MANUFACTURING PRIORITY AGENDA 2018

SPARKING KENYA'S INDUSTRIAL TRANSFORMATION FOR JOB CREATION

Sparking Kenya's industrial transformation for job creation

- Contribution to Gross Domestic Product (GDP) from 9.2% in 2016 to 15% by 2022
- Increase value and volume of exports
- Consumer benefits of manufacturing
- Economic and exports diversification

NAME OF THE PILLAR		AGENDA
PILLAR 1	**Competitiveness and level playing field**	a) Reduce the cost of production for basic commodities b) Promote access to quality, affordable and reliable energy c) Address multiple charges, fees and levies by counties d) Increase circulation of money in the economy e) Reduce transport and logistics costs f) Avail long term financing for manufacturers g) Fight illicit trade, contraband, substandard goods and dumping
PILLAR 2	**Export driven manufacturing**	a) Increase market access for Kenyan exports b) Incentivize and promote exporters c) Protect local and infant industries d) Incentivize value addition and diversification of exports
PILLAR 3	**Pro-industry policy and institutional framework**	a) Predictable and stable industrial policies developed through industry consultations b) National policy and institutional coherence for the manufacturing sector c) Manufacturing sector delivery unit
PILLAR 4	**Government driven SMEs development**	a) Facilitate business compliance with regulation to formalize the informal economy b) Accord preference to local content in government procurement c) Enhance credit and market access to SMEs
PILLAR 5	**Securing the future of manufacturing industry**	a) Green growth and sustainable development b) Industry 4.0 c) Pro-industry skill development d) Enhance access to land e) Fit for purpose public service f) Stable political environment

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ABBREVIATIONS

ACA	Anti Counterfeit Agency
AFC	Agricultural Finance Corporation
AfDB	African Development Bank
AGOA	African Growth and Opportunity Act
APPSBG	All- Party Parliamentary Small Business Group
BKB	Brand Kenya Board
BKBK	Buy Kenya Build Kenya
BPD	Barrels Per Day
CBK	Central Bank of Kenya
CBR	Central Bank Rates
CET	Common External Tariff
CFTA	Continental Free Trade Area Agreement
CPS	Cyber-Physical System
CT	Communication Technology
EAC	East African Community
EPA	Economic Partnership Agreement
EPC	Export Promotion Council
EPZ	Export Promotion Zones
EPZA	Export Promotion Zones Authority
ERC	Energy Regulatory Commission
ERSP	Economic Recovery and Strategy Paper
FDI	Foreign Direct Investment
FMCGs	Fast Moving Consumer Goods
GDP	Gross Domestic Product
GoK	Government of Kenya
ICMS	Integrated Customs Management Systems
ICT	Information and Communication Technology
IDF	Import Declaration Fee
ILO	International Labour Organization
IMF	International monetary Fund
IPR	Intellectual Property Rights
ISIS	Import Substitution Industrialization strategy
IT	Information Technology
KAM	Kenya Association of Manufacturers
KEBS	Kenya Bureau of Standards
KeNHA	Kenya National Highway Authority
KIE	Kenya Industrial Estate
KIPI	Kenya Industrial Property Institute

KIPPRA	Kenya Institute for Public Policy Research and Analysis
KIRDI	Kenya Industrial Research and Development Institute
KITP	Kenya Industrial Transformation Programme
KNBS	Kenya National Bureau of Statistics
KPLC	Kenya Power and Lighting Company
KRA	Kenya Revenue Authority
KRB	Kenya Road Board
KURA	Kenya Urban Roads Authority
MDAs	Ministries, Departments and Agencies
MoDP	Ministry of Devolution and Planning
MoITC	Ministry of Industry, Trade and Cooperatives
MPA	Manufacturing Priority Agenda
MSEA	Micro and Small Enterprise Authority
MTPs	Medium-Term-Plans
NICs	Newly Industrialized Countries
NSSF	National Social Security Fund
NTB	Non-Tariff Barriers
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
PDU	President's Delivery Unit
PMI	Purchasing managers Index
PPADA	Public Procurement and Asset Disposal Act
RDL	Railway Development Levy
SEZ	Special Economic Zones
SGR	Standard Gauge Railway
SME	Small Medium sized Enterprises
SSA	Sub-Saharan Africa
STG	Sterling Pound
TFTA	Tripartite Free Trade Agreement
TTIs	Technical Training Institutions
TVET	Technical and Vocational Education and Training
UAE	United Arab Emirates
USD	United States Dollar
VAT	Value Added Tax

FOREWORD

This year the government has declared manufacturing as a top priority investment area for the country to drive economic growth. Hence this is the year for us to demystify the sector and make it everybody's agenda. It is the year to raise the tenor of discourse on industrialization. Moreover, it is an opportune moment for us to shift these discussions from being the preserve of industrialists, and speak to the rest of the country on our conviction for why we must prioritize a strong manufacturing base.

A strong manufacturing base for any economy is the foundation upon which long-lasting economic frameworks are made. Very few developed economies around the world can speak of their growth success without attributing it largely to their manufacturing sector. For us to achieve the intended growth of GDP contribution from the current 9.2% to 15% by 2025 urgent steps need to be taken, the results of which should be tangible in the next one year. A clear commitment towards centralizing industrialization in every conversation about development in this country is needed, right from the policy makers to each and every citizen.

As we look into stemming manufacturing in all facets of policy development in our country, we need to be cognizant of global trajectories on the fourth industrial revolution and sustainable development. The automation processes of many industries provide an opportunity for us to recalibrate our definition and value of work. Hence our contribution towards revamping our production processes, and using them as centers of excellence towards skills development in the country will go a long way in catapulting our local industry into global standards. Including young people into the industrialization vision by equipping them with skills and providing them with the space to innovate through research and Development, will make this a shared vision in the country as it translates into job creation and economic empowerment.

Manufacturing is the only guaranteed way for a country to increase the number of people earning substantial wages because of strong backward and forward linkages with other sectors in the economy. The more people have reliable and stable jobs, the more they can afford their basic needs. A thriving industry is also a great development partner for Government, as it increases revenue and enables the government to provide social amenities to all citizens. In the long run this translates to a reduced poverty gap and increase in equality in the society.

Industry's intervention is strengthened by a predictable regulatory environment, as well as a commitment to enforce the adherence to the rule of law for all stakeholders. If this is actualized many hurdles that stand in the way of growing the sector, for example illicit trade, counterfeit goods, corrupt practices among many others will be abated.

Lastly, manufacturing should not be seen as one among many solutions towards building an inclusive economic order, but rather as the primary element from which all other development solutions coagulate and take shape. It should be the focal point in our national vision towards creating an inclusive political economy. Manufacturing should underline discussions on nation building, equal distribution of resources and poverty alleviation.

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

Flora Mutahi
Chairlady, Kenya Association of Manufacturers

"In the first pillar of the **Big Four** (food security, affordable housing, **manufacturing** and affordable healthcare for all), we will create jobs by expanding our manufacturing sector. Manufacturing is about believing that we, as Kenyans, can be competitive and ambitious enough, to make products that are as good as any other in the world. **Lazima Tujiamini**"

H.E President Uhuru Kenyatta, CGH
President and Commander in Chief of the Defence Forces of the republic of Kenya

-12th December, 2017

EXECUTIVE SUMMARY

The growth and development of any country is banked on the ability of its industries to compete regionally and internationally. For Kenya, our industrial growth has stagnated with a GDP contribution of 10 % over the last 10 years, and a further reported decline to 9.2 % in 2016. Hence the need to promote the competitiveness of local industries should be prioritized in our rejuvenated endeavour to focus on the manufacturing sector as a country.

Last year, the Association launched its 10 point agenda which is echoed in the recently announced government's action plan for economic growth and the attainment of Vision 2030. The agenda highlights priority areas in the quest to double jobs, double exports, increase foreign exchange earnings and raise manufacturing share of GDP to 15 percent by 2020.

It is within this context that we have developed the 2018 Manufacturing Priority Agenda which outlines the immediate action that will yield tangible results in the short term, and work towards the aforementioned industry goals. This will catalyze the competitiveness of local industry that will be alluded to as well as enable our local manufacturers to compete on an international platform.

Under the theme 'Sparkling Kenya's industrial transformation for job creation', this year's MPA highlights the need to create a sector that has a multiplier effect in the economy through backward and forward linkages in the value chain and consequently, job and wealth creation.

Firstly, the MPA outlines the need for a competitive and level playing field for local manufacturing and growth of SME which can be achieved through sound fiscal and non-fiscal policies.
The agenda also highlights the need for predictable and stable industry policies which should be developed through industry consultations and linked to the wider national policy making process in order to promote the sector.

We have also highlighted the need to prioritize the protection of local infant industries in order to drive creativity and innovation thereby continually creating sustainable and productive jobs.
The diversification of export markets is also key as it centres on enabling local manufacturers to access regional and global markets thereby enhancing export driven manufacturing.

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

The Association is committed towards the achievement of these goals, and we will work closely with both national and county governments and development partners towards the industrialization vision for Kenya.

Phyllis Wakiaga
CEO, Kenya Association of Manufacturers

INTRODUCTION

1.1 Background information

Every year, the Kenya Association of Manufacturers (KAM) sets out advocacy priorities in a publication titled "The Manufacturing Priority Agenda (MPA)". This year's MPA marks the fourth series since commencement of its production in 2015. The theme of the MPA 2018 is "***Sparking Kenya's Industrial Transformation for Job Creation***". It highlights an urgent need for Kenya to focus on the sector and to reignite its potential to achieve a multiplier effect on the economy, ultimately leading to more investments, expanding markets, job creation and better standards of living for all.

Kenya has the highest unemployment rate in the East African Region and stood at 12.5% in 2015, with unemployment rate of 25% among the urban youths and 9% of the youths in the rural areas (KIPPRA, 2017). Interventions to uplift the manufacturing sector, will create backward and forward linkages that will in turn generate opportunities for innovation entrepreneurship, as well as, productive jobs.

Empirical evidence reveals that for all economic sectors, the manufacturing sector has the highest employment multiplier effect in an economy. For instance, empirical analysis by Bivens (2003) indicated that 100 jobs in the manufacturing sector supported 291 jobs in other sectors of the economy. Further, the latest report from Manufacturing Institute in the US revealed that \$1 worth of manufactured product creates \$1.34 in the rest of the economy[6]. This is the largest multiplier of any economic sector.

This shows the enormity of economic development that a country can realize through a well-founded manufacturing base.

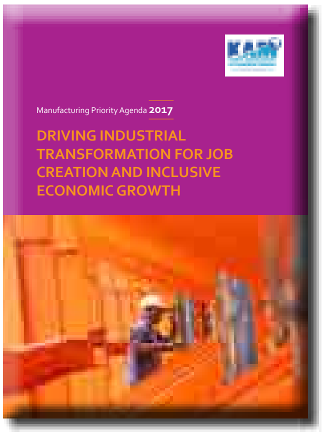
The Government's renewed commitment to the sector through an announcement made by H.E The President of Kenya, on the 28th of November 2017, presents a great opportunity for the country to make leaps on critical economic goals set out in Vision 2030. It is the goal of the National Government to increase the contribution of

6 See: http://www.themanufacturinginstitute.org/Research/Facts-About-Manufacturing/Economy-and-Jobs/Multiplier/Multiplier.aspx.

the manufacturing sector from the current 9.2% contribution to the gross domestic product (GDP) to 15% by 2022. A raft of policy strategies such as Vision 2030, Kenya Industrial Transformation Programme (KITP), National Trade Policy, Investment Policy and Buy Kenya Build Kenya (BKBK) have been devised to spur the manufacturing sector in Kenya. Further, in 2017, KAM published a ten point priorities agenda for transforming manufacturing sector and creating jobs in Kenya.

The MPA highlights current hurdles hampering Kenya's industrial growth and articulates proposals on how these can be overcome. The 2018 MPA will be hinged on five pillars as follows: competitiveness and level playing field; export driven manufacturing; pro-industry policy and institutional framework; government driven SMEs development and securing the future of the manufacturing sector.

1.2 Overview of the 2017 MPA



The 2017 MPA was developed and launched on 30th January 2017 under the theme "*Driving Industrial transformation for job creation and inclusive economic growth*". It was anchored on five pillars, namely: Policy, Legal and Regulatory Reforms, Level playing field for manufacturing in Kenya, Competitive Local Manufacturing Sector, Make Kenya a manufacturing hub for Exports and Securing the future of Industry.

It informed and shaped the advocacy work for KAM during the period under review and the following are some of the key wins:

- Development of Draft County Own Revenue Sourcing Policy which seeks to standardize institutional, framework applicable in all counties for county government own sources of revenue raising measures and enforcement.
- Development of the Public Participation Policy guidelines that seeks to guide stakeholder participation in the development of policies and bills at both levels of government. Nevertheless, there is need to push its adoption and enactment across all counties as only a few have do so.
- Development of a draft East African Community (EAC) Non-Tariff Barriers Regulation that seeks to give effect to the EAC Elimination of Non–Tariff Barrier Act, 2015. The Act aims at removing conditions that affect and distort trade within the EAC, creating a conducive environment for trade within the region.
- Development of Industrial Competitiveness Report. The study findings call for renewed effort to boost the manufacturing sector in the region and in EAC partner's states. It also calls for coordination of industrial policies and related instruments under the regional aegis of the EAC, while ensuring their harmonization with other policies in particular trade.
- Development of draft E-Waste Regulations; it provides guidelines for handling, storage and disposal of e-waste in Kenya.

- Establishment of Climate Change Council in which KAM was nominated to represent private sector. The Council shall publish regulation on design and procedure to ensure efficacy of public consultation, to ensure that they make an impact on the threshold of decision making on climate change at all levels of government.
- Judicial processes automation such as case filing, case date allocation and payment.
- Development and launch of the EAC intellectual Property Rights (IPR) study which aims to enhance regional protection of IPRs, as a contributor to achieving the industrialization agenda.
- The development of the EAC Trade Remedies Act, 2017 that seeks to deal with unfair trade practices such as dumping, subsidizing and import surges.
- Launch of the Buy Kenya Build Kenya Strategy driven by an overriding objective that its successful implementation will encourage the consumption of locally produced goods and services.
- Development and launch of National Trade Policy that seeks to unleash Kenya's potential for targeting domestic, regional and global markets; and
- Development of draft National Water Policy which seeks to bring reforms in the water sector in the country.

Some of the pending proposals made in 2017 MPA include the following:

- Elimination of Import Declaration Fee and Railway Development Levy.
- Rationalize and harmonization of county levies, charges and fees.
- Development of national export and promotion strategy.
- Establishment a of long term financing mechanism for manufacturers.
- Adoption of the Kenya draft regulation for Motorcycles.
- Enactment of the Energy Bill, 2015.
- Creation of prompt payment legislative framework.
- Review of EAC Common External Tarrif (CET).
- Ratification of the Economic Partnership Agreement (EPA) by all 5 Partner States; and
- Creation of land banks for industrial investment.

It worthy to note that full implementation of the 2017 MPA proposals could not be achieved due several reasons including but not limited to: lack of prioritization of sector issues by government Ministries, Departments and Agencies (MDAs) and prolonged electioneering period.

GLOBAL, REGIONAL AND KENYA'S ECONOMIC OUTLOOK

2.1 State of the global economy

In 2017, global economic growth is estimated to have reached 3%, a significant acceleration compared to growth of just 2.4 % in 2016; the highest growth rate recorded since 2011 (World Bank, 2018). The improvement in global economic conditions have been largely attributed to improved commodity prices and stable global macroeconomic environment. The world economy is expected to grow by 3.1% in 2018. This forecast will be supported by recovery in investment, manufacturing and trade as exporting developing economies benefit from rising commodity prices. Nevertheless, the growth could be fragile, with the risk of financial stress, increased protectionism and rising geopolitical tension derailing the expansion.

Global conditions for investment have generally improved amid low financial volatility, reduced banking sector fragilities, recovery in some commodity sectors and a more solid global macroeconomic outlook (World Bank, 2018). However, this improvement is relative to a low starting point following two years of exceptionally weak investment growth, and a prolonged episode of lackluster global investment overall. A firmer and broader based rebound in investment activities may be deterred by elevated levels of trade policy uncertainty as well as rising debt and a buildup of longer term financial fragilities.

The oil market is in the process of rebalancing as demand growth surpasses supply growth. This is expected to spread through 2018 as the Organization of Petroleum Exporting Countries (OPEC) and non-OPEC oil exporters, including Azerbaijan, Kazakhstan and the Russian Federation, agreed to implement a coordinated reduction in production from January 2017 to March 2018, amounting to 1.8 million barrels per day (bpd) in total[6]. In 2018, crude oil prices are expected to average US$60 per barrel which will translate to higher cost of refined fuel. Speculative activities continue to remain influential, creating short term price fluctuations.

6 See: http://www.goldmansachs.com/our-thinking/pages/2018-global-economic-outlook-as-good-as-it-gets.html.

2.2 Sub-Saharan Africa (SSA)

The overall GDP growth for SSA is estimated to be 2.4% for 2017, a rebound from 1.3% in 2016[7]. The improved growth rate has been attributed to recovery of commodity prices, favorable and slowing inflation that lifted household demand. Current account deficits narrowed but remained high, with the medium current account deficit estimated at 7% of GDP. Currencies in the region stabilized in real effect terms. Exchange rate pressure for oil exporters eased due to improved oil prices, increased oil production and a weaker dollar. Headline inflation declined across the SSA region, reflecting the confluence of stable exchange rates and slowing food price inflation. Fiscal deficits declined in non-resource-intensive countries, but remained high, partly due to infrastructure investments.

Economic growth is projected to rise to 3.2% in 2018 and to an average of 3.6% in 2019 as commodity prices rise and domestic demand continue to strengthen, helped by declining inflation. Downside risks continue to predominate, including the possibilities of weak commodity prices, tight global financing conditions and regional political uncertainty and security tensions will intensify. Conversely, a stronger-than-expected pickup in global economic activity could further boost exports, investment, and growth in SSA region. There is also considerable scope for boosting potential growth with structural reforms, including policies to increase investment and improve health[8].

In the Eastern African region, the EAC Partner States, Tanzania, Uganda and Rwanda are projected to grow at a rate of 6.8%,5.1% and 5.9% respectively (IMF, 2018). Ethiopia is expected to grow by 8.2% in 2018.

2.3 Kenya's economic outlook

2.3.1 GDP growth rate

In 2017, economic growth rate for Kenya declined to 4.9%, compared to a growth rate of 5.8% in 2016 (World Bank, 2017). Depressed economic growth rate achieved in 2017 was on account of prolonged drought that had adverse effect on the agricultural sector and reduced generation of hydropower and consequently raised the level of inflation and reduced household consumption. Economic activity was also affected by declining private sector access to credit and prolonged political crisis that weakened private sector activity. Depreciation of the exchange rate against the major foreign currencies during the year further exacerbated the situation by suppressing economic activities.

According to the World Bank Economic Prospects Report for 2018, Kenya's economic growth is forecast to grow at 5.5% in 2018 and 5.9% in 2019 (Figure 2.1), though this is contingent upon implementation of supportive economic reforms and prudent management of macroeconomic condition.

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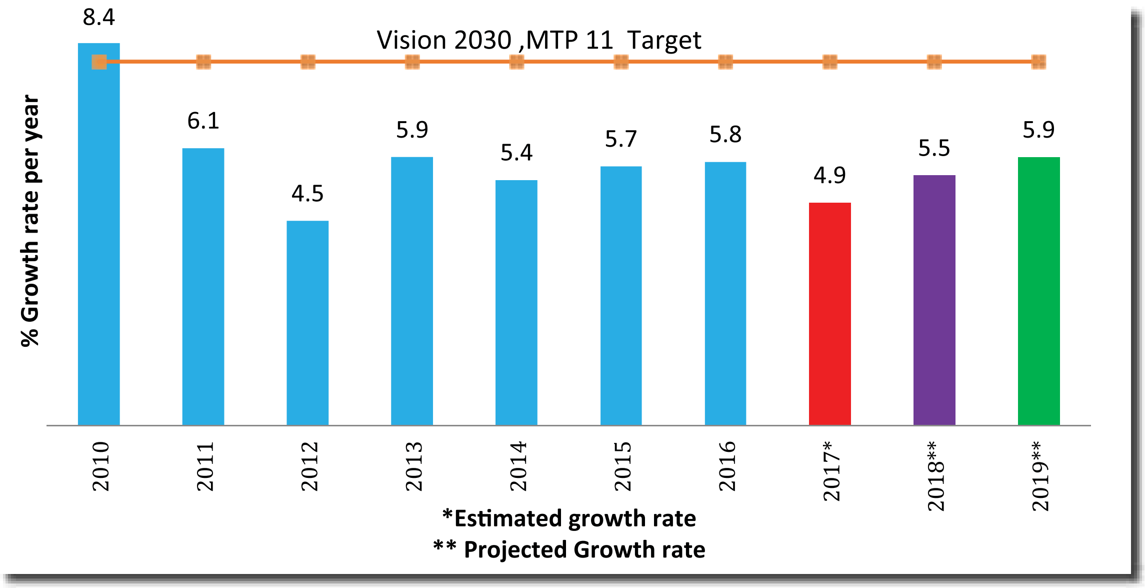
7 See:http://pubdocs.worldbank.org/en/575011512062621151/Global-Economic-Prospects-Jan-2018-Sub-Saharan-Africa-analysis.pdf

8 See:http://pubdocs.worldbank.org/en/575011512062621151/Global-Economic-Prospects-Jan-2018-Sub-Saharan-Africa-analysis.pdf

Figure 2.1 GDP growth rate for Kenya (2010-2018)

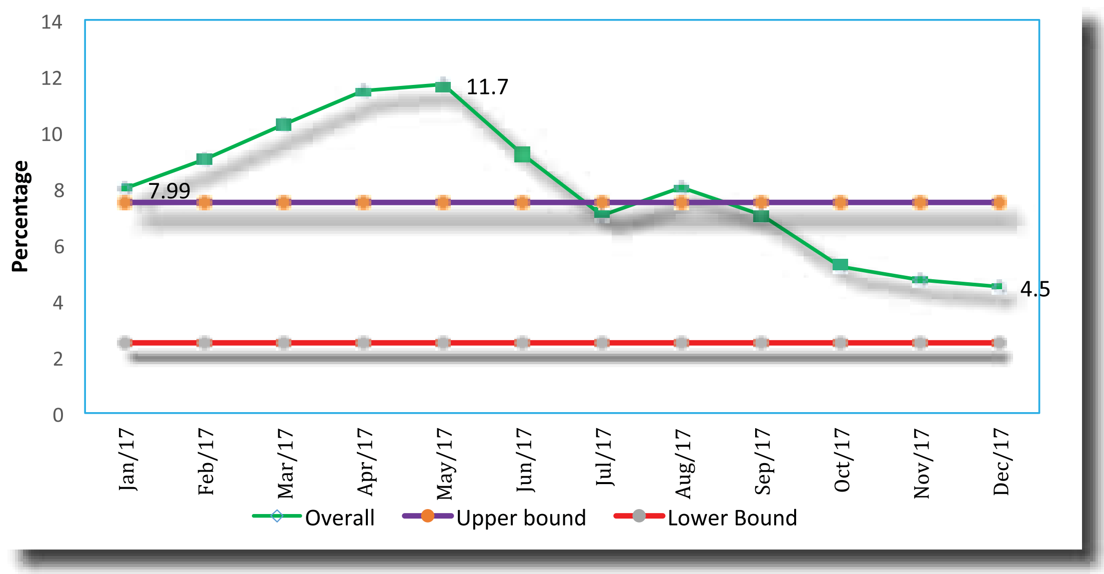


Data source: World Bank (2018)

2.3.2 Inflation rate

The average inflation rate in 2017 was 8%, with May recording the highest rate at 11.7% breaching the single-digit inflation target. Inflation rate however declined to 4.5% in December 2017 (Figure 2.2). The Central Bank of Kenya (CBK) forecasts the inflation rate to remain within policy limits which the World Bank estimates that it will average 6.8% in 2018. The main threat to the maintenance of a single-digit inflation rate is drought, whose frequency has increased; occasioning increase in food prices.

Figure 2.2: Inflation rate trend in 2017

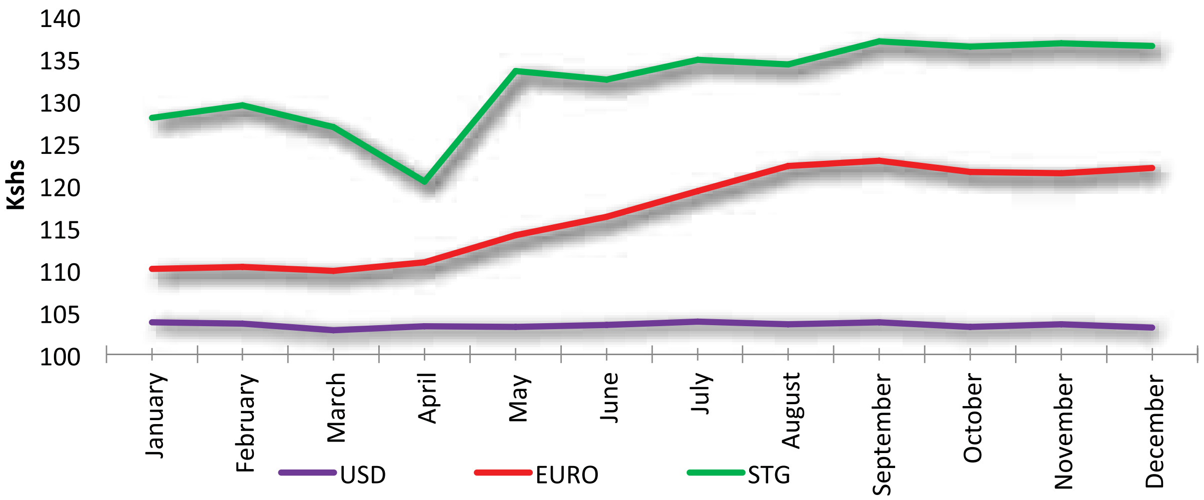


Data source: KNBS, 2017 (Monthly updates)

2.3.3 Exchange rate

The exchange rate against major international currencies portrayed mixed performance. The Shilling remained relatively stable against the USD, but weakened marginally against the Euro and the Sterling Pound (STG) (Figure 2.3). The main challenge affecting the exchange rate is increased imports over exports. The exchange rate is expected to stabilize in 2018 on account of stable political environment and sound monetary policies.

Figure 2.3: Exchange rates for Kenya against major currencies in 2017



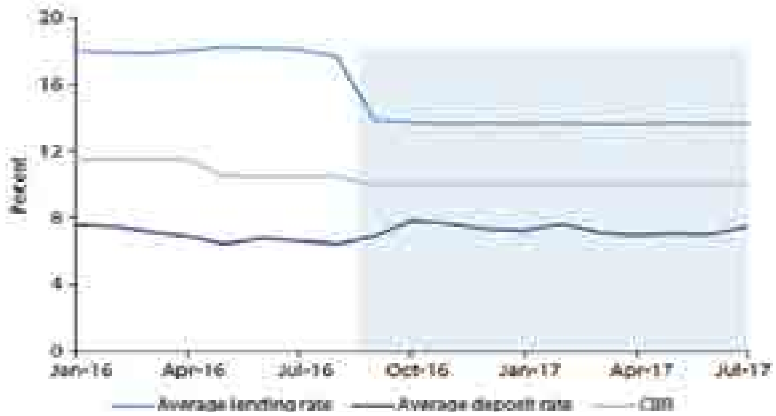
Data source: CBK, 2017 (Monthly updates)

2.3.4 Interest rates

Banks' lending rates in Kenya dipped sharply from September 2016 to an average of 13.65% following the amendment of the Banking Act, which capped lending rates with the aim to encourage increased consumption of credit. The law puts a ceiling on lending rates by banks and financial institutions at 4% points above the Central Banks Rate (CBR), with a floor on term-deposit rate equal to 70% of the CBR. The average lending and deposit rates and the CBR remained stable in 2017 after the law capping interest rates became effective (Figure 2.4). Further, the CBK kept its benchmark interest rate unchanged at 10% in 2017, which has seen bank lending rate maintained at 14%.

In 2018, the CBK is expected to retain the same rates in view of inflation expectations in the context of favorable weather conditions, sustained macroeconomic stability and the conclusion of a prolonged election period.

Figure 2.4: Interest rate in Kenya before and after the cap

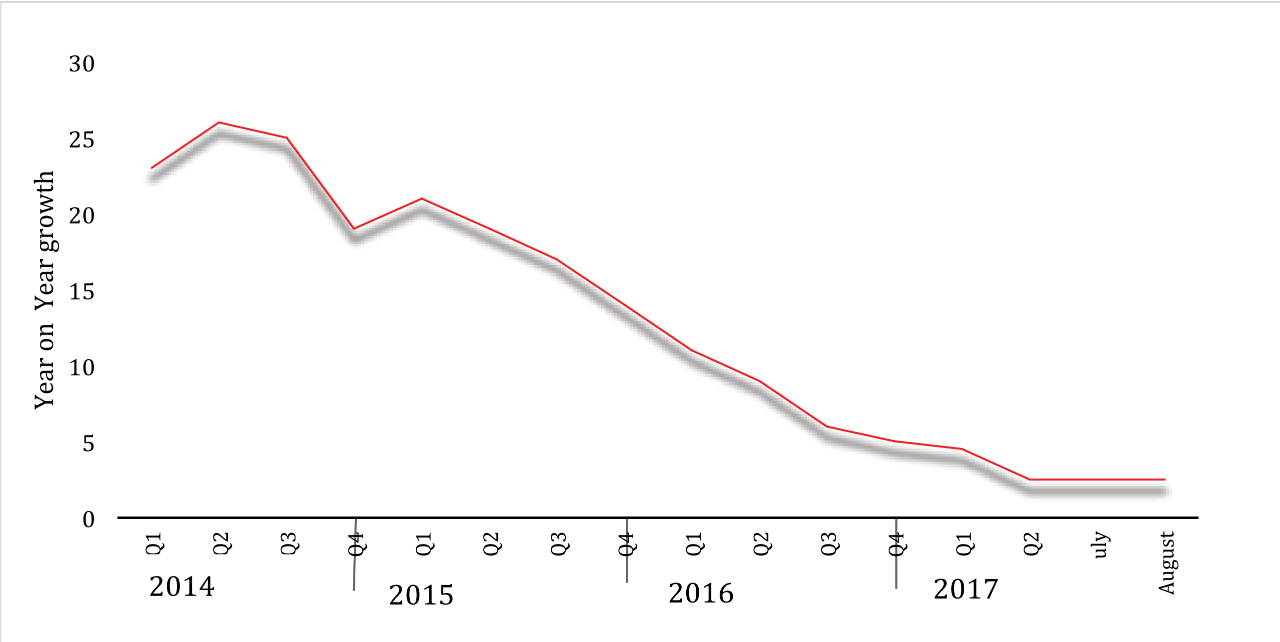


Source: National Treasury, Kenya

2.3.5 Access to credit

Access to credit particularly to the private sector has slowed down significantly in Kenya since 2014 as a result of a series of shocks in the sector (Figure 2.5). Private sector credit growth fell from its peak about 25% in mid-2014 to 1.6% in August 2017; the lowest in the last ten years. According to the World Bank's Kenya Economic Update 2017, the slowdown can be attributed to several factors including the impact of liquidity shock in 2015/16; the impact of liquidation of three commercial banks; the implementation of the interest rate cap; inability of small banks to borrow in the interbank market and the rise in non-performing loan. Although the interest rate cap was meant to reduce the cost of credit, thereby making credit accessible to a wider range of borrowers, after a year of implementation, weakness in private sector credit growth remains[9]. The 2018 outlook for credit growth remains unclear.

Figure 2.5: Growth in private sector credit in Kenya



Data source: National Treasury, Kenya

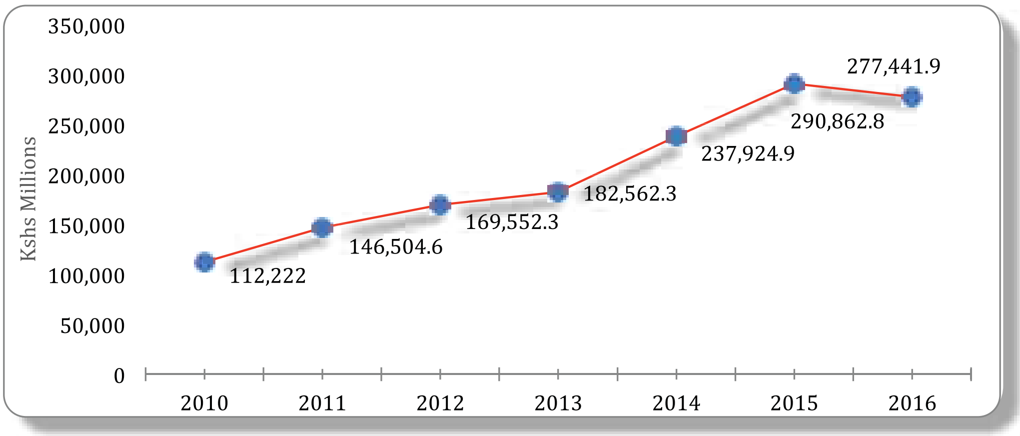
The interest rate cap has negatively affected small borrowers and small and medium enterprises (SME's) as banks have shifted lending to corporate clients whenever possible impacting the allocation of credit to smaller borrowers. Commercial banks have also increased their lending to the government. Kenya's savers access to interest bearing deposit accounts has also been affected as banks are reclassifying interest bearing accounts to non-interest bearing accounts.

2.3.6 Access to credit by the manufacturing sector

Access to finance is a key issue for the manufacturing sector. According to KNBS' Economic Survey 2017, credit advancement to the manufacturing sector decreased for the first time in the last five years from Kshs 290.9 billion in 2015 to Kshs 277.4 billion in 2016 (Figure 2.6).

9 See:https://openknowledge.worldbank.org/handle/10986/29033

Figure 2.6: Approved loans to the Manufacturing sector (2010-2016)

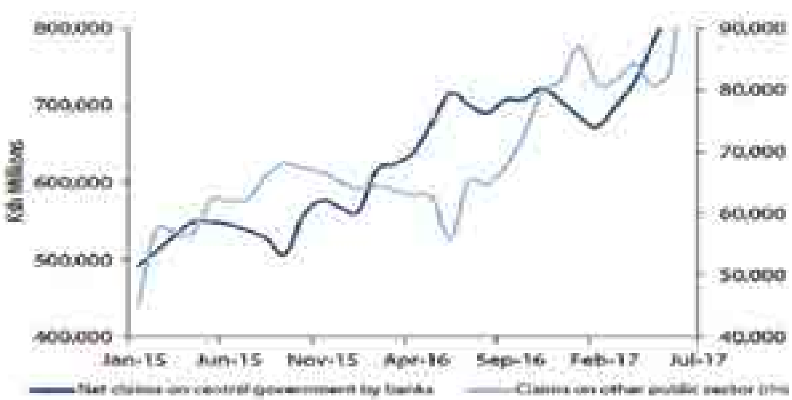


Source: KNBS, 2017

2.3.7 Lending to the government

Figure 2.5 showed that lending to the private sector by Commercial Banks has been on a downward trend however, lending to the National Government has increased (Figure 2.7). The Commercial Banks have re-allocated credit from private to the public sector since the introduction of the interest cap so that credit growth to the National Government averaged about 15% compared to the 2.3% to the private sector in 2017. Commercial Banks have moved to T-Bonds and Bills which have had better profit margins and secure unlike lending to high-risk clients.

Figure 2.7: Access to credit by the National Government from the Commercial Banks in Kenya

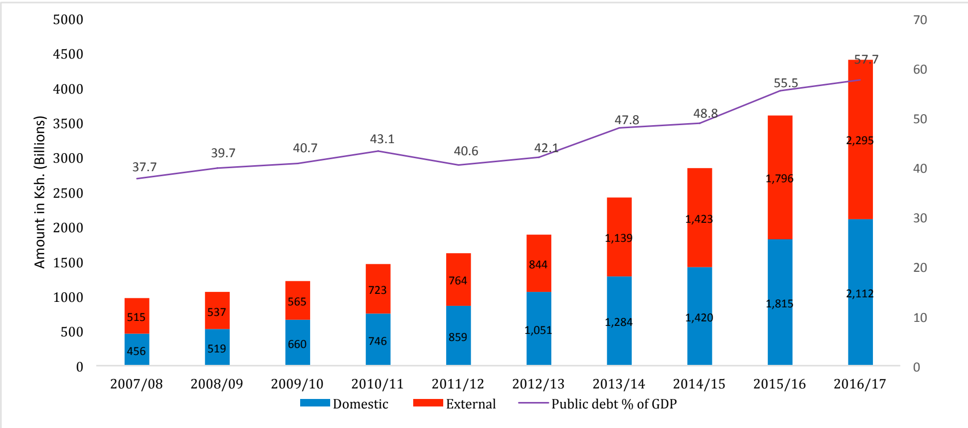


Source: National Treasury, Kenya

2.3.8 Stock of public debt

Kenya's public debt as percent of GDP increased by 3.3% to 57.7% of GDP by June 2017 (Figure 2.8). Increase in the stock public debt was attributed to the increase in both external and domestic debt, as government borrowed to finance budget deficit. The stock of external and internal debt stood at 29.8% and 27.4% of GDP respectively, in June 2017. After the introduction of interest rate cap, government securities are the most preferred investment options by the Commercial Banks and this tends to crowds-out the private sector in the domestic credit market. A sizeable amount of the government's commercial debts will mature in 2019 and this will have implications on budget deficit and consequently on the stock of debt especially in a situation where the government may be forced to borrow to pay off some loans. The stock of public debt is expected to rise on account of unfinished infrastructure projects and government borrowing to refinance loans. Care has to be taken by the government on borrowing to reduce the possibility of running out of fiscal space.

Figure 2.8: Stock of public debt for Kenya as a % of GDP

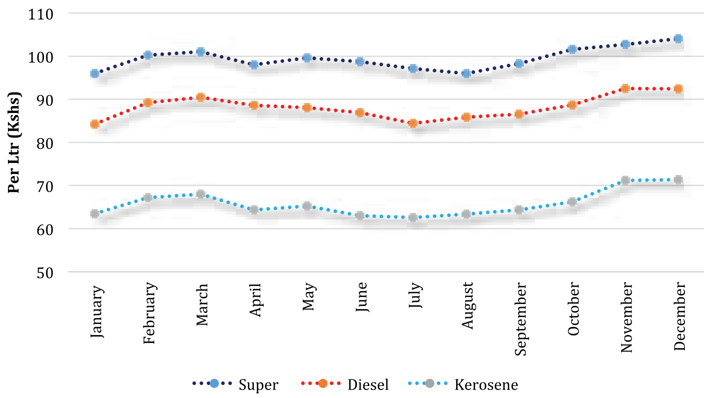


Data source: National Treasury, Kenya

2.3.9 Oil prices

Oil prices in Kenya increased towards the end of 2017 from the month of August, a situation attributed to rising oil prices at the global markets (Figure 2.9). Looking ahead in 2018, oil prices are forecast to rise to an average $60 a barrel from average $53 in 2017. The slight increase in oil prices in 2018 will be as a result of steadily growing demand, agreed production cuts among oil exporters and stabilizing U.S. shale oil production (World Bank, 2018). It is also expected that the government will abandon petroleum price controls which has been in operation since 2010 and administered by the Energy Regulatory Commission (ERC).

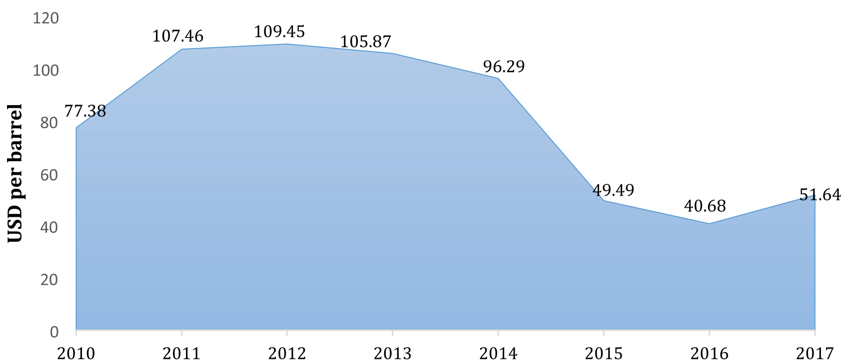
Figure 2.9: Prices of super petrol, diesel and kerosene in Kenya, 2017



Data source: KNBS (Quarterly Reports-2017)

International crude prices declined sharply for the 2014-2016 period but started to increase steadily in 2016-2017 period (Figure 2.10).

Figure 2.10: Average annual OPEC crude oil price from 2010 to 2017 (USD per barrel)



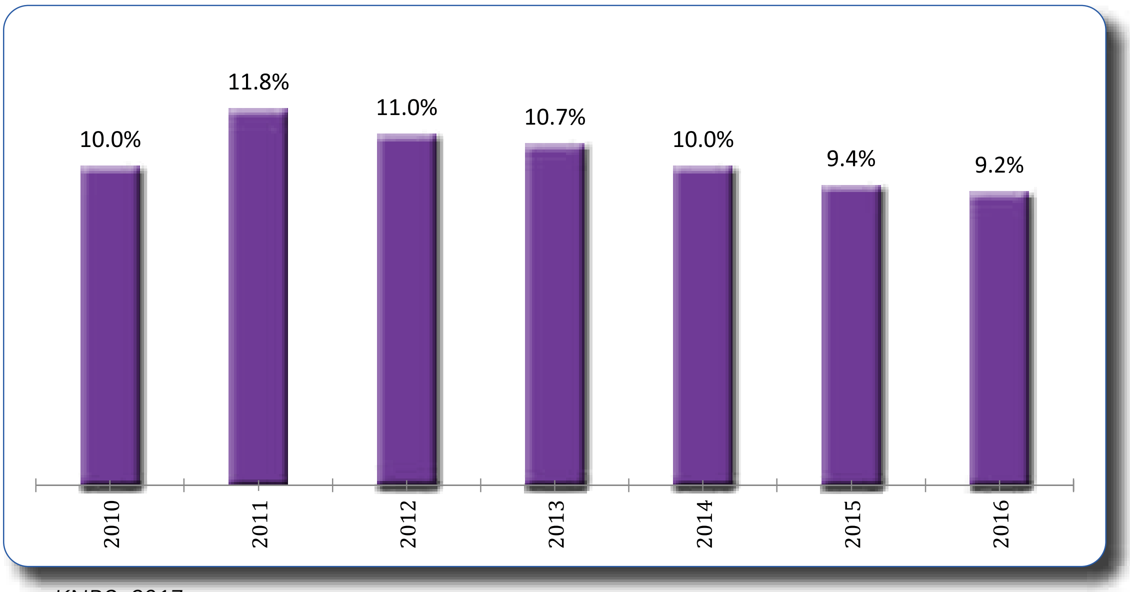
Source: OECD

AN OVERVIEW OF MANUFACTURING SECTOR IN KENYA

3.1 Contribution to GDP

Manufacturing sector contribution to GDP has over the years stagnated at around 10% and stood at 9.2% in 2016 (KNBS, 2017) (Figure 3.1). Nevertheless, the government through the KITP aspires to grow the shares of manufacturing sector from 9.2% to 15% by the year 2022.

Figure 3.1: Manufacturing sector contribution to GDP in Kenya, 2010-2016

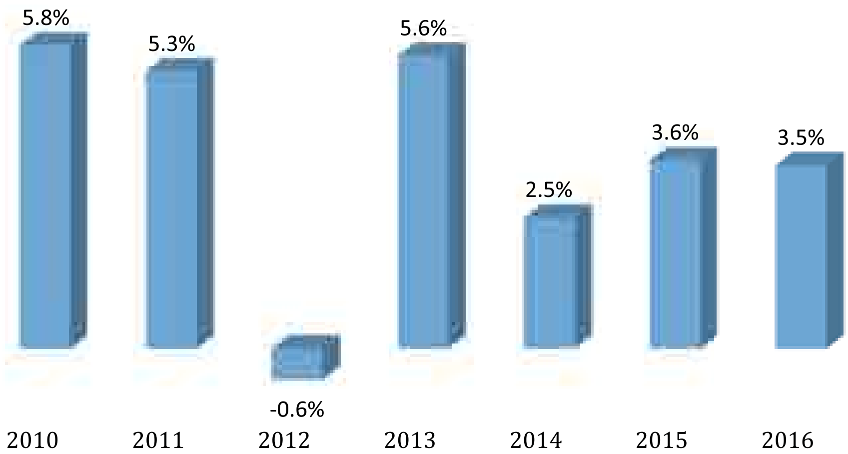


Data source: KNBS, 2017

3.2 Manufacturing sector annual growth rate

Figure 3.2 illustrates annual growth rates of the manufacturing sector for 2010-2016 period. The highest growth rate was recorded in 2010 with 5.8% growth and the lowest in 2012 when the sector grew by -0.6%. These growth rates are way below the anticipated growth rate of 10% as aspired under Vision 2030.

Figure 3.2: Annual growth rate for the manufacturing sector in Kenya, 2010-2016

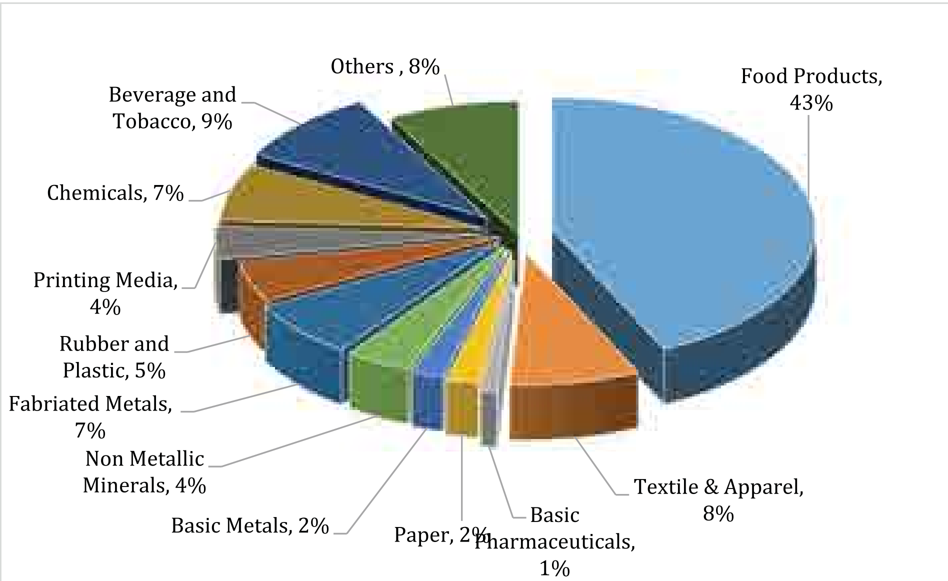


Data source: KNBS, 2017

3.3 Structure of manufacturing sector

Food products sub-sector is the biggest contributing about 43% to the overall manufacturing sector contribution to GDP. Under the category of "others", we have sub-sector such as leather, wood and furniture, transport equipment, and Machinery.

Figure 3.3: Sub-sectors in the manufacturing sector and their contribution-2015

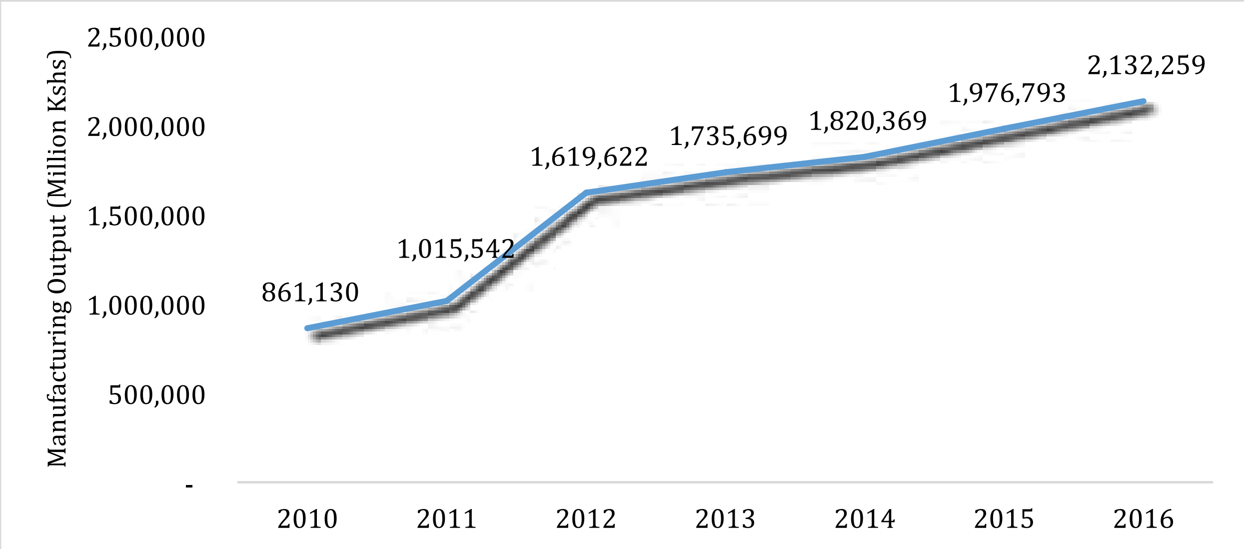


Data source: KNBS, 2016

3.4 Manufacturing sector output

The number of manufacturers in the country has grown over the years and manufacturing output grew by 69% since 2010 as shown in Figure 3.4 where in 2010, it stood at Kshs. 1,258,527 million and Ksh 2,132,259 million in 2016.

Figure 3.4: Manufacturing output in Kenya, 2010-2016

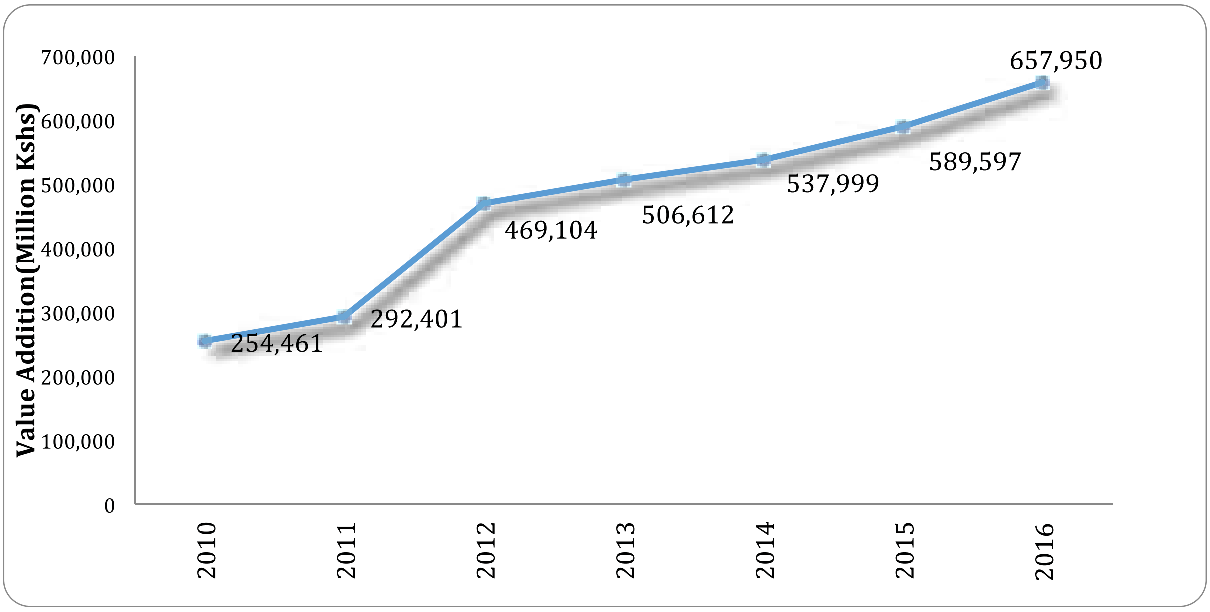


Data source: KNBS, 2017

3.5 Value addition in the manufacturing sector

The value added in the manufacturing sector increased by 11.6% to Kshs 658.0 billion in 2016 (Figure 3.5) which is almost double of 2010.

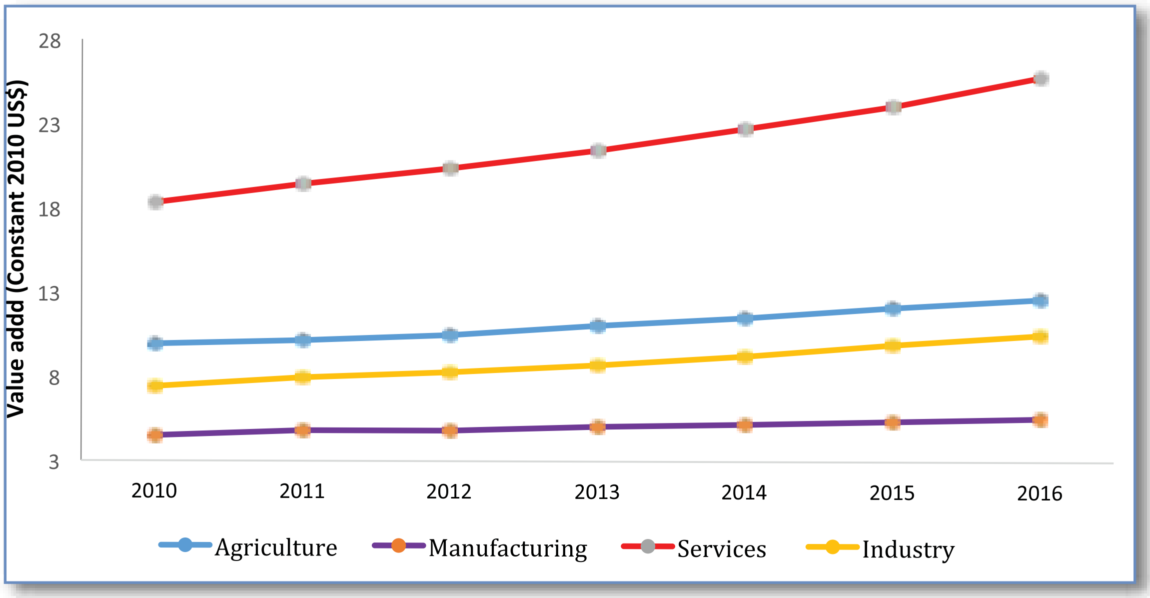
Figure 3.5: Manufacturing value addition in Kenya, 2010-2016



Data source: KNBS, 2017

When compared with other sectors in economy, the manufacturing sector value addition lags far behind (Figure 3.6). There is need for structural changes to revive the manufacturing sector which tends to be labor-intensive and can therefore create jobs for the majority of the unemployed especially the youths.

Figure 3.6: Sectoral value addition in Kenya, 2010-2016



Data source: World Development Indicators of the World Bank (2017)

3.6 Contribution to exports

An estimated 18% of Kenyan manufactured goods are exported of which 6.1% exported to the EAC and 12% to the rest of world (KNBS, 2013).

Kenya's export products are overwhelmingly primary in nature with tea alone constituting about 25% of total value of exports (Table 3.1). Other than being primary in nature, Kenyan exports are also low in technology component. Some of the manufactured exports include food products, on-metallic mineral products, chemical and chemical products, metals, pharmaceutical and botanical products, textiles and apparels. According to KNBS 2017 data, Food and beverage, the largest manufacturing sub-sector, dominated the category of export accounting for 45.2% of total domestic exports in 2016 while industrial supplies (non-food) accounted for 27%.

Table 3.1: Leading commodity exports for Kenya (% share), 2012-2016

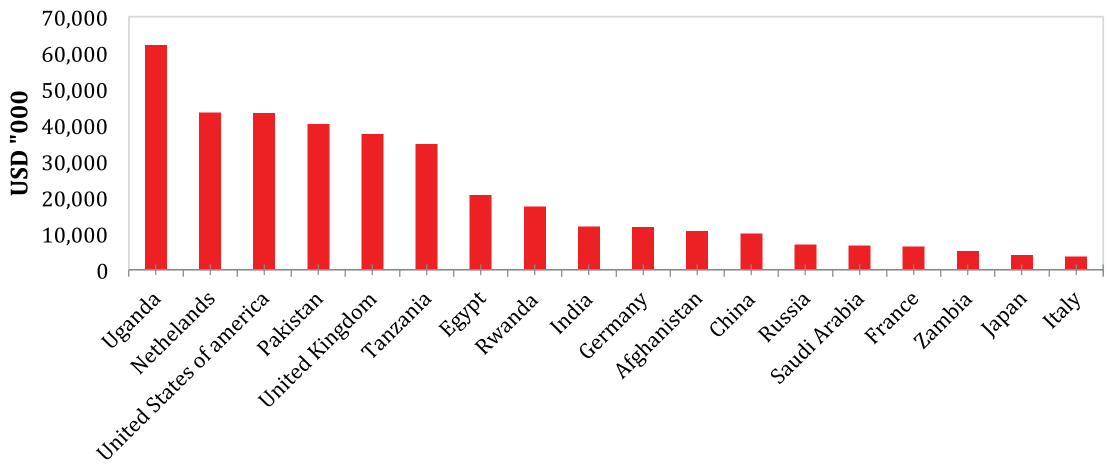
Commodity	2012	2013	2014	2015	2016
Tea	21	23	20	25	25
Horticulture	17	2	21	20	22
Coffee, unroasted	5	4	4	4	4
Articles of apparel and clothing accessories	4	5	6	6	6
Tobacco and tobacco manufactures	3	3	4	3	3
Iron and steel	3	3	3	2	3
Essential oils	3	2	2	2	2
Animal and Vegetable oils	3	2	1	1	1
Articles of plastics	2	2	2	2	2
Soda ash	2	2	2	1	1
Medicinal and pharmaceutical products	2	2	2	2	3

Data source: KNBS, 2017

3.7 Export markets

Kenya's export markets are relatively concentrated and in need of diversification. Ten (10) countries accounted for 61% exports in 2016. Five out of the top ten markets; and seven out of top twenty markets in 2016 are in Africa (Figure 3.7). Over 70% of Kenya's total exports are destined to 12 countries globally. Kenya's exports share in the global market remains dismal at 0.03% of total global trade. Kenya has been experiencing declines and market losses in key traditional markets.

Figure 3.7: Leading export destinations for Kenya in 2016

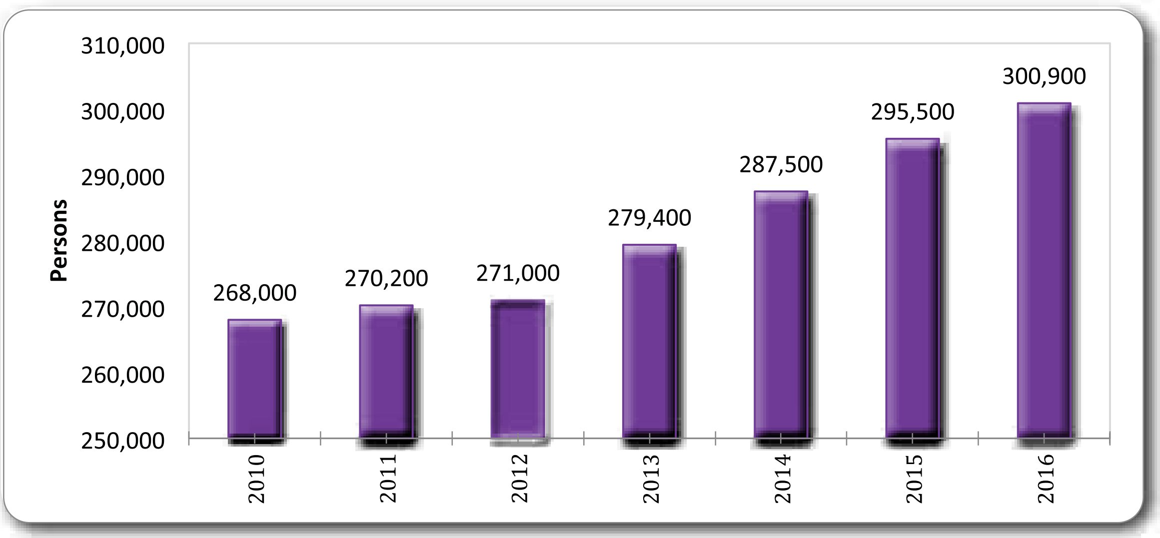


Data source: KNBS, 2017

3.8 Contribution to employment

According to KNBS 2017, the manufacturing sector recorded employment growth rate of 1.8% (300,900 people) of 2.55 million wage employment in 2016 up from 11.9% (295,500 people) of 2.48 million wage employment in 2015 (Figure 3.8). While employment in the sector has been increasing in absolute terms, its share in formal employment has declined marginally in recent years, a situation attributed to sluggish growth rate in the sector.

Figure 3.8: Number of persons employed in the manufacturing sector in Kenya, 2010-2016

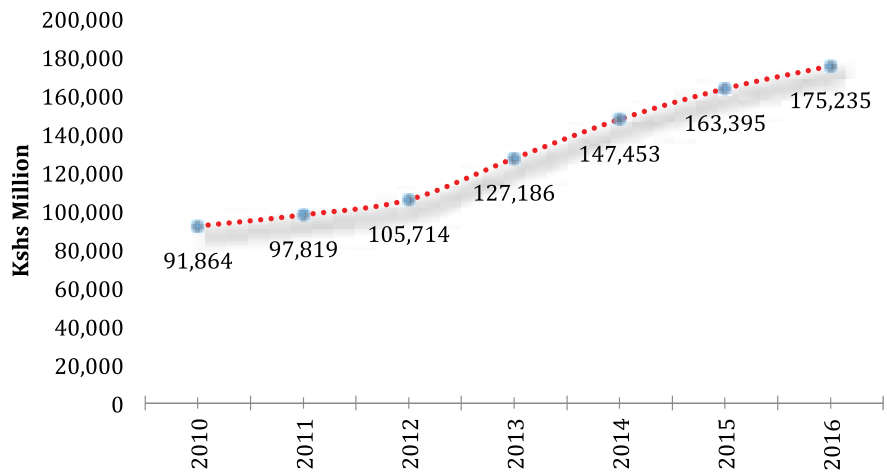


Data source: KNBS, 2017

3.9 Compensation to employees in the manufacturing sector

The employee compensation by manufacturing sector increased by 7.2% to Ksh. 175.2 billion in 2016 (Figure 3.9). Overall, employee compensation by the manufacturing sector has doubled since 2010, increasing by 66% between 2012 and 2016.

Figure 3.9: Compensation to employees in the manufacturing sector (2010-2016)



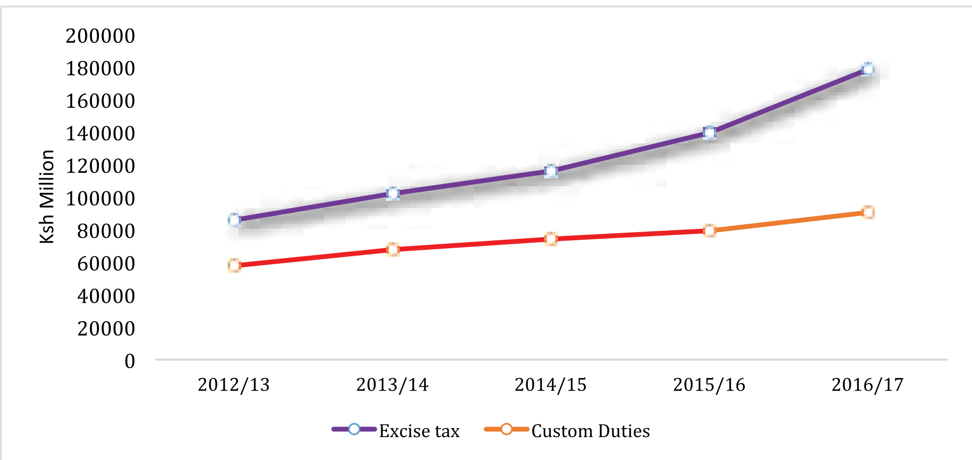
Data source: KNBS, 2017

3.10 Contribution of the manufacturing sector to taxes

Excise duty, which is mainly collected from manufacturing entities with beer and tobacco as main contributors of the tax grew by 13.3% in 2016/17 Financial Year compared to annual average growth of 14.0% in the last four years. Revenue from excise duty has been on an increasing trade from 2012-2016 (Figure 3.10).

Corporation tax showed the strongest performance in the last four years as it grew by 18.2% compared to annual average growth of 13.7%. Further, given the Figure 3.9, it is clear that the manufacturing sector also makes a huge contribution to the tax revenue in terms of income tax recipients from employees, social and security contributions.

Figure 3.10: Total Excise tax and Custom Duties collected (2012-16)



Data source: KNBS, (2017)

3.11 Consumer benefits of manufacturing

Other than creation of jobs, manufacturing sector in a country also makes use of available natural resources, resulting into lower and affordable prices to consumers.

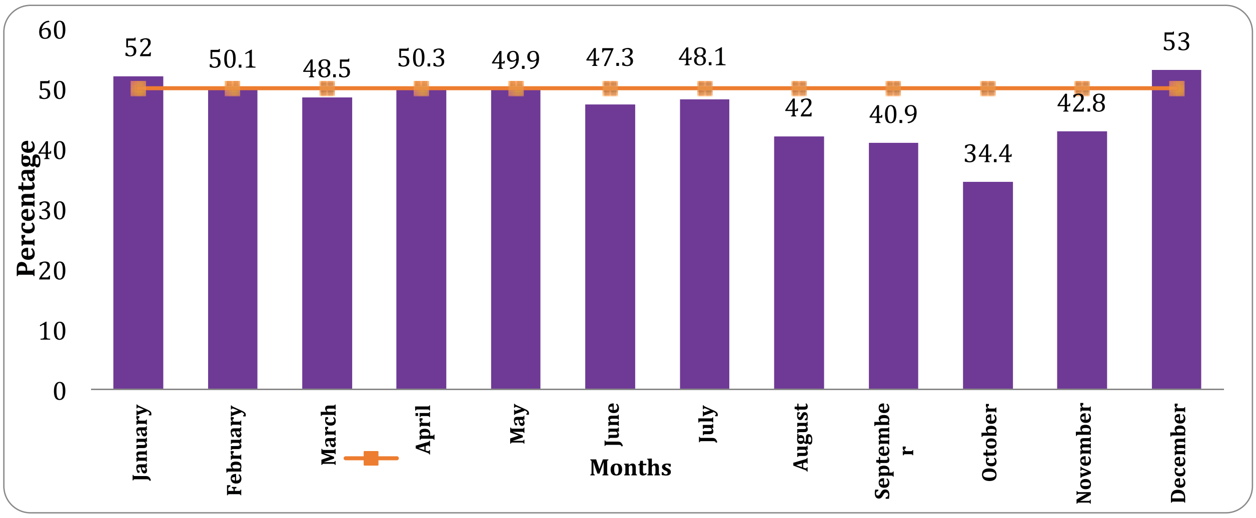
Products and services that manufacturers produce avails to the consumers a basket of varieties from which to choose from.

In the long run, both the value for real money held by consumers and their purchasing power increases. Over 82% of Kenya manufactured products are consumed locally and the rest exported (KNB, 2013). As manufacturing adds value to products and raw materials (mainly from agriculture sector), the sector multiplier effect spills over to other sectors as it is also a consumer of their goods and services. Manufacturing also tend to reduces balance of trade through exports and local sourcing.

3.12 Economic health in the manufacturing sector

The Purchasing Managers Index (PMI) is an indicator used to gauge the economic health of manufacturing sector and reported in Figure 3.11. In Kenya, the PMI is released on a monthly basis by CFC Stanbic Bank Kenya and reported by Markit Economics. It measures changes in activity level across Kenya's manufacturing sector from month to the next. The PMI is based on five major indicators: new orders, inventory level, production, supplier deliveries and the employment environment. The indicator ranges from a score of 0 to 100, with 50 declared neutral. Anything above 50 indicates that the activity level improved. In 2017, the PMI rose to 52 points in January and fell to 34.4 points in October. It recorded a seven months straight contraction from April to October 2017 which was attributed to heightened political environment in the country.

Figure 3.11: The Purchasing Managers' Index for Kenya, 2017



Source: CFC Stanbic, Markit Economics

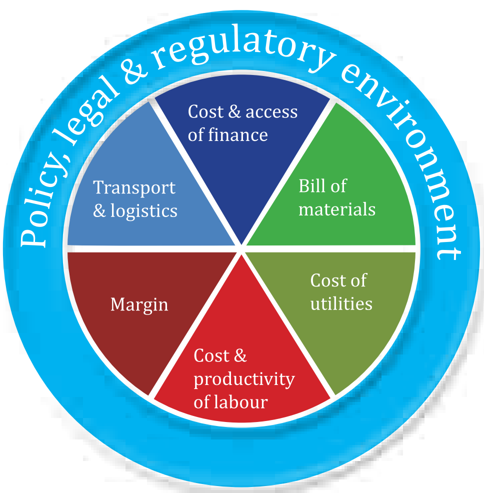
PILLARS TO SUPPORT SPARKING KENYA'S INDUSTRIAL TRANSFORMATION FOR JOB CREATION

4.1 PILLAR ONE: COMPETITIVENESS AND LEVEL PLAYING FIELD FOR KENYAN MANUFACTURERS

There is increased integration of world economies through the forces of globalization. The rapid globalization, technological advancement, changing consumer preference and evolving government policies are reshaping the manufacturing industry exponentially, accelerating the pace of competition and continually raising the bar on the performance of companies' across the globe.

Kenyan manufacturers are not an exception. While this is inevitable, one of determinants for the success or failure of countries and companies is whether they can change in a similar or even faster pace than the global pace. At national level, there is need for sound fiscal and non-fiscal policies to enable manufacturers to compete domestically and internationally. The government should create a level playing field for all manufacturers to ensure equal opportunities in order to enhance fair trade and competitive manufacturing in the country.

Figure 4.1: An illustration of key drivers of manufacturing sector competitiveness in Kenya



Source: Authors' conceptualization

A conducive policy, legal & regulatory environment is necessary for industrial transformation

- Bill of materials - should be equal or lower to those at global market.
- Cost of utilities - this includes, cost of energy, water, sewer age among others should be minimum.
- Cost and productivity of labour - Kenya as one of the highest labour cost.
- Access and cost of finance - if manufacturing sector is to grow it needs access to more finance at lower cost.
- Transport & logistics - effecient and effective transport and logistics is important to move raw materials and finished goods from one point to another.
- Margin - any form of business should earn returns on investment

4.1.1 Reduce the cost of production of basic commodities

Over 82% of Kenyan manufactured goods are consumed locally while the rest are exported (KNBS, 2013). This underscores the importance of the manufacturing industry in the country. The prices of locally manufactured goods have been on a continuous increase, a situation attributed to increasing cost of industrial raw materials.

According to the third quarter Manufacturing Barometer 2017, 45% of manufacturers in Kenya indicated that the cost of industrial input as one of the major concerns in the manufacturing industry today. The high cost of inputs leads to high prices of locally manufactured products thereby limiting their competitiveness in the regional and international markets and hampering the sector's capacity utilization. In order to reduce the cost of basic commodities in the country and improve the competitiveness of manufactured goods especially in the EAC region, the following actions should be undertaken:

- ✓ Zero rate import declaration fee (IDF) for industrial inputs for bona fide manufacturers;
- ✓ Zero rate railway development levy (RDL) for bona fide manufacturers;
- ✓ Clear outstanding VAT refunds and ensure VAT refunds processing and payment is undertaken within 60 days from the date of lodging application in order to ensure companies' healthy cash flow; and
- ✓ Exempt bona fide manufacturers from Withholding VAT.

4.1.2 Promote access to quality, affordable and reliable electricity

Electricity is an important input in the manufacturing processes. The cost of electricity in the country has been highly unstable with bills rising by at least 10% per month. On the supply side, the government has made tremendous efforts in improving electricity generation in the country. Major attempts to diversify Kenya's sources of electricity especially towards wind and geothermal sources are expected to provide as much as 45% of electricity supply by 2022[6].

However, even if power is available, poor transmission and distribution infrastructure leads to erratic power supply and outages in the country (Were, 2016). Further, the quality of electricity supplied is also a major concern for high voltage and bulk consumers as fluctuation in power and power outages lower productivity as machines have to be restarted and their lifetime is shortened. In order to encourage affordable, reliable, quality and sustainable electricity for manufacturing industry in Kenya, the following action should be undertaken:

6 See:http://sbs.strathmore.edu/news/reducing-cost-electricity-kenya/

- Finalize the enactment of the Energy bill 2015 which seeks to resolve energy related issues in the country such as power quality, reliability and distribution of electricity among others;
- Establish autonomous regional Kenya Power & Lighting Company (KPLC) branches to increase competition and reliability of power supply;
- Allow generators of electricity to sell to bulk electricity consumers to enhance the quality and reliability of electricity; and
- Review contracts of thermal power producers and peg them on performance to ensure access to reliable power at affordable rates.

4.1.3 Address multiple charges, fees and levies by counties.

In 2013, a devolved system of government was implemented comprising National Government and 47 County Governments. The Constitution empowers the counties to raise own source of revenue by levies, charges and fees. This has not only increased administrative and financial burden to manufacturers but also continue to discourage investment. Further, these levies, charges and fees are not harmonized across the 47 counties in the country. Inter-county movement of goods now attract a fee charged by each county for goods that pass through. This has resulted to double taxation and consequently increased the cost of doing business between the counties and the country at large. The challenge of multiple charges, fees and levies by counties can be remedied through the following actions:

- Fast track finalization and implementation of county own revenue resource policy which seeks to provide guidelines on revenue collection among counties as per the Constitution; and
- Develop a national legislation to harmonize and rationalize county policies and legislation on fees, charges and levies.

4.1.4 Increase circulation of money in the economy

The circulation of money in an economy is necessary to facilitate economic activities. This implies that issues such as late payment of suppliers by both the public and private sectors reduces cash flow of the affected suppliers. For instance, according to Auditor General Report for Kenya in 2016/17, pending bills by Counties amounted to Ksh. 35.8 billion. In order to address the culture of late payment and the question of corporate governance witnessed in the country's retail sector, the following ought to be undertaken:

- Enactment of prompt payment and accountability legislation;
- Establishment of a Regulatory Authority for the retail sector;
- Set up a supplier portal so that suppliers electronically track status of orders, delivery schedules, potential product shortage and payment received;
- Organization of business ethics and integrity compliance trainings for the private and public sectors; and
- Digitization of payments and refunds by Government.

4.1.5 Reduce transport and logistics costs

Transport is required in the production procedures, from manufacturing to delivery to the final consumers and returns. Only a good coordination between each component would bring benefits to maximum to each party. According to the 2016 logistic performance index by World Bank, Kenya was ranked 42nd out 160 countries, an indication that a lot needs to be done to address logistic

challenges. It costs between US$ 500 to US$ 1000 to transport a twenty foot (20ft) container from the port for Mombasa to Nairobi by road; 60% higher than in the US and Europe (Shipper council of Eastern Africa, 2017).This was however expected to reduce by at least 30% following the construction and launch of the standard gauge railway (SGR) in May, 2017. Kenya Railway Corporation has published SGR freight rates that saw transporting a 20ft container from Mombasa to Nairobi cost US$ 500 (excluding other port charges and last mile cost), a cost deemed not competitive by cargo owners.

Port related inefficiencies have been attributed as a key contributor to the cost of transport. According to the Northern Corridor Report (2017), the average cargo dwell time is 5 days above the global benchmark of 3 days, making cargo owners pay high demurrage charges for storage thus increasing the cost doing business. The delays have been attributed to involvement of many cargo clearance interveners.

The Kenya Roads Board (KRB) report of 2016 indicates that Kenya has a road network of approximately 161,451.4 kilometers (out of which 10% are paved, while the rest of the network is either gravel or earth roads). It is estimated that about 30% of the paved roads are in good condition while only about 20% of the unpaved roads are in maintainable condition. This is to say that a large portion of the network is in either poor or failed condition and requires urgent rehabilitation to restore it to a maintainable condition. Poor infrastructure such as roads increases logistic costs for the cargo owners. Some of the actions that can be undertaken to reduce transport and logistics costs in the country include the following:

- Review the proposed SGR freight rate to make them competitive;
- Implement the Integrated Customs Management System (ICMS) to enhance efficiency of customs processing ;
- Implement the pre-clearance system for cargo and dynamic risk management to reduce the port congestion and cargo dwell time at the port;
- Fast track the country wide rollout of instant fines scheme on minor traffic offenses to minimize corruption on roads and save time;
- Mount a campaign on road safety and discipline to reduce road accidents in the country; and
- Create framework between Kenya Urban Roads Authority (KURA) and Counties to enhance industrial roads upgrade and maintenance.

4.1.6 Avail long term financing to manufacturers

Access to finance especially long term finance is key for manufacturers in terms of expanding business operation and leveraging business and investment opportunities that arise from time to time. Kenya like any other African country has found it challenging to mobilize resources to address the need for long term lending in order to provide capital investment in the manufacturing sector which over years has had weak returns and a high percentage of non-performing loans (Tyson, 2015). Public financial institution such Kenya Industrial Estates (KIE) have limited financial resources to support loan demand from the manufacturing sector. Further, while commercial banks are the most sought-after sources of finance to the manufacturing sector outside the financing from personal sources, they have unfavorable conditions .Most of commercial banks in Kenya give short term loan in order to limit risk exposure associated with doing business in Kenya. The working capital cycle lasts six months on average, demanding patience

Domestic financing to the manufacturing sector declined between 2015 and 2016 after growing steadily between 2006 and 2014. According to KNBS (2017), the total loans advance to the manufacturing sector decrease from 290.9 billion in 2015 to 277.4 billion in 2016 (Figure 2.6).

Foreign direct investment (FDI) in to the sector has also slowed down. According to a study on FDI to Kenya conducted in 2015, 16% of FDI inflow went to manufacturing in 2013.Kenya's challenges in attracting FDI ranges from difficulties in work permits, barrier to qualification and poor government incentives.

Some financing that would be of benefit to the manufacturing sector does not finance the sector itself but rather is aimed at improving the business environment and enablers. For instance, African Development Bank (AfDB) currently does not directly finance manufacturing but provides support to local banks through partial guarantee facilities, which enhance the capacity of banks to provide financing and increase opportunities for businesses to access financing.

Long term financing to the manufacturing sector should come from both the public and private sector through implementation of the following actions:

- ✓ Incentivize saving institutions such as National Social Security Fund (NSSF) to invest in the manufacturing sector;
- ✓ Restructure the Industrial and Commercial Development Corporation, Agricultural Finance Corporation (AFC) and Kenya Industrial Estate (KIE) to create a Kenya Development Bank with an industrial development fund committed to manufacturing;
- ✓ Operationalize the Movable Property Security Rights Act, 2017 (the Act) that provides for the creation of an electronic collateral registry for use by Kenyan banks; and
- ✓ Incentivize International Finance Corporation (IFC) and Exim banks to provide long term loans to the manufacturers.

4.1.7 Fight illicit trade, contraband, substandard goods and dumping

Trade in illicit, substandard and counterfeit products is a major challenge facing manufactures in Kenya today. According to a study on counterfeits conducted by KAM in 2013, manufacturers lose up to 40% on market share, 50% on revenue and 10% on company reputation due to the proliferation of counterfeits in the Kenyan market while the government loses about US$ 80 million in potential tax revenue. An enterprise survey conducted by the World Bank in 2013[7] established that one out of four private sector firms in Kenya consider informal competition as the biggest obstacle.

Most counterfeited goods in Kenya are the fast moving consumer goods (FMCGs). This not only hurts the economy, but also poses health risks to consumers of these goods. Legitimate manufacturers invest in research and development, quality material and manufacturing processes, and work to meet the conformity assessment schemes of the product markets. They also work to build brand recognition and foster goodwill with their end users. Counterfeiters, who are direct competitors, rely on infringing brand names and profiting from their goodwill and reputation resulting in the direct loss of sales, loss of goodwill and trademark dilution.

Three institutions including the Kenya Revenue Authority (KRA), Kenya Bureau of Standards (KEBS) and Anti-counterfeit Agency (ACA) are crucial in the fight against illicit and counterfeit products. However, there is lack of inter-agency collaboration, misinterpretations of law by enforcement officers and failure of courts to impose tough penalties.

*The protection of intellectual property rights is a critical factor in supporting the growth of our local manufacturing. Even as we **Buy Kenya and Build Kenya,** we cannot enrich fraudsters who, masquerading as well-known brands, produce dangerous fakes.*

H.E President Uhuru Kenyatta, CGH President and Commander in Chief of the Defence Forces of the republic of Kenya -12th December, 2017

At regional level, lack of harmonized policy and legislation on counterfeits in the EAC affects the common market despite the fact that all partner state, except south Sudan, are members of the World Intellectual Property Organization (WIPO). The current intellectual property rights (IPR) framework within EAC hinders the fight against counterfeits as the IPRs are country specific and there is no mutual recognition of IPR within the region as there is no regional policy on IP. Further, there is no formal mechanism of bringing together the IP officers of the EAC partner states for purposes of discussing common issues of concern. This has greatly affected enforcement against counterfeits and illicit trade across the borders due to the fact that there are both challenges of transit goods as well as the porous borders where illicit goods could be smuggled back into any of the partner states. Therefore, there is need to push for the harmonization of IPR in EAC and the creation of a centralized database for registered trademarks in order to curb the counterfeit menace. To fight illicit trade, contraband, substandard goods and dumping in Kenya the following actions can be considered:

- ✓ Implement the trade remedies Act (2017) which seek to deal with unfair trade practices such as dumping, subsidizing and import surges;
- ✓ Establish an overarching institution to fight illicit trade which might include changing the Anti-Counterfeit Authority (ACA) into Anti-Illicit Trade Authority;
- ✓ Harmonize EAC IPR framework for mutual recognition by all partner states; and
- ✓ Full enforcement of existing laws to ensure fair trade practices and level playing field

7 See:http://documents.worldbank.org/curated/en/141781468048839839/pdf/923680WP0count000PUBLIC00Kenya02013.pdf

4.2 PILLAR TWO: EXPORT DRIVEN MANUFACTURING

In the 1970's the newly industrialized countries (NICs) adopted an export-led industrialization strategy where incentives were provided to promote non-traditional exports (World Bank, 1993). Kenyan exports are largely primary in nature as indicated in Table 3.1. Thus, an export driven manufacturing strategy can be interpreted to mean that non-primary products are encouraged and promoted, in other words, export diversification is encouraged. It can also involve upgrading primary and low technology primary commodity exports. Export promotion is emphasized in Vision 2030, however, there is no coherent policy framework to support exports (Page, 2016). There is a possibility that this challenge can be overcome in the National Export Development and Promotion Strategy which is under development and aims to grow exports by 20% by 2022.

Agenda to promote export driven manufacturing

4.2.1 Increase market access for Kenyan exports

The third quarter manufacturing barometer 2017 revealed that most of the manufacturer operate at about 53% capacity. This suggest that capacity can be enhanced for purposes of export. In 2016, imports from China, India and United Arab Emirates (UAE) accounted for 23.6%, 14.4% and 6.4% respectively of total imports for Kenya or 44.4% (KNBS, 2017). Kenyan export markets are also shrinking especially within the EAC, a key market for Kenyan manufactured goods (see annex 3). Increased market access to regional and international market is necessary for Kenya to reduce trade deficit (see annex 2). Some of the actions that the government can take to increase market access for Kenyan exports include the following:

- ✓ Seek preferential treatment of Kenyan manufactured goods by countries with huge trade imbalance against Kenya such as India, China and United Arab Emirates;
- ✓ Explore establishment of African Growth and Opportunity Act (AGOA) like trade agreement with Canada;
- ✓ Finalize the review the EAC CET and adopt a 4 band tariff structure with an upper limit of 35% to promote value addition and industrialization ;
- ✓ Fast track Continental Free Trade Area (CFTA) negotiations and its implementation to boost intra-Africa trade;
- ✓ Conclude Tripartite Free Trade Area (TFTA) negotiation and ratify the agreement to increase market for Kenyan manufactured goods;
- ✓ Finalize and implement the EAC Elimination of Non-Tariff barrier Regulation, 2017 that seeks to give effect to the EAC Elimination of Non- Tariff Barriers Act, 2015;
- ✓ Undertake trade missions to target specific markets and specific manufactured goods; and
- ✓ Develop a framework for disseminating manufacturing market intelligence through the Kenya trade portal.

4.2.2 Incentivize and promote exporters

In order to successfully promote an export driven manufacturing, an efficient and effective incentive mechanism is required. Exporters need constant cash flow to fund their operations. Tax incentives where a tax burden on a manufacturer can be eased can of benefit to the manufacturers. There is need to incentivize investors to invest in export-oriented projects or sectors. One of the factor that has adverse effects to manufacturers who export is the new formula to determine the amount due for

VAT refund. The new formula does not address the backlog of VAT refunds and acts as disincentive to exporting manufacturers who have been in VAT refund claim position. Manufacturers who export also lack export finance facility and are affected by exchange rate movements. Exporters can be incentivized through the following actions:

- ✓ Remove the VAT refund formula on exports;
- ✓ Offer export finance to local firms; and
- ✓ Introduce preferential foreign exchange premium for manufacturers doing export.

4.2.3 Protect local and infant industries

This agenda can appear like anti-free trade initiative. Infant industries require protection from the government especially where there are unfair trade practices. Government schemes such as SEZ and EPZ provide various tax (Table 4.1) and non-tax incentives as stipulated in their respective Acts of establishment and whose role and motive is widely acknowledged.

Table 4.1: Tax incentives under the EPZ and SEZ schemes

TAX	EPZ	SEZ Scheme
Value added tax(VAT)-16%	EPZ enterprises are exempt from VAT registration. The supply of taxable goods and services to EPZs is zero rated from VAT	The supply of taxable good and services to SEZs is zero rated from VAT.
Excise Duty – varying rates	Importation of goods and services exempt from excise duty	Importation of goods and services exempt from excise duty.
Income Tax – 30%	Exempt for the first 10 years from the date of first sale and at a rate of 25% for the next 10 years thereafter. 30% rate from the 21st year.	10% for the first 10 years of operation, and thereafter 15% subsequent years
Withholding Tax – 5% to 20%	Dividends and other payments to non-residents during the 10 year tax holiday. Subsequently, withholding tax for non-residents applies as follows: Interest: 15% Dividend: 10% Management & Professional Fees: 20% Royalties: 20%	Payments to non-residents: Interest: 5% Dividend: 0% Management & Professional Fees: 5% Royalties: 5%*
Investment Deductions	100% of the capital expenditure on building and machinery in the first year of use.	100% of capital expenditure on building and machinery in the first year of use.
Import Declaration Fee – 2%	Goods destined to EPZs are exempt from Import Declaration Fees	Goods destined to SEZs are exempt from Import Declaration Fees
Stamp Duty – Nominal to 4%	Execution of any instrument relating to the EPZ business.	Execution of in of any instrument relating to the SEZ business
Railway Development Levy – 1.5%	Applicable on importation	Applicable on importation
Export Levy – ad valorem	Exports to EPZs are exempt from Export Levy	Exports to SEZs are exempt from Export Levy

Data source: Authors' analysis

One of the non-tax incentive is market access. Firm operating under the EPZ scheme can legally sell up-to 20% of their annual output in the domestic market provided that all duties are paid to ensure a level playing field with other local manufacturers who are outside the EPZ scheme. However, in a move aimed at providing cheaper new clothing to its citizens, Kenya applied for a stay of application under the EAC that allowed the EPZ firms to sell to the Kenyan market (only) duty free and VAT free. This creates a situation where firms under the EPZ scheme have an upper hand over non-EPZ firms in the domestic market given the favorable incentives that accrue to them. Further, this has complicated Kenya's trade in textiles in the EAC as textiles are subjected to a rigorous verification process to determine whether they originate from the EPZs. This puts non-EPZ textile manufacturers at a disadvantage when selling in the EAC market. Unlike the EPZs, firms under the SEZ scheme with have unlimited access to the domestic market in terms of quotas.
Clearly, firms operating under the SEZ scheme have a competitive advantage over the non-SEZ manufacturers.

Manufacturing firms in Kenya are heavily dependent of imports of food and non-food industrial supplies. Strengthening of value chains by encouraging and promoting some of the imported inputs will create backward and forward linkages in the economy. A good example is edible oil where crude oil is imported in Kenya but sunflower growing can be encouraged to reduce the need to import. Thus, value chain analysis of those sectors that are likely to have strong linkages in the economy should be identified for purposes of developing them. Local and infant industries in Kenya can be protected in the following ways:

- ✓ Level playing field between SEZ, EPZ and local industry by rationalizing and harmonizing tax incentives to all Manufacturers.
- ✓ Create opportunities for local value chain with forward and backward linkages; and
- ✓ Undertake value chain analysis and offer subsidies to strategic sectors with strong linkages.

4.2.4 Incentivize value addition and diversification of exports

Value addition of export commodities such as coffee, tea and some horticultural products can increase Kenya's foreign exchange earnings. The value addition strategy can also be an export diversification strategy because new products can be developed. Kenya can export everything but arms in the EU market under the EPA and about 6,000 products to the United States under the AGOA; full potential of these markets has not exploited due to low number of exportable products.

The Government of Kenya has put emphasis on attracting Foreign Direct Investment (FDI) and has a dedicated institution (Kenya Investment Authority/KenInvest) to deal with FDIs and other forms of investments. The KenInvest should reconfigure its approach to attracting FDI, for instance by targeting a specific firm in a given country. Table 4.2 provides a summary and actions to be taken in order to realize an export driven manufacturing sector in Kenya. The government can incentivize value addition and diversification of exports by taking the following actions:

- ✓ Create Kenyan brand for some of the key export commodities such as tea and coffee;
- ✓ Targeted FDI campaigns in specific countries targeting specific manufacturers. For example pursuing Toyota Company in Japan to set up an assembly plant in Kenya;
- ✓ Hold sensitization seminars to potential exporters on market access and products that can benefit from the AGOA and EPA trade schemes; and
- ✓ Promote implementation of export oriented investments in SEZs especially those with strong backward and forward linkages with the Kenyan economy.

4.3 PILLAR THREE: PRO-INDUSTRY POLICY AND INSTITUTIONAL FRAMEWORK

Private sector is a major economic actor in any economy and an important agent for poverty reduction and economic development. Business friendly environment in terms of policy, legal and institutional framework is necessary for the private sector activities to flourish and make it better able to further national economic goals.

Agenda to ensure pro-industry policy and institutional framework

4.3.1 Predictable and stable industrial policies developed through industry consultations

The government and affiliated institutions make policy pronouncements on different issues from time to time and in some instances, without stakeholder engagement. In other cases, laws are also made without supporting policies. This means that the operating environment is not captured and laws are prepared without reflection on what is on the ground due to lack of impact assessment. Further, too often regulations are drafted or enforced in a haphazard manner with total disregard of the realities of business sector hence affecting them negatively. This agenda can be realized by taking the following actions:

- ✓ Enact a national policy on public participation;
- ✓ Ensure formulation of overarching policies before an enactment of laws.

4.3.2 National policy and institutional coherence for the manufacturing sector

National industrial policies

Over the years, the National Government has crafted a raft of policy initiatives aimed at supporting the manufacturing to make Kenya an industrialized country. The most recent policy documents include the Export Promotion Zones (EPZ) Act, 1990; Kenya's Vision 2030; Kenya Industrial Transformation Programme (KITP); Buy Kenya Build Kenya (BKBK) initiative; National Trade Policy (NTP); National Export Development and Promotion Strategy (NEDPS) and Special Economic Zones (SEZ) Act, 2015. **EPZ**: The International Labour Organization (ILO) defines EPZs as *"industrial zones with special incentives set up to attract foreign investors, in which imported materials undergo some degree of processing before being exported again"* (ILO, 2014; pg. 1). Some key features of the EPZs are that they are situated at designated geographical areas, have special incentives and the entire production is exported. The EPZ strategy was meant to make the manufacturing sector in Kenya to have an export orientation other than being inward looking. This is after import substitution industrialization strategy (ISIS) proved ineffective in promoting industrial transformation in the country.

Most of EPZs products especially textiles and apparels find their way into the United States through the AGOA programme.

Vision 2030: In 2003, the National Government instituted the Economic Recovery and Strategy Paper (ERSP) for the 2003-2007 period with the aim of speeding economic recovery and growth after decades of economic stagnation. This ERSP was credited with delivering an economic growth rate of 7.1% in 2007; the highest in several decades. After the lapse of ERSP, the government launched Vision 2030 in 2008 whose overall goal was to transform Kenya into a middle-income country by 2030. Vision 2030 seeks to create a manufacturing sector that is robust, diversified and competitive under the economic pillar (Government of Kenya, 2008). The development of industrial and manufacturing zones in eight regions and the development of Small and Medium-Enterprises (SME) industrial parks are identified as the two flagship projects to support the manufacturing sector. Five year Medium-Term-Plans (MTPs) are used in its implementation. Under Vision 2030, agro-processing, meat and fish process are emphasized.

KITP: Related to Vision 2030 is the KITP which was launched in 2015 by the Ministry of Industry, Trade and Cooperatives (MoITC). The KITP seeks to transform the manufacturing sector in Kenya for job creation and inclusive growth (Government of Kenya, 2015). The KITP objectives will be achieved through the following five strategies:

- Launch sector-specific flagship projects in agro-processing, textiles, leather, construction services and materials, oil and gas and mining services and information technology (IT) related sectors that build on our comparative advantages;
- Develop Kenyan SMEs by supporting rising stars and building capabilities with model factories;
- Create an enabling environment to accelerate industrial development through industrial parks/ zones along infrastructure corridors, technical skills, supporting infrastructure and ease of doing business;
- Create an industrial development fund; and
- Drive results through the newly formed Ministerial Delivery Unit.

SEZs: The concept of SEZs came into being in Kenya in 2015 when the SEZ Act was enacted. Baissac (2011) defines SEZs as *"spatially delimited areas within an economy that function with administrative, regulatory, and often fiscal regimes that are different (typically more liberal) than those of the domestic economy"* (Pg 23). The SEZ is a generic concept that encompasses a variety of zones including the EPZs (World Bank, 2008).

The SEZ Act, 2015 identifies ten types of zones, namely free trade zones; industrial parks; free ports; information communication technology parks; science and technology parks; agricultural zones; tourist and recreational zones; business service parks; livestock zones; convention and conference facilities.

BKBK: In 2017, the MoITC launched the BKBK strategy whose aim is to encourage Kenyans to consume locally produced goods and services in order to support the domestic economy. Five key result areas including public procurement, market access, market access, advocacy and institutional framework have been identified for purposes of implementing the strategy (Government of Kenya, 2017).

NTP: Launched in June, 2017 by MoITC alongside the BKBK and seeks to unleash Kenya's potential targeting domestic, regional and global market.The Trade Policy articulates provisions that promote efficiency in the growth of domestic trade through transformational measures that address the constraints impeding against the development of the wholesale, retail and informal sectors. Strengthening the current supply chain is a priority for sustainable development of these trade sectors

NEDPS: This is being developed by MoITC and it is in its final stages of completion. It is a five-year sector development plan with defined actions on issues that affect export development in the country. It is expected to specifically; Induce synergies for higher production in specific export sectors to enable better export performance; enhance market access and sustained performance; identify and align constrains in the export sector and propose mitigation measures; allocate resource based on prioritized objectives and streamline the export sector.

Prevailing institutional framework

There are a host of institutions that affect the operations of the manufacturing sector in Kenya. For the purpose of this current analysis, focus will be limited to those institutions that implement policy strategies to promote industrial manufacturing and they include the following:

- **MoITC**: The mission of this Ministry is to create an enabling environment for a globally competitive, sustainable Industrial, enterprise and co-operative sector through appropriate policy, legal and regulatory framework. The KITP and BKBK strategy are hosted in this Ministry.
- **Ministry of Devolution and Planning (MoDP):** This Ministry spearheads the preparation of MTPs meant to actualize the realization of Vision 2030 and is in the process of finalizing the third MTP for the period 2018-2022. In the MTP, there is a sector plan for the manufacturing sector and prepared by MoITC.
- **Kenya Vision 2030 Delivery Secretariat:** It was created to spearhead the implementation of Vision 2030 and MTPs by providing leadership and coordination.
- **Micro and Small Enterprise Authority (MSEA)**: This institution was established under the Micro and Small Enterprise Act, 2012 to formulate and coordinate policies to integrate and harmonize both public and private sector initiatives to enable the MSEs to become the key industries of tomorrow. It is instructive to note that the development of MSE industrial parks is one of the flagship programme proposed under Vision 2030. The MSEA is under the MoITC.
- **Kenya Investment Authority (KenInvest)**: KenInvest was established in 2004 to promote investments in Kenya and is under the National Treasury. In discharging its responsibilities, KenInvest oversees the implementation of new investment projects, provides after-care services for new and existing investments and organizes investment promotions in Kenya and abroad.
- **Brand Kenya Board (BKB)**: It was created in 2008 to build and enhance Kenya's image and national identity and rallying Kenyans behind it. One of its functions is that of promoting local products and services to encourage economic transformation. The BKB is under the MoITC.
- **Kenya Industrial Property Institute (KIPI)**: It is a government agency under the MoITC having been established in 2002. Its mission is to grant industrial property rights and promote social and economic development.
- **Kenya Industrial Research and Development Institute (KIRDI):** The KIRDI is under the MoITC and it is mandated to undertake multidisciplinary research and development in industrial and allied technologies.
- **Export Promotion Council (EPC)**: It was established in 1992 with a view to develop and promote export trade for the benefit of locally produced goods and services. This was meant to give the economy an outward orientation which was largely inward looking at the time. The EPC is under the MoITC.

- **Export Promotion Zones Authority (EPZA):** It was established in 1990, it is mandated with attracting, and retaining export oriented investments and trade. It is under the MoITC.
- **Special Economic Zones (SEZs) Authority:** It was established in 2015 and it is under the MoITC. One of its responsibilities is to promote and market special economic zones to potential economic zone developers, operators or other investors.
- **President's Delivery Unit (PDU):** It was established in February 2015 by the President to oversee the implementation of flagship projects. Flagship projects are scattered across 12 sector: information communication and technology (ICT); healthcare; lands; infrastructure; social inclusion; food security; energy; youth and women; security; ease of doing business; and Huduma Centers. It is apparent that there are no specific flagship projects for the manufacturing sector in Kenya.

Rationalization of national policy and institutional framework affecting the manufacturing sector is necessary to ensure coherence. This is by instituting actions that might include:

- ✓ Develop and implement a national manufacturing policy; and
- ✓ Review, and rationalize the roles of various regulatory bodies in the manufacturing sector.

4.3.3 Manufacturing sector delivery unit

It is apparent that there are multiple institutions with different mandates and driving in different ways the industrialization agenda. Rationalization of these institutions is important to avoid duplication and confusion with regards to industrialization in Kenya. Vision 2030 Delivery Secretariat is supposed to monitor the implementation of Vision 2030 flagship projects and the MTPs; PDU also oversees the implementation of flagship projects and the MoITC under the KITP has proposed the formation of Ministerial Delivery Unit. A fundamental question can be posed. Which institution should champion industrialization in Kenya? As a stopgap measure, the KAM is of the view that policy and institutional coordination be under the PDU. The PDU does not yet have flagship projects targeting the manufacturing sector in Kenya. This should change because manufacturing is one of the four sectors that HE President Uhuru Kenyatta will prioritize in the next five years. In his inaugural speech on 28th November, 2017, the president noted *"Over my term, we will grow and sustain this manufacturing sector, and raise its share of the national cake from 9 to 15 percent"*. For the manufacturing sector delivery unit to be effective, the following action is proposed:

- ✓ Identification of manufacturing sector flagship projects guided by the proposed national manufacturing policy to be coordinated under the PDU.

4.4 PILLAR FOUR: GOVERNMENT DRIVEN SMES DEVELOPMENT

The Vision 2030, underscores the importance of the Small and Medium Enterprises (SMEs) subsector in the country's industrial transformation agenda. The SMEs have been recognized for their role in providing goods and services, enhancing competition, fostering innovation and generating employment leading to alleviation of poverty. The SMEs cut across all the sectors of the economy and provide one of the main sources of employment as well as generating widespread economic benefits (Government of Kenya, 2005). National Economic Survey report by the Central Bank of Kenya of 2017, SMEs constitute 98% of all businesses in Kenya, create 30% of the jobs annually and contributes 3% of GDP. While the sector continues to create numerous jobs and boost the country's GDP, it faces a myriad of challenges that hamper its growth.

*"Here in Kenya, the bulk of employment comes from SMEs, which are an important contributor to our gross domestic product (GDP). Our plan is to create an additional **1,000 SMEs** focused on manufacturing: they will have access to affordable capital, **skills and markets;** and they will accelerate the growth in manufacturing".*

H.E President Uhuru Kenyatta, CGH
President and Commander in Chief of the Defence Forces of the republic of Kenya
-12th December, 2017

These challenges range from product development, market access (both local and international), access to affordable finance, supply chain/raw material management, quality standards and certifications, access to technology, production innovation and patenting to policy, regulatory and business environment problems. In fact, the KNBS 2016 study on the sector revealed that close to half a million small enterprises in Kenya die annually as the business environment in the country gets bumpy. Furthermore, SME sub-sector has the highest informal sectors in the country with close to 5.58 million unlicensed businesses (National Micro, Small and Medium Establishment Survey, 2016).

Agenda to promote government driven SMEs growth and development

4.4.1 Facilitate business compliance with regulations to formalize the informal economy

Unfriendly policies and regulatory regimes are key hindrances to a conducive business environment. Facilitation to business compliance through SME supportive regulations has been seen as key a driver in formalizing the informal businesses[8]. SMEs operate partly or wholly in the informal sector, especially when at start-up stages, due to the nature of markets which are often over-regulated through licensing among others (Antonopoulos and Mitra, 2009). The National Micro, Small and Medium Establishment Survey by KNBS in 2016, established that there were about 1.56 million licensed SMEs and 5.85million unlicensed businesses in the country. Challenges such as complex and tedious registration processes and procedures, high fees by some of the industry regulators, charges and fees on new product development and their introduction to market, high local authorities trade licensing fees, competition from uncontrolled imports and lack of subsidies to support SMEs exporters, unclear government policies and regulations and poor or lack of infrastructure in production zones have been cited to cause this. In order to address these challenges, the following actions should be undertaken:

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- ✓ Promote simplification of business startup procedures;
- ✓ Encourage informal industries and associations to register with MSEA and use this body to voice the concerns and ideas of the sub-sector;
- ✓ Establish incubation centers for SMEs in all 47 counties in order to resolve issues such as product design, access to technology, production innovation and patenting;
- ✓ Provide trainings for SMEs on cash flow management, marketing and exporting, intellectual property management and corporate governance;
- ✓ Reduce barriers to registration through formulation of a policy that simplifies and spells out the registration process; and
- ✓ Corporate Tax relief for start-up SMEs for the first three years of operation.

4.4.2 Accord preference to local content in government procurement

Government in any country is the largest consumer of goods and services and this implies that it can be of great benefit to the SMEs especially by procuring their products. Public procurement serves as a window through which the public sector can interact with the private sector. How such interaction is managed is very important in fostering a sense of fairness and widening the base for participation by the private sector in public procurement (All- Party Parliamentary Small Business Group (APPSBG), 2006). While the public procurement market in Kenya, like other countries worldwide, deals with wide ranges of supplies, SMEs have been sidelined (Afande, 2015). Some contracts are within capabilities of SMEs but they are shelved from participating in public procurement despite their qualification, sizes and level of production because of a myriad of issues ranging from documentation, financials, to unfair processes. Creation of linkages between large enterprise and SMEs through subcontracting is one of the main determinants for the success of SME growth and development. The interaction has impact on knowledge and skill transfer and enhanced technological adoption. The government could also focus on improving trade financing which will go a long way in improving the sector. In general terms, SMEs can be accorded preference through the following actions:

- ✓ Fast track the implementation of BKBK policy;
- ✓ Create linkages between large enterprise and SME through subcontracting;
- ✓ Review, simplify and publish guidelines of the Public Procurement and Asset Disposal Act (PPADA) , 2015 with step by step instructions and tips on how to respond to public tenders with a focus on Kenyan goods and services; and
- ✓ Review PPADA, 2015 to enforce the directive to reserve 40% of the procurement budget for locally produced goods and services.

4.4.3 Enhance credit and market access to SMEs

Understanding the market dynamism in both the domestic and international market, where finished products are sold, is key to the success of any firm. Most of Kenyan SMEs sell their products and service in the domestic market. The domestic market is small for mass production and to benefit from economies of scale. Hence inability for SMEs to reduce unit cost of production and the only way to increase their share of market is by developing new and innovative products which has substantial financial implication. On the hand, the country's appetite for imported manufactured goods has continued to rise and has had adverse effect on the SME sector in the county competition.

If the SMEs sub-sector in manufacturing, is to grow, there is need to access more finances and at a lower cost. Several studies have consistently cited lack of financial access as a major problem among SME in the country. Access to financial resources is constrained by both internal and external factors. Internally, most SMEs lack creditworthiness and managerial capacity, so they have trouble securing funds for their business activities such as procuring raw materials and products and investing in plant and equipment. From the external perspective, SMEs are regarded as insecure and costly businesses to deal with because they lack required collaterals and have low absorption capacity of funds. They are therefore rationed out in their access to credit due to high intermediated costs, including cost of monitoring and enforcement of loan contracts.

Further, a challenge linked to expanding bank lending is the interest rates cap, which capped lending rates at 4% above the CBK base rate since August 2016. The interest rate capping has negatively affected the SMEs as banks have turned to risk profiling, a move which has seen the SMEs fall under the most risky category hence crowding them out. According to available data from The National Treasury, Private sector credit growth fell from its peak of about 25 percent in mid-2014 to 1.6% in August 2017, the lowest in ten years (Figure 2.5). Actions that can be taken to enhance credit and market access include the following:

- ✓ Set up a stock exchange for SMEs and implementation of NSE's framework to boost the access of venture capital funds to small and medium enterprises;
- ✓ Rethinking and updating risk assessment tools, especially when assessing SMEs;
- ✓ Offer loan guarantees to SMEs;
- ✓ Incentivize commercial banks to provide low interest rate loans targeting manufacturers and SMEs; and
- ✓ Encourage Kenya Credit Reference bureaus to work closely with manufacturers in determining credit worthiness.

4.5 PILLAR FIVE: SECURING THE FUTURE OF MANUFACTURING INDUSTRY

To secure the future of the manufacturing sector, its operations has to be environmentally friendly and sustainable, keep pace with the ever changing technological advances which necessitates continuous skill development of the labour force. Also important is access to land especially with the coming into being of the County Governments, an efficient public service and a stable political environment.

Agenda for securing the future of Manufacturing Industry in Kenya

4.5.1 Green growth and sustainable development

According to the Organization for Economic Cooperation and Development (OECD, 2011), green growth can be seen as a way to pursue economic growth and development, while preventing environmental degradation, biodiversity loss, and unsustainable natural resource use. For development to be sustainable, it has to meet the needs of the current generation without compromising the ability to meet the needs of the future generations. The following actions need to be taken to promote green growth and sustainable development:

- ✓ Incentivize industries excelling in energy management through a national award;
- ✓ Promote self-regulation for manufacturer on environmental issues;
- ✓ Apply for the green climate change fund;
- ✓ Finalize and enact the National Waste Management Bill 2017;
- ✓ Support the finalization and implementation of the National Water Policy;
- ✓ Promote industry symbiosis to encourage green economy and create new culture of economic growth ; and
- ✓ Promote and recognize the certification mark for responsible care.

4.5.2 Industry 4.0

Industry 4.0 (4th industrial revolution) is a name for the current trend of automation and data exchange in manufacturing technologies. Industry 4.0 creates what has been called a "smart factory". It includes cyber-physical systems, the Internet of things, cloud computing and cognitive computing Industry. Given that Industry 4.0 is still a very new concept, one of the action that can be implemented is stated as follows:

- ✓ Develop a national policy framework and programme to implement industry 4.0 with sectoral bias.

4.5.3 Pro-industry skill development

Constant training of workers is critical for the manufacturing sector because technological advances have ensured that the skill gaps continue to increase and hence the need for continuous training. While over thousand youth graduates from higher education enter the Kenya job market every year, the 2017 industrial competitiveness report points out dire situation in skill sector in Kenya. There are gaps in the human skill, curriculum and technology that do not adequately address the ever changing skill and technology need for the manufacturing sector.

There is growing mismatch between available technical skill and the market demands due to a weak linkage between training institution and the industry at the three levels of training (Universities, Tertiary colleges and Youth polytechnics). Generally, the labour market in Kenya is in the dire need for a bridging dialogue and structured way forward between the skill need by industry and the rather lacking training place in technical training institutions (TTIs).

There are various policy instrument and private sector initiatives that have been developed to address challenges. The KAM is implementing a technical and vocational education and training (TVET) project with main goal of improving access to technical and vocational jobs and economic opportunities for youth in Kenya. Some of the government policy and legal instruments geared towards addressing training at the three levels mentioned above include: Education Act Cap 211, SME Sessional Paper No.2 of 2005, and TVET Strategy 2008, TIVET Act, 2013, Industrial Training Act 2012,Employment Act 2007,Ministry of Youth Affairs and Sports' Curriculum for Youth Polytechnics – being piloted in 100 Youth Polytechnics. The Nation Government can initiate one of the following policy actions:

- Introduce subsidized apprenticeship programme and provide tax holidays for companies taking up interns;
- Development and implementation of Sector Skills Advisory Committees (SSACs) that will guide in the development of occupation standards to influence curriculum development;
- Review the Public Service Commission Internship Policy and Guidelines for the Public Service (2016) to accommodate TVET graduates interns;
- Popularize and strengthen TVET education and training through National TVET conferences and skills shows;
- Establish job matching database to link the employers and employees; and
- Strengthen the links between industry and academic institutions through research.

4.5.4 Enhance access to land

Land is one of the basic factor of production and remain key to vast majority industries in Kenya. The cost and ownership of land in Kenya is high and the issue of land has been complicated with the onset of County governments which do not have land banks designated for industrial development. Processing of title deeds is time consuming primarily because it is a manual process. The following actions can foster access to land in Kenya include:

- ✓ Proactively create land banks earmarked for industry at county and national levels of government perhaps through institutions such as KIE;
- ✓ Advocate for speedy digitization of land registry; and
- ✓ Prompt issuance of title deeds including for SMEs.

4.5.5 Fit-for-purpose public service

An efficient, responsive and effective Public administration is necessary if the manufacturing sector agenda and indeed if the country develops. Thus, efforts to revitalize public services delivery, fight against corruption and reduction of loss of public funds and enhancement of labour productivity will go a long way in creating a fit-for-purpose public service delivery in Kenya. Some of the actions that can be implemented to achieve this objective includes the following:

- ✓ Replace cash-based accounting system with accrual-based accounting system in public finance;
- ✓ Strengthening performance contracting enhance public service delivery;
- ✓ Initiate an annual Presidential event to recognize top performing public institutions and public servants; and
- ✓ De-peg the piece rate from minimum wage to encourage labour productivity.

4.5.6 Stable political environment

For the private sector activity to flourish and realize its objective of satisfying the customers, employees and the society, a stable political environment is an important ingredient. For purpose of argument, a stable political environment is one that is devoid of violence or disruptive effects on business. In Kenya, most of elections are disruptive to business and leads to steep reduction in the rate of economic growth. There is need to find a permanent solution to the violence that often erupts during an election year. Some of the suggested actions include the following:

- ✓ Address the root cause of political crisis that erupts in an election year; and
- ✓ National debate on political cohesion.

> Let me emphasize that political stability and harmonious labour relations are the bedrock on which we will achieve a robust manufacturing sector.
>
> H.E President Uhuru Kenyatta, CGH
>
> President and Commander in Chief of the Defence Forces of the republic of Kenya
>
> **-12th December, 2017**

SUMMARY AND CONCLUSION

5.1 Summary

The MPA 2018 themed, *"Sparking Kenya's industrial transformation for job creation"* will drive the KAM advocacy agenda this year. A spark in industrial manufacturing sector is required to increase its share to GDP from 9.2% to 15%, create employment for the unemployed majority of whom are the youths and in the end become the engine that drives the economy as was the case in the industrialized countries. Creation of the "spark" in the manufacturing sector will revolve around five pillars: competitiveness and level playing field; export-driven manufacturing; pro-industry policy and institutional framework; SMEs development and securing the future of manufacturing industry.

Manufacturers need to be competitive and produce goods and services that can compete regionally and internationally, given that trade barriers have declined globally as a result of multilateral trade agreements and regional trade integration initiatives. Fairness, rules of the game, and incentives for all categories of manufacturing are necessary. Some of the impediments towards a competitive and level playing field include levies such as IDF and RLD, VAT refunds and WVAT, expensive and unreliable electricity, multiple charges, fees and levies by counties, liquidity constraints in the economy, expensive transport and logistics, lack of long-term finances to manufacturers; illicit and contraband trade.

A manufacturing sector that is export driven is required to overcome limitations of small domestic markets. Challenges on access to regional export markets have to be sought and overcome. Disincentives to manufacturers such as VAT refund backlogs with KRA have to be addressed, protect local and infant industries and incentive value addition and diversify exports.

For the manufacturing sector in Kenya to flourish, there is need for supportive policy and institutional framework. There is a host of policies such as Vision 2030, KITP, BKBK and the NEDPS that can create confusion instead of clarity in terms of what the focus should be in developing and supporting the manufacturing sector in Kenya. Responsibilities of implementing these policies rests in many institutions such as Vision 2030 Secretariat, SEZ Authority, EPZA, and PDU among others. This suggest that there is no centralized entity to harmonize and coordinate activities of these institutions. This needs to change

The importance of SMEs sector contribution to the overall growth of economy cannot be overemphasized. There is need for government to put more focus on addressing the challenges in the SMEs sector in the country. Robust SMEs financing framework will go a long way in enhancing access to finance among SMEs. Government need to simplify business registration process while promoting start up business through trainings that focus on cash flow management, intellectual property management product design and development, market access, and corporate governance among others for SMEs. Promotion of sub-contracting between large and SME will also go a long way in promoting the subsector. Enforcement of the 40% local sourcing requirement will also be instrument in building the SMEs sector in the Country. A wide spectrum such as this may only be tackled by mainstreaming SME development in national frameworks

The future of the manufacturing sector in Kenya has to be secured. Natural environment is continuously getting degraded as a result of human activity, skills gaps are increasing and life of skills already acquired shortening because of technological advances; land is Kenya is an issue of concern for manufacturers; an effective and effective public service and a stable political environment is required for effective functioning of the manufacturing sector.

5.2 Conclusion

Kenyan manufactures need an outward orientation through increased exports to regional and international markets. A particular focus should be given to those countries that Kenya can has an ever increasing trade deficit with especially China, India and UAE and should review any of the current bilateral trade agreement to address this problem. Exporters need to be incentivized to export more for example through availability of affordable exchange rate regime. Local and infant industries require support especially those that have strong backward and forward linkages in the economy. Targeted approach to attract some specific investors in particular countries can be used as innovative way to attract FDI to foster value addition and diversification of exports.

Policy and institutional coherence is required such that there is only one policy document to guide development and promotion of the manufacturing sector in Kenya. Such policies should be predictable and stable and involving all the relevant stakeholders in course of their development. This will reduce confusion and "many voices" talking about the same thing. The MPA 2018 proposes the development of a National Manufacturing Policy whose implementation and coordination should be under the PDU.

A government driven SMEs development (while stakeholder involvement) will be instrumental in turning around the sector. Government procurement should be pro-SMEs and with effective SMEs financing framework and a supportive business facilitation compliance while encouraging SMEs subcontracting with large firms.

To secure the future of the manufacturing sector in Kenya, green growth practices such efficiency in energy use, industry symbiosis and recycling have to be pursued. Development of national policy framework and programme to implement Industry 4.0 creating need-based curriculum is necessary to keep pace with the ever changing technology. Efforts to increase efficiency and room for leakage of public funds such as implementing accrual-based accounting system in public finance and reinvigorating performance-based management system in public service is crucial. A lasting solution to political crisis that Kenya experiences in an election year has to be sought.

ANNEXES

Annex 1: Summary of pillars, agenda and actions for MPA 2018

THEME: SPARKING KENYA'S INDUSTRIAL TRANSFORMATION FOR JOB CREATION			
S/N	**NAME OF THE PILLAR**	**AGENDA**	**ACTIONS**
1.	**Competitiveness and level playing field**	**a) Reduce the cost of production for basic commodities**	1) Zero rate import declaration fee (IDF) for industrial inputs for bona fide manufacturers. 2) Zero rate railway development levy (RDL) for bona fide manufacturers. 3) Clear outstanding VAT refunds and ensure VAT refunds processing and payment is undertaken within 60 days from the date of lodging application in order ensure companies healthy cash flow. 4) Exempt bona fide manufacturers from Withholding VAT.
		b) Promote access to quality, affordable and reliable energy	1) Finalize the enactment of the Energy bill 2015 which seeks to resolve energy related issues in the country such as power quality, reliability and distribution of electricity among others in Kenya. 2) Establish autonomous regional KPLC branches to increase competition and reliability of power supply 3) Allow generators of electricity to sell to bulk electricity consumers to reduce enhance the quality and reliability of electricity. 4) Review contracts of thermal power producers and peg them on performance to ensure access to reliable power at affordable rates.
		c) Address multiple charges, fees and levies by counties	1) Fast track finalization and implementation of county own revenue resource policy which seeks provide guidelines on revenue collection among counties as per the constitution. . 2) Develop a national legislation to harmonize and rationalize county policies and legislation on fees, charges and levies.
		d) Increase circulation of money in the economy	1) Enactment of prompt payment and accountability legislation. 2) Establishment of a Regulatory Authority for the retail sector. 3) Set up supplier portal so that suppliers can electronically track status of orders, delivery schedules, potential product shortage and payment received. 4) Organize business ethics and integrity compliance trainings for the private sector. 5) Digitize payments and refunds by Government.

S/N	NAME OF THE PILLAR	AGENDA	ACTIONS
		e) Reduce transport and logistics costs	1) Review the proposed SGR freight rate to make competitive. 2) Implement the Integrated Customs Management System (ICMS) to enhance efficiency of customs processing. 3) Implement the pre-clearance system for cargo and dynamic risk management to reduce the port congestion and cargo dwell time at the port. 4) Harmonize Kenya's road humps with EAC standards. 5) Fast track the country wide rollout of instant fines scheme on minor traffic offenses to minimize corruption on roads and save time. 6) Mount a campaign on road safety and discipline.
		f) Avail long term financing for manufacturers	1) Incentivize saving institutions such as National Social Security Fund (NSSF) to invest in the manufacturing sector. 2) Restructure the Industrial and Commercial Development Corporation, Agricultural Finance Corporate (AFC), Kenya Industrial Estate (KIE) to create a Kenya Development Bank with an industrial development fund committed to manufacturing. 3) Operationalize the Movable Property Security Rights Act, 2017 (the Act) that provides for the creation of electronic collateral Registry for use by Kenyan banks 4) Incentivize International Finance Corporation (IFC) and Exim banks to provide long term loans to the manufacturers
		g) Fight illicit trade, contraband, substandard goods and dumping	1) Implement the trade remedies Act (2017) which seek to deal with unfair trade practices such as dumping, subsidizing and import surges. 2) Establish an overarching institution to fight illicit trade which might include changing the Anti-Counterfeit Authority (ACA) into Anti-Illicit Trade Authority. 3) Full enforcement of existing laws to ensure fair trade practices and level playing field 4) Harmonize EAC intellectual property right (IPR) framework for mutual recognition am by all partner states.
2.	**Export driven manufacturing**	**a) Increase market access for Kenyan exports**	1) Seek Preferential Treatment of Kenyan manufactured goods by countries with huge trade imbalance against Kenya such as India, China and United Arab Emirates. 2) Explore establishment of "AGOA" like trade agreement with Canada. 3) Finalize the Review the EAC CET and adopt a 4 band tariff structure with an upper limit of 35% to promote value addition and industrialization 4) Fast track Continental Free Trade Area (CFTA) negotiations and its implementation to boost intra-Africa trade. 5) Conclude Tripartite Free Trade Area (TFTA) negotiation and ratify the agreement to increase market for Kenyan manufactured goods. 6) Finalize and implement the EAC Elimination of Non-Tariff barrier Regulation, 2017 that seeks to give effect to the East African Community Elimination of Non- Tariff Barriers Act, 2015. 7) Undertake trade missions to target specific markets and specific manufactured goods. 8) Disseminate manufacturing market intelligence through the Kenya trade portal

S/N	NAME OF THE PILLAR	AGENDA	ACTIONS
		b) Incentivize and promote exporters	1) Remove the VAT Refund formula on Exports 2) Offer export finance to local firms; and 3) Introduce preferential foreign exchange premium for Manufacturers doing export.
		c) Protect local and infant industries	1) Level playing field between SEZ, EPZ and local industry by rationing and harmonizing tax incentives to all Manufacturers. 2) Create opportunities for local value chain with forward and backward linkages 3) Undertake value chain analysis and offer subsidies to strategic sectors with strong linkages. 4) Establish a National Automotive Council to drive the agenda for the sector.
		d) Incentivize value addition and diversification of exports	1) Create Kenyan brand for some of the key export commodities such as tea and coffee. 2) Targeted foreign direct investment (FDI) campaigns in specific countries targeting specific manufacturers. For example pursuing Toyota Company in Japan to setup an assembly plant in Kenya. 3) Hold sensitization seminars to potential exporters on market access and products that can benefit from the AGOA and EPA trade schemes. 4) Promote implementation of export oriented investments in SEZs especially those with strong backward and forward linkages with the Kenyan economy.
3.	**Pro-industry policy and institutional framework**	**a) Predictable and stable industrial policies developed through industry consultations**	1) Enact a national policy on public participation. 2) Ensure formulation of overarching policies before an enactment of laws.
		b) National policy and institutional coherence for the manufacturing sector	1) Develop and implement a national manufacturing policy. 2) Review, and rationalize the roles of various regulatory bodies in the manufacturing sector.
		c) Manufacturing sector delivery unit	1) Identification of manufacturing sector flagship projects guided by the proposed national manufacturing policy to be coordinated under the Presidential Delivery Unit.

S/N	NAME OF THE PILLAR	AGENDA	ACTIONS
4.	**Government driven SMEs development**	**a) Facilitate business compliance with regulation to formalize the informal economy**	1) Promote simplification of business startup procedures. 2) Encourage informal industries and association to register with Micro and Small Enterprise Authority and use this body to voice the concerns and ideas of the sub-sector 3) Establish incubation centers for SMEs in all 47 counties in order to resolving issues such as product design, access to technology, production innovation and patenting. 4) Provide trainings for SMEs on cash flow management, marketing and exporting, intellectual property management and corporate governance for SMEs. 5) Reduce barrier to registration through formulation of a policy that simplifies and spell out the registration process. 6) Set up a database for formalized SMEs for inform decision making and policy formulation 7) Review regulation affecting SMEs such, taxation and related tax exemption ,tax administration and business registration regulation 8) Review EPZ and SEZ policies to make them supportive of SME development. 9) Strengthen SME capacities to improve their competitiveness in domestic, regional and global markets.
		b) Accord preference to local content in government procurement	1) Fast track the implementation of Buy Kenya Build Kenya (BKBK) policy. 2) Create linkages between large enterprise and SME through subcontracting.
		c) Enhance credit and market access to SMEs	1) Set up a stock exchange for SMEs and implementation of NSE's framework to boost the access of venture capital funds to small and medium enterprises. 2) Rethink and update risk assessment tools, especially when assessing SMEs. 3) Offer loan guarantee to SMEs 4) Incentivize commercial banks to provide low rate loan targeting manufacturers and SMEs. 5) Encourage Kenya Credit Reference bureaus to work closely with manufacturers in determining credit worthiness

S/N	NAME OF THE PILLAR	AGENDA	ACTIONS
5.	**Securing the future of manufacturing Industry**	**a) Green growth and sustainable development**	1) Incentivize industries excelling in energy management through national award 2) Promote self-regulation for manufacturers on environmental issues 3) Apply for the green climate change fund 4) Finalize and enact the National Waste Management Bill 2017 5) Support the finalization and implementation of the National Water Policy 6) Promote industry symbiosis to encourage green economy and create new culture of economic growth 7) Promote and recognize the certification mark for responsible care
		b) Industry 4.0	1) Develop a national policy framework and programme to implement industry 4.0 with sectoral bias.
		c) Pro-industry skill development	1) Introduce subsidized apprenticeship programme and provide tax holidays for companies taking up interns. 2) Development and implementation of Sector Skills Advisory Committees (SSACs) that will guide in the development of occupation standards to influence curriculum development. 3) Review the Public Service Commission Internship Policy and Guidelines for the Public Service (2016) to accommodate TVET graduates interns. 4) Popularize and strengthen TVET education and training through National TVET conferences and skills shows. 5) Establish job matching database to link the employers and employees. 6) Strengthen the links between industry and academic institutions through research.
		d) Enhance access to land	1) Proactively create land banks earmarked for industry at county and national levels of government perhaps through institutions such as KIE. 2) Advocate for speedy digitization of land registry. 3) Prompt issuance of title deeds including for SMEs.
		e) Fit for purpose public service	1) Replace cash-based accounting system with accrual-based accounting system in public finance. 2) Strengthening performance contracting enhance public service delivery. 3) Initiate an annual Presidential event to recognize top performing public institutions and public servants. 4) De-peg the piece rate from minimum wage to encourage labour productivity.
		f) Stable political environment	1) Address the root cause of political crisis that erupts in an election year. 2) National debate on political cohesion

Annex 2: Kenyan balance of trade (Bot) 2010-2016 - Kshs. "000"

	2010	2011	2012	2013	2014	2015	2016
Balance of Trade	(537,412)	(788,145)	(856,740)	(911,029)	(1,081,085)	(996,532)	(853,678)
Total Exports	409,794	512,604	5,17,847	502,287	537,236	581,045	578,067
Total Imports	947,206	1,300,749	1,374,587	1,413,316	1,618,321	1,577,577	1,431,745
Cover ratio (%)	43.26	39.41	37.67	35.54	33.20	36.83	40.37

Data source: KNBS, 2017

Annex 3: Kenyan export and imports to and from EAC countries (2010-2016) - Kshs. "000"

Country	2010	2011	2012	2013	2014	2015	2016
Tanzania	33,211,132	41,743,395	46,036,163	40,496,493	42,724,911	33,663,396	34,796,571
Uganda	52,108,047	75,953,923	67,450,115	65,361,907	60,782,664	68,573,904	62,163,383
Rwanda	10,535,164	13,553,558	16,151,363	13,499,695	14,440,844	17,949,831	17,499,630
Burundi	5,458,274	5,903,760	5,308,763	5,598,956	7,849,463	6,594,983	7,242,223
Total Export to EAC	101,312,617	137,154,636	134,946,404	124,957,051	125,797,882	126,782,114	121,701,807

Data source: KNBS, 2017

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Who we are

Established in 1959, Kenya Association of Manufacturers (KAM) is the largest manufacturing association in Kenya representing small and large manufacturers alike in every industrial sector. KAM is the consistent voice of the sector and the leading advocate for a policy agenda that helps manufacturers to create jobs and compete both within Kenya, regionally and globally.

Our Vision

To be a world class business membership organisation effectively delivering services to its members wherever they operate

Our Mission

To promote competitive local manufacturing in a liberalised market

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