenya worsened by 30 per cent in 2014 and now stands at KSh 536 billion (US$ 6.1 billion) – mainly because of the widening trade deficit. The trade balance deteriorated by 26 per cent, as a result of faster growth in the import bill than in exports. Trade in services recorded a surplus of KSh 184 billion, despite a 19 per cent decline compared to 2013, while the merchandise trade deficit surpassed KSh 1 trillion. The primary income account, which includes investment income flows (such as interest and dividends), deteriorated by 59 per cent in 2014 – although it remained a small component in the current account. The secondary income account, which includes private and public current transfers, grew by 29 per cent, reaching KSh 332 billion in 2014, mainly thanks to larger diaspora remittance

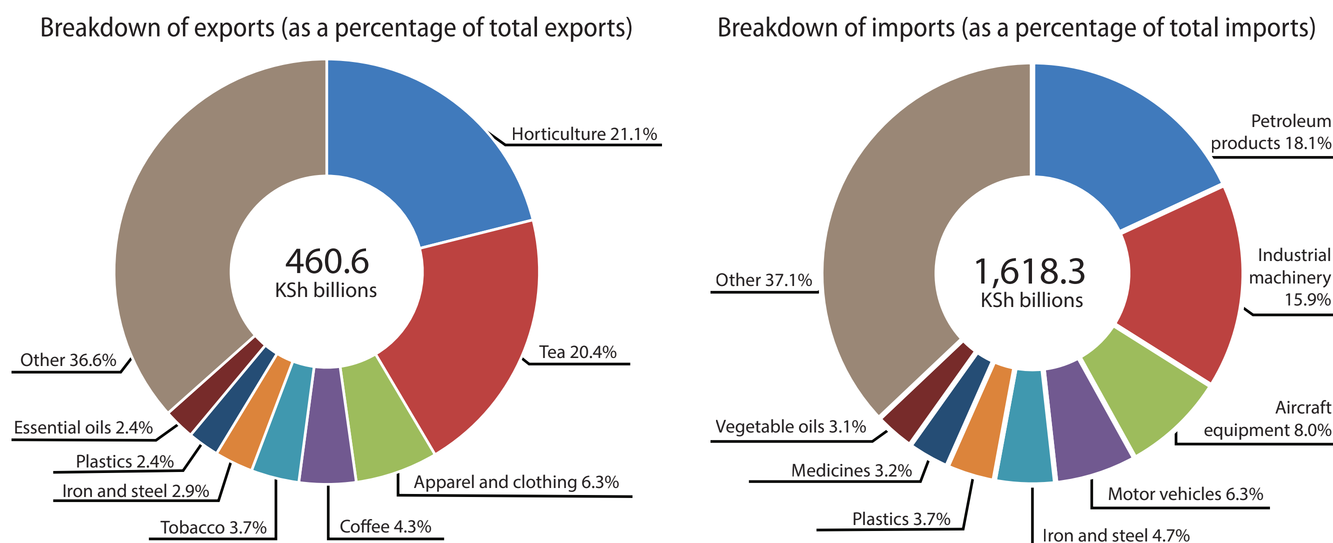
Figure 5: Current account balance



Source: KNBS (2015a)

15 This mainly reflects the strengthening of the dollar against other major world currencies.

Figure 6: Foreign trade (2014)



Source: KNBS (2015a)

inflows (KNBS, 2015a, p. 140). The current account deficit has deteriorated considerably in the first half of 2015 by comparison with the same period in 2014 – by about 60 per cent. This was mainly due to a widening merchandise trade deficit and higher service imports (KNBS, 2015c, p. 12).

The country's merchandise exports increased by 7 per cent in 2014, mainly due to the re-export of petroleum products (KNBS, 2015a, p. 118). Agricultural products largely dominate the export profile, with horticulture and tea accounting for over 40 per cent of total merchandise exports (excluding re-exports).[16] The composition of exports provides further evidence of the limited structural transformation taking place in Kenya. By comparison with 2013, horticultural exports grew by 9 per cent, and coffee and tobacco each by some 22 per cent, while tea declined by 10 per cent. The decline in tea export proceeds was mainly due to lower prices. Exports of apparel and clothing increased by 19 per cent, owing to increased production under the African Growth Opportunity Act.

16 Horticultural exports mainly comprise cut flowers, but also fresh vegetables and fruits.

Africa was the destination of 45 per cent of total exports from Kenya, with EAC accounting for half of that share (KNBS, 2015a, p. 134). Exports to the European Union represented 22 per cent of the total. The Netherlands and the United Kingdom, which are key destinations for cut flowers and tea, accounted for 14 per cent. Despite a decline in export values, Asia still accounted for about 19 per cent of the total – exports of tea to Pakistan and the United Arab Emirates were particularly important. Export performance in the first half of 2015 has been disappointing, with total exports declining by 4 per cent when compared to the same period in 2014, while imports increased by 1 per cent (KNBS, 2015c, p. 13).

Merchandise imports increased by 15 per cent in 2014 (KNBS, 2015a, p. 118). Petroleum products accounted for 18 per cent of merchandise imports, followed by industrial machinery (16 per cent), aircraft equipment (8 per cent), and road motor vehicles (6 per cent). When compared to 2013, imports of petroleum products increased by 16 per cent, while road motor vehicles and industrial machinery increased by 22 per cent and

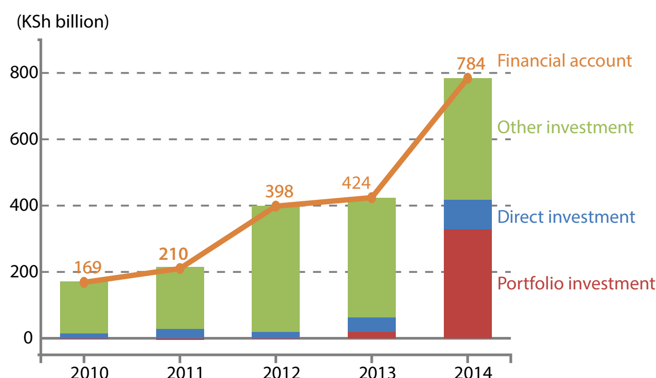
11 per cent, respectively.[17] Imports of aircraft and associated equipment grew sixfold, with the (one-off) purchase of new aircrafts by Kenya Airways. In 2014, only 9 per cent of total imports came from African countries, including 4 per cent from South Africa and 2 per cent from EAC countries (KNBS, 2015a, p. 136). The bulk of imports – 61 per cent of the total – came from Asia, mostly from India (16 per cent) and China (15 per cent). The European Union accounted for 14 per cent of the total import bill, while imports from the United States amounted to 10 per cent – although the latter mainly reflects the purchase of commercial aircrafts.

Where service exports are concerned, tourism has been negatively affected by security concerns – leading to adverse travel advisories – and health concerns linked to the spread of Ebola in West Africa. Tourist arrivals dropped by 20 per cent in 2014, with a severe impact on tourism earnings, which declined from KSh 94 billion in 2013 to KSh 87 billion in 2014 (Central Bank of Kenya, 2015a, p. 20; KNBS, 2015a, p. 9). Exports of other private services, however, such as insurance services, royalties and licence fees, have increased substantially (Central Bank of Kenya, 2015a, p. 24).

3.5 Financial and capital accounts

The financial account surplus increased by 85 per cent in 2014, rising from KSh 424 billion to KSh 784 billion (US$ 8.9 billion).[18] This remarkable performance largely reflected a very sharp increase in portfolio investment inflows. In particular, debt securities provided a KSh 248 billion windfall compared to

Figure 8: Financial account balance



Source: KNBS (2015a)

2013, mostly owing to the Eurobond issuance, while equity and investment fund shares increased by KSh 62 billion. The Eurobond provided a total of US$ 2.75 billion – US$ 2 billion in June 2014 and an additional US$ 750 million in December 2014. The Nairobi Security Exchange (NSE) recorded some gains in 2014, but large losses in 2015. For instance, the NSE 20 Share Index fell by 24 per cent between February and August 2015 (KNBS, 2015d, p. 13).

Direct investment inflows more than doubled in 2014 to KSh 92 billion (US$ 1 billion) – but remain marginal in terms of total financial flows. According to a recent survey, however, in 2013 foreign direct investment inflows amounted to KSh 170 billion and outflows to KSh 91 billion, which is significantly above the values reported for 2013 in the balance of payments – with inflows at KSh 44 billion and outflows at KSh 2 billion (KNBS and others, 2015b, p. 8).[19] Other investment inflows increased by 27 per cent in 2014, partly owing to an increase in other debt instruments by the Government,

17 Although world crude oil prices declined sharply in the second half of 2014, Kenya mainly imports petroleum products – whose prices have declined at a slower pace. In addition, lower prices have been offset by an increase in import volumes and the depreciation of the currency.
18 The capital account has a very limited weight in the Kenyan balance of payments.

19 Portfolio investment flows are also considerably larger in the survey, while other investment flows are significantly smaller. Net errors and omissions are extremely high in the Kenyan balance of payments – KSh 124 billion in 2014 – which suggests that a substantial portion of flows are not being captured.

although other investment outflows also increased by a similar amount (about KSh 120 billion).

The country's overall balance of payments position improved from a surplus of KSh 32 billion in 2013 to a surplus of KSh 126 billion in 2014. Gross international reserves increased by 32 per cent to KSh 704 billion (as of December 2014), mainly owing to proceeds from the sale of the Eurobond (KNBS, 2015a, p. 142). Official foreign exchange reserves have declined from five months of import cover in December 2014 to 4.6 months in June 2015, but remain above the recommended threshold of four months (Central Bank of Kenya, 2015a, p. 25).

4

SOCIAL DEVELOPMENTS

Advancing human development is critical to engendering and sustaining structural transformation. A healthy and skilled workforce contributes to increased overall productivity, which in turn enables growth in per capita income. However, the lack of recent data on key social outcomes places a major constraint on policymaking. In some cases, the last data point available is 2005.[20] Household surveys designed to collect vital data on expenditures and employment are infrequent, thus impeding the timely tracking of living standards, poverty levels and inequality. The second integrated budget and household survey is currently under way in Kenya, with results expected in 2017.

4.1 Demography

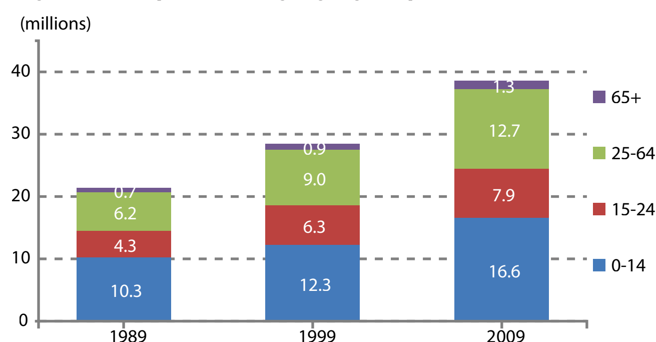
The Kenyan population is growing rapidly, at an average of 3 per cent per year (KNBS, 2010a). The urban population, in particular, is expanding very fast – the share of population living in urban areas rose from 19 per cent in 1999 to 32 per cent in 2009 (Central Bureau of Statistics 2002; KNBS, 2010c). While urbanization can bring many economic benefits – by creating economies of scale and enabling a more efficient provision of public services – it can also place heavy pressure on social and economic infrastructure, undermine social cohesion, and harm the environment. In 2009, more than 8 per cent of the population (3.1 million

Box 3: Devolution in Kenya

The ambitious decentralization process in Kenya has made important strides in recent years, especially with the election of 47 county governors and assemblies in 2013. County governments are now responsible for certain functions in areas such as agriculture, trade regulations, health, education, and public works. Part of the national revenue is being transferred to county governments, while certain local taxes can also be collected. These major changes in the country's institutional framework present numerous opportunities and challenges. Devolution could potentially bring significant economic benefits, through its ability to catalyse local economic development and focus public service delivery. At the same time, however, devolution can also increase economic uncertainty, compound inefficiencies, and heighten fiscal pressures – especially if capacity constraints are not addressed and clear fiscal management rules are not agreed upon. While devolution can have a transformative impact on the Kenyan economy, it is crucial to ensure policy coherence and coordination among the different levels of government.

20 For instance, the allocation of devolved resources among county governments is defined by a formula that includes a poverty index with a 20 per cent weight. Hence, one fifth of the resource envelope relies on data that are 10 years old.

Figure 9: Population by age group



Source: Calculated from CBS (1994, 2002) and KNBS (2010a, 2010c)

people) lived in Nairobi, making it one of the largest cities in Africa. Devolution is expected to support local economic development in the counties, which may help ease population pressures on the capital (box 3).

Kenya is also undergoing a demographic transition. Improved health care and malaria prevention have led to a significant decline in child mortality, while total fertility has fallen sharply from 8.1 children per woman in 1978 to 3.9 children per woman in 2014 (KNBS and others, 2015a).[21] Declining death and birth rates are contributing to a relative increase in the size of the working age population, thus reducing the dependency ratio.[22] These population trends can yield a significant demographic dividend, as long as new entrants in the labour market are equipped with the right skills and are able to find decent jobs: a chronic lack of decent job opportunities for young people could fuel social instability. In 2009, the country's youth (aged 15-24) represented 21 per cent of the total population, while children (aged 0-14) accounted for 43 per cent.

4.2 Poverty and employment

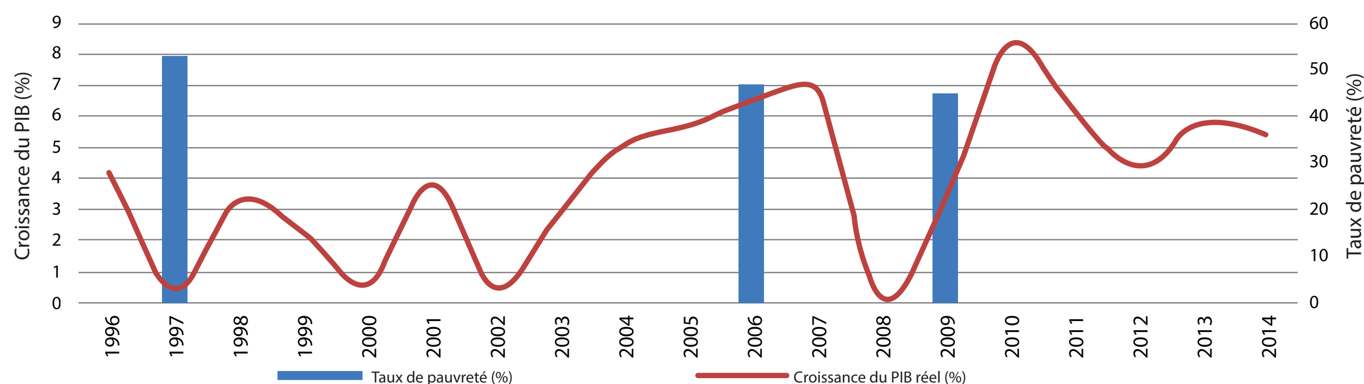
Despite some progress, poverty remains endemic and spatial inequalities very high. The incidence of poverty declined from 53 per cent in 1997 to 47 per cent in 2005/06, with most gains being achieved in urban areas.[23] Small area estimates put poverty at 45 per cent in 2009, ranging from 22 per cent in Nairobi to 88 per cent in Turkana County (KNBS, 2014a). Severe poverty remains high, although it has declined by 11 percentage points – mainly due to progress achieved in rural areas. Poverty levels were particularly high in large households (more than seven persons) and for lower levels of education (KNBS, 2007, p. 82). Available data suggest that Kenya has one of the highest levels of income inequality in Eastern Africa – with a Gini coefficient estimated at 0.45 in 2005/06 (World Bank, 2008, p. 20). Between 1997 and 2005/06, income disparities have declined in rural areas, but increased in urban areas (KNBS, 2007, p. 83). The national consumption decile ratio (richest to poorest) rose from 13 to 19 between 1997 and 2005/6, which suggests large and growing inequality (World Bank, 2008, p. 20).

The labour participation rate declined from 66 per cent in 1999 to 58 per cent in 2009 (KNBS, 2010d, p. 24).[24] However, higher inactivity levels are mainly attributable to children staying longer in education – since the data relate to people aged 5 and above. Over the same period, employment declined from 92 per cent of the labour force to 88 per cent – implying that the unemployment rate grew from 8 to 12 per cent (KNBS, 2010d, p. 24). Agriculture accounted for 59 per cent of total employment in 2005, with services (34 per cent) and industry (7 per cent) following behind – which is broadly similar to the situation in 1997 (World Bank, 2008, p. 103). Similarly, the share of paid work remained fairly static, at about 33 per cent of

21 The total fertility rate in Kenya is significantly lower than those in Uganda (5.8) and the United Republic of Tanzania (5.1) (African Development Bank, African Union Commission and Economic Commission for Africa, African Statistical Yearbook 2015).
22 The dependency ratio measures the number of children and elderly supported by each person of working age – usually persons between the ages of 15 and 64.

23 Poverty incidence (or the poverty headcount ratio) is the proportion of the population whose consumption expenditure was below the national poverty line.
24 The labour participation rate is the ratio of the economically active population (or labour force) to the total age-relevant population.

Figure 9: Poverty rate (1997, 2006 and 2009) and real GDP growth (1996-2014)



Note: Data for 2009 were estimated using a small area procedure
Source: National Bureau of Statistics (2014) and Central Bank of Kenya (2015b)

total employment (ILO, 2015a; KNBS and Society for International Development, 2013, p. 29). This stagnant structure of employment, both in terms of sectors and type of jobs, corroborates the limited transformation observed in the production and export profiles.

In 2014, total employment (excluding small-scale farming and pastoral activities) increased by 6 per cent, reaching 14.3 million (KNBS, 2015a, p. 67). The informal sector accounted for 11.8 million jobs (83 per cent of the total), 60 per cent of which were in rural areas (KNBS, 2015a, p. 80). Most informal jobs are found in the services sector, such as small-scale retailers, unlicensed street traders and "boda boda" (motorcycle taxi) operators. However, the manufacturing sector also accounts for a significant share, at about 19 per cent (KNBS, 2015a, p. 80). The modern (formal) sector accounted for about 2.5 million jobs, mostly wage employees. Wage employment growth in the private sector decelerated from 7.1 per cent in 2013 to 4.4 per cent in 2014. In particular, agriculture lost about 9,300 jobs, while education and construction gained 24,300 and 13,800 jobs, respectively (KNBS, 2015a, p. 69). Meanwhile, wage employment growth in the public sector slowed from 3.2 per cent to 2.6 per cent.[25] The recent slowdown in wage employment growth – from 6 to 3.8 per cent – raises concerns, given the need to create a large number of decent employment opportunities to absorb new entrants in the labour market. Moreover, casual wage employment represented 22 per cent of the total (KNBS, 2015a, p. 71). Real average wage earnings grew by 0.5 per cent in 2014 – to KSh 370,340 per annum – compared to 11 per cent in 2013 (KNBS, 2015a, p. 80).[26] The growth of self-employment in the modern sector has been partly attributable to new businesses set up by women and young entrepreneurs. Greater access to grants and interest-free loans, for example through the Uwezo Fund, has helped to empower these groups.

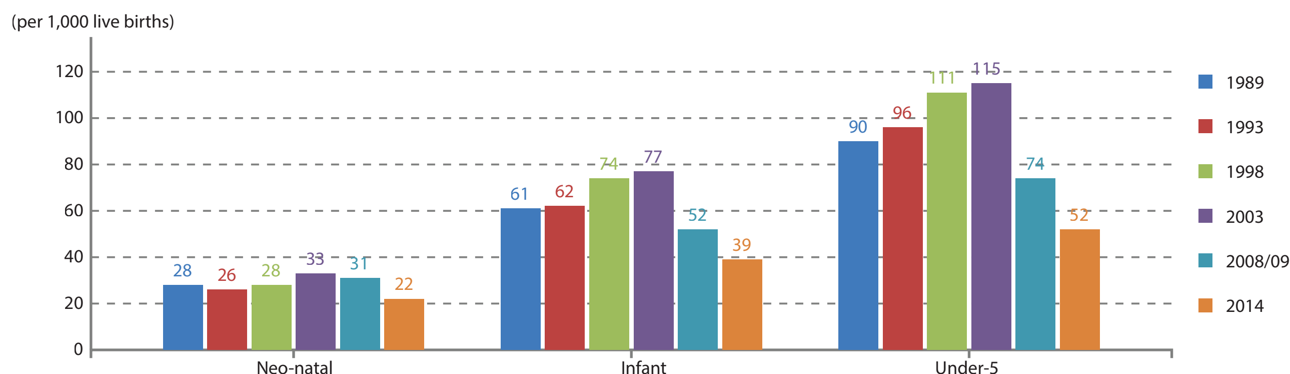
4.3 Health

The health status of the Kenyan population has improved in recent years, countering the deterioration observed in the 1990s and early 2000s. Life expectancy at birth was estimated at 57 in 2009 (National Council for Population and Development,

25 There was a considerable shift of wage employment in the public sector from the national Government to the county governments in 2013 – about 53,000 jobs. Subsequently, employment in county governments increased by 5.2 per cent in 2014, compared to 1.1 per cent in the national Government (KNBS, 2015a, p. 70).

26 High nominal wage increases in 2013 might have been induced by high consumer price inflation in 2011 and 2012. Statutory minimum wages were not increased in 2014 (KNBS, 2015a, p. 81).

Figure 10: Infant, child and under-5 mortality



Source: KNBS and others (2015a) and KNBS and others (2015c)

2013).[27] The HIV/AIDS pandemic alone is thought to have shortened life expectancy by about six years, when compared to a scenario without HIV/AIDS (KNBS, 2015b). Estimated HIV prevalence rates have dropped from a peak of 10.3 per cent in 1996 to 3.3 per cent in 2014. In 2014, malaria and pneumonia were the leading causes of death – accounting for 12 per cent and 11 per cent of all reported deaths, respectively – followed by cancer, HIV/AIDS and tuberculosis (KNBS, 2015a).

The country's maternal mortality ratio was estimated in 2014 at 362 (KNBS and others, 2015c).[28] The risk of death or disability at birth can be significantly reduced by ensuring that all births are managed by skilled health professionals – such as doctors, nurses or midwifes – who are specifically trained to address complications at birth. In 2013, the Government introduced free maternity services in all public facilities with a view to improving maternal health. Recent statistics suggest that this measure has already had a positive impact. In 2014, 62 per cent of births were delivered by a skilled provider, compared to 44 per cent in 2008/09. Trends in the proportion of births occurring in a health facility were very similar, while increases in postnatal care were also noticeable.[29] Nonetheless, while most mothers received antenatal care from a skilled health professional – regardless of age, location, education level and wealth – urban, wealthier and more educated mothers were much more likely to receive delivery care.

The under-5 mortality rate increased from about 90 in 1989 to 115 in 2003.[30] Since then, this trend has been sharply reversed, falling to 52 in 2014, but it still implies that about one in every 20 children born in Kenya die before reaching the age of 5 (KNBS and others, 2015a, p. 23). These recent achievements were mainly due to an increased use of mosquito nets and improved maternal health. Improvements were also visible in terms of the nutritional status of children. Between 2008 and 2014, stunting decreased from 35 per cent to 26 per cent, wasting declined from 7 per cent to 4 per cent, and the proportion of underweight children fell from 16 per cent to 11 per cent. At the same time, the proportion of children that have received all basic vaccinations slightly increased from 77 per cent in 2008/09 to 79 per cent in 2014.

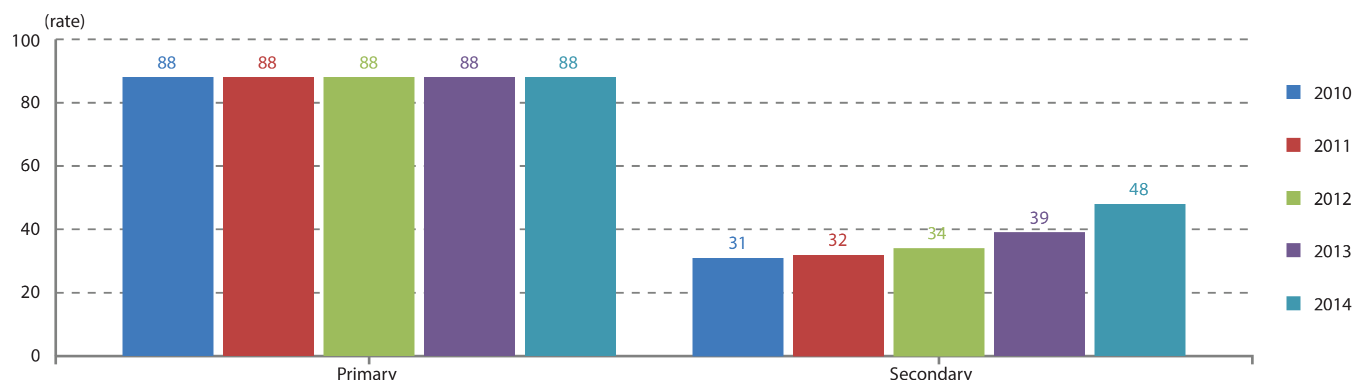
27 Census data suggest a broadly flat trend between 1999 and 2009, but the World Health Organization points to a significant increase – average life expectancy was estimated to have dropped from 60 years in 1990 to 52 years in 2000, but subsequently increasing to 61 years by 2013 (World Health Organization, 2014).

28 The maternal mortality ratio measures the number of maternal deaths (e.g., due to complications during pregnancy and childbirth) per 100,000 live births.

29 In addition to the cost, other key reasons for not delivering in a health facility include the distance (or lack of transport), a perception that it is not necessary, and the occurrence of an abrupt delivery (KNBS and ICF Macro, 2010).

30 The under-5 mortality rate measures the probability of a newborn baby dying before attaining the age of 5 (per 1,000 live births).

Figure 11: Net enrolment rates



Source: KNBS (2015a)

4.4 Education

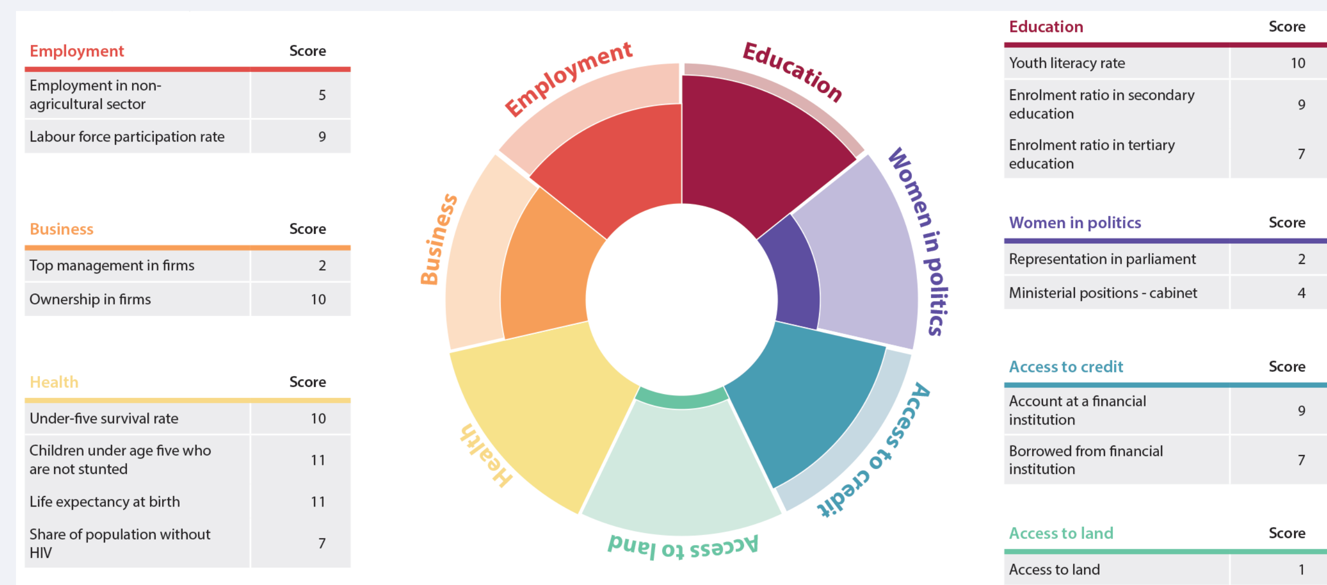
Literacy levels have improved over time. For instance, the literacy rate for women aged 15-19 was 92 per cent in 2008/09, compared to 62 per cent for women in the 45-49 age cohort (KNBS and ICF Macro, 2010). However, literacy levels vary considerably across the country – they are particularly low in the north-east of the country. The mean years of schooling for women was 7.3 in 2008/09, compared to 7.8 for men, although there are also large gaps across regions and wealth quintiles.

Between 2010 and 2014, the primary net enrolment rate stagnated at 88 per cent. This still represents a significant improvement over the 1990s, mainly thanks to the introduction of free primary education in 2003. Moreover, primary completion rates have increased in recent years. The quality of primary education remains cause for concern, however, in particular since the pupil-teacher ratio in public primary schools worsened from an already high 41:1 in 2013 to 43:1 in 2014 (KNBS, 2015a, p. 44). The primary-secondary transition rate increased from just under 60 per cent in 2007 to over 80 per cent in 2014. This is attributable to the introduction of free secondary education in 2008 and the expansion of education facilities (KNBS, 2009, 2015a). The secondary net enrolment rate increased from 31 per cent in 2010 to 48 per cent in 2014 (KNBS, 2015a). Those positive steps notwithstanding, enhancing the quality of secondary and tertiary education is crucial to ensuring that young people have the required skills for the labour market. Devolution is unlikely to have a significant effect on the sector, since only the responsibility for early childhood education has been devolved to the counties.

4.5 Gender scorecard of the African Union Commission*

The African Union declared 2015 as the Year of Women's Empowerment and Development towards Africa's Agenda 2063, with a view to building momentum for gender equality and women's empowerment on the continent. Based on this commitment, the African Union developed the African gender scorecard. The scorecard is designed to measure the status of gender equality and women's empowerment in seven core sectors that have a transformative impact on women's lives through their contribution to broad-based, sustainable and inclusive growth. These core sectors are: employment, the business sector, access to credit, access to land, women in politics and decision-making, health, and education at the secondary and tertiary levels.

*Interpretation of the pie chart: The scoring is between 0 and 10, with 0 being the worst level of inequality, 5 suggesting middle parity, and 10 indicating perfect parity. Perfect parity connotes a situation where the proportion of men and women is equal, irrespective of the developmental level of the variable or indicator being assessed. Some countries go beyond the score of 10, thus showing that women may be more highly empowered in that subsector than men for that country. However, caution is needed when drawing conclusions based only on the scores, particularly when there are large variations in levels of developmental achievements between countries.***



Employment	Score
Employment in non-agricultural sector	5
Labour force participation rate	9

Business	Score
Top management in firms	2
Ownership in firms	10

Health	Score
Under-five survival rate	10
Children under age five who are not stunted	11
Life expectancy at birth	11
Share of population without HIV	7

Education	Score
Youth literacy rate	10
Enrolment ratio in secondary education	9
Enrolment ratio in tertiary education	7

Women in politics	Score
Representation in parliament	2
Ministerial positions - cabinet	4

Access to credit	Score
Account at a financial institution	9
Borrowed from financial institution	7

Access to land	Score
Access to land	1

* The data used in the calculation of the scorecard are drawn from several international databases and sources, including: United Nations, Statistical Division; World Development Indicators, Global Financial Inclusion Database and Enterprise Surveys of the World Bank; the Gender and Land Rights Database of the Food and Agriculture Organization of the United Nations; International Labour Organization; United Nations Children's Fund; Joint United Nations Programme on HIV/AIDs; World Health Organization; International Food Policy Research Institute; United Nations Educational, Scientific and Cultural Organization; United Nations Population Division; United Nations Population Fund; Inter-Parliamentary Union; and some national data sources. Data on access to land were drawn from several sources, with the scoring and harmonization of legislative frameworks done in-house by the African Centre for Statistics and the African Centre for Gender.

** The pie chart is based on the African gender scorecard, which was presented to the Heads of State and Government at the twenty-fifth ordinary session of the Assembly of the African Union in June 2015.

5

MAJOR POLICY CHALLENGE: REVITALIZING THE MANUFACTURING SECTOR

The Kenyan economy has experienced limited structural transformation over the past few decades. In fact, the share of agriculture in total output increased from 23 per cent in 2006 to 30 per cent in 2014, while the relative importance of industry and services has gradually declined. This trend is at odds with the experience of most African economies (KNBS, 2014b, p. 11).[31] It should be noted that the share of the manufacturing sector fell from 14 to 11 per cent over the same period. The 1997 and 2005 household surveys both estimated agricultural employment at about 60 per cent of total employment, with industry accounting for only 7 per cent – of which less than 4 per cent was in manufacturing (World Bank, 2008, p. 103).[32] While Ethiopia, Uganda and the United Republic of Tanzania have experienced relatively fast levels of structural transformation since the early 2000s, Kenya is lagging behind (Martins, 2015, p. 39).

Accelerating structural transformation in Kenya will require a reallocation of productive resources – labour, in particular – from subsistence farming to manufacturing and modern services. These shifts will boost aggregate productivity, which is essential to the sustaining of economic growth and raising of per capita income. Given the large productivity gaps across sectors, in particular between agriculture and the non-agricultural sectors, even small shifts towards off-farm work could generate significant economic and social benefits.[33] For instance, labour productivity in manufacturing is about 12 times higher than in agriculture.[34]

The manufacturing sector, in particular, could play a critical role in accelerating the structural transformation of Kenya. The sector is predominantly labour-intensive and thus capable of employing large numbers of workers, which is especially important given the country's demographic trends. Manufacturing is also a fairly dynamic sector with considerable productivity growth potential, meaning that it can absorb new workers without sacrificing productivity. Moreover, the sector has strong backward and forward linkages to both agriculture and services, as it creates demand for these sectors while providing them with key supplies. Strengthening the manufacturing sector could also help narrow the trade deficit, by boosting exports and competing with imported manufactured goods, while diversifying the structure of production and exports – thus contributing to a more resilient economy.[35] Low and volatile commodity prices provide an additional opportunity

31 Industry accounted for 19 per cent of total output in 2014 – comprising manufacturing (11 per cent), construction (5 per cent), utilities (2 per cent), and mining and quarrying (1 per cent). These shares are calculated as a percentage of total gross value added (excluding financial intermediation services indirectly measured) so that sectoral shares add up to 100.

32 Between 2010 and 2014, the share of manufacturing in total wage employment declined from 13 per cent to 12 per cent (KNBS, 2015a, p. 69).

33 This should not, however, lead to neglect of the agricultural sector. Investments in irrigation, fertilizers, improved seeds and extension services are key to raising labour productivity and thus reducing poverty in rural areas.

34 ECA calculations based on Martins (2015).

35 Imports of manufactured goods have grown by nearly 50 per cent between 2011 and 2014 (in volume terms), while exports have actually declined in the same period (KNBS, 2015a, p. 121).

to develop industrial capabilities.[36] As production costs continue to rise in traditional export markets, many Asian firms may decide to relocate their production plants to Africa.

Revitalizing the manufacturing sector will require a strong policy commitment. The industrial strategy of Kenya is currently guided by several documents. Vision 2030 provides the blueprint for the transformation of Kenya into a newly industrialized middle-income country, which is implemented through five-year medium-term plans. During the first five-year period (2008-2012), Kenya undertook policy, legal and institutional reforms with a view to creating an environment conducive to industrialization.[37] The second plan (2013-2017) aims to build on the earlier plan and address the existing gaps. Flagship projects in manufacturing include the establishment of special economic zones in Mombasa, Lamu and Kisumu, the development of small and medium-sized enterprises and industrial parks in each of the 47 counties, and the development of industrial clusters, in such sectors as meat and leather, and dairy products.

Launched in 2015, the country's industrial transformation programme seeks to transform Kenya into an industrial hub within 10 years. The programme identifies key opportunities with a view to increasing manufacturing to over 15 per cent of GDP, creating 1 million formal sector jobs, increase foreign direct investment fivefold, and placing Kenya among the world's top 50 countries in terms of the ease of doing business (Ministry of Industrialization and Enterprise Development, 2015, p. 6).[38] It aims to achieve these results by launching sector-specific flagship projects where the country has a competitive advantage – such as in agro-processing, textiles, leather, construction, mining and information technology – and by creating an enabling environment to attract investment. The latter includes the creation of industrial parks and zones along infrastructure corridors and investment in industrial skills. The recent establishment of the Ministerial Delivery Unit and the proposed creation of an industrial development fund are envisaged to support this industrialization drive.

The lack of competitiveness of the country's manufacturing sector is undermining its expansion, and is attributable to the relatively low productivity levels, the high costs facing firms, and a fairly challenging business environment.[39] These challenges are elaborated below.

First, the productivity of Kenyan manufacturing firms is generally low. Although the productivity of labour in the sector is high in the context of Kenya, it is relatively low in international terms. In addition, capital productivity is considerably weak – as much as three or four times lower than comparable Indian firms – primarily because of declining capital investments in the 1980s and 1990s. Although recent trends have been encouraging, the sector is highly fragmented and predominantly composed of small family-owned firms. Moreover, the vast majority of Kenyan manufactured goods are basic products, such as food, beverages, building materials and basic chemicals. Only 5 per cent are classified as skill-intensive, such as pharmaceuticals (Government of Kenya, 2007, p. 89-91).

Second, production costs are relatively high in Kenya, especially when compared to its African competitors and China. Despite recent improvements in the energy sector, commercial electricity tariffs average US$ 0.15 per kilowatt-hour, compared to US$ 0.07 in China, and US$ 0.04

36 EAC has traditionally been a very important market for Kenyan manufactured products, although it has recently lost some ground to Asian competitors.

37 This included the development of the National Industrialization Policy Framework (2013-2030) by the Ministry of Industrialization and Enterprise Development.

38 The programme identifies the following six challenges: (1) infrastructure and land availability; (2) skills and capabilities in priority sectors; (3) quality of inputs; (4) cost of operation; (5) access to markets; and (6) investor-friendly policies.

39 In 2013, Kenyan manufacturing firms identified the following obstacles as a top constraint to doing business: practices of the informal sector (19 per cent of firms), electricity (17 per cent) and access to finance (13 per cent) (World Bank, 2014, p. 43).

in Ethiopia and South Africa (EAC, 2015, p. 73; Government of Kenya, 2007, p. 91). These high energy costs place Kenyan manufacturing firms at a significant disadvantage. The high cost of capital is also a burden to businesses and often limits access to finance. The average bank lending rate in Kenya is 16 per cent, compared to 6 per cent in China and 12 per cent in Ethiopia. In fact, manufacturing currently receives only 13 per cent of the credit granted to the private sector, compared to the 24 per cent destined for private households, 21 per cent for trade, and 12 per cent for real estate (Central Bank of Kenya, 2015a, p. 12).[40] In terms of labour costs, the average wage in manufacturing is about US$ 360 per month in Kenya and under US$ 100 in Ethiopia.[41] These direct costs – electricity, interest and wages – represent a large share of a firm's cost structure. The competitive disadvantage of Kenya is also due, however, to high indirect costs. These typically include the cost of transport, logistics and security, along with costs arising from power interruptions and transport delays. In 2013, indirect costs related to electricity, security and crime represented over 10 per cent of annual sales for the average Kenyan manufacturing firm (World Bank, 2013a).[42] The high cost of imported intermediate goods can also significantly increase production costs.

Third, surveys suggest that the business environment remains a challenge, despite recent improvements. Kenya has recently climbed from 129th to 108th in the ranking of countries by ease of doing business, but it continues to rank particularly low in terms of starting a business (151st), dealing with construction permits (149th) and resolving insolvency (144th) (World Bank, 2015). Devolution could further undermine the business environment if counties impose regulations and local service charges that raise business costs and create economic uncertainty.

Accelerating industrialization in Kenya requires boosting competitiveness, increasing productivity and strengthening local production capacities. Kenya is making significant efforts to revitalize its industrial sector, in particular through considerable public investments in transport and power generation. The development of the transport infrastructure – including railways, roads and ports – is aimed at reducing costs and facilitating trade. Improving the access, reliability and affordability of electricity is also critical to enhancing the competitiveness of the manufacturing sector, since expensive and erratic supply deters investors. The planned expansion of installed power capacity and regional interconnections of national grids will improve the supply and trade of electricity, lowering the direct and indirect costs of manufacturing firms. Moreover, rather than competing on a low-wage platform, Kenya could take advantage of its well-educated labour force and target industries that require semi-skilled work by further developing industrial skills. Government guarantees could also be used to stimulate commercial lending to the productive sectors of the economy. Lastly, raising productivity would require investments in vocational skills, adequate funding for research and development, and technological upgrading.

Implementing these measures will, however, require a significant mobilization of financial resources, combined with policy coherence and coordination. For instance, many foreign investors tend to focus on the domestic market, rather than helping Kenya to enter global value chains. Indeed, a recent survey revealed that domestic market growth potential was the major factor affecting business location (KNBS and others, 2015b). Export processing

40 The proportion of non-performing loans (in value terms) is lower in manufacturing (4 per cent) than in most sectors, including construction (12 per cent), trade (7 per cent) and private households (5 per cent) (CBK, 2014, p. 33).
41 Calculated as the ratio of total wage payments to wage employment in the sector – KSh 31,866 (KNBS, 2015a, pp. 69 and 73). The median wage is likely to be lower.
42 Data refer to manufacturing firms only. Losses due to electrical outages represented 5.6 per cent of annual sales, security costs 3.5 per cent, and losses due to theft and vandalism against the firm 1.3 per cent – 93 per cent of manufacturing firms paid for security. Moreover, the number of days needed to clear exports and imports through customs increased considerably between 2007 and 2013, suggesting that capacity is not keeping pace with growing demand (World Bank, 2013b).

zones were introduced in the 1990s with a view to providing an attractive business environment for exporting firms. These zones provide a range of tax benefits – including a 10-year corporate and withholding tax holiday, and also VAT and customs exemptions – streamlined regulations, and physical infrastructure benefits (including a recent 50 per cent electricity subsidy). Export processing zones have recently been responsible for a growing share of exports, amount in 2014 to 10 per cent of total exports, although employment levels remain relatively low (KNBS, 2015a, p. 201). The export processing zone under the African Growth and Opportunity Act has been a major force behind this performance. The Government is planning to introduce special economic zones in 2016, however, which will replace the export processing zones. Despite the generous tax incentives, export processing zones have generated modest benefits to the economy. For their part, the special economic zones are based on a more controlled use of tax benefits, such as a reduced corporate tax rate (10 per cent) in the first 10 years. It is hoped that the zones will help in surmounting many of the constraints facing manufacturing firms and thus spur industrial activity.

6. NATIONAL DATA QUALITY EVALUATION

Methodological note on data quality evaluation

The quality of national data sources for key indicators in the country profiles was evaluated. The result is presented in colour codes, with green indicating a "good" data source, yellow for "satisfactory", and red for "needs improvement".

The evaluation focused on the transparency and accessibility of each national data source. The evaluation took into consideration the timeliness and periodicity of data publishing, based on the punctuality of publication and frequency of data updates in accordance with international standards. It also measured the comparability of the data series, based on their length, definition and standard units of measurement. It evaluated database accessibility, specifically whether the data were open and freely available to the general public, the format of the data, and the ease of downloading and sharing. Data citation, together with references to primary or secondary sources, was also assessed. Finally, the evaluation checked the completeness of metadata for data release and the completeness and clarity of documentation and notes.

Demography	Value (Year)	Evaluation
Population (millions)	38.6 (2009)	1 (green)
Children (0-14 years)	16.6 (2009)	1 (green)
Adults (15-64 years)	20.6 (2009)	1 (green)
Elderly (65+ years)	1.3 (2009)	1 (green)
Urban population (%)	32 (2009)	1 (green)
Growth rate (%)	3 (2009)	1 (green)
Life expectancy at birth (years)	57 (2009)	1 (green)

Key macroeconomic and sectoral performance	Value (Year)	Evaluation
Real GDP growth rate (%)	5.3 (2014)	1 (green)
GDP, current prices (billion US$)	60.9 (2014)	1 (green)
Inflation rate(%)	6.9 (2014)	1 (green)
Current account balance (billion US$)	-6.1(2014)	2 (green)

Economic trends and performance indicators	Value (Year)	Evaluation
Inward flows of foreign direct investment (million US$)	1,022.8 (2014)	1 (green)
Total Exports Total (million US$)	6,110.5 (2014)	1 (green)
Total Imports (million US$)	18,406.7 2014)	1 (green)

Data sources code index

1. Kenya National Bureau of Statistics
2. Central Bank of Kenya/Treasury

Education and employment	Value (Year)	Evaluation
Net enrolment rate in primary education (%)	88 (2014)	1 (green)
Proportion of pupils starting grade 1 who finish primary school	80 (2014)	1 (green)
Ratio of girls to boys in primary education	97 (2014)	1 (green)
Ratio of girls to boys in secondary education	92 (2014)	1 (green)
Population below national poverty line (%)	45 (2009)	1 (yellow)

Health	Value (Year)	Evaluation
Under-5 mortality rate (per 1,000)	52 (2014)	1 (green)
Maternal mortality ratio per 100,000 live births	362 (2014)	1 (green)
Prevalence of underweight children under-5 years of age(%)	11 (2014)	1 (green)
Infant mortality rate per (1,000 live births)	39 (2014)	1 (green)
Proportion of births attended by skilled health personnel	62 (2014)	1 (yellow)
Contraceptive prevalence rate	58 (2014)	1 (green)
HIV prevalence among population	3.3 (2014)	1 (green)
Incidence and death rates associated with malaria(%)	12 (2014)	1 (yellow)

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