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Improving public policy making for economic growth and poverty reduction

Rebased Economy and the Implications on Kenya's Participation in International Trade

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The Kenya National Bureau of Statistics completed the exercise of rebasing the economy in September 2014. In this exercise, the old base year of 2001 was replaced with a new one of 2009. The main aim of rebasing an economy is to provide more accurate statistics in terms of the size and structure of the economy. This is done by incorporating new economic activities that were previously not captured.

So what do some of the new statistics imply to Kenya in terms of participation in international trade?

One of the main outcomes of rebasing the economy is that the size of the economy increased by 25.3%. However, this does not mean that the productive capacity (ability to produce) of the economy in terms of export of goods and services has improved. Truth remains that Kenya, just like many other developing countries, has a very narrow export base. Kenyan exports are less diversified and are mainly agricultural products, with tea, horticulture and coffee accounting for almost 50% of total exports.

This narrow export base means that Kenya is not able to take advantage of trade opportunities that emerge in the world. To illustrate this point, despite the fact that Kenya can export about 4,600 products without tax and quantity restrictions to the United States (US) under the African Growth and Opportunity Act (AGOA), a staggering 91% of Kenyan exports to the US in 2013 comprised of only textiles. A similar trade picture persists between Kenya and the European Union (EU), where agricultural products account for more than 90% of total exports.

Under the new rebased figure for average income per person (per capita income) of US$ 1,269, Kenya is now classified as a lower middle-income country. But this classification does not affect its categorization as a developing country in terms of participation in international trade. Export of goods from least developed countries (LDCs) and developing countries are supposed to get preferential treatment (paying less or no taxes) in developed country markets. This trade regime is known as Generalized System of Preferences (GSP). The LDCs can export tax free everything apart from arms (everything but arms - EBA), while developing ones such as Kenya under standard GSP, which is less favourable for Kenya compared to EBA.

For instance, of the five countries in the East African Community (EAC), only Kenya is considered a developing country. Thus, given that trade negotiations between the EAC and the EU under the Economic Partnership Agreements (EPAs) are yet to be concluded, Kenya will experience tax increases for its exports to the EU while the rest of the EAC members will not.

Increased size of the economy and per capita incomes can attract foreign investors to Kenya.

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These two indicators show increased ability to buy goods and services. Depending on the nature of these investments, there may be a reduction of goods and services imported, or there may be growth in exports. This is likely to improve balance of payments position and enhance national debt sustainability.

Another macroeconomic variable that registered marked improvement after rebasing was public debt to GDP ratio. This ratio declined from 52.9% to 42.2%, suggesting that debt sustainability has improved. Debt to GDP ratio can also be interpreted to mean that the government can borrow more, since the ratio is below the 50% threshold. However, this does not necessarily imply that the government's ability to repay new debts has improved. There are other indicators that need to be taken into account in assessing debt sustainability profile. One such indicator is debt service to exports ratio, which one would expect to worsen since exports are growing at a lower rate compared to imports, and this is likely to make national debt less sustainable.

The rebased figures for export of goods and services, as was the case before, still indicate that imports are growing faster than exports. If this situation persists, it is likely to worsen the overall balance of payments position for Kenya. This increases the vulnerability of the economy to external shocks. An external shock such as oil crisis can be expected to have serious implications in the domestic economy through imported inflation. If imports continue to increase while exports decline, that can put pressure on the exchange rate to depreciate. Depreciation of the exchange rate would make Kenyan exports more expensive and, therefore, less competitive and imports cheaper.

Kenya has devised various approaches to grow exports in the past, for example manufacturing under bond; regional trade integration such as the EAC; establishment of the Export Processing Zones (EPZs); and export promotions strategies. Despite these efforts, Kenya has not made substantial progress in increasing and diversifying exports.

While it is true that rebasing of the economy has improved the accuracy of economic indicators, this does not imply that the level of economic activity has improved. Kenya has to devise means of growing and diversifying exports to exploit export opportunities in international trade. Constraints such as poor infrastructure (such as roads, railways, energy), and unfavourable legal and institutional frameworks must be addressed.

This calls for a change in strategy to address this problem. Kenya has to develop capacity in high technology exports by developing the manufacturing sector. One can think of electronic and software products, pharmaceuticals, and automobiles through reverse engineering strategy. It will be appropriate to have a champion for this approach. Diversification of exports basket does not imply neglect of traditional exports; there could be reserve potential in exports such as tea, horticulture and coffee that can be developed.

About KIPPRA Policy Briefs

KIPPRA Policy Briefs are aimed at a wide dissemination of the Institute's policy research findings. The findings are expected to stimulate discussion and also build capacity in the public policy making process in Kenya.

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