MANUFACTURING
PRIORITY AGENDA 2020

Establishing a competitive manufacturing-led economy for job and wealth creation

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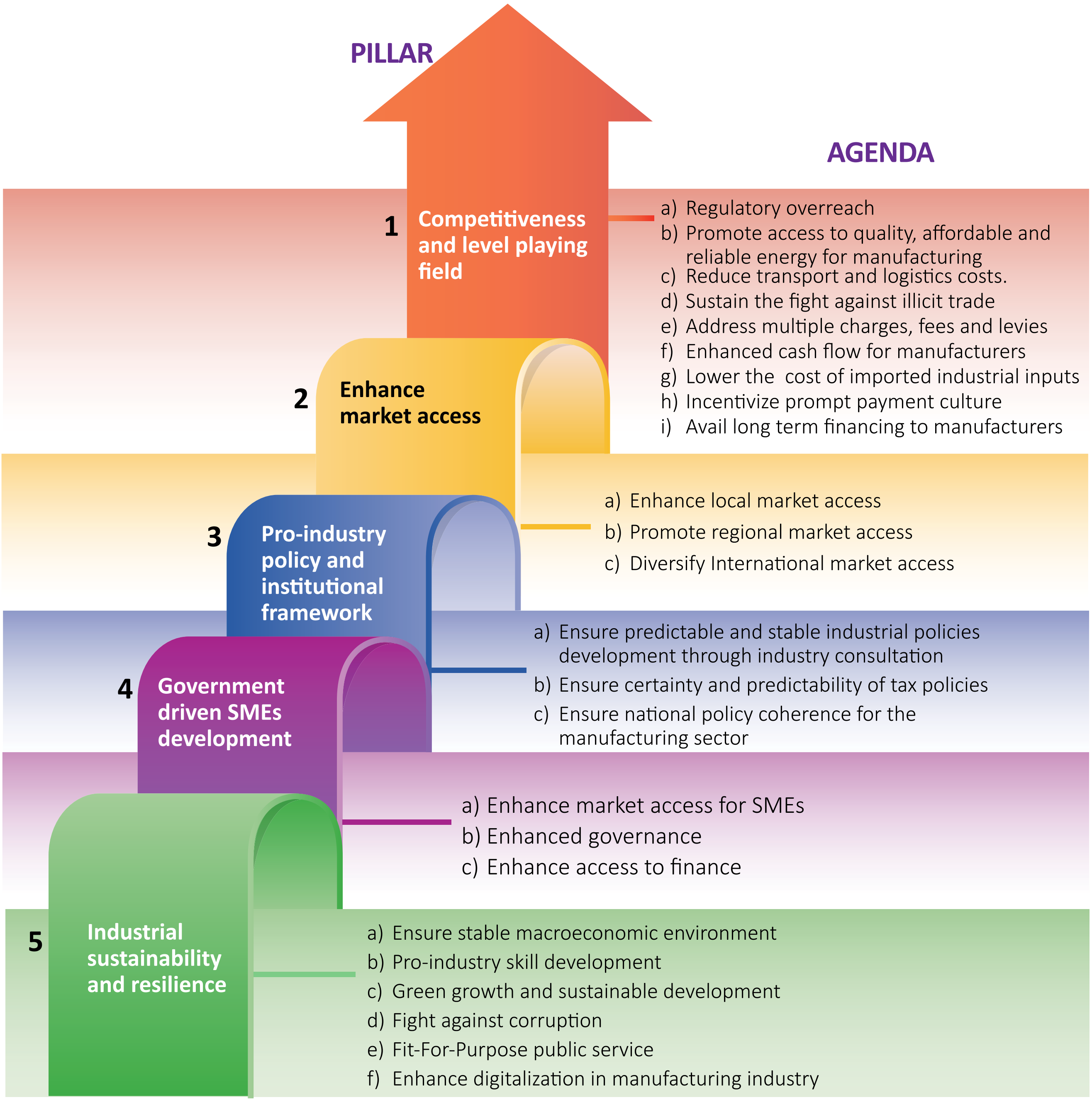

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Abbreviations

AfCFTA	Africa Continental Free Trade Area
AGOA	African Growth and Opportunity Act
AU	African Union
BKBK	Buy Kenya Build Kenya
EAC	East African Community
EPZ	Export Processing Zone
CBK	Central Bank of Kenya
CET	Common External Tariff
COMESA	Common Market for Eastern and Southern Africa
CIP	Competitive Industrial Performance
CPI	Consumer Price Index
EPZ	Export Processing Zone
GDP	Gross Domestic Product
ICDN	Inland Container Depot Nairobi
IDF	Import Declaration Fee
IMF	International Monetary Fund
KNBS	Kenya National Bureau of Statistics
KRA	Kenya Revenue Authority
MPA	Manufacturing Priority Agenda
MSE	Micro and Small Enterprises
MSME	Micro, Small and Medium Enterprises
MTP	Medium Term Plan
MVA	Manufacturing Value Added
NEPDS	National Export Promotion and Development Strategy
NSE	Nairobi Securities Exchange
NTB	Non-Tariff Barriers
OECD	Organization for Economic Cooperation and Development
OSR	Own Source Revenue
PFM	Public Finance Management
PMI	Purchasing Manager's Index
RDL	Railway Development Levy
SGR	Standard Gauge Railway
SSA	Sub Saharan Africa
TFTA	Tripartite Free Trade Area
TVET	Technical and Vocational Education Training
UN	United Nations
UNIDO	United Nations Industrial Development Organization
VAT	Value Added Tax
WHVAT	Withholding Value Added Tax

Foreword

Sachen Gudka
KAM Chairman

With the manufacturing sector facing dynamic changes in the wake of globalization and technology disruption, it is imperative for Kenya to position itself as an industrial hub that promotes competitive industries in the global sphere.

Globally, the sector has continued to provide sustainable decent jobs and created wealth resulting in high growth among industry-driven economies, such as the East Asian countries.

Kenya aspires to attain an industrialized economy status as outlined in Vision 2030 and the National Industrialization Policy. Despite this, the contribution of Kenya's manufacturing sector to the GDP has been declining in recent years, pointing towards premature deindustrialization.

To transform Kenya into a competitive industrial hub, we must implement effective strategies to drive the growth of local industries whilst encouraging new investments. Global competitiveness is essential to industrialization and sustained productivity. It ensures a country's capacity to provide productive jobs, decent wages and consequently a dependable social support system for its population.

Kenya sits in a privileged position. It is one of the largest and resilient economies in East and Central Africa and is recognized as an investment destination due to factors such as, political and economic stability and its role as a regional hub. In addition, through devolution, counties are the new frontiers for the promotion of investments and growth of the manufacturing sector. However, our initiatives to sustain existing investments and attracting new investors is impeded by the increasing cost of doing business at national and county levels, slow rate of circulation of money in the economy, low volume of trade and regulatory overreach.

We can only ensure our sustainability and self reliance as a nation if we set the tone for a vibrant economy. Time is of the essence, hence, strategic implementation of effective policies not only ensures that such challenges are addressed but also results in new ideas on increasing productivity and bolster job creation.

It is also vital for Kenya to implement strategies in line with global trends. The new decade promises huge opportunities for the sector particularly in the wake of the Fourth Industrial Revolution including adoption of new technology such as e-commerce and continued automation and use of data in manufacturing. Additionally, we expect to see more industries take up initiatives to drive Kenya's circular economy as we strive for sustainable industrial development. It is time that we put in place measures to ensure that we reap from the global trends and markets and to build a strong future for our country.

The Association remains committed to working with the government and other stakeholders in developing policies and frameworks to boost industrial growth. We will continue to provide strategic advocacy to support the country's transformation into the newly industrialized economy.

I look forward to working with all of our stakeholders in realizing the potential of the sector towards uplifting our great nation.

Sachen Gudka,
KAM Chairman

Executive Summary

Phyllis Wakiaga
KAM Chief Executive

Each year, the Association develops a Manufacturing Priority Agenda (MPA) to highlight action plans to address challenges hampering the growth of the manufacturing sector as we aim to transform Kenya into an industrial-led economy. The Agenda is developed from engagements with our members, observations of emerging issues and a review of the business environment.

Last year's Priority Agenda aimed at advancing measures that would close the widening manufacturing gap in line with the Big 4 Agenda. Through the outlined actions, we made significant progress in the war against counterfeits, tax regulations that had previously stifled export trade, and strengthening EAC trade relations by reducing non-trade barriers. However, as we made these gains, other challenges namely, increased cost of doing business and unpredictable policy environment, sprouted and negatively impacted sector's competitiveness. This resulted in scaling down of operations, job losses and profit warnings from different players in the industry.

It is within this context that we have developed the 2020 MPA under the theme ***"Establishing a competitive manufacturing-led economy for job and wealth creation".***

Our emphasis at the start of this decade is that industry will only thrive if National and County Governments develop cohesive and progressive policies. Policies aligned to the overall economic goal of the country and will outlive the typical 5-year election cycles. The MPA highlights the need for policy measures to be tailored towards nurturing local businesses which directly translates to increased employment and poverty reduction.

The Agenda also outlines the need for enhanced market access. Our prosperity is not only dependent on productivity but also on the strategic choice of trading partners, export promotion and diversification. External markets play a crucial role in supporting economic growth and industrial development.

Boosting productivity of SMEs is also prominent in the Agenda. For SMEs to thrive, they need enhanced market access for their products and access to affordable finance. This will not only increase their productivity, in turn creating additional jobs but also render them competitive as they expand their markets.

KAM has consistently championed the adoption of critical tenets of sustainable development towards actualizing green growth. In the same breath, industrial sustainability and resilience is only possible if the workforce has the relevant skills to operate industries effectively. This is why our advocacy for a continued revamp of technical skills under TVET continues to play a central role in the need for pro-industry skills development.

The Association is committed towards the achievement of these goals. We will work closely with both national and county governments and development partners as we aim to transform Kenya into a competitive regional industrial hub.

Phyllis Wakiaga
KAM Chief Executive

Acknowledgment

The development of the KAM Manufacturing Priority Agenda (MPA) 2020 has been made possible through participation of various departmental units within KAM. Acknowledgment is made to the KAM Board, led by the Chairman, Mr. Sachen Gudka for offering strategic direction for MPA 2020 and KAM Chief Executive, Ms. Phyllis Wakiaga, for providing continued guidance in the preparation of the report.

Oversight of the development of the content for MPA 2019 was provided by Policy, Research and Advocacy Unit (PRAU) Team headed by Mr. Job Wanjohi. Special thanks goes to Dr. Simon Githuku (Research and Fiscal Policy Manager) and Mr. Rodgers Agwaya for coordination and content development.

The document benefited from contributions of various staff on the fourth chapter. Content on Pillar one- Competitiveness and level playing field for manufacturers in Kenya was written by Ms. Miriam Bomett (Deputy Head, PRAU), Ms. Ruth Lemlem (Manager, Legal and Regulatory Affairs), Innocent Onserio, Jackson Wambua (Manager, Sectors), Samuel Mutisya (Regional and Devolution Affairs Manager), Dr. Simon Githuku (Research and Fiscal Policy Manager) and Reinhard Wanakacha. Pillar two- Enhancing market access was written by Mr. Walter Kamau (Trade and Policy Technical Advisor), Mr. Manaseh Oiro (Manager, Trade and Policy) and Abel Kamau. Pillar four- Government driven SME growth and development was written by Ms. Nduta Ndirangu and Mr. Joseph Wairiuko.

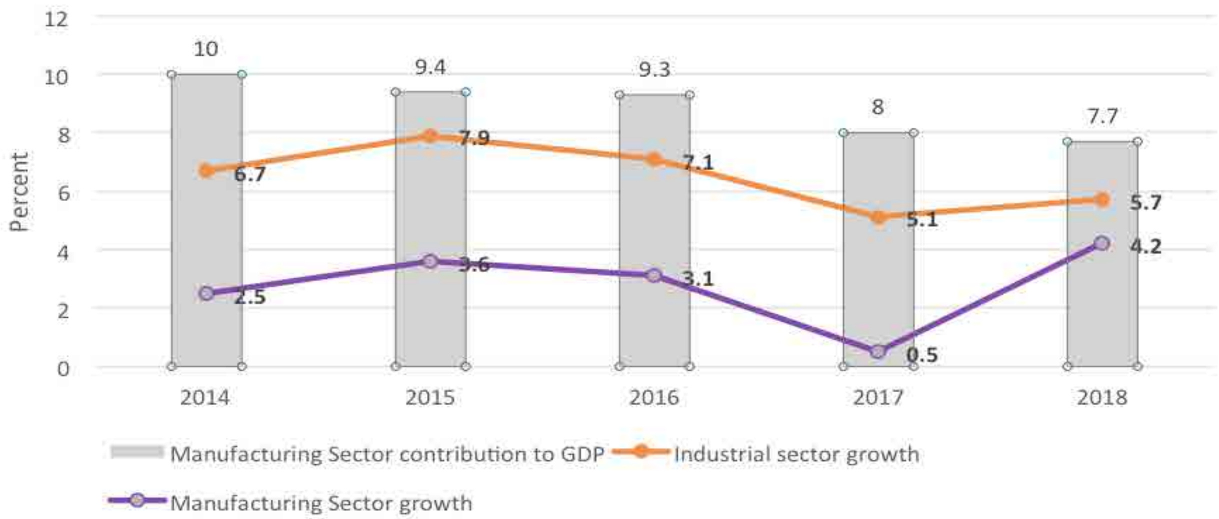
Sincere appreciation goes to Ms. Phelgon Molaa Okiya for providing pictorials, Ms. Grace Mbogo, Ms. Sally Rotich and Ms. Sally Kahiu (Head of PR, Communications and Marketing) for reviewing and editing the report.

1. INTRODUCTION

1.1. Background information

The National Industrialization policy aims at transforming Kenya into a globally competitive regional industrial hub. To do so, Kenya needs to achieve a sustained annual industrial sector's[1] growth of 15 percent. However, the industrial sector has witnessed a declining trend in growth in the recent past which has been below the envisioned 15 percent (as shown in Figure 1.1). Similarly, manufacturing sector has experienced fluctuating growth with the sector expanding by a high of 3.6 percent in 2015 to a low of 0.5 percent in 2017 then recovered to 4.2 percent in 2018. Consequently, the contribution of manufacturing sector to Gross Domestic Product (GDP) has declined from 10 percent in 2014 to 7.7 percent in 2018. The pick-up in growth in 2018 was attributed to recovery of agro-processing activities and increased manufacture activities including assembly of vehicles (KNBS, 2019b).

Figure 1.1: Sectoral growth and contribution to GDP, 2014-2018

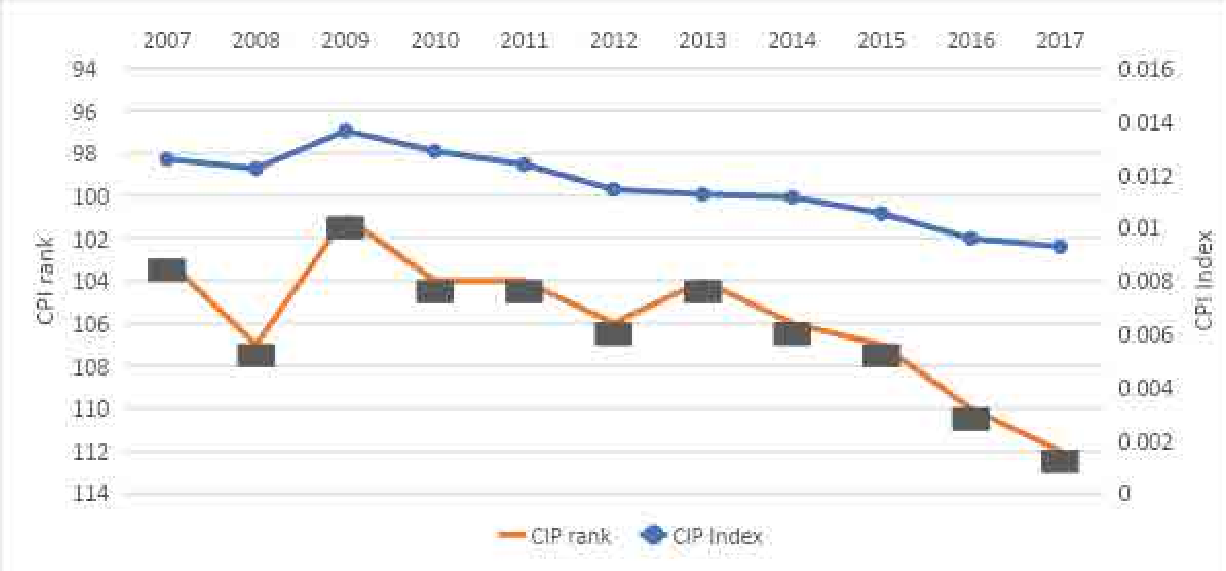


Source: KNBS, Economic Survey 2019

At the heart of manufacturing sector's performance is its competitiveness. Latest Competitive Industrial Performance (CIP) Index data from United Nations Industrial Development Organization (UNIDO) ranks Kenya's manufacturing sector's competitiveness at position 112 out of 150 economies in the global manufacturing as shown in Figure 1.2. Kenya's CIP index has been on a downward trend dropping from 0.0136 in 2009 to 0.0093 in 2017.

1 Industrial sector broadly covers manufacturing, electricity, water and construction subsectors

Figure 1.2: CIP index and rank for Kenya, 2007-2017



Source: UNIDO, CIP 2019

The CIP Index benchmarks the ability of countries to produce and export manufactured goods competitively based on a set of indicators which measure the structure, productive capacity and impact of an economy's manufacturing sector in the global manufacturing, and intensity of industrialization. Indicators of CIP that capture structural change; capacity to produce and export; impact on world production and trade are indicated in Table 1.1.

Table 1.1: Indicators of CIP

Dimension	Indicators
Structural change	• Manufacturing Value Added (MVA) as a share of GDP • Manufactured exports as a share of total exports
Capacity to produce and export	• MVA per capita • Manufactured exports per capita
Impact on world production and trade	• Share in world MVA • Share of manufactured exports in world manufactured exports

Source: UNIDO, 2019

From the industrial competitiveness scorecard presented below (see Table 1.2), Kenya's economy has experienced structural change pointing towards premature deindustrialization. Manufacturing sector's contribution to GDP and total exports both declined in the period under review. MVA as a share of GDP declined from 10.29 percent in 2015 to 9.9 percent in 2017. In the same period, manufactured exports as a share of total exports declined from 48.6 percent to 41.6 percent. Manufacturing capacity to produce has increased as reflected in the rise of MVA per capita from 113.95 in 2015 to 115.99 US dollars in 2017. However, the capacity to export manufactured goods has declined from 57.44 to 42.93 US dollars. The country seems to be more capable of producing manufactures than exporting them. This may likely be attributed to a dominant domestic demand, low competitiveness of Kenyan manufactures in the international market or trade barriers on exports (UNIDO, 2015). Finally, Kenya's share of world manufacturing production has increased from 0.0439 percent in 2015 to 0.0441 percent in 2017, indicating that other economies have expanded their MVA at a slower rate than Kenya. However, the share of world manufactured exports has reduced from 0.00195 percent to 0.00176 percent over the same period, indicating that the market share for manufacture exports has reduced.

Table 1.2: Industrial competitiveness scorecard for Kenya

SCORECARD: Kenya's manufacturing sector								
	Industry Indicators (MVA)				Trade Indicators (Exports)			
	2015	2016	2017	2015-2017	2015	2016	2017	2015-2017
Structure (%)	10.29	10.05	9.9	↓	48.6	41.6	41.6	↓
Capacity (constant 2010 US $)	113.95	114.93	115.99	↑	57.44	42.93	42.93	↓
Impact (%)	0.0439	0.0442	0.0441	↑	0.0195	0.0176	0.0176	↓

Source: UNIDO, CIP 2019

1.2. An overview of 2019 Manufacturing Priority Agenda

The MPA 2019 was launched on 5th February, 2019 under the theme "Closing the manufacturing gap through the Big 4 Agenda for shared prosperity". In 2018, the contribution of the manufacturing sector to the GDP was 7.7 percent implying that a gap of 7.3 percent has to be closed if the 15 percent target by 2022 as per the aspirations of the Big Four Agenda is to materialize. MPA 2019 comprised 5 pillars, 25 Agenda and 70 Actions. Of the 70 actions, nine 9 were fully achieved, 35 partly done while no progress was registered for the remaining 26 actions. Table 1.3 provides details of the main achievements realized under MPA 2019.

Table 1.3: Main achievements realized under MPA 2019

	Action	Outcome
a)	Fast track the enactment of the Energy Bill 2018 which seeks to resolve energy related issues in the country such monopoly of distribution and allow for net metering feeding into national grid among others.	• This came into effect on March 2019 with the enactment of Energy Act, No. 1 of 2019
b)	Establish a coordination framework for all government agencies involved in clearance of cargo to reduce the duplication of interventions by various agencies.	The Head of Public Service Directive issued a directive on 4th June 2019 reducing intervening agencies at Ports from 28 to 4 among other directives.
c)	Fast track development of Kenya Standard (parameters) under the Pre-Verification for Conformity (PVOC) to be adopted and mutually recognized by all government agencies.	• PVOC was enriched to consider the criteria for agencies which were removed from the Port following Head of Public Service directive on 4th June 2019.
d)	Fast track development of National Strategy for combating illicit trade in Kenya;	• The Strategy was launched in July 2019. Currently, there is an ongoing effort to implement the Strategy together with the Government.
e)	Review the VAT refund formula	• The VAT refund formula was amended in order to allow full recovery of the portion of input tax relating to zero-rated supplies. • The new VAT refund formula was gazetted on 17th June 2019.
f)	Develop framework for prompt resolution of reported NTBs through bilateral initiatives between Kenya the EAC Partner states and other regional States outside the EAC;	• There has been enhanced bilateral negotiations to resolve NTBs. On 14th -18th October 2019 there was an engagement between Kenya and respective EAC Partner States in Arusha, Tanzania where out of the 41 reported export challenges 31 (75%) have been resolved, outstanding 10 (25%) are being addressed by the EAC Partner States.
g)	Incentivize commercial banks (through the introduction of tax rebates) to provide low interest loans targeting manufacturers and SMEs.	• Through the Finance Act 2019, Section 33b of the Banking Amendment Act 2016 was repealed to permit free floating of interest rates. • In 2019, the Cabinet Secretary for the National Treasury while reading the Budget Statement stated that the Government will introduce an amnesty on the tax penalties and interests on any outstanding tax to enable SMEs to enlist in the Growth and Enterprise Market Segment (GEMS) segment of the Nairobi Stock Exchange (NSE) Market.
h)	Provide incentives for adoption of circular economy waste management	• 15% corporate reduction on new plastic recyclers for the next 5 years and VAT exempt for service providers to recyclers was provided via Budget Statement 2019/2020
i)	Incentivize industries excelling in energy management through a National award.	• KAM has partnered with Ministry of Energy to run an annual Energy Management Awards.
j)	Fast track finalization of the Public Procurement and Asset Disposal (PPAD) Regulations on provision of preference and reservation for locally manufactured goods and services	• Under the Buy Kenya Build Kenya strategy, manufacturers of textile and apparel, leather and footwear have supplied government agencies with assorted products particularly boots and fabrics for uniforms.
k)	Popularize and strengthen Competence Based Education and Training (CBET) with industry for buy in through awareness creation.	• KAM piloted CBET placements and engagement with industries. Awareness creation on CBET done nationally in collaboration with Ministry of Education (TVETA and TVET-CDACC). CBET assessments done.
l)	Fast track development and Operationalization of the Sector Skill Advisory Committee (SSACs) that will guide in the development of occupation standards to influence curriculum development	• Through the manufacturing academy, there was a signed MOU with National Industrial Training Authority (NITA) to support NITA in forming the Manufacturing Sector Training Committees. So far KAM is represented in the following Sector Skills Committees: Leather: Automotive: Agricultural Inputs respectively. • Through the Sector Training Committees, KAM shall support NITA in the following: Development of occupational standards for the manufacturing sector; avail a list of assessors for up to and including Master craftsperson level and development of curriculum and assessment standards for the manufacturing sector.
j)	Remove all taxes, levies and charges on power bills for manufacturers to reduce the cost of power	• On 31st July 2019, the government gazetted the cost of electricity rebate program that allows deduction of an additional 30% of electricity costs incurred by manufacturers while computing corporation tax.

Source: KAM, 2019

2. GLOBAL, REGIONAL AND KENYA'S ECONOMIC OUTLOOK

2.1 Global economic outlook

Global economic growth is estimated to have slowed down to 3 percent in 2019 in comparison to a 3.4 percent growth in 2018 (IMF, 2019). The International Monetary Fund (IMF) attributes this slowdown on growth to increased trade barriers across economies and uncertainties surrounding geopolitics, low productivity growth, macroeconomic distress in emerging economies and a demographic shift to aging population in developed economies. The US-China trade tension and Brexit uncertainty continue to cast a negative outlook on global economic growth. Brexit uncertainty is at risk of disrupting the global supply chain while US-China trade tension is expected to cumulatively reduce global Gross Domestic Product (GDP) by 0.8 percent by 2020.

Growth in 2020 is projected to improve to 3.4 percent, however, IMF cautions that global growth will not be broad based. Emerging and developing economies are set to experience a 4.6 percent growth in 2020 in contrast to developed economies' projected growth of 1.7 percent.

2.2 Regional economic outlook

Africa's economy is projected to grow by 4 percent in 2019, an improvement from 3.5 percent in 2018 (AfDB, 2019). East Africa leads with an economic growth of 5.9 percent, followed by North Africa at 4.4 percent, Central Africa and West Africa both experiencing a 3.6 percent growth and lastly Southern Africa at 2.2 percent. The growth is supported by increased consumption level, improving commodity prices and high agricultural output. However, the impressive growth has not been pro-employment

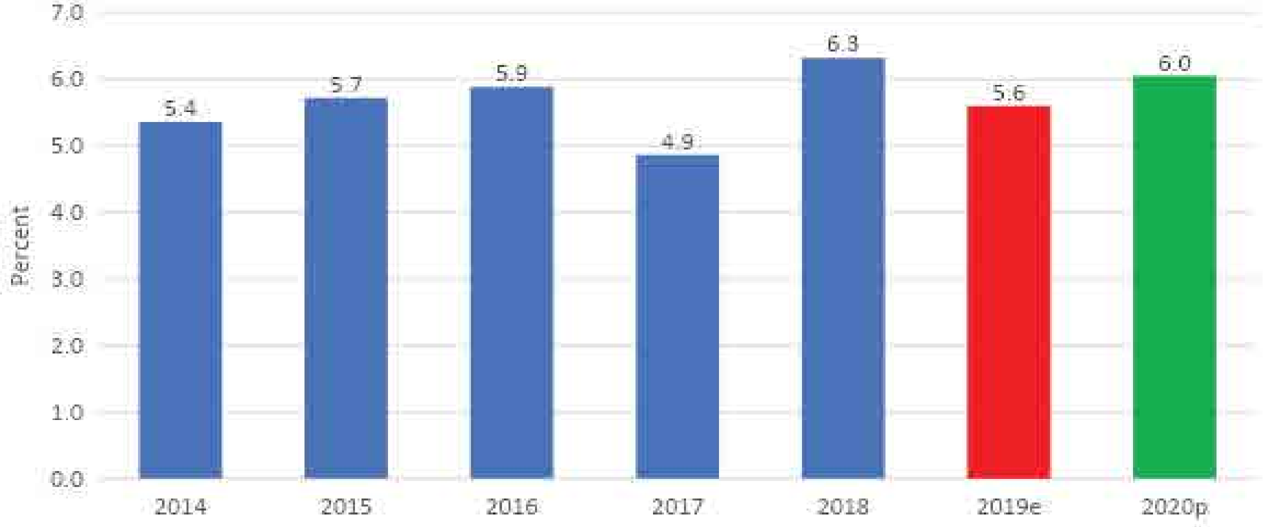
In 2020, Sub Saharan Africa economy is forecast to grow by 3.9 percent in 2020 with East Africa leading by 6.1 percent followed by North Africa at 4.4 percent, West Africa at 3.6 percent and lastly Southern Africa by 2.2 percent. Going forward, rising political tension and insecurity, increased cost of external funding, climate change, commodity prices volatility and a slowdown of the global economy pose a threat to Africa's economic growth.

2.3 Kenya's economic outlook

a). GDP growth

Kenyan economy expanded by 6.3 percent in 2018 compared to 4.9 percent in 2017 (KNBS, 2019b) as shown in Figure 2.1. The growth was supported by increased agricultural output due to sufficient rains, accelerated manufacturing activities in agro-processing and growth in transport and service sectors. The economy is expected to experience a slowdown in growth to 5.6 percent in 2019 and pick up to 6 percent in 2020 (World Bank, 2019). In the first three quarters of 2019, the Kenyan economy grew by an average of 5.7 percent (KNBS, 2019c). This reduced growth in 2019 is attributed to notable reduction in cash crop production and low level of manufacturing activity.

Figure 2.1: Kenya's GDP growth rate and projections, 2014-2020



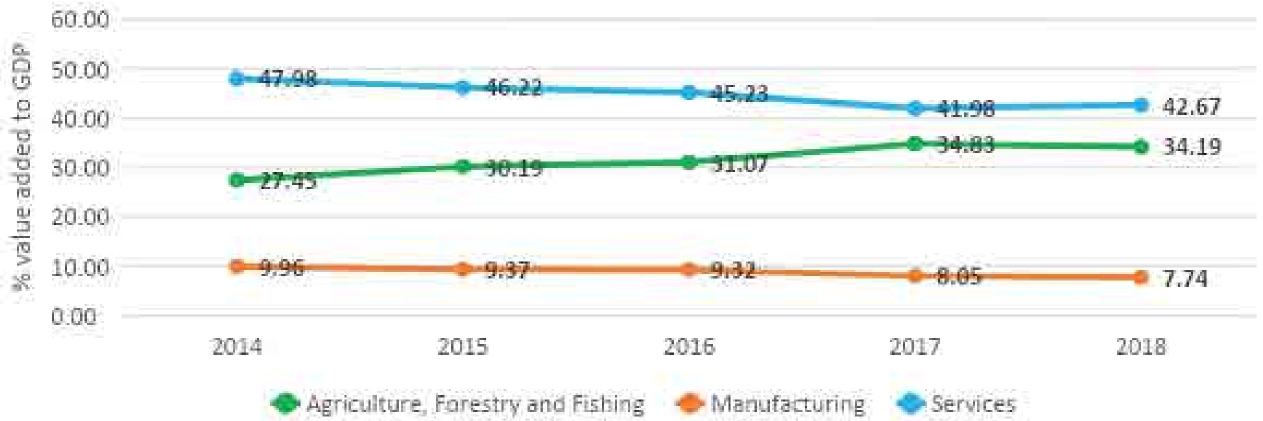
Source: KNBS and World Bank, World Development Indicators 2019

e- denotes estimate figure, p- denotes projected figure

b). Structure of the Kenyan economy

Kenya's economy continues to be dominated by the services sector with a 42.7 percent contribution to GDP as shown in ***Figure 2.2***. It is worth noting that the share of agricultural output in the economy has been increasing from 27.5 percent in 2014 to 34.2 percent in 2018 while the contribution of services sector has declined from approximately 48 percent in 2014 to 42.7 percent in 2018. In the same period, manufacturing sector contribution to GDP has shrunk from approximately 10 percent to 7.7 percent. This signals a slow pace of structural transformation towards an industrialized economy. Services sector continued dominance on value addition to the economy hampers creation of new employment opportunities since it absorbs less labour market entrants as opposed to manufacturing which is labour intensive (AfDB, 2019).

Figure 2.2: Sectoral[2] contribution to GDP, 2014-2018



Source: World Bank, World Development Indicators 2019

c). Inflation

Consumer Price Index (CPI) inflation remained within the envisioned target of 5± 2.5 percent. Maintaining price stability is key in Kenya's macroeconomic stability. In the year 2019, the highest change of consumer prices occurred in April with inflation coming in at 6.58 percent as shown in ***Figure 2.3***. This was attributed to increase in food prices due to drought conditions experienced in the country, increased cost of transportation due to increase in fuel pump prices (KNBS, 2019a). Lowest recorded inflation was 3.83 percent in the month of September.

2 In this case, contribution of electricity, water and construction subsectors are excluded in the computation

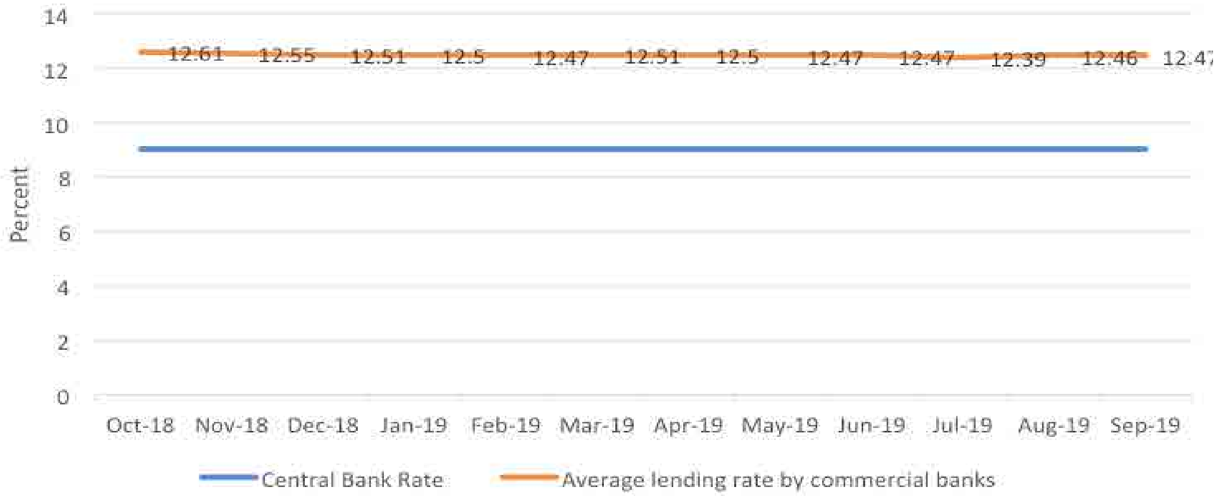
Figure 2.3: Trend in inflation, January-December 2019

Source: KNBS, Various issues of Consumer Price Indices Report

d). Interest rate

In the 12 month period running from October 2018 to September 2019, the Central Bank of Kenya (CBK) monetary policy committee maintained the CBK rate at 9 percent as shown in ***Figure 2.4***. The weighted average lending rate by commercial banks remained relatively stable at an average of 12.5 percent. Following the assent of Finance Bill 2019 on November 2019, section 33b of the Banking Amendment Act of 2016 was repealed to remove a cap on commercial bank lending rates. This sets stage to unlock banks' lending to the private sector by adjusting risk premium to lenders risk profile.

Figure 2.4: CBK rate and average lending rate by commercial banks, Oct 2018-Sep 2019



Source: CBK, Monthly Economic Indicators October 2019

e). Exchange rate

Compared against major currencies, the Kenyan shilling strengthened against the sterling pound and Euro but weakened against the US dollar and Japanese Yen in the fourth quarter of 2019 as shown in Table 2.1. On quarterly basis, the shilling weakened against regional currencies but gained against major world currencies with an exception of the sterling pound in the fourth quarter of 2019. Strengthening of the shilling was supported by adequate foreign reserve which exceeded the fourth month import cover.

Table 2.1: Kenya shilling exchange rate, 2018-2019

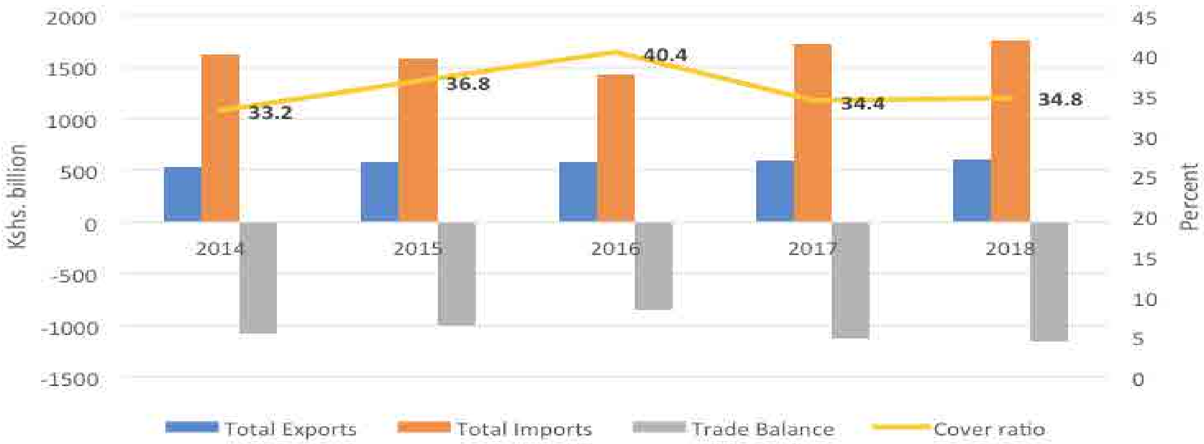
	2018	2019Q1	2019Q2	2019Q3	2019Q4	% change (2019Q1-2019Q4)
US Dollar	101.3	100.72	101.3	103.42	102.55	-1.8%
Sterling Pound	135.33	131.98	130.27	127.56	131.8	0.1%
Euro	119.7	114.42	113.83	115.05	113.46	0.8%
100 Japanese Yen	91.74	91.48	92.17	96.35	94.35	-3.1%
SA Rand	7.7	7.18	7.03	7.06	6.96	3.1%
Ugandan shilling	36.79	36.67	36.97	35.67	35.99	1.9%
Tanzanian shilling	22.47	23.1	22.74	22.24	22.44	2.9%
Rwandan Franc	8.6	8.9	8.94	8.87	9.07	-1.9%
Burundi Franc	17.47	17.88	18.1	17.83	18.22	-1.9%

Source: Central Bank of Kenya

f). External trade

Kenya's trade deficit widened from Kshs. 1131.5 billion in 2017 to Kshs. 1147.3 billion in 2019 (Figure 2.5) on account of increased imports expenditure (KNBS, 2019b). Value of exports rose by 3.2 percent from Kshs. 594.1 billion in 2017 to Kshs. 612.9 billion in 2018. The rise in value of exports was supported by increase in re-export of petroleum products. On the other hand, imports rose to Kshs. 1147.3 billion from Kshs. 1131.5 billion. However, the cover ratio, which is a ratio between the value of exports and imports improved marginally from 34.4 percent in 2017 to 34.8 percent in 2018.

Figure 2.5: Balance of trade for Kenya, 2014-2018



Source: KNBS, Economic Survey 2019

Kenya's total export earnings rose by 3.2 percent from Kshs. 594.1 billion in 2017 to Kshs. 612.9 billion in 2019 as shown in Table 2.2. However, value of exports to Africa continued to exhibit a declining trend. Value of exports destined to Africa dropped by 3.4 percent from Kshs. 223.9 billion in 2018 to Kshs. 216.2 billion in 2019. This represents a 35.27 percent share of total Kenyan exports.

Exports to East African Community (EAC) were valued at Kshs. 129 billion accounting for 59.67 percent of exports to Africa while exports to Common Market for Eastern and Southern Africa (COMESA) region dropped to Kshs. 160 billion representing 74 percent of total Kenyan exports.

Table 2.2: Kenyan exports to Africa (Kshs. Billion), 2014-2018

	2014	2015	2016	2017	2018
Total Exports	537.2	581	578.1	594.1	612.9
Of which : Africa	241.3	242.2	234.7	223.9	216.2
% of all exports	44.93	41.68	40.6	37.68	35.27
Of which : a) EAC	125.8	126.8	121.7	114.8	129
EAC as a % of total exports to Africa	52.12	52.35	51.86	51.3	59.67
b) COMESA	170	179.1	170.2	166.4	160
COMESA as a % of total exports to Africa	70.42	73.94	72.54	74.34	74

Source: KNBS, Economic Survey 2019

Value of imports to Kenya rose marginally by 2 percent from Kshs. 1725.6 billion in 2017 to Kshs. 1760.2 billion in 2018 as shown in Table 2.3. Imports from EAC and COMESA regions represented 33.27 percent and 56.1 percent of total imports from Africa respectively.

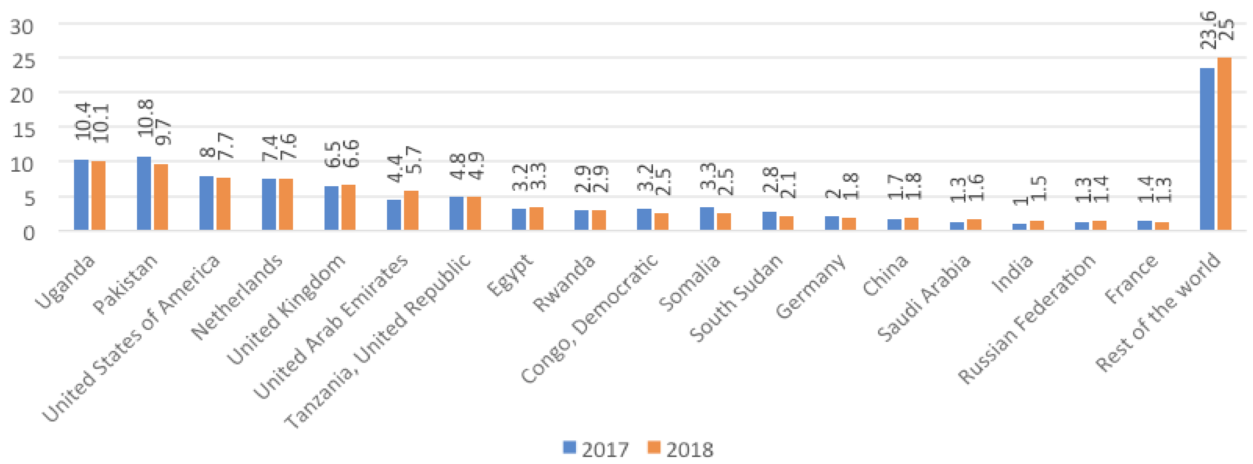
Table 2.3: Kenyan imports from Africa (Kshs. billion), 2014-2018

	2014	2015	2016	2017	2018
Total Imports	1618.3	1577.6	1431.8	1725.6	1760.2
Of which: Africa	146.1	149.1	140.2	200.5	205.9
% of all Imports	9.03	9.45	9.8	11.62	11.7
Of which : a) EAC	36.7	40.2	33	61	68.5
EAC as a % of total imports from Africa	25.08	26.96	23.48	30.4	33.27
b) COMESA	60.4	67.1	70	115.3	115.5
COMESA as a % of total imports from Africa	41.3	45.03	49.63	57.5	56.1

Source: KNBS, Economic Survey 2019

75 percent of Kenya's exports were destined to 18 countries in 2018 as shown in Figure 2.6. Uganda was the top destination of Kenyan exports representing 10.1 percent of total exports. This was followed by Pakistan, U.S.A and Netherlands with exports to these countries accounting for 9.7 percent, 7.7 percent and 7.6 percent of total Kenyan exports respectively.

Figure 2.6: Leading export destinations for Kenyan products, 2017-2018



Source: Computation based on ITC trade map

g). Composition of Kenyan exports and imports

Food and beverages constitute the biggest share of Kenyan exports accounting for 47.7 percent value of exports in 2018 as shown in Table 2.4. This was followed by consumer goods not elsewhere specified at 25.5 percent and industrial supplies at 23.5 percent. Dominance of food and beverage exports was an account of increased primary and processed food and beverages for household consumption (KNBS, 2019b).

Capital goods constituted a large share of Kenyan imports in 2018. Industrial supplies, machinery and transport equipment accounted for 34.7 percent, 16.5 percent and 10.7 percent of Kenyan imports respectively. Fuel and lubricants import bill represented 19.1 percent of total Kenyan imports.

Table 2.4: Exports and Imports by broad economic category (% share), 2014-2018

	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018
	Exports					Imports				
Food & Beverage	40. 84	44.68	45.17	48	47.73	6.91	7.82	8	14.21	9.93
Industrial Supplies (Non-Food)	27.02	25.87	24.51	23..63	23.54	28.56	33.25	36.23	31.93	34.66
Fuel and lubricants	0.71	1.26	0.9	0.99	0.86	21.43	15.04	14.53	16.09	19.08
Machinery and other capital Equipment	1.63	1.91	2.62	1.34	1.25	17.22	18.23	21.8	18.01	16.51
Transport Equipment	1.57	1.42	1.15	0.84	1.12	17.22	18.23	21.8	18.01	10.74
Consumer Goods not elsewhere specified	27.89	24.85	25.64	25.21	25.49	7.02	7.98	8.85	8.01	8.44

Source: KNBS, Economic Survey 2019

h). Kenya's public finance

- Government revenue

Total government revenue rose by 11.3 percent from approximately Kshs. 1.5 trillion in 2017/18 to approximately Kshs. 1.67 trillion in 2018/19 as shown in Table 2.5. This was 7.2 percent lower than the targeted Kshs. 1.79 trillion (GoK, 2019). Ordinary revenue to GDP ratio registered a marginal rise from 16 percent in 2017/18 to 16.1 in 2018/19, this was below the Medium Term Plan (MTP) projection of 18.9 percent (GoK, 2018b).

Table 2.5: Government revenue, 2014/15-2018/19 (Kshs. billion)

	2014/15	2015/16	2016/17	2017/18	2018/19
1. Ordinary Revenue	1031819	1152972	1306568	1365063	1496930
2. Appropriation-in-Aid	75953	79671	115963	157356	174140
Total revenue (1+2)	1107772	1232644	1422531	1522419	1671071
External Grants	28117	29597	26962	26484	19702
Total revenue and External grants	1135889	1262240	1449493	1548903	1690773
Ordinary Revenue (% of GDP)	17.8	17.2	17.1	16	16.1
Total revenue & external grants (% of GDP)	19.5	18.8	18.9	18.2	18.1

Source: National Treasury, Various issues of Budget review & Outlook Paper

- Government expenditure

Total government expenditure rose by 14.3 percent from Kshs. 2.1 trillion in 2017/18 to Kshs. 2.4 trillion in 2018/2019 as shown in Table 2.6. Recurrent expenditure accounted for 62 percent of total expenditure with operation and maintenance constituting the biggest share of recurrent expenditure. Wages and salaries made up 28 percent of the recurrent expenditure. Development expenditure rose from Kshs. 327 billion to Kshs. 360 billion, constituting 23 percent of total government expenditure, which is below the Public Finance Management (PFM) Act requirement of 30 percent. Transfers to county government increased in nominal terms from Kshs. 327 billion in 2017/18 to Kshs. 360 billion in 2018/19 but remained constant as a percentage of total expenditure at 15 percent.

Table 2.6: Government expenditure, 2014/15-2018/19 (Kshs. billion)

	2014/15	2015/16	2016/17	2017/18	2018/19
Total Expenditure	**1640022**	**1781945**	**2109976**	**2146651**	**2405932**
Of which					
1) recurrent expenditure	895199	1027543	1165037	1349704	1496223
as % of total expenditure	**55%**	**58%**	**55%**	**63%**	**62%**
a. wages & salaries as % of total recurrent expenditure	33%	30%	29%	29%	28%
b. interest payment as % of total recurrent expenditure	19%	21%	23%	24%	25%
a) Pensions as % of total recurrent expenditure	4%	5%	5%	5%	5%
b) Operation & Maintenance as % of total recurrent expenditure	43%	44%	42%	40%	39%
2) Development expenditure and net lending	510136	478964	639923	469673	542007
as % of total expenditure	**31%**	**27%**	**30%**	**22%**	**23%**
3) Transfer to County Governments	229336	264039	305016	327274	360740
as % of total expenditure	14%	15%	14%	15%	15%

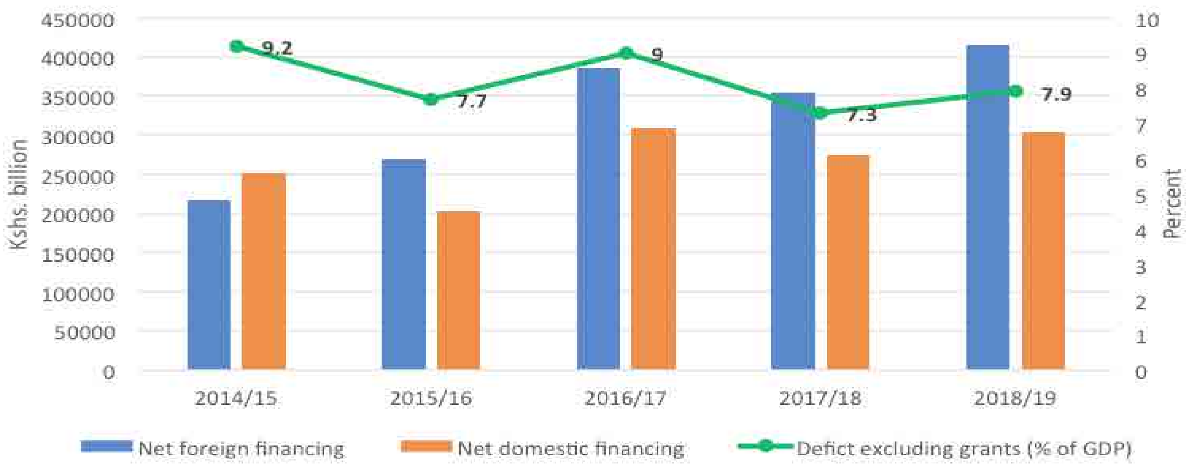
Source: National Treasury, Various issues of Budget review & Outlook Paper

- Fiscal deficit

Kenya's fiscal deficit widened to 7.9 percent of GDP from Kshs. 624.2 billion in 2017/18 to Kshs. 734.9 billion in 2018/19 as shown in Figure 2.7. Subsequently, total debt financing increased from Kshs. 628.7 billion in 2017/18 to Kshs. 718.2 billion in 2018/19. The fiscal deficit was plugged with Kshs. 414.5 billion of foreign financing and Kshs. 303.7 billion of net domestic financing. Foreign financing accounted for 58 percent of deficit financing while net domestic financing accounted for 42 percent in line with the government's borrowing strategy aimed at extending the maturity profile of overall debt (GoK, 2018a).

The 2018/19 fiscal deficit was below the target of 8 percent of GDP as per the 2019 Budget Review and Outlook Paper but above the 6.5 percent projection in the third MTP (GoK, 2018b). The deficit is expected to narrow on the back of fiscal consolidation efforts to cut down on recurrent expenditure and expand the tax base to boost revenue collection. The National Treasury aims at ultimately reducing the fiscal deficit to 3 percent of GDP in financial year 2022/23 in line with the EAC monetary convergence criteria.

Figure 2.7: Kenya's fiscal deficit and net lending, 2014/15-2018/19



Source: National Treasury, Various issues of Budget review & Outlook Paper

- Stock of public debt

Kenya's stock of public debt has been on an upward trend as a result of persistent fiscal deficit. The level of public debt increased from Kshs. 5.04 trillion in 2017 to Kshs. 5.8 trillion in 2018 as shown in Figure 2.8. External debt continues to constitute a large proportion of the debt stock. In 2018, external debt stood at Kshs. 3.02 trillion while domestic debt stock was Kshs. 2.78 trillion, each accounting for 52 percent and 48 percent of the total public debt respectively. Increase in external debt has been attributed to lower interest charge on external borrowing as compared to domestic borrowing.

Figure 2.8: Stock of public debt in Kenya, 2014/15-2017/18

Source: National Treasury, Various issues of Annual Debt Management Reports

i. Distribution of domestic credit

Credit to the central government rose by 2 percent in 2018 to account for a quarter of the total credit advanced by commercial banks as shown in Table 2.7. The persistent rise in provision of credit to the central government can be attributed to a rise in issuance of treasury bills and bonds necessitated by the need to plug a deficit in the fiscal balance. Credit issuance to the private sector continues to exhibit a downtrend accounting for 74 percent of domestic credit in 2018 from 75 percent in 2017. The trend comes on the back of interest cap law that limited adjusting of risk premium to Micro and Small Enterprises (MSE) bank in arriving at interest rate charged, making commercial banks shift their lending pattern towards creditors perceived to be less risky including the government. It is expected that credit advanced to the private will increase following a repeal of section 33b of the Banking Amendment Act of 2016 which removes a cap on interest rate charged by commercial banks.

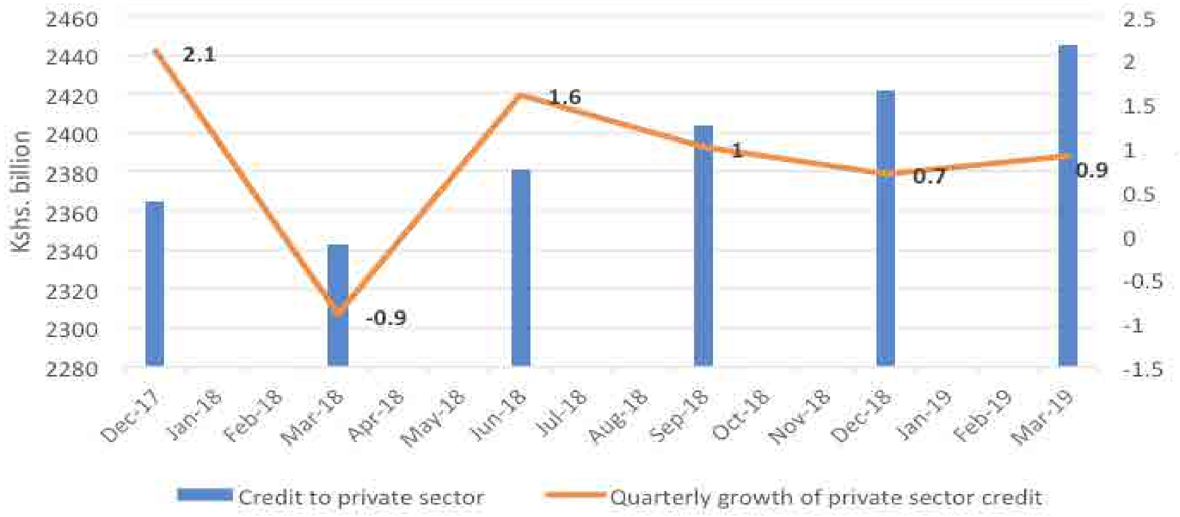
Table 2.7: Distribution of domestic credit, 2014-2018

	2014	2015	2016	2017	2018
Domestic credit (Kshs. million)	2,312,178	2,817,470	3,003,646	3,232,565	3,381,067
Central Government	16%	19%	20%	23%	25%
Other Public Sector	2%	3%	3%	3%	3%
Private Sector	82%	79%	78%	75%	74%

Source: CBK, Monthly Economic Indicator, October 2019

Credit advanced to the private sector dropped to Kshs. 2.34 trillion in March 2018 from Kshs. 2.36 trillion in December 2017 but picked up to peak at Kshs. 2.44 trillion in March 2019 as shown in Figure 2.9. On quarterly basis, growth of credit to the private sector registered an improvement from a negative growth of 0.9 percent in the first quarter of 2018 to a positive growth of 0.9 percent in the first quarter of 2019.

Figure 2.9: Growth of credit to the private sector, December 2017-March 2019



Source: CBK, Monthly Economic Indicator, October 2019

> The removal of the interest rate cap in November last year will facilitate the availability of more credit to businesses which will in turn increase the circulation of money
>
> H.E President Uhuru Kenyatta, CGH
> President and Commander in Chief of the Defense Forces of the Republic of Kenya
>
> **January 14, 2020**

j. Non-performing loans

Gross non-performing loans increased by 16 percent from Kshs. 264.6 billion in December 2017 to Kshs. 316.7 billion in December 2018 as shown in *Table 2.8*. The financial services sector registered the highest increase at 85 percent with non-performing loans increasing from Kshs. 4.4 billion in 2017 to Kshs. 30.4 billion in 2018. In nominal terms, trade, manufacturing and real estate sectors accounted for the highest value of gross non-performing loans in 2018 at Kshs. 81.6 billion, Kshs. 51.8 billion and Kshs. 47 billion respectively. This was attributed to slow uptake of commercial and housing units and delayed payments from both public and private sectors (CBK, 2018).

Table 2.8: Sectoral contribution of gross non-performing loans (Kshs. million)

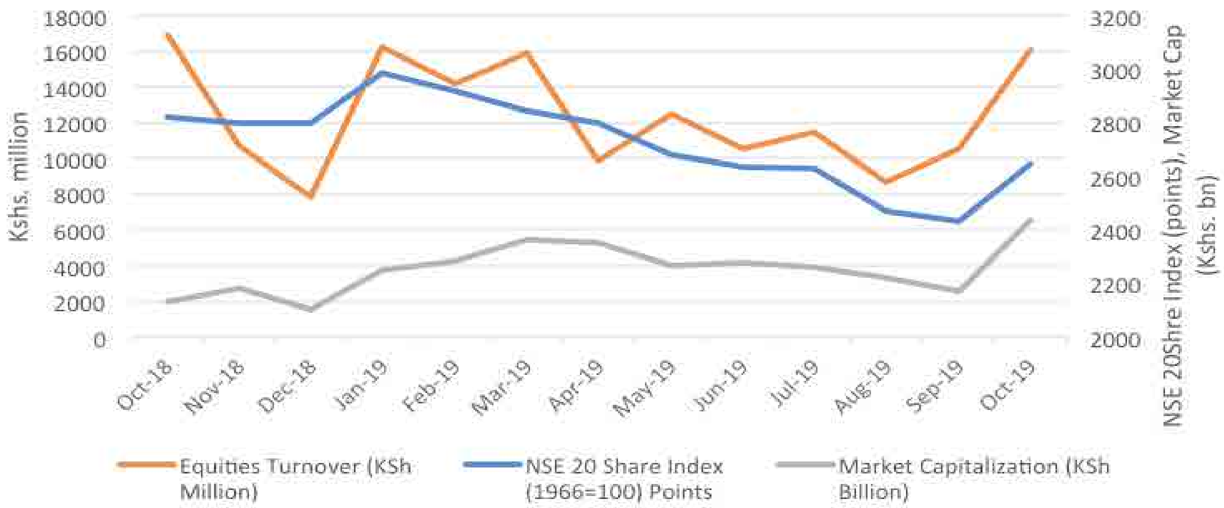
Economic Sector	December 2017	December 2018	% change
Personal/Household	43101	45,672	6%
Trade	78337	81,622	4.2 %
Real Estate	37799	47,033	24.4%
Manufacturing	39540	51,791	31%
Transport & Communication	17418	14,674	-15.8%
Energy & Water	6015	6,859	14%
Building & Construction	19230	23,692	23.2%
Agriculture	8973	6,049	-32.6%
Financial Services	4441	30,452	585.7%
Tourism, Restaurant & Hotels	7323	6,392	-12.7%
Mining & Quarrying	2439	2,478	1.6%
Total	**264617**	**316,712**	**19.7%**

Source: CBK, Various issues of Bank Annual Supervision Reports

k. Performance of the Nairobi Securities Exchange

In the 12 months running to October 2019, the Nairobi Securities Exchange (NSE) market recorded mixed performance with the NSE 20 Share Index and equities turnover exhibiting a general declining trend but recorded a slight increase in October 2019 as shown in ***Figure 2.10***. The NSE 20 share index shed 13.6 percent from 2820 points in October 2018 to 2435 points in October 2019 while equities turnover declined from Kshs. 16.89 billion to Kshs, 16.02 billion in the same period. The declining trend could be attributed to increased profit warnings by companies in 2019. On the other hand, market capitalization was on an upward trend with capitalization increasing from Kshs. 2132 billion in October 2018 to Kshs. 2435 billion in October 2019.

Figure 2.10: Equity market performance, October 2018- October 2019



Source: CBK, Monthly Economic Indicator October 2019

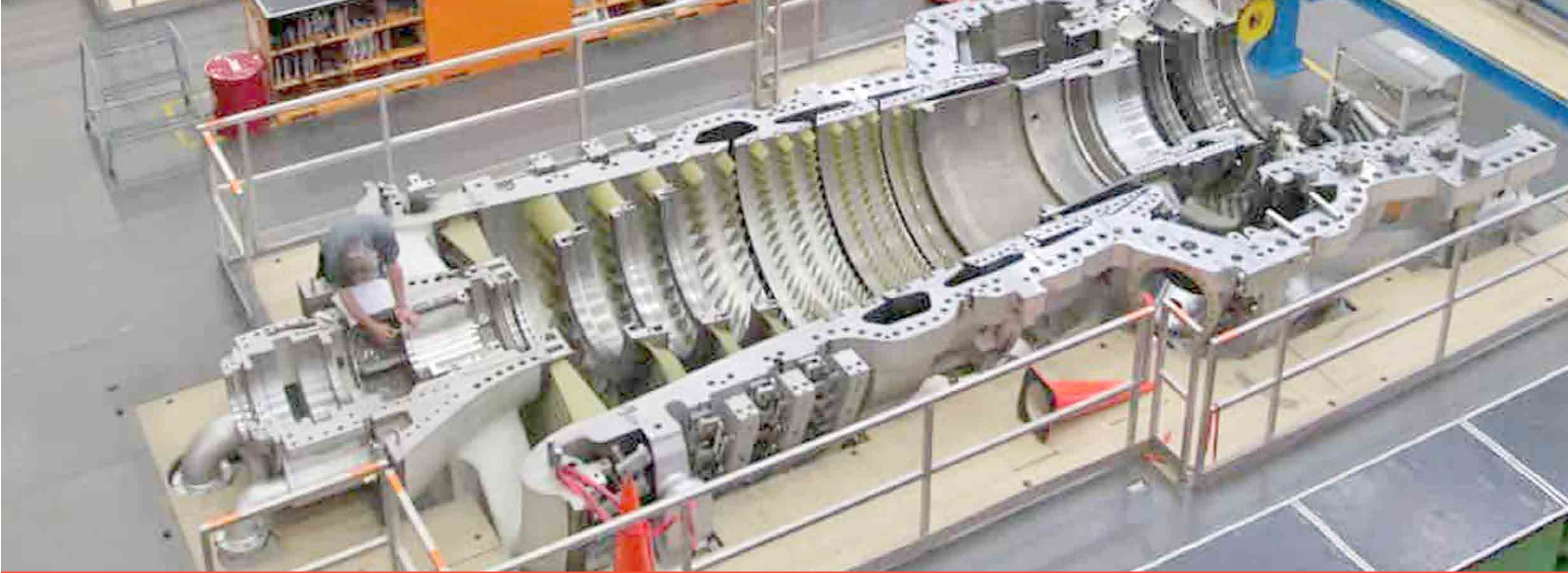
l. Ease of doing business

Kenya improved five places up in 2019 to rank at position 56 in the World Bank Ease of Doing Business Report from position 61 out of 190 countries in 2019 as shown in ***Table 2.9***. Kenya seems on course of ranking at position 45 by 2022 as per the third MTP. The country ranked third in Sub Saharan Africa after Mauritius (13th) and Rwanda (38th). Kenya attained a score of 73.2 out of 100. Kenya improved on all indicators of ease of doing business except registering property and trading across borders. Registering property was made difficult due to increased consent application and title search fees (World Bank, 2020).

Table 2.9: Ease of doing business indicators, 2018-2019

	2018	2019	change in score
Overall rank	**61/190**	**56/190**	**5**
Overall score (out of 100)	71	73.2	2.2
Starting a business	82.4	82.7	0.3
Dealing with construction permits	63.5	67.6	4.1
Getting electricity	76.8	80.1	3.3
Registering property	55.1	53.8	-1.3
Getting credit	90	95	5
Protecting minority investors	90	92	2
Paying taxes	68.2	72.8	4.6
Trading across borders	68.1	67.4	-0.7
Enforcing contracts	58.3	58.3	_
Resolving insolvency	57.4	62.4	5

Source: World Bank, Ease of Doing Business reports

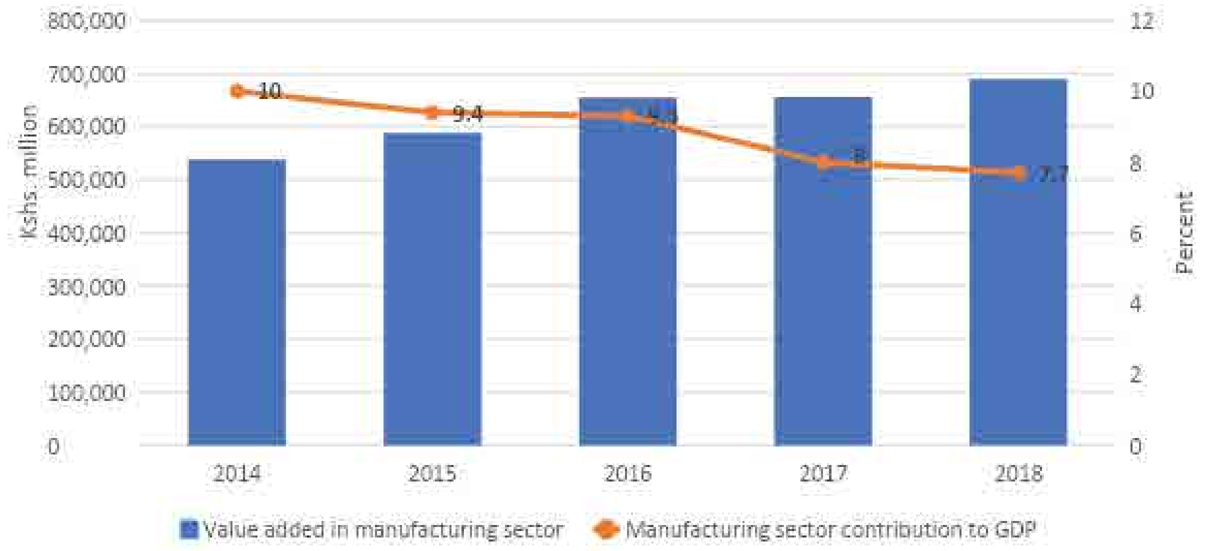


3. AN OVERVIEW OF MANUFACTURING SECTOR IN KENYA

a. Contribution to GDP

Manufacturing sector contribution to GDP reduced to 7.7 percent in 2018 from 8 percent in 2017 as shown in ***Figure 3.1***. However, the value added in the manufacturing sector increased from Kshs. 655.3 billion to Kshs. 689.3 billion over the same period. The increase in value addition was supported by recovery of agro-processing activities, beverage production following a decline in 2017 and increased manufacture of non food items (KNBS, 2019b). The declining trend in manufacturing sector's contribution to GDP calls for concerted efforts to spur the sector's growth for it to attain a 15 percent contribution of GDP by 2022 as envisioned by the 'Big Four Agenda'. To accelerate structural transformation of Kenya's economy towards an industrial economy, there is need to revitalize leather, textile and apparel industries as well as boost competitiveness of manufacturing industries.

Figure 3.1: Value added in manufacturing sector and contribution to GDP, 2014-2018



Source: KNBS, Economic Survey 2019

Value of output and intermediate consumption by the manufacturing sector grew by 7.2 percent and 8 percent respectively in 2018 as shown in ***Table 3.1***. Output increased from Kshs. 2.2 trillion in 2017 to Kshs. 2.4 trillion in 2018 while the value of intermediate consumption increased from Kshs. 1.6 trillion to Kshs. 1.7 trillion.

Table 3.1: Value of output, intermediate consumption and value added, 2014-2018 (Kshs. million)

	2014	2015	2016	2017	2018	% change (2017-2018)
Value of output	1,820,369	1,977,169	2,131,907	2,245,376	2,407,188	7.2%
Intermediate consumption	1,282,369	1,388,274	1,477,450	1,590,044	1,717,847	8%
Value added	537,999	588,896	654,456	655,332	689,341	5.2%

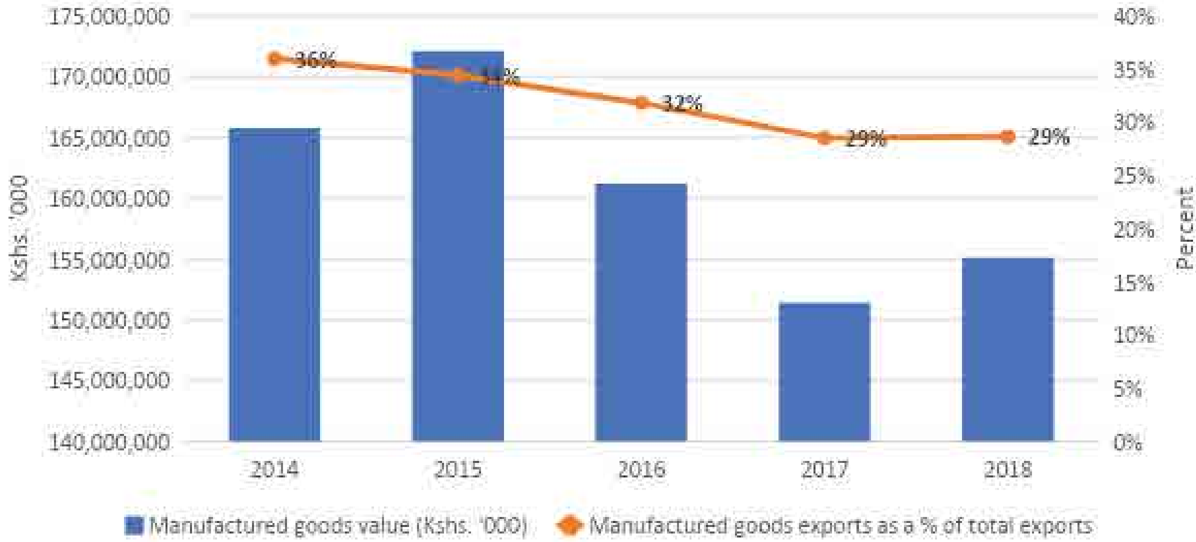
Source: KNBS, Economic Survey 2019

> *"To **earn more** value from our tea,*
> *we need to **add value** to it before exporting it"*
>
> H.E President Uhuru Kenyatta, CGH
> President and Commander in Chief of the Defense Forces of the Republic of Kenya
>
> **January 14, 2020**

b. Contribution to exports

Export value of Kenyan manufactured goods has been on a decline, dropping from Kshs. 172.1 billion in 2015 to Kshs. 151.4 billion in 2017 but picked up to Kshs. 155.1 billion in 2018 as shown in ***Figure 3.2***. On the same breadth, share of manufactured exports as a share of total Kenyan exports dropped from 36 percent in 2014 to 29 percent in 2017 and stagnated at 29 percent in 2018. The declining trend in Kenyan manufactured goods exports can be partly attributed to a drop in Kenyan export market share in EAC market.

Figure 3.2: Manufactured products exports for Kenya, 2014-2018

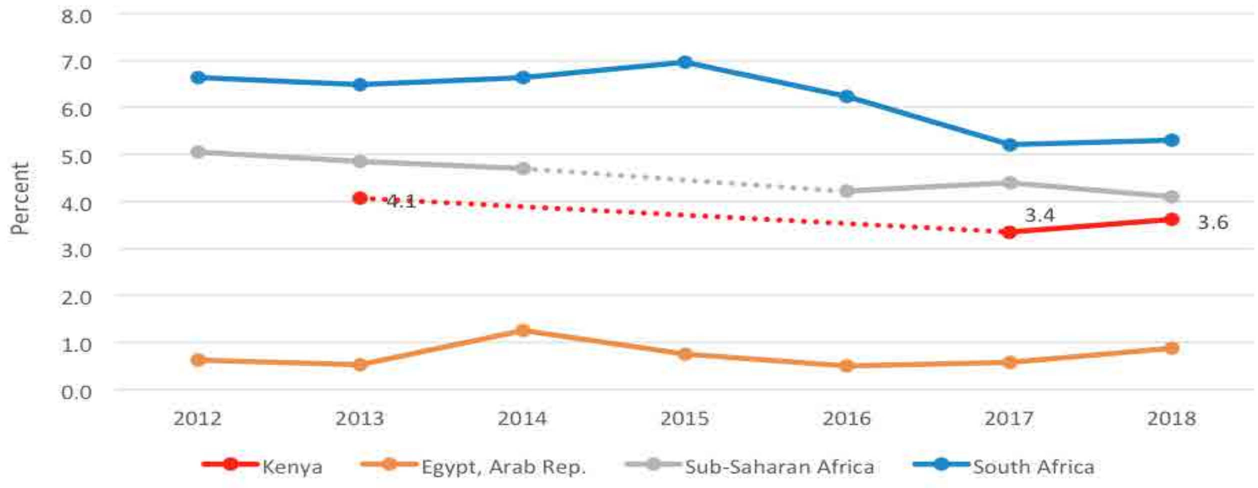


Source: KNBS, Statistical Abstract 2019

Kenya's export of high technology products as a share of manufactured exports marginally increased from 3.4 percent in 2017 to 3.6 percent in 2018 as shown in ***Figure 3.3***. However, this was lower than South Africa's 5.3 percent and Sub Saharan Africa's (SSA) average of 4.1 percent but higher than Egypt's 0.9 percent.

To achieve higher technology exports, Kenya needs to promote value addition in raw and unprocessed products to increase product complexity. Increasing product complexity is associated with increased level of income (Felipe et al., 2012).

Figure 3.3: High technology exports (% of manufactured export) for selected countries and SSA, 2012-2018



Source: World Bank, World Development Indicators 2019

c. Contribution to employment

Formal wage employment in the manufacturing sector recorded an overall growth of 1.9 percent in 2018 as shown in ***Table 3.2***. Wage employment in the private manufacturing sector rose from 276,900 in 2017 to 281,100 in 2018 while employees in the public manufacturing sector rose from 26,400 to 26,500 in the same period. The number of employees engaged in manufacturing in the informal sector grew by 5.4 percent 284,260 in 2017 to 299,620 in 2018.

Earnings per worker in the private manufacturing sector grew higher compared to the public manufacturing sector. In 2018, formal wage earnings grew by 9.5 percent and 3.5 percent in private and public manufacturing sectors respectively. However, annual wage per worker remained high in the public sector at Kshs. 912,927 compared to Kshs. 502,042 in the private sector.

Table 3.2: Wage employment and earnings in manufacturing sector, 2014-2018

	Sector	2014	2015	2016	2017	2018	% change 2017-2018
Formal wage employment '000	Private	261.3	269	274.3	276.9	281.1	1.5%
	Public	26.1	26.5	26.5	26.4	26.5	0.4%
Formal wage earnings employment (Kshs. Million)	Private	91469.7	105013.8	114079.8	126924	141116	11.2%
	Public	20813.6	22331.9	23339.5	23317.8	24199.9	3.8%
Formal average annual wage per person (Kshs.)	Private	350037.6	390406.1	415959.4	458321.7	502042	9.5%
	Public	796173.9	843573.8	881901.1	881745.9	912927	3.5%
Informal employment '000		2364.9	2545.3	2710.2	2842.6	2996.2	5.4%

Source: KNBS, Economic Survey 2019

d. Credit to the manufacturing sector

In 2018, Kshs. 335.7 billion credit was advanced to manufacturing ventures compared to Kshs. 315.4 billion in 2017 as shown in ***Table 3.3***. Commercial banks remain the largest lenders of manufacturing entities accounting for 99.6 percent of loans advanced to manufacturing projects at Kshs. 334.4 billion. In comparison, industrial finance institutions advanced Kshs. 1.34 billion in 2018, representing 0.4 percent of total credit to the manufacturing sector.

Table 3.3: Credit advanced by commercial banks and industrial finance institutions (Kshs. million)

Institution	2014	2015	2016	2017	2018
Industrial Development Bank Capital Ltd	74.2	252	129.8	200.1	551.8
Development Bank of Kenya	66.6	341	292.3	130.5	230
Kenya Industrial Estates Ltd	194.3	120.8	165.3	181	243.7
Industrial and Commercial Development Corporation	234	421.2	495.6	791	315
Sub Total	**569.1**	**1135**	**1083**	**1302.6**	**1340.5**
All other commercial banks	237355.8	289727.8	274725.4	314045.5	334388
TOTAL	**237924.9**	**290862.8**	**275808.3**	**315348.1**	**335728.5**
% of credit advanced by industrial financial institutions	0.24%	0.39%	0.39%	0.41%	0.40%
% of credit advanced by commercial banks	99.76%	99.61%	99.61%	99.59%	99.60%

Source: KNBS, Economic Survey 2019

Manufacturing projects that were approved for funding by industrial finance institutions dropped to 240 in 2018 from 293 in 2017 as shown in ***Table 3.4***. The reduction in approved projects is partly attributed to reduction in Micro and Small Enterprises (MSE's) funded by Kenya Industrial Estates.

Table 3.4: Number of manufacturing projects approved by financial institutions

Institution	2014	2015	2016	2017	2018
Industrial Development Bank Capital Ltd	3	5	3	3	8
Development Bank of Kenya	2	6	6	3	3
Kenya Industrial Estates Ltd	543	233	325	280	225
Industrial and Commercial Development Corporation	1	7	4	7	4
Sub Total	549	251	338	293	240
All other commercial banks	...	...	...	...	...
TOTAL	549	251	338	293	240

Source: KNBS, Economic Survey 2019

e. Performance of the Export Processing Zone

In 2018, an additional four enterprises joined the Export Processing Zone (EPZ) bringing the number of enterprises operating in EPZ to 135 as shown in ***Table 3.5***. EPZ activities increased with both capital investment and value of exports registering a positive growth of Kshs. 96.27 billion and Kshs. 72.3 billion respectively. Similarly, the number of employees rose to 57,581 in 2018 from 55,486 in 2017.

Table 3.5: Selected EPZ performance indicators, 2014-2018

	2014	2015	2016	2017	2018
Number of Enterprises	86	89	111	131	135
Number of Employees	46738	50899	53565	55486	57581
Capital Investment (KSh Million)	44218	48128	88977	95278	96271
Exports (KSh Million)	51377	60879	64151	60729	72295

Source: KNBS, Economic Survey 2019

f. African Growth and Opportunity Act (AGOA)

Kenya's trade balance with the US has been positive for the last three years in favour of Kenya. Total Kenyan exports to the US was valued at $ 644.8 million in 2018 while Kenya imported goods and services worth $ 253.3 million from the US as shown in ***Table 3.6***. Value of Kenyan manufactured exports to the US increased from $ 353.9 million in 2017 to $437.3 million in 2018. On the other hand, manufactured imports from the US dropped from $ 301.4 million to $ 253.3 million over the same period. However, manufactured goods constituted a higher value of US exports to Kenya at 76.4 percent compared to Kenya's export to US at 67.8 percent in 2018.

Table 3.6: Kenya-US trade in manufactured goods, 2016-2018 (value in $'000)

Product category	Exports			Imports		
	2016	2017	2018	2016	2017	2018
Chemicals & related products	5069	5136	12391	50421	45115	62926
Energy related products	…	…	…	6059	159	404
Textiles and Apparel	341050	339134	392006	12504	11808	12838
Footwear	144	107	127	1316	561	567
Machinery	308	285	694	33273	43041	19802
Transportation equipment	758	539	1312	106199	163840	115097
Electronic products	2664	1056	23254	63667	33749	36670
Miscellaneous manufactures	7644	7605	7524	7077	3095	4991
Sub Total (manufactured goods)	**357637**	**353862**	**437308**	**280516**	**301368**	**253295**
Total Kenya-US Trade	552563	572111	644842	377536	428341	331564
Share of manufactured goods in total Kenya-US trade	**64.7%**	**61.9%**	**67.8%**	**74.3%**	**70.4%**	**76.4%**

Source: US, Department of Commerce

Unless a Free Trade Area is negotiated, Kenya's top exports will not qualify for duty free market access under most favoured nation or General System of Preferences arrangements. There is however a strong indication that the US is intent on initiating talks with Kenya on a bilateral trade pact, going by the pronouncements made during the third meeting of the US-Kenya Trade and Investment Working Group, held in Washington between 3rd to 5th February 2020.

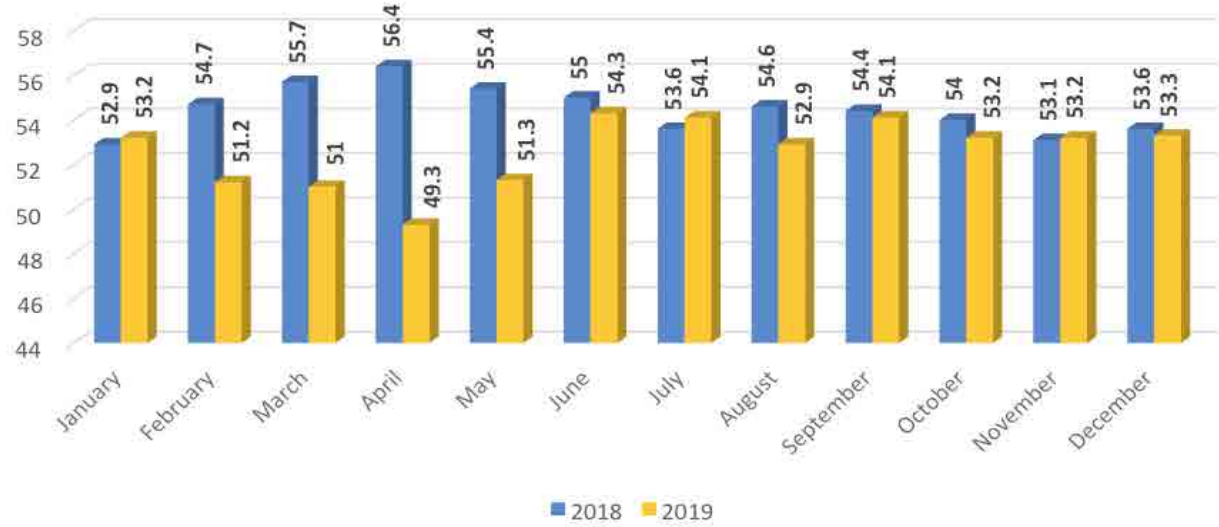
A challenge with this arrangement is that Kenya is in a Customs Union with her EAC partner states and therefore obliged to adhere to the Common External Tariff. A bilateral agreement with the US without involvement of other EAC Partner states is likely to cause jitters and further complicate deepening of integration efforts in the region.

Since the FTA will be implemented on a reciprocal basis, Kenya is likely to face stiff competition by American products domestically because the USA has a strong manufacturing sector and their products are likely to be more competitive than the locally produced commodities. Products like pharmaceuticals, plastics, industrial machinery, paper board and agro processed products are likely to give competition to locally produced products. This may consequently depress Kenya's exports because local production might fall. A clearer picture of the impact of the FTA will emerge once the tariff liberalization modalities are agreed upon by the two parties.

g. Purchasing Manager's Index

Purchasing Manager's Index (PMI) is an economic indicator that provides a foresight of an economy's performance base. The index is based on a survey of purchasing managers regarding sales, inventory, employment, pricing and supply delivery. The average headline PMI for 2019 was 52.6 compared to 54.5 in 2018. This signaled a weakening of the business environment in 2019. The PMI dipped to 49.3 in April 2019 (*Figure 3.4*) due to depressed agricultural output, reduced money circulation, retrenchment of staff and rise of input cost. However, the PMI improved to 53.3 in December, marking an improvement in the business environment by the end of the year.

Figure 3.4: Purchasing manager's index for Kenya, 2018-2019



Source: Markit Economics & Stanbic Kenya, 2019

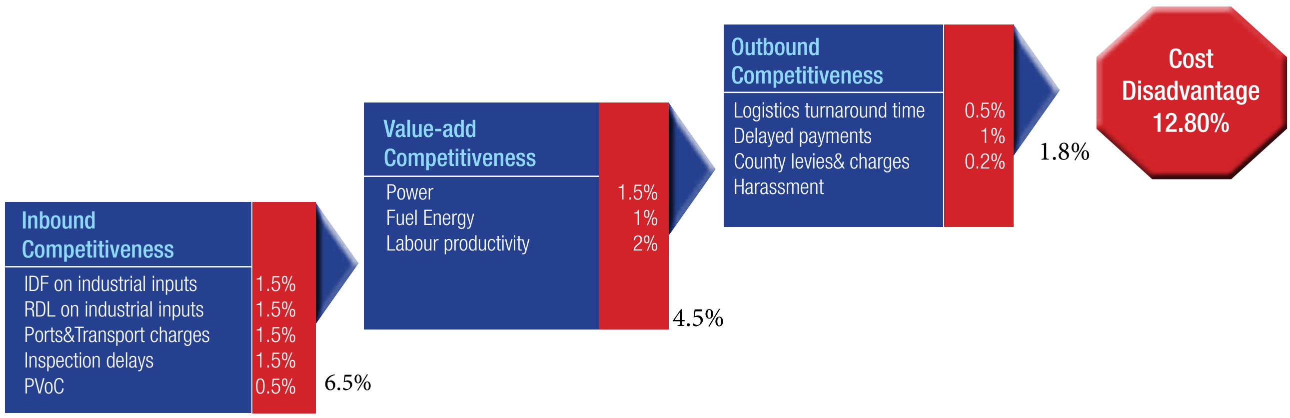
4. PILLARS TO ESTABLISH A COMPETITIVE MANUFACTURING-LED ECONOMY FOR JOB AND WEALTH CREATION

4.1 Pillar One: Competitiveness and level playing field for manufacturers in Kenya

It is a proven fact that trade is a powerful engine of economic growth and poverty reduction (Frankel and Romer, 1999). There is a bi-directional relationship between economic growth and trade: rich countries trade more and countries that trade more tend to become richer quickly (Farole et al., 2010). Kenya, like other developing countries has failed to achieve much success in growing exports despite enormous preferential market access opportunities in the region and the globe. Under the COMESA trade regime, Kenya faces stiff competition from imports from Egypt and with the African Continental Free Trade Area (AfCFTA) that is set to come into effect on 1st July 2020, Kenya can expect more competition from South African goods which are currently facing an EAC customs duty rate of 25 percent. Competition in the manufacturing realm has also increased due to the emergence of China and India as major producers of manufactured goods.

Clearly, preferential market access is a necessary but not sufficient condition to guarantee success in terms of exports. To effectively participate in global trade, Kenyan manufactured goods have to be competitive. According to the Organization for Economic Co-operation and Development (OECD), competitiveness can be defined as a measure of a country's advantage or disadvantage in selling its products in international markets. Aiginger et al., (2013) define three facets of competitiveness: price (cost), quality and outcome. Figure 4.1 provides a breakdown of inbound, value add and outbound costs that impede competitiveness of manufactured goods in the export market. In total, it amounts to about 12.8 percent cost disadvantage.

Figure 4.1: Factors that determine the global competitiveness of Kenyan exports



Source: KAM. 2019

a) Agenda one: Regulatory overreach

There are many good reasons to have regulations in that it enables the business environment to be dynamic, productive and ready to thrive. It is expected that regulations will benefit businesses by protecting the consumer, creating markets and allowing a competitive market for products. A good regulatory regime allows for progressive implementation of the desired outcomes. However, not all regulatory changes make it easier for entrepreneurs to do business.

Manufacturing sector is plagued with numerous regulations and over taxation. This comes at a time when it is being relied on as a key pillar in the Big Four Agenda. In the last few years, Kenya introduced a raft of regulations that, if not properly checked, may in the end stifle efficiency.

Another aspect is the fact that bodies mandated by law to regulate have overlapping functions spread across multiple government ministries, regulatory bodies, and institutions, each of which derives its mandates from different policies. This has often led to duplicative, unclear roles. To improve regulatory overreach, the following should be undertaken:

i Review the roles and mandate of regulatory agencies.

ii Establish a uniform high level government approval process for any regulatory agency imposing corrective measures touching on businesses.

iii Review and establish a uniform government communication process for regulatory agencies to the public touching on businesses regulatory operations.

iv Review corrective penalties on businesses with a view of putting in place options for compliance programs, voluntary disclosures and alternative dispute to support business to correct the problem and avoid stoppage of operations.

v Develop a clear chain of command by government regulators for approval and in multi-agency teams.

vi Conduct a legislative review of the processes of administrative actions; and

vii Amendment of the Fair Administrative Act of 2015; this is to incorporate the policy recommendations proposed herein such as reporting, communication among others.

b) Agenda two: Promote access to quality, affordable and reliable energy for manufacturing

The coming into force of Energy Act 2019 has ushered in new dimensions in the area of power generation in Kenya. The Energy Act 2019 has provided for net metering for individual power generation from renewable resources. The year 2019 also saw the gazettement of electricity rebate scheme guidelines that allows manufacturers connected to the grid to deduct up to 30% of electricity expenses from their respective taxable profit, subject to qualifications criteria as set out in the guidelines. The manufacturing sector also enjoys the benefits of Time-of-Use Tariff for the qualifying electricity consumption under the conditions and guidelines outlined in the Time-of-Use policy.

With an installed capacity of 2711 MW and peak demand of 1860 MW, electricity consumption reflects a capacity utilization factor of 70% with 30% potential energy not put to use.

This calls for deliberate efforts to spur accelerated consumption from the grid through unlocking of the unserved potential and opening up manufacturing space for new industries and economic zones. The government has set aside 1,000 acres of land in Naivasha for an SEZ. Infrastructure is under construction expected to be completed by mid-2021. In order to attract investments particularly textiles, steel and agro-processors, the government has gazette a reduced tariff of Ksh. 5.00 per KhW as indicated in Table 4.1. Any other heavy manufacturer in any other part of the country and connected to the 220 KV with a demand of 40 MW and above will enjoy a reduced tariff rate of Ksh. 7.99 per KhW.

Table 4.1: New electricity tariffs for industries

	Tariff
Peak	Ksh. 7.99 per KhW
Off-peak	Ksh. 3.995 per KhW
Demand charge	Ksh. 200 per KVA
Minimum load	40 MVS
Olkaria Kedong (SEZ)	Ksh. 5.00 per KhW

Source: Kenya Power, 2020

However, call for increased electricity consumption should come hand-in hand with call to address SDG Goal number 7 on sustainable and energy efficiency and conservation.

The following actions can be undertaken to increase access to quality, affordable and reliable energy for manufacturing sector:

- i Fast track the establishment of 400/220kV substation at the Coast to enhance the transfer of geothermal bulk power to the Coast.
- ii Fast track the completion of OlKaria Narok-Kisii power line to unlock unserved capacity in Western Kenya to increase consumption and reduce unit cost of electricity.
- iii Review time-of use policy (2018) to allow freezing of baseline reference period for time-of-use tariff.
- iv Bring SMEs into the Time-of-Use metering regime by installing SMART Meters to SMEs players.
- v Improve reliability of grid supply by establishing a 400/220kv substation at the Coast to evacuate bulk supply from Olkaria to Coast to stabilize coastal grid.
- vi Develop relevant regulations to guide operationalization of Energy Act (2019) regarding net metering and power wheeling markets.
- vii Consider USD9 cents/KwH for import substitution heavy industries such as metal, textile sectors & glass manufacturers.

c) Agenda three: Reduce transport and logistics costs

Transport and logistics is a critical element of competitiveness and economic performance of countries in this era of globalization. Most African countries are currently focusing on strategies to increase trade and enhance economic integration. For such strategies to succeed, a key component is a cost effective and efficient logistics framework that addresses the full spectrum of the value and production chain. A logistics framework includes hardware, which is the physical infrastructure needed to move goods effectively, and software, which is the associated services and processes needed to move and trade goods effectively. The impact of logistics costs on competitiveness, industrial productivity, and manufactured goods prices, cannot be understated. Kenya logistics costs range from 18% to 30% of product value and even higher for SMEs at about 40% — compared to benchmarks of around 8% of product value in OECD (SCEA, 2018).

The government has been undertaking a raft of measures in rail, road and maritime sectors in an effort to reduce the cost related to transport and logistics. To mention but a few, in 2017 the government successfully completed and launched phase one (Mombasa-Nairobi) Standard Gauge Railway (SGR) and later the SGR Phase 2 B (Nairobi-Naivasha). Commercialization of freight service for the Nairobi-Naivasha route is yet to commence. Development of vast roads networks across the country. Construction of Inland Container Depot Nairobi (ICDN) gate "A" access road kicked off in December, 2019 and is expected to be completed within a year. Further, in order to streamline operations and with an aim to improve efficiency at the port and ICDN, on 4th June 2019, the government issued a directive to reduce the number of government agencies operating at the port and inland container depot from approximately 27 to 4 frontline agencies (Kenya Bureau of Standards, Kenya Port Authority, Kenya Railways Corporation and KRA).

Despite these and many other government initiatives, the industry continue face a myriad of challenges ranging from delay of cargo from Mombasa to ICDN, lengthy clearance at the ICDN and port (this is despite the reduce of number of agencies operating at the port and ICDN to 4) and poor system interlink. This has led to a high cargo dwell time at ICDN with 40 percent of imports container staying for more than 21 days against the 4 days free clearance period. According to a 2019 report by Northern Corridor Secretariat, the average import cargo dwell time for all the cargo at ICDN is 11 days out of which 8.5 days was a result of overstayed containers (containers that had stayed for over 21 days) (NCTTCA, 2019). The compounding effect of this has resulted in huge payment of storage charges to Kenya Port Authority (KPA), custom warehouse rent to KRA and demurrage to shipping lines by importers majority of who are manufacturers. Some of the actions that can be undertaken to reduce transport and logistics costs in the country include the following:

- i Review SGR freight tariff rates to make them competitive and address last mile costs.
- ii Allow either road haulage or railage from Mombasa to Nairobi so that manufacturers have two options.
- iii Develop and implement a framework for pre-arrival clearance for bonafide manufacturers.

d) Agenda four: Sustain the fight against illicit trade

Illicit trade is an organized transnational crime that harms economic growth and job creation, challenges the rule of law, robs governments of needed revenue and threatens human rights and quality of life. It is a global problem that is not unique to Africa and Kenya in particular.

In the East African Community (EAC) region, OECD estimated that in 2008 the EAC lost over US$500 million in tax revenue annually due to counterfeiting (GoK, 2019). Unfortunately, there are no statistics on the economic size and impact of counterfeiting or illicit trade as a whole in Kenya.

The National Action Plan and Implementation Framework to Combat Illicit Trade in Kenya (2019-2022) proposes a national structure that is capable to marshal all the needed resources required to win the war against illicit trade in Kenya.

Despite numerous legislative and regulatory efforts to streamline commerce in Kenya, illicit trade continues to plague the country. There are those who choose not to play according to the rules, circumventing, infringing and violating laws, regulations, licensing regimes, taxation systems and embargoes. Sometimes, illicit trade in Kenya is treated as a victimless crime that law enforcers regard as petty.

Yet, illicit trade poses a serious socio-economic challenge to not only Kenya, but also to the East African region and the world at large. Illicit trade undermines the concept of a free and open market, which is fundamental to improving competitiveness, increasing investment, creating jobs and improving the economic situation of not only Kenya but also of the EAC partner states. Illicit trade undermines industries in the region, poses health risks to consumers, sabotages tourism, stunts innovation and breeds lawlessness.

In order to mitigate the negative impact brought by the various forms of illicit trade, the Government must put in place deliberate efforts to:

i Sustain the fight against illicit trade through a well-anchored Multi-Agency Team under the current National Action Plan and Implementation Framework to Combat Illicit Trade (2019-2022).

ii Enhance effective collaboration, cooperation and coordination of both enforcement initiatives and awareness creation against illicit trade at National and County Governments levels.

e) Agenda five: Address multiple charges, fees and levie

Article 202 of the Constitution provides for unconditional and conditional allocation of revenues to county governments from nationally raised revenues. Article 209 (3) empowers county governments to raise their own source revenue (OSR) through imposition of rates, taxes, fees and charges on services. Article 212 of the Constitution stipulates that Counties may borrow. In spite of this, equitable share is the major source of unconditional revenue to the counties and accounts for more than 90% of revenue to the Counties. However, there has been increased levies, rates, user fees and charge by county governments with no commensurate growth in the taxation base.

It is therefore timely to use the following bills as a complement in the ongoing discussions on OSR potential and tax gap study of Kenya's county governments by the National Treasury as well as counter mechanisms for multiple user fees, levies, rates and fees through:

1. **County Own Source Revenue Raising Bill 2018** aimed at regulating the process to be followed by county governments in the exercise of their power under Articles 209 and 210 of the Constitution to impose, vary or waiver taxes, fees, levies and other charges, and for connected purposes.
2. **County Licensing (Uniform Procedures) Bill 2019** meant to establish standards uniform procedures for licensing by county governments; and for connected purposes.
3. **County Planning (Roads, Pavements And Parking Bays) Bill 2018-**(Short title of Bill amended to: The County Roads, Walkways and Parking Bays Bill) whose aim is to provide a legislative framework for the planning, construction and maintenance of county roads, streets lanes, alleys, parking bays, drainage systems and pavements in each county. It also provides for the proper planning and placement of access ways to commercial buildings along major roads within counties.

4. **The County Outdoor Advertising Control Bill, 2018:** An Act of Parliament to provide for a legal framework for the regulation of outdoor advertisement in the counties; and for connected purposes.

The Commission on Revenue Allocation (CRA) has developed a third basis for revenue sharing, currently before the Parliament for consideration. The basis is as summarized below:

- Health service- 17%
- Agricultural services-10%
- Other County Services (County population index)-18 %
- Minimum Share (Basic Share Index)-20%
- Land-8%
- Roads- 4%
- Poverty level-14%
- Urban Service- 5%
- Fiscal effort-2%
- Fiscal prudence- 2%

In aggregate, the framework allocates 65% of the revenue for enhancing delivery of public services, 31% for promotion of balanced development, and 4% to incentivize revenue collection and fiscal prudence.

While the fiscal effort index is aimed at incentivizing capacity to raise revenue, there is risk of levying distortionary tax on businesses to meet revenue targets. This concern is anchored on past experience where this has been attributed to be a major reason why counties have introduced various levies, charges and fees, which are not linked to services including distribution fees, vehicle branding fees among others. To address this challenge, the following measures can be actioned:

i Review the fiscal effort parameter in the revenue sharing formula to discourage counties from developing no-service linked fees, charges and levies.

ii Expedite finalization of County Government Revenue Raising Regulation Process Bill (2018) that provides mechanisms for introducing new levies, fees and charges by the County Governments.

f) Agenda six: Enhance cash flow for manufacturers

Liquidity is an indispensable precondition for smooth day to day operation of any enterprise. Liquidity position of manufacturers has in the past been constrained by accumulation of VAT credits arising from withholding VAT (WHVAT) and VAT refund formula. The Withholding VAT system was re-introduced in 2014. Appointed WHVAT agents were required to withhold 6 percent of the tax payable at the time of paying for the supplies and remit the same directly to KRA. The government under the Finance Act 2019 reduced the WHVAT rate from 6% to 2%. This reduced WHVAT has already been operationalized by KRA. A legal mechanism was created under the Miscellaneous Amendment Act 2019 to allow refund/offset of VAT arising from excess credit out of VAT withheld by tax withholding agents.

The VAT Regulations 8(2), 2017 had introduced a formula to determine the amount due as a refund to a registered person who makes taxable supplies at both the general rate and zero rate. In 2019, the government through the Cabinet Secretary of the National Treasury and Planning published the VAT (Amendment) Regulations, 2019 under Legal Notice No. 86 in the Kenya Gazette Supplement No. 84 dated 17th June 2019. The Regulation amended the existing VAT formula to ensure full recovery of the portion of input tax relating to zero-rated supplies. This move supported reduction of perpetual status of credit excesses by manufacturers applying the formula. However, the revised formula is not working for manufacturers whose businesses are seasonal in nature because they have more input tax than output.

Arising from these challenges, there is already a backlog of refunds owed to manufacturers which to date remains unpaid. A tax refund is the excess amount of tax that a taxpayer has paid to the government arising from any of the taxes. It therefore be reimbursed upon confirmation of the same. The payment of refunds in the country has faced a lot of delays and affected the liquidity of businesses especially for manufacturers. The delays have been attributed to the process of reversing back the money once it has been paid into the national consolidated fund. The Commissioner General of KRA has no expropriation powers. The government has acknowledged the challenges of refunds and has over the years addressed backlogs of refunds owed to manufacturers. However, the issue continues to recur and there is a need for a sustainable solution. KRA receives about Kshs. 1.2 billion per month for VAT refunds which KRA has confirmed is inadequate to meet monthly requirements. According to KRA estimates as at 30th November 2019, VAT refunds backlog stood at about Kshs. 27.07 billion. In addition, tax refund situation has arisen as a result to administrative challenges in implementing reduced Import Declaration Fee (IDF) and Railway Development Levy (RDL) rates for manufacturers who have in some instances paid higher rates and therefore should be refunded. From the foregoing, some of the measures that can be instituted to ensure cash-flow to manufacturers should include the following:

i Amend the Public Finance Management (PFM) Act 2012 to establish a Tax Refund Fund.

ii Amend Miscellaneous Fees and Levies Act to allow refund of excess tax paid for the IDF and RDL.

iii Increase monthly budgetary allocation for VAT and excise tax refunds to about Ksh. 3 billion.

iv The National Treasury to make a one-off payment to clear all outstanding VAT and Excise Tax refunds.

v Amend the VAT Regulations 2017 and VAT Act 2013 to recognize refund/offset of tax arising from the VAT formula and facilitate outstanding payment through retrospective provisions.

g) Agenda seven: Lower the cost of imported industrial inputs

Manufacturing sector in Kenya is heavily dependent on imported inputs in the form of raw materials and intermediate inputs. The IDF and RDL have increased the cost of imported inputs and thereby undermining price competitiveness. The Finance Act 2019 provides for levying of IDF and RDL at 3.5 percent and 2 percent respectively on customs value of imports. It further provides for preferential levying of the IDF and RDL both at 1.5 percent on the customs value on imported raw materials and intermediate products by approved manufacturers. The two miscellaneous levies combined account of 3 percent of Cost, Insurance and Freight import value, the highest burden in the region. This results in an increased cost of imported raw materials and thus increases the unit cost of production. In 2018/2019 KRA collected Ksh. 48.09 billion of revenue (or 3 percent of total tax revenue) from RDL and IDF as shown in Table 4.1.

Table 4.2: RDL and IDF revenues realized in the FY 2018/19 (Ksh. mn)

	Actual 2018/19	Treasury target	Performance rate (%)	% of total revenue	Actual 2017/18	Growth over 2017/18 (%)
RDL	21,303	24,719	86.2	1.3	20,780	2.5
IDF	26,782	26,509	101.0	1.7	26,189	2.3
Total	**48,085**	**51,228**	**93.6**	**3.0**	**46,969**	**4.8**

Source: KRA, 2019 and KAM analysis

To improve the competitiveness of the manufacturing sector in Kenya in both the domestic and global market, the following should be undertaken:

i Reduce IDF rate from 1.5 percent to 0 percent for all industrial inputs (basic raw materials and intermediate inputs) and industrial machinery and spare parts for manufacturers.

ii Reduce RDL to 1 percent for all industrial inputs (basic raw materials and intermediate inputs) and industrial machinery and spare parts for manufacturers.

h) Agenda eight: Incentivize prompt payment culture

Both the National Government and various County Governments have in the past persistently lagged in payment for goods and services provided by the private sector, including SMEs. This has led to deterioration of financial positions of businesses and has limited liquidity in the economy.

Amid the persistent credit crunch in the country, manufacturers are owed a large sum of money by the government and it is exacerbating the liquidity crisis in the country. In addition, delay in disbursing VAT refunds has resulted in cash flow constraints to businesses.

Public Procurement and Asset Disposal Act Regulations are yet to be finalized. When complete, they are expected to operationalize the Public Procurement and Assets Act 2015 by coordinating the general process of procurement and disposal procedures by all the government procuring bodies. To ensure prompt payment of suppliers and standardize the procurement functions across government bodies, the following should be undertaken:

i The National Treasury's Committee constituted in 2019 to validate and clear outstanding refunds in 2 months' time to publish the report and implement it immediately.

ii Both the National and County Governments commit to pay suppliers of goods and services within 60 days.

iii Fast track finalization of Public Procurement and Asset Disposal Act Regulations to address payment issues and penalties on late payment by government.

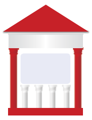
i) Agenda nine: Avail long term financing to manufacturers

In most developing economies, the banking sector is underdeveloped thus undermining the ability of banks to provide financial instruments with a long-term maturity. This is because there is a direct link between the size of an economy and the size of the banking sector. Merging of existing financial instruments is one of the ways that can be used to enhance their long-run sustainability. Lack of collateral required by banks and other financial institutions limits access to credits. In addition, pension funds hold huge financial assets that can be invested in sectors such as manufacturing. According to an end of year report by the Retirement Benefits Authority, aggregate financial assets holdings by pension schemes in Kenya as of December 2017 was approximately Kshs. 1.1 trillion in which about Ksh. 394.19 billion (36.49 percent) had been invested in government securities (RBA, 2018). Part of the pension fund could be invested in low risk manufacturing ventures. Some of the ways to avail long-term finance to manufacturers includes the following:

i Fast track the merger of the Tourism Finance Corporation, IDB Capital and the Industrial & Commercial Development Corporation to form the Kenya Development Bank Ltd with a capacity to provide long term industrial finance to manufacturers.

ii Fast track finalization of the Movable Property Security Right Act, 2017 that provides for creation of electronic collateral registry for use by Kenyan Banks.

iii Incentivize saving institutions and pension funds to invest in the manufacturing sector.



4.2 Pillar Two: Enhance Market Access.

The fact that there are no successful countries that undertake economic development while depending solely on their own domestic market to support their own economic growth means that many countries depend on external markets to sell their goods and services to support their economic growth and industrial development.

For African countries like Kenya, increased regional market access is visualized as one of the key strategies to spur industrial development and expansion through production for domestic and regional markets. Kenya's manufacturing sector plays a key role in stimulating industrial growth and economic development. It is important to note that when it comes to overcoming the limitations of small domestic markets and achieving economies of scale for industries, regional markets provide great opportunities for Kenya to realize her export potential. This calls for Kenya to play an active role in negotiations of the upcoming preferential trade agreements like Africa Continental Free Trade Area (AfCFTA), Tripartite Free Trade Area (TFTA) and consolidating EAC and COMESA markets. In addition, Kenya should aim at diversifying exports as well as enhancing local market access of goods and services.

a) Agenda one: Enhance local market access

Kenya's economic development blueprint, the Kenya Vision 2030, the Big Four Agenda and the Kenya Industrial Transformation Programme (KITP) all identify manufacturing for exports as a basis for spurring broad based economic growth and generating employment. Through enhanced productivity, it is envisioned that the economy will produce enough to satisfy the domestic market and surplus for sale in foreign markets. However, market access for locally manufactured products has been a challenge. To this end, the Government of Kenya through the Buy Kenya Build Kenya (BKBK) Strategy aims to address this issue by instituting policy measures to reverse this situation. Under the BKBK strategy, manufacturers of textile and apparel, leather and footwear have supplied government agencies with assorted products particularly boots and fabrics for uniforms. In turn, this has increased their capacity utilization and created more jobs.

However, domestic producers find difficulties in accessing procurement opportunities because: they are often unable to compete with foreign suppliers; are generally perceived to be producers of inferior products compared to imports from developed countries; are unable to compete both in terms of price and quality from foreign goods. To this end, relevant laws such as the Public Procurement and Disposal Act, 2015 and the Competition Act, 2012 are being reviewed to give the strategy a strong legal backing as efforts are being made to enhance productivity and the country's general export competitiveness.

In order to operationalize the strategy, a local content policy framework is required to provide a criteria for which goods to be classified as locally manufactured products in terms of local value threshold and the use of local factors of production. This needs to be accompanied by a list of locally available goods and their manufacturers, so that locally produced commodities are given preference over imported supplies. To ensure authenticity of the locally manufactured goods therefore, it will be important for the country to come up with a commodity certification scheme that only guarantees accredited commodities preferential treatment for government procurement opportunities. The commodity certification criteria then needs to be gazetted to validate these rules. In the 2019/2020 Budget Statement, the Cabinet Secretary for the National Treasury indicated that a catalogue of locally manufactured goods will be developed for prioritization in public procurement. Manufacturers have already submitted the list of products that can be procured locally for consideration by the Government. In addition, the Cabinet Secretary for the National Treasury also promised that effective 1st July, 2019, all Public Entities will be required to give exclusive preference in procurement of motor vehicles and motorcycles from firms that have assembly plants in Kenya.

Finally, the BKBK strategy needs to employ a mechanism for systematically measuring and appraising progress in attainment of results following its implementation. Digitization of procurement services would provide a good platform for ensuring compliance with the new requirements because of the transparency element and the ease with which monitoring of implementation can be carried out. A monitoring and evaluation framework would also be important in ensuring compliance with the directive to allocate 40% of all government procurement opportunities to local manufacturers. To this end, government entities need to develop a standard template on procurement activities, upon which data will be kept on the local entities that have benefitted from provisions of the PPDA. In addition to this, a list of all the activities aimed at supporting implementation of the strategy needs to be populated and a tracking methodology be developed to allow periodic evaluation of compliance.

In order to increase local market access for locally manufactured goods, the following actions are proposed:

i Government to adopt and gazette list of locally manufactured goods for exclusive local sourcing.

ii A clear Monitoring & Evaluation Framework to be established at Presidential Delivery Unit and respective Ministries to track sourcing of locally manufactured goods in line with 40% rule as per the Public Procurement and Disposal Act (2015).

iii Sector specific local content guidelines adopted and regulations formulated.

iv Certification for locally manufactured products validated and adopted for use.

b) Agenda two: Promote regional market access

An analysis of the regional markets reveals that Africa market accounts for about 35.3% of Kenya's total market in 2018 (KNBS, 2019). Total exports to Africa declined by 10.4% from Kshs. 241.3 billion in 2014 to Kshs. billion 216.2 in 2018. On the other hand, total imports from Africa grew from Kshs. 146.1 billion to Kshs. 205.9 billion in the same period. Subsequently, Kenya's trade deficit rose by 1.4% from 1.13 trillion in 2017 to Kshs. 1.15 trillion by the end of 2018.

Exports to the EAC market declined marginally from Ksh.131.6 billion in 2017 to Ksh. 129 billion in 2018 mainly due to non-tariff barriers imposed to Kenyan products, growing manufacturing sector by other partner states and increased competition of the Kenyan products by similar products from Asian countries especially China and India. Similarly, exports to the COMESA region declined from Ksh. 166.4 billion in 2017 to Ksh. billion 160 in 2018.

Kenya needs to close the export deficit gaps explained above by consolidating the traditional regional markets of EAC and COMESA and explore the emerging new markets of the TFTA composed of 26 member states and the AfCFTA composed of 55 member countries.

The ongoing EAC Common External Tariff (CET) review once completed is expected to tilt the Kenyan economy into more manufacturing activities. The EAC Partner States have already agreed on a four tariff band CET structure which will create tariff differentials between basic raw materials, secondary raw materials, intermediates not manufactured locally and those produced locally, finished products and sensitive products which will attract higher rates of EAC tariff above 30% or 35% once there is consensus by all partner states on upper rate of the CET for finished products.

The current EAC CET structure of 0% on raw materials and capital goods, 10% on intermediate products and 25% on finished products has been responsible for tilting economies of EAC partner states to more importing and trading economies rather than manufacturing economies. This is mainly due to the reason that the current CET structure is limited to 3 bands tariff structure, lumps some finished products like fabrics and finished garments under one band and does not encourage new investments in products value chains due to limited tariff differentials in the EAC CET tariff structure. Additionally, the sanctity of CET structure has been undermined by stays of applications or importation of industrial inputs under duty remission scheme. This will be cured once the CET review process is completed.

Currently, the EAC Partner States have agreed on a four band tariff structure: 0% for raw materials and capital goods, 10% for intermediate products not available in EAC, 25% for intermediate products available in EAC and either 30% or 35% for finished products

The criteria for assigning a rate above 25% include:

- Finished products of priority value chains under the EAC industrialization Policy & Strategy.
- Strategic goods (revenue contributing e.g. luxurious goods, unfair competitive goods, subsidized and dumped goods).
- Availability based on defined industry capacity to meet local/regional demand. Partner states are yet to agree on the thresholds of 30%, 60% and 80% as determinants of availability in terms of supply and demand.

In the Regional Task Force meeting held from 28th January 2020 to 1st February 2020 in Zanzibar, Partner states submitted a total of 1,294 products for consideration above the rate of 25% where there was consensus on 327 tariff lines for a rate above 25%, there was an agreement to maintain 566 tariff lines in their current CET rate and there was no consensus on 401 tariff lines.

It is expected that the new EAC CET structure will have an ideal tariff differentials based on the existing and visualized value chains to make Kenya and EAC economies to become net manufacturing export economies, create a level playing field for all industrial players in the EAC and shield them from unfair competition on manufactured products coming mainly from the Asian countries.

In regard to realizing potential in AfCFTA, Kenya is one of the 55 African Union (AU) member states have already signed the agreement establishing AfCFTA and Twenty nine (29) AU members have ratified the AfCFTA Trade Agreement and among 29 countries which have deposited their instruments of AfCFTA ratification.

There will be new market opportunities which will emerge in AfCFTA and in regional economic communities where Kenya has no functional trade agreements because of new value chains and economies of scale that will emerge with support of proper trade policy instruments like tariff liberalization and industry friendly preferential rules of origin. There is a need for Kenya to prioritize those countries with greater market opportunities.

In regard to regional market opportunities under the TFTA, EAC and South Africa Customs Union concluded their tariff liberalization offers in 2018. A key concern is the low number of the member states that have ratified. Only 6 countries which have ratified TFTA out of 26 countries which signed the TFTA agreement in 2015. These are Kenya, South Africa, Egypt, Uganda and Rwanda and Burundi. There is need therefore for Kenya to continue driving TFTA agenda by appealing to like-minded member states to ratify the TFTA Agreement and bring the numbers to a minimum of 14 member states in order to operationalize this trade regime.

The finalization of the Non-Tariff Barriers (NTB) Act 2017 in the EAC will also go a long way in coming up with clear procedures and timelines for settling trade disputes and giving private sector alternatives to deal with NTBs including going directly to East African Court of Justice. The revised EAC NTB Act 2017 is expected to be adopted by the EAC Sectoral Council of Ministers meeting in February 2020.

Some of the actions Government should take to promote regional market access for Kenya products include:

i Fast track finalization of the EAC CET review to promote value addition and industrialization.

ii Fast-track the finalization of the NTB Act 2017 amendments and development of requisite regulations.

iii Develop a national strategy to guide the implementation of the AfCFTA.

iv Advocate for ratification of TFTA by member states.

c) Agenda three: Diversify international market access

Kenya's export destination markets remain quite low with over 70% of Kenya's total exports being destined to about 12 countries globally mainly European Union (Netherlands, UK, Germany, Belgium and Italy), U.S.A, EAC and COMESA (DRC, Egypt) (KNBS, 2019b). Kenya's export base remains narrow with about 5 sub sectors i.e. tea, unroasted coffee, horticulture, clothing & apparel and tobacco accounting for over 56% of the total exports. Product and market diversification should be undertaken through export promotion and development of supply value chains that respond to regional and international market opportunities and end user requirements. The establishment of product development incubation centers linked to export markets, establishment of special and free economic zones, industrial parks, establishment of export financing institutions and instruments will greatly promote export markets diversification and value addition.

The National Export Promotion and Development Strategy (NEPDS) which was launched in 2018 aims to increase Kenya's exports share in the regional and global market through sustained production of goods and services for export. The strategies' specific objectives include:

- stimulate production of goods and services for target export markets.
- catalyze strengthening of export value chains to ensure coordinated and sustainable approach to export development for purposes of responding to regional as well as global market demand.
- catalyze development of business enabling environment in support of export development and facilitate diversification of export products and destination markets among others.

There are five strategic interventions of the manufacturing chapter of NEPDS which if well implemented will address Kenya's declining performance in exports and go a long way in addressing the diversification of Kenya's products and markets. These are:

a. To establish a database of manufacturing sector exporters in all focal sub-sectors and exporter support system for enhanced production and export of manufactured products exports.
b. To promote development of enabling business environment for target manufactured products to ensure their competitiveness in destination markets.
c. To promote production of manufactured products in all NEPDS focal sub-sectors for target export markets.
d. To promote destination market access of all target manufactured products in the identified destination markets.

There are also a number of countries trading with Kenya which have huge potential for Kenya's export products like apparel, textiles, processed tea, coffee, leather products, fish and other processed products. These include countries like India, China, Canada, Japan and US which have trade balance in their favour. State Department of Trade should initiate bilateral agreements with such countries. EAC market which is also the biggest market for Kenya's manufactured can be strategically secured if Kenya played an influential role in convincing Democratic Republic of Congo (DRC) and Somalia to join East African Community. Somalia has already secured membership of COMESA which comprise of 21 African Nations. By allowing DRC and Somalia into EAC bloc, the region will benefit from a larger consumer market consisting of over 235 million people up from 172 million people in the EAC.

In regard to Post AGOA after 2025, Kenya needs to come with clear strategies now that Kenya has agreed to establish a bilateral free trade agreement with USA. It will be important to improve the performance of other sectors identified under AGOA and come up with clear strategies on how Kenya will continue trading with USA now that a free trade area deal between USA and Kenya is already at an advanced stage. The key sectors of interest which are in the current AGOA strategy mainly apparel, home decorations and personal accessories, processed foods and specialty foods including nuts, flowers, coffee, tea, fresh fruits and vegetables will continue to be Kenya's key exports even after the expiry of AGOA.

The proposed actions to diversify international market access include:

i Implement the 5 strategic objectives of the manufacturing chapter of the National Export Development and Promotion Strategy.

ii Negotiate market access agreements with other countries with huge trade imbalance against Kenya such as India and Canada.

iii Kenya to lobby EAC partner states for the membership of DRC and Somalia.

iv Develop post-AGOA strategy to guide Kenya's National Trade Policy beyond 2025.

4.3 Pillar Three: Pro-industry policy and institutional framework.

There is no generally agreed definition among institutions or authors on the definition of industrial policy. The most commonly used definition of industrial policy is by Pack and Saggi (2006) who define it as “any type of selective intervention or government policy that attempts to alter the structure of production toward sectors that are expected to offer better prospects for economic growth than would occur in the absence of such intervention.” Sound industrial policies are necessary but not sufficient to realize the anticipated outcomes. They must be supported by a cohesive institutional framework. This is particularly important to Kenya which has a devolved system of government making coordination in implementing policies a critical element of governance.

a) Agenda one: Ensure predictable and stable industrial policies development through industry consultation

Industry consultations affords the manufacturing sector as well as the general public with balanced and objective information so as to enable them understand the issues and challenges as well as alternative market solutions or opportunities. This gives the manufacturers an opportunity to work directly with the government and the policy makers throughout the process to ensure predictability knowing that their concerns and aspirations are consistently understood and considered. It also increases the level of collaboration between the manufacturers and the government for sustained growth of the sector. To enhance industry consultation, the following actions should be attained:

i Finalize the Public Participation Bill (2018) that seeks to provide a national framework for public participation; to promote transparency and accountability in governance processes.

ii Develop compliance support mechanisms and corrective action plans collaboratively to avoid local brands being destroyed.

b) Agenda two: Ensure certainty and predictability of tax policies

Manufacturers play a critical role in an economy not only by creating jobs, producing export goods and therefore earning foreign exchange but are also major contributors of tax revenues. Manufacturing sector contributes 18.2 percent of total tax revenue in FY 2018/19 (GoK, 2019). Certainty and predictability of tax policies is an important prerequisite for businesses to flourish. Certainty and predictability are important elements of good governance. As such the government should always avoid Adhoc and arbitrary tax policies and this can be ensured through the following:

i Developing and implementing a National Taxation Policy that should amongst other things creates a 5 year cycle for reviewing tax rates and measures.

ii The government to engage stakeholders in advance before new tax proposals are embedded in the Finance Bill.

c) Agenda three: Ensure national policy coherence for the manufacturing sector

The OECD defines policy coherence as the systematic promotion of mutually reinforcing policy actions across government departments and agencies creating synergies towards achieving the agreed objectives. The importance of policy coherence in Kenya cannot be overemphasized with the onset of a devolved system of government comprising the National Government and 47 County Governments. In such a governance system, policy coordination between the two levels of Government is required if development objectives are to be achieved. This can be achieved through the following:

i Amending the Intergovernmental Relations Act 2012 to create an institutional framework that ensures better coordination of the two levels of Government in terms of policy, budgeting and implementation.

4.4 Pillar Four: Government driven SMEs development

The MSMEs are the bedrock of almost all economies of the world and are estimated to comprise more than 95% of registered businesses worldwide, accounts for more than 50% of jobs and more than 35% of GDP in emerging economies (World Bank, 2017). Micro, Small and Medium Enterprises (MSME's) contribute 33.8% of Kenya's GDP with the majority falling in the informal sector (KNBS, 2016). While there are about 7.41 million SMEs in Kenya, only 1.56 million are licensed whereas 5.85 million are unlicensed. The high concentration of SMEs in the informal sector is a course of concern in terms of quality of jobs that sector provides. While the informal sector acts as a buffer to employment, it is however characterized by low productivity which does not translate to decent jobs.

The high number of unlicensed SMEs is indicative that the time is ripe to create a conducive space for SMEs to formalize, be productive and competitive at local and regional levels. Boosting productivity of SMEs will in turn create more decent jobs. Key focus should be placed in expanding market access, improving corporate governance and ease of access to finance for SMEs to increase their productivity.

a) Agenda one: Enhance market access for SMEs

Despite the huge role that SMEs play in driving growth of the economy, their contribution to production is limited, and many of them specialize in low-value addition. 18.3% and 11.7% of SMEs surveyed in 2016 cited market access and lack of fair competition as challenges that constraints their growth respectively (KNBS, 2016). Essentially, the majority of SMEs are part of a huge informal economy that may seem to offer relief for their short-term gains but in the long run, minimizes their potential for growth, access to wider resources and markets – and ultimately limit their socio-economic impact. Low access to the market for goods and services hinders SMEs survival and expansion, therefore incorporating SME's in public procurement supply chain will provide them a much needed life line.

In addition, new business enterprises face a myriad of challenges that hinders their survival during the infancy stage. Business incubation services are therefore crucial in supporting SMEs development by nurturing them through their nascent stage.

To further complement Government efforts, KAM on 4th July 2019 launched the "Manufacturing SME Hub" which is geared towards preparing, nurturing and growing SMEs to take full advantage of available markets. About 65% of KAM Members are SMEs. SMEs receive a number of services to support their growth and development including: capacity building (incubation, acceleration and scale-up services) and policy, research and advocacy services.

Some of the key challenges cited by members facing SMEs are:

- Unfriendly policies and regulatory regime which are key hindrances to a conducive business environment.
- Low innovation on product development.
- Market Access.
- Access to affordable Finance.
- Fragmented and complex supply chain (raw materials management).
- Tedious and lengthy process in quality standards and certifications.
- Inadequate knowledge and skills.

To ease challenges of market access by SMEs, the following can be undertaken:

i Development a government subcontracting policy for SMEs to boost linkages between SMEs and large firms.

ii Introduce import substitution strategies in areas where SMEs have a comparative advantage in Kenya.

iii Establish incubation centers at the County levels to support the respective comparative economic advantages.

b) Agenda two: Enhanced governance for SMEs

Good governance is key to good performance and ought to be implemented no matter the size of the enterprise. Most SMEs start as family businesses and as they grow, they require a robust corporate governance structure for their long-run sustainability. To improve governance among SMEs, the following actions are proposed:

i Implementation of the Reviewed MSME Policy 2020 so as to spur SME Development.

ii Support institutions providing training focused on SMEs on corporate governance to promote ethical business practices, cash flow management, marketing, intellectual Property Management among others.

iii Low cost, Green Channel Regulatory Treatment of SMEs- Facilitation by relevant institutions e.g. registration & cost at Kenya Industrial Property Rights Institute, standard development at Kenya Bureau of Standards, etc.

iv Promote simplification of business startup procedures by reviewing various certifications and fees.

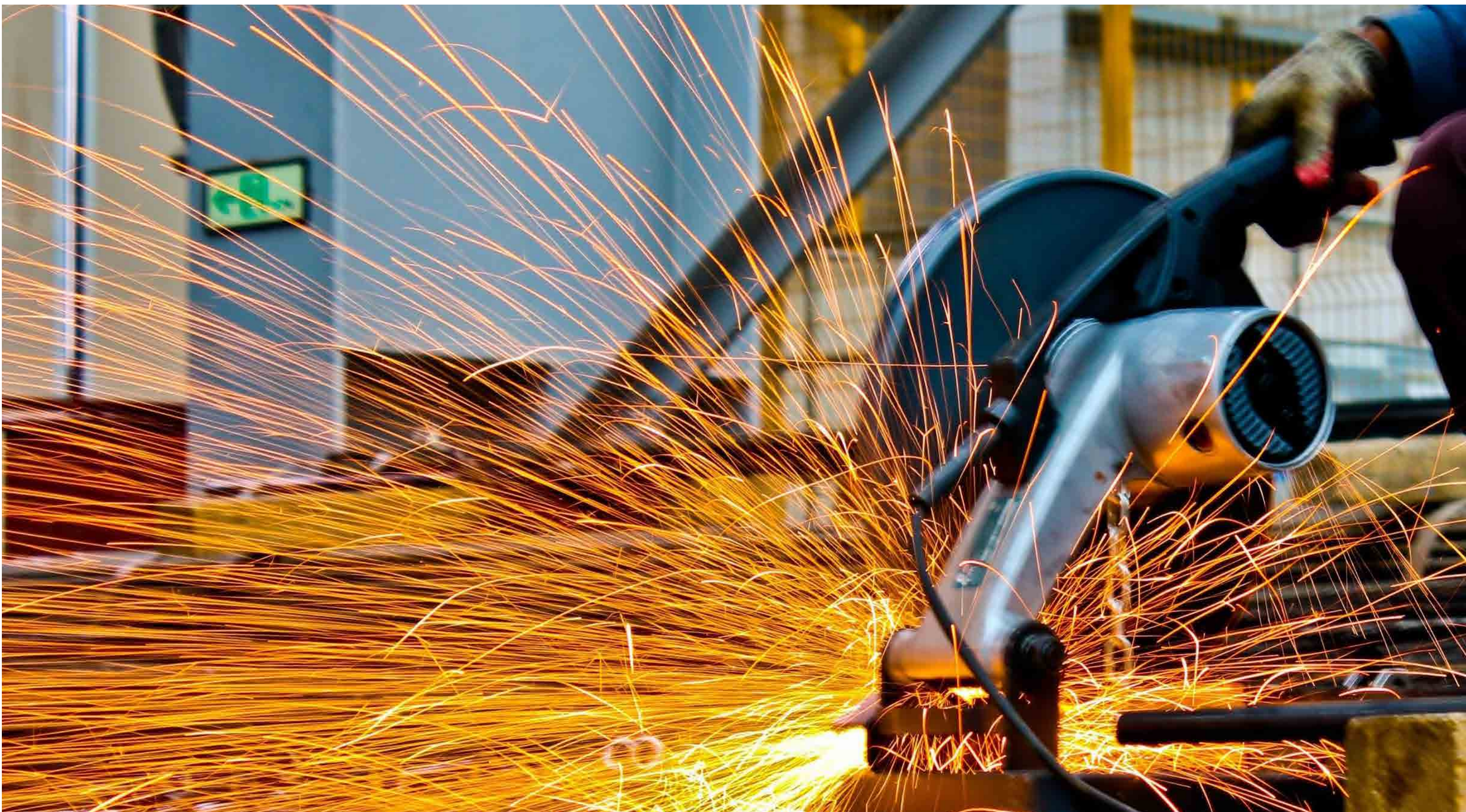
c) Agenda three: Enhance access to finance

According to the 2016 MSME survey by KNBS, SMEs cite lack of collateral for credit as an impediment to accessing finance. Globally, SMEs experience difficulty accessing finance because of cost thus affecting their growth and survival. To enhance access to finance for SMEs, the following actions are proposed:

i Implement a credit guarantee fund as proposed by the government in the 2019 budget.

ii Increase budgetary allocation to Kenya Industrial Research & Development Institute and Kenya Industrial Estates to support industrial research and national industrial incubation centers.

> *The (MSME) sector accounts for more than 80 percent of all businesses in Kenya, create around 75 percent of the jobs and are key contributors to broad-based and inclusive economic growth*
>
> *H.E President Uhuru Kenyatta, CGH President and Commander in Chief of the Defence Forces of the republic of Kenya*
>
> *January 14, 2020*



4.5 Pillar five: Industrial sustainability and resilience

Globally, manufacturing remains a critical engine of growth, driver of economic transformation and job creation. Sessional paper number 9 of 2012 on the national industrialization policy framework for Kenya aims to attain and sustain industrial sector annual growth rate of 15 percent (GoK, 2012). To accelerate industrial development in the country, appropriate measures ought to be put in place to sustain the sector's growth. The investment climate in which manufacturing entities operate is a crucial determining factor of manufacturing sector performance. Macroeconomic stability is essential in not only in influencing economic growth but also investor's participation in manufacturing ventures and price competitiveness of manufactured goods. The fast pace of technological change demands enhanced skills development for economies to proactively participate in the fourth industrial revolution.

a) Agenda one: Ensure stable macroeconomic environment

Persistent fiscal deficit and increasing public debt level pose a risk to the stability of the Kenyan economy. Rise in public debt stock subsequently leads to an increase in interest payments which constraints the fiscal space for development expenditure. The ongoing fiscal consolidation measures put in place need to be sustained. Macroeconomic stability of the economy can be enhanced through undertaking the following prudent fiscal policy stance:

i Reduce fiscal deficit to a target of 3 percent deficit to the GDP by 2023 in line with the EAC Monetary Union Protocol.

ii Enhance accuracy of revenue projections to allow realistic budget proposals.

iii Ensure that all public investments by both levels of Government are subject to economic appraisal to guarantee value for public finances.

b) Agenda two: Pro-industry skill development

Human capital is an engine of industrial and economic growth at large. An essential component of human capital is the skills stock of a worker that drives labour productivity. This is true for the industrial sector where technical skills are crucial in driving industrial productivity. However, development of the industrial sector in Kenya is partly hampered by skill mismatch between job seekers knowledge and industrial labour market needs. This calls for curriculum development that addresses the skills gap. In addition, rapid technological changes in the industry demand skills upgrade for effective participation in the fourth industrial revolution. Technical and Vocational Education Training (TVET) bridges the skills gap by equipping learners with the skills and competence that meet the demands of the labour market. Further, TVET promotes social equity and inclusion by imparting skills that provide an opportunity to obtain decent jobs in the industrial sector. In order to develop curriculum in line with the industry needs, the following actions are proposed:

i Operationalization of Sector Skill Advisory Committee that will guide in the development of occupation standards and ensure to influence curriculum development.

ii Skills development in relation to driving the SDG's (SDG 4: Quality Education, SDG 8: Decent work and economic growth: SDG 12 Responsible Consumption and Production, SDG 17: Partnerships).

c) Agenda three: Green growth and sustainable development

The SDG's calls for countries to undertake economic development while tackling climate change, environmental protection and ensuring that the needs of the present generation are met without compromising the ability of future generations to meet their own needs. Plastic wastes and use of fossil fuel to generate energy are some of the pollutants of the environment. Therefore, efforts need to be enhanced to better manage solid waste to reduce disposal of plastics as well as adopt usage of clean energy sources. Some of the actions that can be undertaken to promote green growth and sustainable development include:

i Gradually reduce dependency on thermal production to renewable energy production.

ii Localize and Implement SDGs Goal No, 12 on Responsible Production and Consumption under circular economy.

iii Implement KAM's Plastic Action Plan 2019.

d) Agenda four: Fight against corruption

Corruption remains to be an impediment to public service delivery and private sector development. In the public sector front, corruption is manifested through different forms including embezzlement of public funds. Strengthening public finance management to enhance transparency and accountability in public financial reporting is therefore one way of preventing corrupt practices in the public sector. The United Nations (UN) takes cognizance of the fact that the private sector has a role to play in achieving Sustainable Development Goals and thus developed a voluntary initiative for the private sector to commit to change their business operations in line with UN Global Compact principles. The UN Global Compact principles relate to human rights, anti-corruption, labour standards and environment. The principles aim to encourage the private sector to adopt socially responsible policies. To deter corruption in both public and private sector, the following actions should be pursued:

i Promote uptake of the Code of Ethics for Business in Kenya and compliance to the Bribery Act to foster transparency and accountability in industry.

ii Replace cash-based accounting system with accrual-based accounting system in public finance.

iii Synchronize the Integrated Financial Management System, Integrated Payroll and Personnel Database and iTax to reduce ghost worker and unplanned expenditures.

e) Agenda five: Fit-For-Purpose public service

Public employees play a key role in implementing the government's development agenda. In the face of a constrained fiscal space, efficiency in public service delivery is essential. A fit-for-purpose public service should be based on value driven culture and leadership; skilled and effective public officers; responsive and adaptive public employment systems. To ensure a fit-for-purpose public service, the following actions are proposed:

i A clear Monitoring & Evaluation Framework to be established at the Presidential Delivery Unit and respective ministries to track implementation of government policies and directives.

ii Finalize implementation of key recommendations in the 2013 Parastatal Taskforce report to reduce duplication and overlaps.

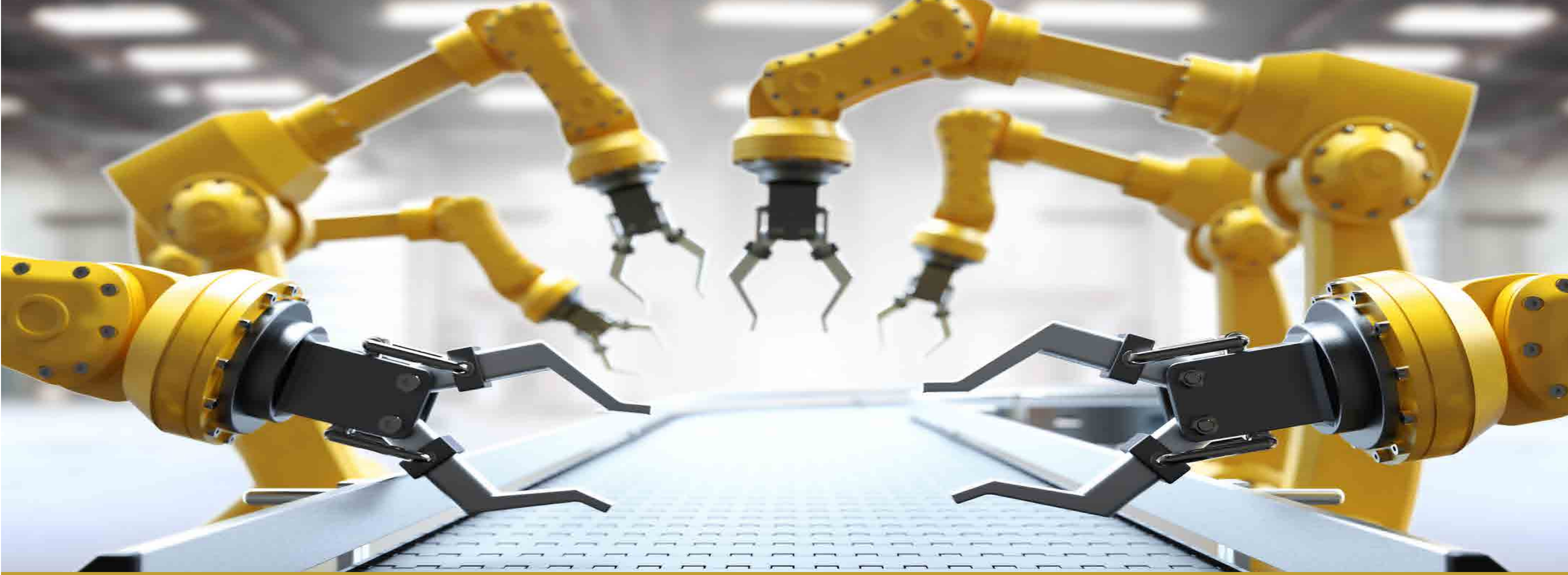
iii Strengthen performance contracting to enhance public service delivery.

f) Agenda six: Enhance digitalization in manufacturing industry

The fourth industrial revolution, which is premised on technological revolution, presents both opportunities and challenges to economies. The innovations that come along with the fourth industrial revolution are likely to disrupt the labour market as automation replaces physical labour. On the other hand, the revolution is likely to lower barriers between innovators and markets, increase fusion of technologies that lead to more opportunities for innovation and advance connectivity through the internet of things (Xu et al., 2018). To reap the benefits that come with the fourth industrial revolution, the following measures need to be undertaken:

i Develop a national policy framework and program to implement industry 4.0 with sectoral bias.

ii Support a well-embedded manufacturing ecosystem of start-ups and technology hubs.



5. CONCLUSION AND POLICY RECOMMENDATION

5.1 Conclusion

The MPA 2020 is based on the theme 'Establishing a competitive manufacturing-led economy for job and wealth creation'. This is in line with the government's Big Four Agenda, particularly increasing the contribution of manufacturing sector to GDP to 15 percent by 2022 to create more employment opportunities. Based on the review of previous economic performance, status of manufacturing sector, economic outlook and pillars to support establishment of a competitive manufacturing led economy, the following can be concluded;

i **Status of the Kenyan economy:** Kenyan economy expanded by 6.3 percent in 2018 compared to 4.9 percent in 2017. The growth was supported by increased agricultural output due to sufficient rains and growth in transport and service sectors. The economy is expected to experience a slowdown in growth to 5.6 percent in 2019 due to a notable reduction in cash crop production and low level of manufacturing activity and pick up to 6% in 2020.

ii **Stability of the macroeconomic environment:** Kenya's macroeconomic environment is stable with inflation remaining within 5± 2.5 percent target and exchange rate remaining relatively stable against major world currencies. However, the persistent fiscal deficit and rising public debt level may pose a risk in future outlook of Kenya's macroeconomic stability.

iii **Conducive business environment:** Kenya improved five places up in 2019 to rank at position 56 in the World Bank ease of doing business report from position 61 out of 190 countries in 2019. Kenya improved on all indicators of ease of doing business except registering property and trading across borders. Registering property was made difficult due to increased consent application and title search fees.

iv **Competitiveness and level playing field for manufacturers in Kenya:** The manufacturing sector's competitiveness has been on a declining trend. Kenya's Competitive Industrial Performance index dropped from 0.0136 in 2009 to 0.0093 in 2017. High transport and logistics cost, multiple charges, fees and levies are among the issues that negatively affect the competitiveness of Kenyan manufactured goods.

v **Market access for manufactured goods:** Kenya's regional market in both EAC and COMESA has been shrinking. Exports to the EAC market declined marginally from Kshs.131.6 billion in 2017 to Kshs. 129 billion in 2018 mainly due to non-tariff barriers imposed to Kenyan products, growing manufacturing sector by other partner states and increased competition by similar products from Asian economies. Similarly, exports to COMESA declined from Kshs. 166.4 billion in 2017 to Kshs billion 160 in 2018.

vi **Pro-industry policy and institutional framework:** Government policies play an important role in re-orienting the economy in a particular direction to achieve the desired outcomes. Government is comprised of many institutions that must act in sync while implementing Government policies. In Kenya, the issue of policy coherence has gained prominence with the adoption of a devolved system of Government. Policies have to be coordinated at both levels of Government to create requisite synergies and avoid any duplication.

vii **Government driven SME growth and development:** SME's contribute 33.8 percent of Kenya's GDP with the majority falling in the informal sector. Low access to finance and market for SME goods and services hinders SME's survival and expansion.

viii **Industrial Sustainability and Resilience:** Sessional paper number 9 of 2012 on the national industrialization policy framework for Kenya aims to attain and sustain industrial sector annual growth rate of 15 percent. However, manufacturing sector has been experiencing fluctuating annual growth, from a high of 3.6 percent in 2015 to a low of 0.5 percent in 2017 then recovered to 4.2 percent in 2018.

5.2 Policy recommendations

The following measures will assist in establishing a competitive manufacturing-led economy for job and wealth creation;

i **Status of the Kenyan economy:** The government should undertake pro poor policies that will promote broad based economic growth that translates to employment creation and poverty reduction. In addition, the government should aim at clearing all the pending bills as per the president's directive, so as to increase money circulation in the economy.

ii **Stability of the macroeconomic environment:** The National Treasury should sustain the ongoing fiscal consolidation measures and ensure that the fiscal deficit ultimately reduced to 3 percent of GDP in financial year 2022/23 in line with the EAC monetary convergence criteria.

iii **Conducive business environment:** The government should aim at reducing regulatory overreach that increases the cost of doing business; incentivize prompt payment culture to ease cash flow constraints faced by suppliers;

iv **Competitiveness and level playing field for manufacturers in Kenya:** To enhance competitiveness of Kenyan manufactured goods, the government should review SGR freight tariff rates to make them competitive and address last mile costs to reduce the transport and logistics cost; sustain the fight against illicit trade; address multiple charges, fees and levies imposed on business.

v **Market access for manufactured goods:** To enhance market access to regional markets, Kenya should push for the finalization of the NTB Act amendments and development of the regulations for EAC; advocate for ratification of TFTA by member states; fast track finalization of an optimal EAC CET structure review which can promote value addition and industrialization. In addition, the government should adopt and gazette list of locally manufactured goods for exclusive local sourcing to enhance access to local market access.

vi **Pro-industry policy and institutional framework:** Given that Kenya has a devolved system of Government, it goes without saying that cooperation is of utmost importance in designing policy interventions, planning and budgeting. Intergovernmental framework should be reviewed to seal any institutional gaps to foster closer collaboration in planning and development.

vii **Government driven SME growth and development:** The government should develop a subcontracting policy for SMEs to boost linkages between SMEs and large firms to enhance market access; promote simplification of business startup procedures by review various certifications and fees to facilitate formalization of informal SME's and implement a credit guarantee fund as proposed in the 2019 budget to enhance access to finance by SME's.

viii **Industrial Sustainability and Resilience:** To accelerate industrial development in the country and proactively participate in the fourth industrial revolution, the government should address the skills gap faced by the manufacturing sector by operationalizing Sector Skill Advisory Committee that will guide in the development of occupation standards and ensure to influence TVET curriculum development; promote circular economy to promote green growth in the sector and enhance digitalization in manufacturing industry.

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MPA 2020

Theme: Establishing a competitive manufacturing-led economy for job and wealth creation

S/N	PILLAR	AGENDA	ACTIONS
1)	**Competitiveness and level playing field**	**a) Regulatory overreach**	i Review the roles and mandate of regulatory agencies.
			ii Establish a uniform high level Government approval process for any regulatory agency imposing corrective measure touching on businesses.
			iii Review and establish a uniform government communication process for regulatory agencies to the public touching on businesses regulatory operations.
			iv Review corrective penalties on businesses with a view of putting in place options for compliance programs, voluntary disclosures and alternative dispute to support business to correct the problem and avoid stoppage of operations.
			v Develop a clear chain of command by Government regulators for approval and in multi-agency teams.
			vi Conduct a legislative review of the processes of administrative actions.
			vii Amendment of the Fair Administrative Act of 2015: This is to incorporate the policy recommendations proposed herein such as reporting, communication among others.
		b) Promote access to quality, affordable and reliable energy for manufacturing	i Fast track the establishment of 400/220kV substation at the Coast to enhance the transfer of geothermal bulk power to the Coast.
			ii Fast track the completion of Ol Karia Narok-Kisii power line to unlock unserved capacity in Western Kenya to increase consumption and reduce unit cost of electricity.
			iii Review time-of use policy (2018) to allow freezing of baseline reference period for time-of-use tariff.
			iv Bring SMEs into the Time-of-Use metering regime by installing SMART Meters to SMEs players.
			v Improve reliability of grid supply by establishing a 400/220kv substation at Coast to evacuate bulk supply from Ol karia to Coast to stabilize coastal grid.
			vi Develop relevant regulations to guide operationalization of Energy Act (2019) regarding net metering and power wheeling markets.
			vii Consider USD9 cents/KwH for import substitution heavy industries such as Metal, Textile Sectors & Glass Manufacturers.
		c) Reduce transport and logistics costs.	i Review SGR freight tariff rates to make them competitive and address last mile costs.
			ii Allow either road haulage or railage from Mombasa to Nairobi so that manufacturers have two (2) options.
			iii Develop and implement a framework for pre-arrival clearance for bonafide manufacturers.

S/N	PILLAR	AGENDA	ACTIONS
		d) Sustain the fight against illicit trade	i Sustain the fight against illicit trade through a well-anchored Multi-Agency Team under the current National Action Plan and Implementation Framework to Combat Illicit Trade (2019-2022). ii Enhance effective collaboration, cooperation and coordination of both enforcement initiatives and awareness creation against illicit trade at National and County Governments levels.
		e) Address multiple charges, fees and levies	i Review the fiscal effort parameter in the revenue sharing formula to discourage counties from developing no-service linked fees, charges and levies. ii Expedite finalization of County Government Revenue Raising Regulation Process Bill (2018) that provides mechanisms for introducing new levies, fees and charges by the County Governments.
		f) Enhanced cash flow for manufacturers	i Amend the Public Finance Management (PFM) Act 2012 to establish a Tax Refund Fund; ii Amend Miscellaneous Fees and Levies Act to allow refund of excess tax paid for the IDF and RDL; iii Increase monthly budgetary allocation for VAT and excise tax refunds to about Ksh. 3 billion; iv The National Treasury to make a one-off payment to clear all outstanding VAT and Excise Tax refunds; and v Amend the VAT Regulations 2017 and VAT Act 2013 to recognize refund/offset of tax arising from the VAT formula and facilitate outstanding payment through retrospective provisions.
		g) Lower the cost of imported industrial inputs	i Reduce Import Declaration Fee rate from 1.5 percent to 0 percent for all industrial inputs (basic raw materials and intermediate inputs) and industrial machinery and spare parts for manufacturers. ii Reduce Railway Development Levy to 1 percent for all industrial inputs (basic raw materials and intermediate inputs) and industrial machinery and spare parts for manufacturers.
		h) Incentivize prompt payment culture	i The National Treasury's Committee to validate and clear outstanding refunds in 2 months' time to publish the report and implement immediately. ii Both the National and County Governments to commit to pay suppliers of goods and services within 60 days. iii Fast track finalization of Public Procurement and Asset Disposal Act Regulations to address payment issues and penalties on late payment by Government.
		i) Avail long term financing to manufacturers	i Fast track the merger of the Tourism Finance Corporation, IDB Capital and the Industrial & Commercial Development Corporation (ICDC) to form the Kenya Development Bank (KDB) LTD with a capacity to provide long term Industrial Finance to manufacturers. ii Fast track finalization of the Movable Property Security Right Act, 2017 that provides for creation of electronic collateral registry for use by Kenyan Banks. iii Incentivize saving institutions and pension funds to invest in the manufacturing sector.

S/N	PILLAR	AGENDA	ACTIONS
2)	**Enhance market access**	**a) Enhance local market access**	i Government to adopt and gazette list of locally manufactured goods for exclusive local sourcing. ii A clear Monitoring & Evaluation Framework to be established at Presidential Delivery Unit and respective Ministries to track sourcing of locally manufactured goods in line with 40% according to the Public Procurement and Disposal Act (2015). iii Sector specific local content guidelines adopted and regulations formulated. iv Certification for locally manufactured products validated and adopted for use.
		b) Promote regional market access	i Fast track finalization of an optimal EAC Common External Tariff structure review which can promote value addition and industrialization. ii Fast track the finalization of the NTB Act amendments and development of the regulations. iii Develop a national strategy to guide the implementation of the AfCFTA. iv Advocate for ratification of TFTA by member states.
		c) Diversify international market access	i Implement the 5 strategic objectives of the manufacturing chapter of the National Export Development and Promotion Strategy. ii Negotiate market access agreements with other countries with huge trade imbalance against Kenya such as India and Canada. iii Kenya to lobby EAC partner states for the membership of DRC and Somalia. iv Develop post-AGOA strategy to guide Kenya's National Trade Policy beyond 2025.
3)	**Pro-industry policy and institutional framework**	**a) Ensure predictable and stable industrial policies development through industry consultation**	i Finalize the Public Participation Bill (2018) that seeks to provide a national framework for public participation; to promote transparency and accountability in governance processes. ii Develop compliance support mechanisms and corrective action plans collaboratively to avoid local brands being destroyed.
		b) Ensure certainty and predictability of tax policies	i Develop and implement a National Taxation Policy that should amongst other things creates a 5 year cycle for reviewing of tax rates and measures. ii The government to engage stakeholders in advance before new tax proposals are embedded in the Finance Bill.
		c) Ensure national policy coherence for the manufacturing sector	i Amend Intergovernmental Relations Act to create an institutional framework that ensures better coordination of the two levels of Government in terms of policy, budgeting and implementation.

S/N	PILLAR	AGENDA	ACTIONS
4)	Government driven SMEs development	a) Enhance market access for SMEs	i Development a government subcontracting policy for SMEs to boost linkages between SMEs and large firms. ii Introduce import substitution strategies on area where SMEs have comparative advantage in Kenya. iii Establish incubation centers at the county levels to support the respective comparative economic advantages.
		b) Enhanced governance	i Implementation of the Reviewed MSME Policy 2020 so as to spur SME development. ii Support institutions providing training focused on SMEs on corporate governance to promote ethical business practices, cash flow management, marketing, intellectual Property Management among others. iii Low cost, Green Channel Regulatory Treatment of SMEs- Facilitation by relevant institutions e.g. Registration & Cost at KIPI, standard development at KEBS, etc iv Promote simplification of business startup procedures by reviewing various certifications and fees.
		c) Enhance access to finance	i Implement credit guarantee fund as proposed by the government in the 2019 budget. ii Increase budgetary allocation to KIRDI and KIE to support industrial research and national industrial incubation centers.
5)	Industrial sustainability and resilience	a) Ensure stable macroeconomic environment	i Reduce Government budget deficit so as to attain a target of 3% deficit to the GDP by 2023 in line with the EAC Monetary Union Protocol. ii Enhance accuracy of revenue projections to allow realistic budget proposals. iii Ensure that all public investments by both levels of Government are subject to economic appraisal to guarantee value for public finances.
		b) Pro-industry skill development	i Operationalization of Sector Skill Advisory Committee that will guide in the development of occupation standards and ensure to influence curriculum development. ii Skills development in relation to driving the SDG's (SDG 4: Quality Education, SDG 8: Decent work and economic growth: SDG 12 Responsible Consumption and Production, SDG 17: Partnerships).
		c) Green growth and sustainable development	i Gradually reduce dependency on thermal production to renewable energy production. ii Localize and Implement SDGs Goal No. 12 on Responsible Production and Consumption under circular economy. iii Implement KAM's Plastic Action Plan 2019.

S/N	PILLAR	AGENDA	ACTIONS
		d) Fight against corruption	i Promote uptake of the Code of Ethics for Business In Kenya and compliance to the Bribery Act to foster transparency and accountability in industry. ii Replace cash-based accounting system with accrual-based accounting system in public finance. iii Synchronize the Integrated Financial Management System, Integrated Payroll and Personnel Database and iTax to reduce ghost worker and unplanned expenditures
		e) Fit-For-Purpose public service	i A clear Monitoring & Evaluation framework to be established at the Presidential Delivery Unit and respective Ministries to track implementation of government policies and directives. ii Finalize implementation of key recommendations in the 2013 Parastatal Taskforce report to reduce duplication and overlaps. iii Strengthen performance contracting to enhance public service delivery.
		f) Enhance digitalization in manufacturing industry	i Develop a national policy framework and program to implement industry 4.0 with sectoral bias. ii Support a well-embedded manufacturing ecosystem of start-ups and technology hubs.

Who we are

Established in 1959, Kenya Association of Manufacturers (KAM) is a representative of manufacturing and value-add industries in Kenya. The Association has grown into a dynamic, vibrant, credible Association that unites industrialists and offers a common voice for businesses.

We have been front and centre in driving fact-based policy advocacy towards the formation of industrial policies to strengthen and support the country's economic development. Through fact-based advocacy, KAM partners with Government and its associated agencies to ensure a dynamic and flourishing manufacturing sector in Kenya, to realize a double-digit contribution to GDP.

Our Vision

To be a World Class BMO that effectively delivers services to its members

Our Mission

To promote competitive and sustainable local manufacturing

A publication of the Kenya Association of Manufacturers (KAM)

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