The KENYA INSTITUTE for PUBLIC POLICY RESEARCH and ANALYSIS

Policy Brief

Thinking Policy Together

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Enhancing Productivity for Sustained Inclusive Growth

1. Overview

This Policy Brief is based on the Kenya Economic Report (KER) 2024, themed "Enhancing Productivity for Sustained Inclusive Growth." The country has recorded a recovery in economic performance since 2020, when the economy contracted by 0.3 percent. However, this recovery momentum was disrupted by weaker global growth due to the Russia-Ukraine war, tightened international financial markets, and a prolonged drought. Various policy measures have been employed to enhance the countries productivity growth including the provision of subsidized fertilizer, investment in research and development, improvement of infrastructure and skills development. The analysis in the report covered interplay between a conducive policy environment, infrastructure development, human capital investment, technology and innovation, market access, and sustainable resource management is crucial.

The Report offers an in-depth analysis that highlight how the country can unlock its full potential and propel the economy toward sustained and inclusive growth through enhanced productivity. The Report covers a review of recent macroeconomic performance and discusses the medium-term prospects. For a more comprehensive understanding, it provides sectoral analysis covering manufacturing, agriculture, and the digitalization of the informal sector. With the 10-year milestone of devolution, the report analyses productivity at the county level to strengthen devolution. It also explores international engagements and collaborations to leverage to boost productivity. Additionally, the report considers key enablers of productivity, including trade for efficient distribution, skills development, and the public sector role in providing essential services. The report concludes by providing key recommendations that can be considered to drive productivity growth in the country.

2. Macroeconomic Performance and Medium term macroeconomic prospects

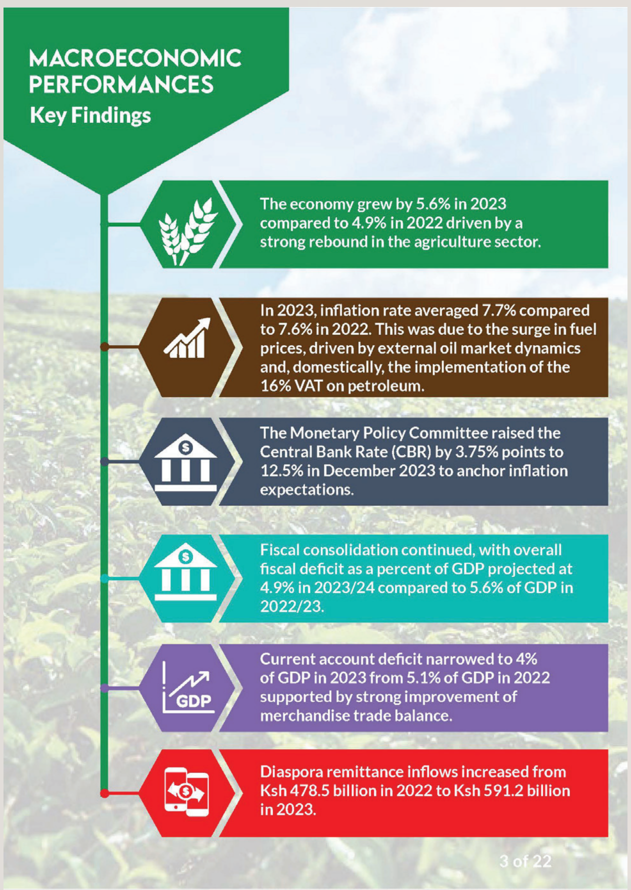
The economy grew by 5.6 per cent in 2023 compared to 4.9 in 2022. This was driven by a strong rebound in the agriculture sector expanding by 6.5 per cent supported by favourable weather conditions and timely implementation of fertilizer and seed subsidy programme. The average growth rate for the services sector was 7.0 per cent, supported by resilient performance of accommodation and food services that grew by 33.6 per cent. Industrial activities moderated, with manufacturing growth rate declining from 2.6 per cent in 2022 to 2.0 per cent in 2023. Total new jobs generated in the economy increased to 848,200 jobs compared to 816,600 new jobs generated in 2022.

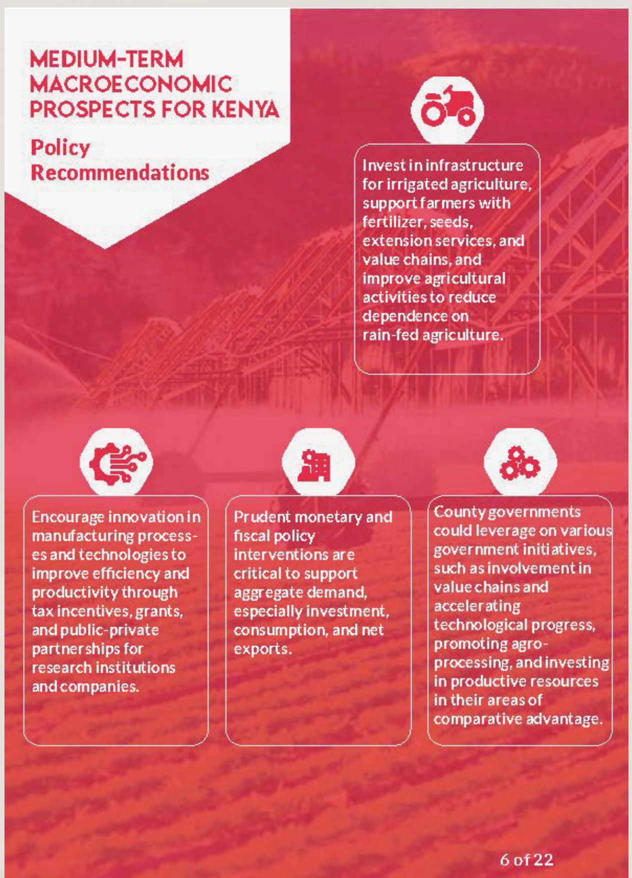
In 2023, inflation rate averaged 7.7 per cent compared to 7.6 per cent in 2022. This was due to surge in fuel prices, driven by external oil market dynamics and, domestically, the implementation of the 16 per cent VAT on petroleum. The Monetary Policy Committee raised the Central Bank Rate (CBR) by 3.75 percentage points to 12.5 per cent in December 2023 to anchor inflation expectations. Further, in August 2023, the Central Bank of Kenya introduced an interest rate corridor spanning ±2.5 per cent around the CBR as a measure to reduce market volatility and uncertainty while improving the transmission of CBR to other interest rates.

Total revenue declined from 17.3 per cent of GDP in 2021/22 to 16.5 per cent of GDP in 2022/23. Similarly, total expenditure declined from 23.9 per cent of GDP in 2021/22 to 22.6 per cent of GDP in 2022/23. Fiscal consolidation continued, and the overall fiscal deficit to GDP was projected at 4.9 per cent in 2023/24 compared to 5.6 per cent in 2022/23. Pending bills amounted to Ksh 539.9 billion or 3.3 per cent of GDP comprising of Ksh 448.4 billion and Ksh 91.5 billion owed by state corporations, ministries/state departments and other government agencies, and county government, respectively.

Public debt increased, attributed to depreciation in exchange rate that put pressure on external debt payments. As a percentage of GDP, public debt increased to 70.8 per cent in 2022/23 from 57.4 per cent in 2016/17. Total debt service as a share of revenue increased from 47.9 per cent in 2021/2022 to 58.8 per cent in 2022/23.

Current account deficit narrowed t0 4.0 per cent of GDP in 2023 from 5.1 per cent of GDP in 2022 supported by a strong improvement in merchandise trade balance. Trade balance as a per cent of GDP narrowed from a deficit of 10.3 per cent in 2022 to a deficit of 9.3 per cent of GDP in 2023.





Diaspora remittance inflows increased from Ksh 478.5 billion in 2022 to Ksh 591.2 billion in 2023. Foreign exchange reserves remained at the margins of the statutory requirement of at least four months of import cover amounting to US$ 7,341 million (3.9 months of import cover) in December 2023.

Savings and investments fell short of MTPIII targets that projected savings and investments ratios to GDP to rise from 12.4 per cent and 17.5 per cent respectively in 2017 to 21.2 per cent and 25.4 per cent in 2022. The share of domestic savings to GDP displayed volatility, reaching a high of 16.5 per cent in 2021 and demonstrating a need for sustained growth to support savings. Investment activity exceeded 19 per cent of GDP between 2018 and 2021 but slowed down to 18.6 and 17.2 per cent in 2022 and 2023, respectively.

At the baseline, growth is projected at 6.2 per cent in 2024, and 6.7 per cent in the medium-term, with inflation remaining within the government policy target range. Growth is likely to accelerate to 6.1 per cent in 2024, and 6.6 per cent in the medium-term by taking advantage of such opportunities as favourable weather and growing economic partnerships. Should downside risks materialize, which include poor rainfall patterns and heightened debt vulnerabilities, growth could be depressed to 5.3 per cent in 2024, and 5.6 per cent in the medium-term.

On average, counties are expected to grow their GCP at 5.9 per cent and maintain a growth rate of 6.5 per cent in the medium-term. The outlook assumes favourable weather conditions to spur agricultural activities. For the ASAL counties, investing in livestock production and leveraging on programmes such as the livestock off-take programme during natural disasters, creative economy, and wholesale and retail, and transport and storage services, could be areas to focus on.

To drive productivity growth and sustain overall economic recovery in the medium term:

1. Increase investment in infrastructure to support irrigated agriculture, coupled with subsidizing inputs such as fertilizer, early maturing seeds, and strengthen extension services for farmers. Further, support development of value chains in agriculture and take measures to promote agro-processing and agri-business to improve agricultural activities.

2. Encourage innovations in manufacturing processes and technologies to improve efficiency and productivity by providing tax incentives while promoting public-private partnerships for research institutions and companies. Have in place trade policies that are favourable for the manufacturing sector, including reducing tariffs on imports of machinery, equipment, and raw materials to lower production costs and improve productivity.

3. Prudent monetary and fiscal policy interventions are critical to support aggregate demand, especially investment, consumption, and net exports. This means leveraging on upside risks such as good weather and strategic partnerships, while mitigating potential risks such as poor rainfall patterns and debt vulnerabilities. Policy makers need to be more vigilant of the likely risks and mitigate against them.

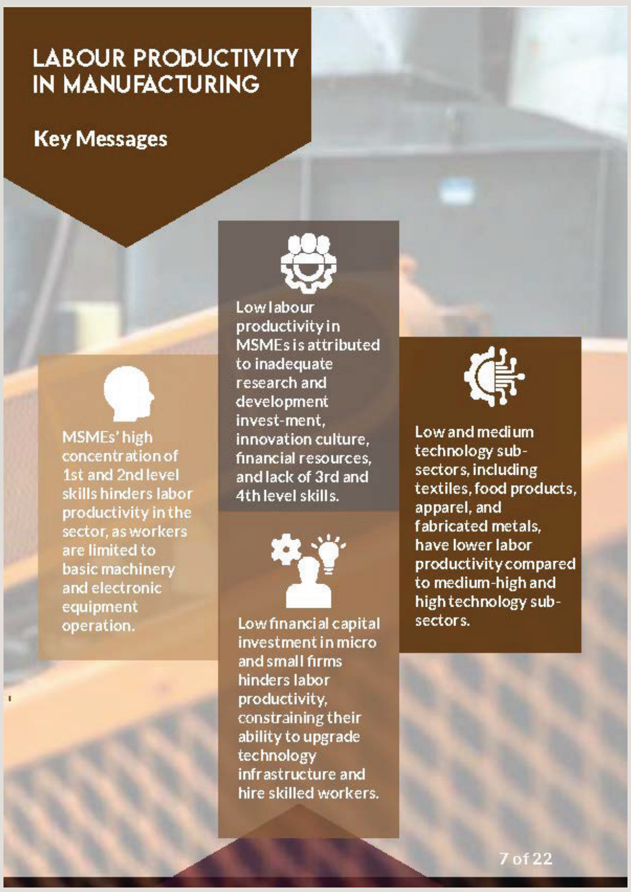
4. County governments have potential to strengthen growth rate by leveraging on various government initiatives, such as involvement in value chains and accelerating technological progress, promoting agro-processing, and investing in productive resources in their areas of comparative advantage.

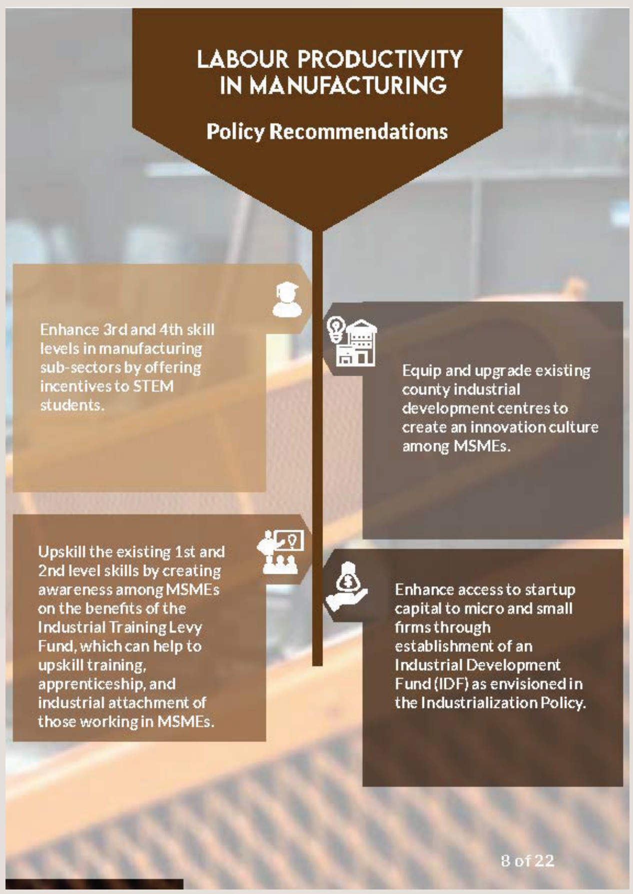
3. Labour Productivity in Manufacturing

The manufacturing sector plays a pivotal in its contribution to gross domestic product, employment creation, and spurring innovation. That said, the sector contribution has remained below the targeted 15 per cent of GDP. The contribution of food manufacturing to total manufacturing gross value added increased from 15.0 per cent during the ERS period to 28.4 per cent in the third medium term plan (2018-2022). Non-food manufacturing declined during the same period. At the firm level, micro and small enterprises form the largest proportion (97 per cent) of firms operating in the sector. Despite this, medium and large industries that constitute less than 5 per cent of the total number of enterprises contribute over 60 per cent to the manufacturing sector GDP, whereas micro and small firms contribute to an estimated 20 per cent to sector GDP. Manufacturing is concentrated in low technology, labour-intensive industries, including agro-processing and fabricated metals. Moreover, firms rely on the 1st and 2nd level skills, where most employees have basic skills and which limit workers to perform basic operation of machinery, thus constraining labour productivity. There is low investment in research for development and innovation which limits the ability of micro and small manufacturers to upgrade their technology and hire skilled workers, resulting in low labour productivity.

To enhance labour productivity in manufacturing:

1. Equip and upgrade existing county industrial development centres to create an innovation culture among MSMEs. Also provide fiscal incentives to firms that engage in Industrial Innovation Programme aimed at commercialization of viable innovations.
2. Enhance access to startup capital to micro and small firms through establishment of an Industrial Development Fund (IDF) as envisioned in the Industrialization Policy. Specifically, the policy recommends an IDF with a minimum of Ksh 10 billion for long term financing of manufacturing enterprises, including MSMEs.
3. Upskill the existing 1st and 2nd level skills by creating awareness among MSMEs on the benefits of Industrial Training levy Fund, which can be used to upskill training, apprenticeship, and industrial attachment. Further, there is need to develop 3rd and 4th skills by providing





scholarships and bursaries to educational programmes necessary to drive the design of innovative technologies.

4. Enhancing Productivity through trade

Trade is essential to sustain economic growth through promoting specialization, attracting foreign investment, fostering technological advancements, and expanding market access for domestic producers. At the domestic level, the wholesale and retail trade sectors are critical drivers of overall productivity, economic growth, and development. However, the growing informal trade sector, an unconducive business environment and gaps in market infrastructure constrain the sector's contribution to overall productivity. At the international level, trade facilitation measures like the Single Customs Territory (SCT) have significantly reduced import and export costs and time. Trade agreements such as the African Continental Free Trade Area (AfCFTA) and the African Growth and Opportunity Act (AGOA) have played a pivotal role in enhancing export growth. Even greater benefits can be realized when tariffs and Non-Tariff Measures (NTMs) are eliminated and harmonized across agreements.

To enhance the role of trade in driving productivity growth:

1 Enhance and modernize market infrastructure to create a dynamic and supportive business environment. Prioritize the completion of tier one markets with sufficient budget allocation, build adequate warehouses for aggregation and storage, and improve rural road transport infrastructure to overcome logistical constraints and enhance market accessibility for small farmers. Additionally, strengthen market linkages for MSMEs by removing regulatory barriers, improving market information systems, promoting e-commerce and digital trade, and increasing market access.

2 Empower MSMEs to strengthen their procurement practices by providing training (capacity building), legal support, and standardized contract templates. Additionally, facilitate collaboration among businesses in the sector to further enhance their contracting capabilities.

3 Enhance the quality and competitiveness of MSME products in the export market through providing training in entrepreneurship culture and value addition, support the certification of MSME products, assist in registering Industrial Property Rights (IPRs) for MSMEs, and

facilitate their access to local, regional, and international markets through market development initiatives such as funding their participation in regional and continental trade fares.

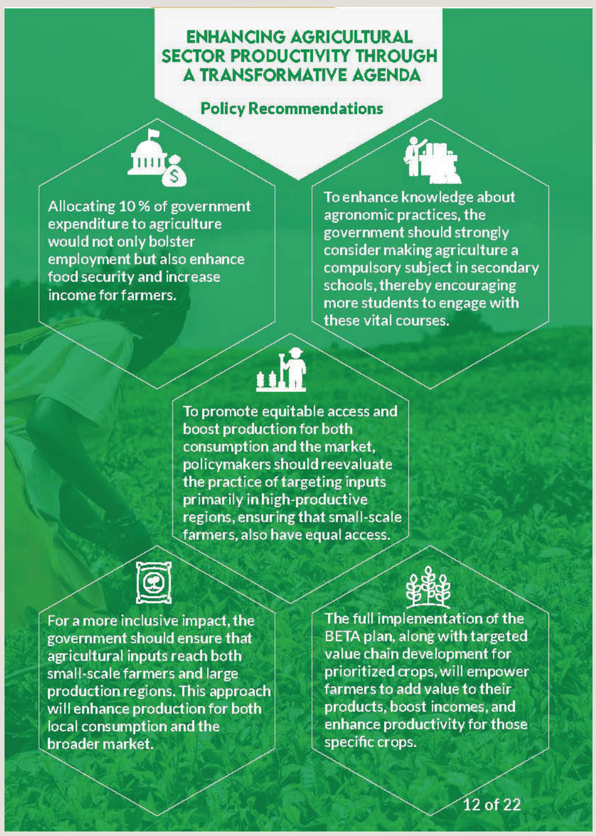
4 Prioritize the implementation of the National AfCFTA Strategy (2022-2027) to boost intra-continental trade and leverage on targeted product and service exports through the AfCFTA Guided Trade Initiative (GTI). The government could allocate sufficient resources towards implementing the strategy through the National Implementation Committee (AfCFTA-NIC) and raise awareness within the business community about the potential benefits of the AfCFTA.

5 Strengthen the existing trade facilitation efforts such as implementation of the Single Customs Territory to further reduce the cost of doing trade in the region. To achieve this, the Northern Corridor States could streamline customs procedures for imports, exports, and transit of goods. This involves reducing documentation requirements, expediting cargo release times, and implementing mutual recognition of authorized operator schemes to promote smoother trade transactions within the region.

5. Enhancing agricultural sector productivity through a transformative agenda

In the last two decades, the agriculture sector growth and its contribution to GDP averaged 2.3 per cent and 22.4 per cent, respectively. The production of food and cash crops and their yields have declined due to low investment and the growing effects of climate change. Labour productivity, crop yields and efficiency of input use have been declining over time. Furthermore, despite the sector's crucial role in the economy and livelihoods, government spending on agriculture has been below the Malabo commitment of 10 per cent. Despite these challenges, the Kenya Vision 2030 identifies agriculture as a key driver towards the country's attainment of 100% food and nutrition security. Over the past two decades, the government has aimed to modernize and transform the agriculture sector through development and review of various policies and strategies. The Medium-Term Plan IV and the Bottom-up Economic Transformation Agenda (BETA) plan outlines measures to address these challenges, focusing on increasing productivity and development of high-return value chains such as livestock, dairy, tea, rice, edible oils, and textiles.

To enhance agriculture productivity, the government needs to focus on the following key drivers.



1. Ensure timely procurement of seeds and fertilizer, monitor the distribution and access by farmers and ensure use and application by the farmers is per the requirements to facilitate transformation and increase yields. Sensitize farmers on timely application of fertiliser, application rates and the appropriate production process.
2. Implement the Malabo commitment by allocating adequate budget to agriculture both at national and county level.
3. Invest in human capital and revise the school curriculum to ensure agriculture subject is made a compulsory subject in secondary schools. Also facilitate training and monitor the supply and the requirement of various professionals in the agriculture sector, such as extension officers, plant and crop breeders, and other scientists
4. Implementation the proposed agro-processing and value chain projects outlined in MTP IV such as storage and cooling plants to provide the required infrastructure for storage to increase outputs, reduce wastage and increase productivity.
5. Fully implement the proposed value chains for the prioritized crops in MTP IV to help farmers add value to their products, increase their incomes and productivity.
6. Develop and implement crop and livestock insurance schemes to protect farmers from vagaries of weather and ensure they can recover from failed rains will be necessary to raise the value of the livestock subsector.

6. Developing Skills for Productive and Future Ready Workforce

Kenya has significantly invested in skills development through the expansion of education and training, workplace training, apprenticeships and internships, and lifelong learning innovations to enable individuals be adaptability in the ever-evolving labour market. Despite these efforts, skills development remains misaligned with national priority areas. The education and training sector faces challenges such as inequalities, wastage, poor educational outcomes, and gender disparity, which hinder its ability to maximize human capital potential for increased productivity. Apprenticeship programs, particularly in the informal sector are hindered by structural limitations and inadequate standards. Workplace training is burdened by financial costs that organizations

must bear. In addition, the emerging skills demands driven by technological changes, globalization, climate change, and demographic shifts should guide the focus areas for skills development.

To develop skills that are aligned the national priority areas and the evolving skills demand:

1. Mobilize adequate financial resources to provide targeted scholarships, loans, and bursaries to students to pursue priority programmes. Operationalize the National Skills and Funding Council to oversee funding initiatives; retooling workers already in the labour market and enhance centres of excellence in priority areas such as dairy training, leather development, agricultural colleges, and medical colleges.
2. Strengthen the implementation of Recognition of Prior Learning policy which acknowledges apprenticeship in the informal sector as a valuable pathway for skills development. This is through creating awareness on RPL among employers and employees using radio, television, and social media. Also, enforce implementation of tax rebates for training expenditures to alleviate budget constraints by providing financial relief to organizations investing in employee development.
3. Mobilize adequate financial resources to support implementation of curriculum reforms in terms of human resources, enabling legal and institutional framework and infrastructure consistent with relevant courses. Enforce equitable funding formulas for free primary and free day secondary education to address the inequalities in the education sector.

7. Productivity at county level with focus on arid counties

County productivity is important to the country in achieving sustainable and inclusive economic growth. Economic activities take place at the county level and therefore interventions to enhance productivity at this level would increase productivity at the national level. From the analysis, although arid counties have the smallest economies, they have latent natural resources such as land, wildlife and renewable energy resources that hold potential for sustainable economic growth. However, climate change, insecurity and inadequate infrastructure constrain the growth and optimal utilization of their potential. Additionally, arid counties have a comparative advantage in livestock production, but the potential in the livestock value chain is yet to be fully exploited. While the services sector dominates the share of county GVA, it is the non-market services that dominate in arid counties. On employment, the low quality and quantity of labour in the arid counties, coupled with low labour utilization, has significant implications on productivity. Consequently, arid counties have the lowest

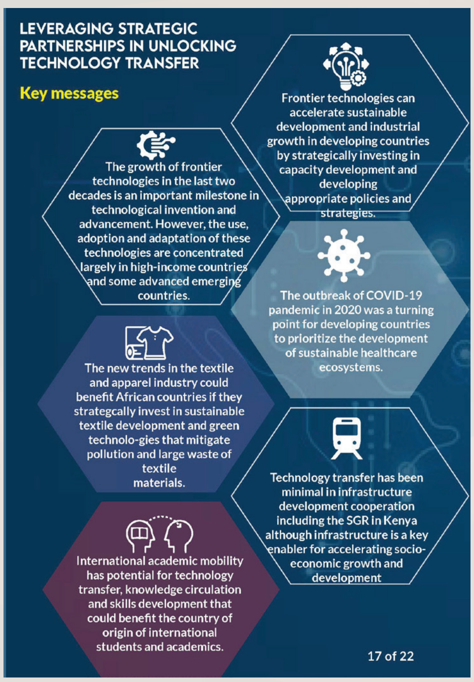
labour productivity.

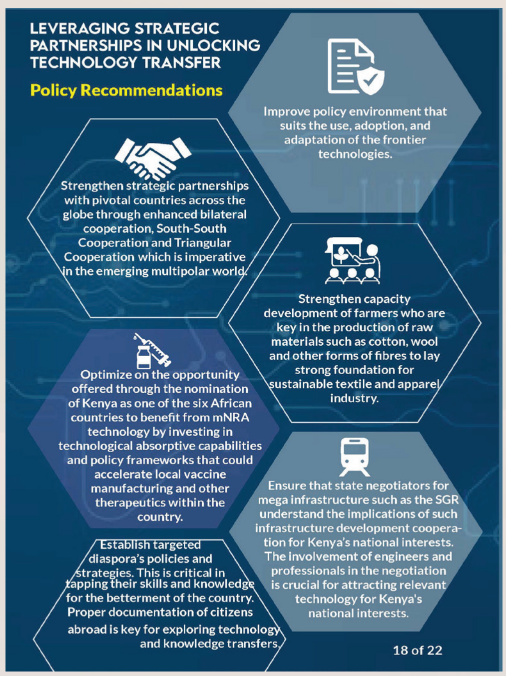
To improve labour productivity:

1. Optimize the livestock production potential in arid counties and grow the counties economies, this can be achieved by: Building climate resilience in the livestock sub-sector, integration of livestock production into the leather value chain and increasing investments in meat processing for export.
2. Reduce the dominance of non-market services in arid GVA and encourage development of market-oriented services. To achieve this, leverage on tourism resources in the arid counties, accelerate infrastructural development to open the region for investments, and curb insecurity in the arid counties.
3. Create jobs and optimally utilize the labour in arid counties. This to be attained by providing incentives to attract investment in industries that expand employment opportunities and increasing funding to businesses established by vulnerable groups such as women and youth to ensure inclusive support of persons in the informal sector.
4. Improve the quality of labour in arid counties by encouraging participation in the Adult and Continuing Education programme to improve the quality of the current labour force and accelerate the implementation of programmes aimed at improving the effectiveness of the education system in the arid counties to improve the quality of the future labour force.

8. Leveraging Strategic Partnerships in Unlocking Technology Transfer

Technology plays a significant role in increasing productivity, creating new industries, generating job opportunities, and enhancing competitiveness for a country's wellbeing. However, technology gap and unequal access to technology can adversely undermine sectors of economy including agriculture, manufacturing, energy, infrastructure development, mining, tourism, health, education, and services sector. Technological capabilities play a considerable role in guaranteeing national interests of countries in international relations. Powerful countries with advanced technological capabilities are likely to have strategic advantage over others. States that lack capacity to develop their own technology often rely on technology transfer to meet their technology needs. Political economy of technology transfer and power geometries are likely to have ramifications on critical sectors in developing countries including healthcare and vaccination production, textile and apparel industry, infrastructure development, international higher education, and frontier technologies. To address this:





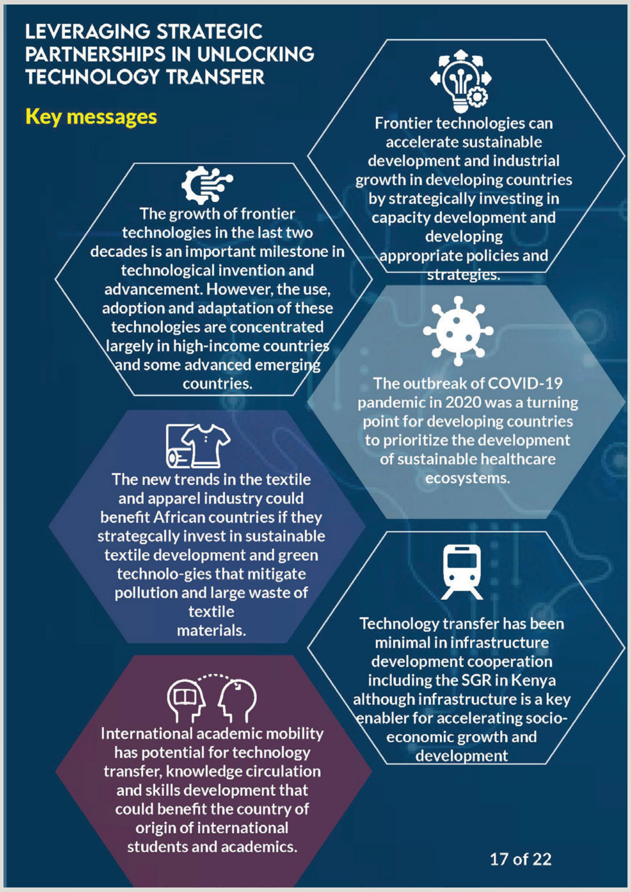
1. Strengthen strategic partnerships with pivotal countries across the globe through enhanced bilateral cooperation, South-South Cooperation and Triangular Cooperation. Target critical technologies for digital economy and overall inclusive growth and development in the new strategic relationships.
2. Improve policy environment that suits the use, adoption, and adaptation of the frontier technologies. This might involve policy and institutional reforms to support public-private partnership and improving business environment that will attract investors of frontier technologies to the domestic market.
3. Optimize on the opportunity offered through the nomination of Kenya as one of the six African countries to benefit from mNRA technology by investing in technological absorptive capabilities and policy frameworks that could accelerate local vaccine manufacturing and other therapeutics within the country.
4. Strengthen capacity development of farmers who are key in the production of raw materials such as cotton, wool and other forms of fibres to lay strong foundation for sustainable textile and apparel industry. Through strategic partnerships, conduct an elaborate survey and benchmarking in selected Asian countries and in African countries that have made progress in textile industry.
5. Ensure that state negotiators for mega infrastructure such as the SGR understand the implications of such infrastructure development cooperation for Kenya's national interests. Involvement of engineers and other professionals in the negotiations of such infrastructure development project is critical for attracting relevant technology for domestic needs.
6. Establish targeted diaspora's policies and strategies are critical in tapping their skills and knowledge for the betterment of the country. Proper documentation of citizens abroad is key for exploring technology and knowledge transfers.

9. Enhancing Productivity in the Public Service

The introduction of a devolved system of government in 2013 brought significant changes to the public service, requiring adjustments in employment practices as responsibilities shifted to the county level. However, recruitment freezes and disruptions from the COVID-19 pandemic posed challenges in labor management. Variances among counties underscore the importance of strategic policies, infrastructure development, human capital investment, and governance reforms in driving productivity and economic growth. While national productivity has risen, county-level differences highlight the need for targeted interventions in technology, personnel quality, infrastructure, and governance to enhance public service delivery. This improvement necessitates a holistic approach involving capacity building, performance management, technology integration, and oversight mechanisms. Budgetary and financial management challenges, such as revenue shortfalls and low allocations to key areas, impact service quality. Public satisfaction hinges on creating a conducive business environment, promoting national values, and ensuring good governance practices.

To enhance productivity in public service

1. Develop standardized training programs tailored to the specific needs of different counties, streamline recruitment processes, offer competitive salaries, and implement performance management systems to enhance accountability and performance in human resource management.
2. Implement targeted interventions to improve technology access, enhance personnel quality, invest in infrastructure, and strengthen governance practices. Prioritize human capital development, economic and fiscal management improvements, and transparency and accountability measures to foster a conducive environment for increased productivity.
3. Prioritize a comprehensive approach to enhance public service delivery by expanding training programs, optimizing performance management, leveraging technology for digitization, and promoting citizen engagement through e-participation. Ensure effective coordination among



government, civil society, and stakeholders for successful implementation.

4. Strengthen budgetary and financial management practices at both national and county levels by enhancing revenue collection, improving budget execution, adhering to spending limits for wages and salaries, increasing allocations for operations and maintenance, prioritizing capital expenditure, and addressing pending bills to enhance service delivery.

5. Focus on creating a supportive environment for businesses, promoting national values, and upholding good governance practices. This can be achieved through reforms such as simplifying business registration, improving access to credit, protecting property rights, investing in infrastructure, promoting diversity and inclusivity, maintaining ethical standards, and enhancing conflict resolution mechanisms to boost public satisfaction and productivity.

10. Leveraging on Digitalization to Increase Productivity in the Informal Economy

The informal sector contributes over 80 per cent of the total employment; but has low productivity level contributing about 3.2 per cent of value added to the economy. There are over 5.9 million unlicensed establishments countrywide, an indication of a growing informal economy. The largest proportion of the informal establishments, operate in open places (40.6 per cent), temporary structures (24.8 per cent), while 13.8 per cent in permanent structures. The level of digitalization vary as service sector is digitalized at 0.56, industry at 0.28 and agriculture at 0.14 which shows the low level of digitalization in the sector. This is associated with low digital skills (low skills to operate tools and software systems), low digital literacy level and high cost of digital tools such as computers and mobile phones. There is growing use of digital tools such as mobile phone and computer and digital services and applications such as internet and websites used across the sector. These offering opportunities to improve operational efficiency, expand market reach, and access financial services. In supporting the informal sector to digitalize, the government is to rolling out the 250,000 hotspots through the Digital Superhighway programme targeting marketplaces and is expected to increase connectivity.

For the informal sector to leverage on digitalization to improve on its productivity.

1. Bridge the digital gap in the informal sector, by expanding government programs that targets to build digital skills and literacy among the population especially in rural and underserved areas. Also increase coverage for digital hubs to enhance accessibility by the informal sector. Such hubs will serve to provide basic digital skills and build a digitally enabled workforce.

2. Enhance affordability, access, and competitiveness of digital infrastructure, by the government fast-tracking internet connectivity, broadband fibre, and electricity connectivity in different parts of the country. Additionally, accelerate production of locally produced digital tools such as mobile phone to make them affordable by subsidizing costs and providing incentives for digital investments in the country. To enhance competitiveness of digital infrastructure the government can encourage more investors in the digital sector as increased competition leads to reduced cost of digital tools and infrastructure.

3. Business Associations within the informal sector to collaborate with government and other stakeholders to create mentorship and networking opportunities for women entrepreneurs: Connect women in the informal sector with successful digital savvy business owners to provide guidance, support, and insights on leveraging digital tools efficiently. They can share experiences and best practices from successful businesses.

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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For More Information Contact:

Kenya Institute for Public Policy Research and Analysis
Bishops Road, Bishops Garden Towers
P.O. Box 56445-00200, Nairobi
Tel: 2719933/4, Cell: 0736712724, 0724256078
Email:admin@kippra.or.ke
Website: http://www.kippra.org
Twitter: @kippra.kenya