SUPPORTING ECONOMIC TRANSFORMATION

SUPPORTING MANUFACTURING IN KENYA: SCOPING NEW ACTIVITIES 29 AUGUST 2016, NAIROBI

Event Report

Sonia Hoque

Overseas Development Institute, London

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INTRODUCTION

On 29 August 2016, the Overseas Development Institute (ODI) in partnership with Department for International Development Kenya (DFID) held a roundtable to explore key questions around Kenyan manufacturing including: Why is productivity low in manufacturing? Why is informality not decreasing with economic growth? Why is there a lack of linkages between services on the one hand, and manufacturing and agriculture on the other hand? And what can be done about these challenges?

Supporting Economic Transformation programme (SET) is an applied research and advisory programme at the Overseas Development Institute (ODI) funded by the UK Department for International Development (DFID). The programme's reports, dialogue sessions and events cover four dimensions of a country's experience in economic transformation: (i) what is happening? (ii) why is it happening? (iii) what should be done? And (iv) how to make it happen. The SET team is scoping out support for Kenya's transformation with analytical and other inputs. The roundtable aimed to discuss and develop this collaboratively. It benefitted from scoping inputs from Anzetse Were, John Page and Dirk Willem te Velde and views from Government of Kenya and DFID Kenya.

Chair
Dirk Willem te Velde – Senior Research Fellow, ODI and Director, SET

Presenters
John Page – Senior Fellow, Brookings Institution

Anzetse Were – Economist and independent consultant

Detailed views were also expressed by **Government of Kenya representatives, Kenyan Association of Manufacturers (KAM), DFID Kenya and several others.**

Key Points

- There is a need for a new industrial strategy. In addition to basics (infrastructure, skills etc.), exports, agglomeration and firm capabilities are key for successful industrial development. Special Economic Zones (SEZs) should also be supported. Kenya also needs an East Asian-style export push and leadership from the top.
- The recently agreed Kenya's Industrial Transformation Programme (KITP) includes many elements of a modern industrialisation strategy, but it needs careful implementation and a co-ordinated approach. Must coordinate work within ministries, between donors, between public and private sector, and amongst the private sector. Learning from other countries is important.
- We need to look at the informal sector and on how devolution is affecting manufacturing. County governments have a more localised view on infrastructure and there is emerging competition to attract investment.
- Need alternative sources of finance as banks are not lending enough to manufacturers. National and county governments should discuss financing streams and access to finance.
- Logistics needs more thought to become more dynamic – think about trade bottlenecks (such as ports) and reducing logistical costs.
- SET work: bring diagnostics together and think on moving to implementation. Targeted intervention to support co-ordination around key industrialisation issues (e.g. around the planned SEZs) could be important.

DIRK WILLEM TE VELDE - HEAD OF INTERNATIONAL ECONOMIC DEVELOPMENT GROUP AND DIRECTOR OF SET, ODI

Dirk Willem opened the event with an introduction to SET (see slides).

We would like to discuss shifts in the economy in Kenya, as well as strategies for economic transformation. What can SET do to support? A lot of growth in sub-Saharan Africa has not been employment intensive which reflects a lack of economic transformation. There are many factors why productivity (change) has not been high – often lower than East Asian comparators. There is also a high degree of informality.

Three background papers for this event are available online. One of these was written by John Page who presented a number of slides discussing Brookings Institute research and findings (see slides).

PRESENTATIONS

JOHN PAGE – SENIOR FELLOW, BROOKINGS INSTITUTION

Kenya stood out in post-colonial times as giving more emphasis to private sector and had more early success in building the economy. However, we find it is an outlier in the industrialisation process.

It may turn out the African economic structure will be very different than East Asia and it could be a mix of manufacturing, resource exploitation and services. Kenya wants to become upper middle country in next 20-30 years. But services have not generated enough jobs for skilled/semi-skilled workers and there is definitely a problem in Kenya with manufacturing. However, it is more sophisticated than we would expect for its income. Having said that, it is becoming less sophisticated compared to others in East Africa.

A third phase of economic policy represents a change in orientation on part of international donors – investment climate becomes key framework. Macroeconomic management and the private sector are key.
Donors forgot that their support should include infrastructure and relevant productive skills which is why industry has not taken off. This indicates there is a need for more than just investment reform.

Drivers of industrial location

- The “basics” (infrastructure and skills, policies and institutions).
- Exports (successful industrialisation episodes have been accompanied by export success and firms in low income countries increase their productivity by exporting).
- Firm capabilities (tacit knowledge and working practices that affect both productivity and quality, which can spill over to other firms through supply chain links).
- Agglomerations (industrial clusters confer significant productivity gains but what we know about agglomeration economies comes from middle and high income countries. Clustering is very important to low income countries too).
- Kenya export story – became less successful in last 10-15 years.

Window of opportunity
Kenya has a chance to break into the global market for industrial goods but while some firms are competitive many others are not. This places a premium on policies to raise firm-level productivity. There are also too few firms which place a premium on attracting competitive firms. The key question is: how do we find ways to raise firm-level productivity and how do we get more firms in?

Keep focus on investment climate. Can you mount an export push? Kenya tends to push non-traditional exports but needs East Asian-style export push and leadership from the top. You have two FDI agencies (EPZ and Keninvest) and Kenya should be supporting clusters. EPZs perform better in Kenya than others in the region – however it has ‘hit a wall’. We need to think about how to we strengthen spatial policies.

Issues to discuss in the slides can be divided into three broad areas:

1. What aren’t we doing to get from where we are to where we want to be?
2. Are there specific interventions?
3. Is there institution and political support we need to get there?

ANZETSE WERE – ECONOMIST AND INDEPENDENT CONSULTANT

The paper by Were was looking at constraints to manufacturing in Kenya. It also examines how devolution is affecting manufacturing. County governments have a more localised view on infrastructure issues and there is an emerging competition to attract investment. National and county governments should have a conversation on financing streams and access to finance.

Banks are going to cap lending so alternative financing is needed. Kenyans are 'obsessed with control'. Alternative financing is key and not very creative; banks are not generous with lending and the interest rate cap will complicate things.

Family business is important in Kenya. The productivity story needs to look at family businesses. We also have a big informal sector. With regards to labour and skills – Kenyans are well educated but not highly skilled. Need more technical and vocational education.

Technology is leading in Africa (innovation) – how do we make it interact with manufacturing? Work with local tech scene. Research and development (R&D) is important. Currently people are working in silos – academics, think tanks, etc. don't talk to each other. People are asking the same questions. We need better coordination in R&D.

Dirk Willem te Velde (reflections on presentations):

1) Is there a common view on current performance on Kenyan manufacturing? Do we agree it was doing well, but now falling behind?
2) Do we buy into John Page agenda of investment climate plus including capability building and clustering?
3) What do we do to support actions?

PETER BIWOTT – HEAD OF POLICY, RESEARCH AND ADVOCACY, KENYA ASSOCIATION OF MANUFACTURERS (KAM)

Our agenda has several key areas:

1) General policy framework – shift from centralised system to devolved one.
2) Regulatory environment.
3) Firm size (many firms have downsized).
4) Level playing fields – currently in region we have contraband trade etc. This is really affecting industry. We feel we need strong institutions.
5) Informality is coming from heavy regulatory regime.
6) Fiscal regime – does this line up with our target of what we want to achieve?
7) The market is a challenge – can we look at supplying to local markets? Procurement laws trying to encourage local sourcing. We are operating within EAC but our main priority is local, then regional. At EAC level, we are at common market – but we still see a lot of bilateral trade barriers. Can regional integration be smooth? Common external tariffs are not supporting manufacturing – we are suggesting bands for tariffs.
8) Exports – we want to promote joint ventures between FDI (manufacturing in energy). How do we support tech transfers?

9) Culture of late payments is affecting light manufacturers and agro-processing (ranges from 60 days to 6 months). Suggest interest to be paid.
10) Innovation and technological upgrade, and green growth issues.

Dirk Willem te Velde: John Page said manufacturing is stagnant (10% debased). Kenya's Industrial Transformation Programme (KITP) wants it higher than 15%. Are you positive this can be done?

Peter Biwott (KAM): Growth is constant because other sectors growing further. Labour intensive sector focus is great (jobs) but manufacturing cannot grow in isolation.

Dirk Willem te Velde: With regards to agglomeration and clustering – what are you doing?

Peter Biwott (KAM): This is based on value addition. We are working hard on this.

RAJEEV ARORA - TEXTILE ADVISOR, KENYA MINISTRY OF INDUSTRIALISATION AND ENTERPRISE DEVELOPMENT

The KITP vision was developed in 2015 (summarised on page 15 of Anzetse Were paper).

Enabler 1 – ease of doing business.
Enabler 2 – SEZs and private sector involvement.
Enabler 3 – Investing in industrial skills – believe we will see a vocational focus.
Enabler 4 – Attracting local capital and FDI.
Enabler 5 – Government industrial fund (for SMEs – including private sector). Need to bring in big institutions.

In terms of what is happening – the ministry wants to grow specific relationships with private sector. Enabling sectors that bring import substitutions (textiles, agro).

Government has implementation teams within sectors to work with private sector. In terms of textiles – we are setting up textile parks.

YASSIN AWALE - LEATHER ADVISOR, KENYA MINISTRY OF INDUSTRY TRADE AND CO-OPERATIVES

The KITP is very much in line with John Page presentation. Clustering exists in the informal sector. Quality is an issue. Government is putting up manufacturing facilities to ensure quality is as good as international. Waste water treatment costs are being covered by government.

Fashion and trends in leather sector are important and we are getting designers to develop this. Quality of leather – government should take ownership of critical aspects of quality.

It is important to understanding finance, what is available, etc. We have run training and capacity building. How do we get a multiplier effect?

DISCUSSION

Dirk Willem te Velde: So a lot is happening in government – do we agree with the following narrative: we think the ambitious target is correct, and there are strategies and a reform agenda, and the KITP lays out vision but we now need to think about implementation.

Rajeev Arora: There are bigger challenges – devolvement is good but are they linked up? Everyone needs to adopt the strategy. Even within government – not all departments have adopted industrialisation. Within ministries we have regulatory bodies but are they all working towards growth of strategy. Must coordinate work within ministries and devolvement.

Garrison Ikiara (Professor, University of Nairobi): Trade unions making us less competitive in terms of EPZs. Costs of transportation from EPZ are high. Are business associations working? Are they expecting too much from government (farms)?

Frank Matsaert (TMEA): We think about logistics. Bringing things in and out of port is very costly. Agglomeration is a good idea, also want to make logistics better and more dynamic – think about trade bottlenecks (such as ports). Have a go at reducing logistic costs. What are government thoughts on sectors/logistics?

Peter Kimuyu (University of Nairobi): Informal sector is important – government should think about this.

Anzetse Were: Yes, government should think about formalising informal sector. Not just about getting money. Give government practical strategies. For example, give informal sector enterprises a tax holiday? Informal economy has to be a part of EPZs. Help them see the benefits of formalisation.

Garrison Ikiara: How do we bring a transformative impact?

World Bank: Thank you for convening. Good to hear other perspectives. We are preparing a programme of support for the Ministry so this is a very opportune time. The relocation of Chinese jobs to Africa is one aspect – but very difficult to get things in and out of Kenya. Growth of manufacturing has to slow as productivity is growing faster than demand. Kenya is not a low cost destination (high wages, cost of transport) – not as easy as East Asia. We hope to work on infrastructure. Government has not overlooked this. But skills development needs more smart investment that helps businesses.

Ian Mills (DFID): There is momentum around infrastructure. We are supporting national export strategy. Support for skills, clustering, etc. EPA hasn't been mentioned – risks for future. Also thinking about the cap on interest rates.

Dirk Willem te Velde: Yes, there is momentum building, but needs a lot of coordination. There has been little bank lending to manufacturing. Ethiopia has recently been able to promote manufacturing (from a very low base) involving joined up action.

SESSION ON SCOPING ANALYTICAL WORK

Dirk Willem te Velde: There seemed to be a consensus in the previous session that it is not necessary to undertake many new diagnostics. At most, it will be important to bring together and synthesise the existing diagnostics. In addition, more attention needs to focus on implementation challenges, specifically on co-ordination amongst ministries (when vertical and horizontal issues collide), between donors, between public and private sector, and amongst the private sector.

Rajeev Arora: The Permanent Secretary was not able to attend but would like to thank you for inviting the ministry – grateful you can bring together such a good group together. KITP was developed by cabinet secretary. Key issues: labour, costs, unions, logistics, informal sector, compliance, coordination. These have been identified as issues. But have they been implemented?

Labour – ministries have all been brought together, for the first time, to discuss labour. Unions must work with industry. They are good but must work together in harmony. Multiplicity of unions – more than one union per sector can create competition. Should be one per sector. Capacity of employers on needs to work harmoniously – international good practises. Evaluate industry. Lack of competition is biggest challenge.

Transport companies will have to compete. Informal sector is the biggest challenge – can't identify them, or how to approach, or with whom (at county level) – we need an entry point. A regulatory agency was set up (EMSEA) but could not have a coordinated approach. Compliance – Kenya has standards to ensure compliance at production level and working with KEBS to have a standard of manufacturing that is in line with domestic and regional markets.

Yaw Ansu (ACET): Maybe Kenya could learn from Ghana. Coordination failures in Ghana are all over the place, as with Kenya. Lots of plans, bureaucratic agencies, and more plans! Need more coordination between government, private sector and donors.

Garrison Ikiara: I worked in the Ministry of Transport focusing on a small number of projects. This programme could identify key areas and projects. Biggest success was airports, Mombasa port and northern corridor which had performance contracts for key individuals in government. Key to coordination was the increased competition between ministries. It needs implementable projects with a champion.

Peter Biwott (KAM): A key question is how to bring the Ministry of Industry and Trade together with fiscal policies? Getting the taxes right.

Dirk Willem te Velde: Need an effective tax system that balances the need to get revenues and the need to provide an incentive framework to invest.

Peter Kimuyu: Targeting EPZs for informal sector. New ones have more potential. We have seen that informal firms do transform – they are not dead ends. They are the base of our private sector. Big companies are sometimes formed informally. Could learn by looking at them.

Dirk Willem te Velde: What helps them transform? Clusters?

Peter Kimuyu: Not sure. We need a dynamic study. Informal firms already agglomerate. Could be good to link them to formal zones. Entrepreneurship is key. Train those with potential. Depends on the person (some become bigger companies).

Simon Wachira (Gearbox): Look at products made locally. Skills are key.

Kimiaki Jin (JICA): KAIZEN – applying this can be entry point. Coordination issue – JICA worked on ingredient approach – scheduling issues. Human factors, time management, business process reengineering were all considerations. Different from a framework (investment climate) approach.

<u>What SET should be doing?</u>

Peter Kimuyu: Understand informal sector to tease out interventions.
Walter Odero (AFDB): Understand what development partners can do. Continue supporting lowering of costs (use technology). No more diagnostics – focus on implementation.
Frank Matsaert: Drill down – comparators of Kenya in international context (e.g. around coordination, competitiveness).
Simon Wachira: Linkages – find out who can draw solutions.
Anzetse Were: Need data on informal manufacturing (national growth stats). Bring in county governments early.
Rajeev Arora: Put down diagnostics in one paper and work out 'what to do'. We also need coordinating body support – coordination body (interministerial, public-private etc.). Gaps in papers. Also help to set up a financing fund – how to bring in partners.
John Page: Look at role of leadership.
Lucy Muchoki (KAAA): Bring together different players and actors in agro-processing. Public private partnerships.
Yaw Ansu: Evaluation of implementation and institutional arrangements.
Daniel Marks (DFID): Moving from diagnostic to implementation. Recognise strength of different donors e.g. WB / JICA better on infrastructure.
Peter Biwott: Industrial policy should inform trade policy, which in turn should inform fiscal policy.
Arensen Reid (BRCK): Look at subsectors for key constraints.
Garrison Ikiara: Infrastructure – look at linking entry points etc. producers with markets. Some sectors have done very well – telecoms. What is done right in successful sectors?
World Bank: Think about firm level data. Also linkages – we know at high level, but what works given Kenyan context (analytical work to compare what has been done in other places)?
Stephen Gelb (ODI): Understand how Kenyan business class is structured and organised. Barriers to markets. Links to leadership and coordination. We need to understand which bodies should lead and who (will they resist?). FDI needs to be understood – what are potential sources of FDI? PIGA project – Kenya is a pilot project for promoting trade and investment in a value chain context.
Others: Think about key priority areas – disseminate information to county levels. Look at inclusive ownership of policy at top and bottom levels.

Dirk Willem te Velde: Areas that have come out today include:

- Bringing diagnostics together.
- Moving to implementation.
- Learning from other countries.
- Agglomeration and clustering needs co-ordination.

Next steps: We will share report of this meeting and main messages of papers. We will develop a workplan by the end of September.

ODI would like to thank participants including representatives from African Development Bank, World Bank, TMEA, JICA, DFID Kenya, Government of Kenya, KAM, ACET, private sector and all others.

More information on the Supporting Economic Transformation programme (SET) at ODI can be found on the SET website.