

Supporting Sustainable Development through Research and Capacity Building

Sustaining Kenya's Economic Development by Deepening and Expanding Economic Integration in the Region

Kenya aspires to transform from a lower middle income country to an upper middle income country by year 2030. This aspiration is valid and attainable because most of the economic fundamentals are largely in place to enable the country take off. The economy has remained resilient over time, with economic growth rate increasing from 5.7% in 2015 to 5.8% in 2016 largely due to a stable macroeconomic environment.

However, the difference between Kenya's total value of exports and total value of imports has been negative for some time. Due to the recent increase in government investments in infrastructure, public debt has increased to 52% of GDP, surpassing the East African Community (EAC) convergence criteria of 50% of GDP. But government borrowing plans are well anchored in the medium term debt management strategy to ensure debt sustainability.

The gap between savings and investment has remained high over time, meaning that there is need to boost the mobilization of domestic resources to enable access to adequate and appropriate financing of the required investment. Interest rates are stabilizing following the capping in 2016 and continued tight monetary policy stance adopted to maintain stability. However, the capping has partly resulted into decline in credit to the private sector as banks tighten lending requirements.

To attain the upper middle income category and sustain growth that creates employment opportunities, reduces poverty, and provides access to essential services by the poor, the economy needs to grow at an annual rate of 10%. This requires accelerated growth in private investments to reach investment/GDP ratio of 30% and over 9% growth in exports.

Besides, regional economic integration is an essential economic development channel to deliver sustainable development because it helps a country achieve economies of scale and enhance competitiveness, which are necessary for industrialization and structural transformation. In Africa, regional economic integration also enables countries to enhance domestic and foreign investments as well as promote peace and security. Furthermore, economic integration provides an opportunity to expand private investments in support of value addition and diversification of exports, thus placing the economy on a stable and sustainable growth path.

This brief is based on the Kenya Economic Report 2017 by KIPPRRA.

The report has been prepared at a time when the government is taking stock on implementation of Medium Term Plan (MTP) II, and kick-starting preparations for the second last medium term plan (MTP III) of Vision 2030. Worth noting is that Kenya is currently classified as a lower middle income country as per the World Bank classification and to attain the upper middle income category, significant growth of economic activity is required to move from per capita income of US\$ 1,361 in 2015 to upper middle income per capita of US\$ 4,000.

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To achieve the upper middle income category, at the minimum, the economy needs to be on Vision 2030 growth trajectory. This means achieving a projected growth of 8.0% in 2018 and 9.5% by 2020, facilitated by accelerated growth in investments, both public and private, and a boost in exports.

Increased private investments will support job creation and, therefore, the need for continued efforts to create an enabling business environment. Growth in public investments can be achieved without compromising fiscal sustainability by rationalizing current expenditures and strengthening debt management. Public investments are critical in addressing the infrastructure gaps, thus solidifying the foundations for strong economic growth.

In exploiting the opportunities provided through deepened regional integration, there is need to:

1. Diversify export products and destinations. The bulk of Kenya exports are raw materials and primary products, and the major export destination is EAC, which accounts for more than 20% of total exports while trade outside EAC and COMESA is minimal at about 5%. To secure her market share for manufactured exports in the EAC region, Kenya needs to expand the range of manufactured goods as the region is experiencing expansion of manufacturing activity, and competition from cheap imports from India and China. In addition, there is need to strengthen bilateral engagements with other regional/African countries outside EAC to diversify destinations, and exploit potential value chains.
2. Establish a National Trade Commission to implement the National Trade Policy, and coordinate bilateral, regional and multilateral trade issues. The Commission should be empowered to investigate and analyse the impact of dumped and subsidized imports on domestic industries, and appropriately advice on protections, safeguard measures and compensations.
3. Enhance development of domestic infrastructure, and ensure it feeds into regional connectivity to facilitate growth in Intra-regional trade. In addition, there is need to design a package of infrastructure services that strongly position Kenya as a regional hub. This includes enhancing competitiveness of Mombasa port, with allied inland services, further reducing the energy tariffs and ensuring appropriate power mix, and expediting the implementation of Konza Technology City.
4. Continue promoting peace and security in the region to build a stable foundation for economic development. Furthermore, joint security surveillance and development of a tourism master plan will go a long way in boosting tourism. Kenya also needs to take full advantage of the opportunities opened up by the ranking of JKIA as a Category One airport.
5. Enhance productivity of agriculture to promote agriculture trade, and address the challenge of food security in the region. Key among the major hindrances to cross-border agriculture trade includes low value addition, poor infrastructure, weak marketing systems, and non-tariff barriers. Therefore, there is need to invest in road network to facilitate movement of agricultural produce within and across the region. Cross-border traders should also be sensitized on the EAC simplified rules of origin to enhance cross-border trading. Mechanisms for effective resolution of reported non-tariff barriers should be put in place.
6. Enhance competitiveness of manufactured products by progressively diversifying into medium and high technology sub-sectors, and reducing further the cost of power while also enhancing the quantity and quality of power supply. Measures to curb counterfeit products also need to be put in place as a priority.
7. Promote labour market participation, taking advantage of opportunities in the region, by establishing a joint labour portal to create awareness and encourage labour mobility. This will support efforts to exploit the youthful population potential.

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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