

The GLOCEPS

Policy Paper

Research and Analysis in Development Pillar

Kenya's Economic Recovery Policy Prioritization Amidst COVID-19 Pandemic

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The rejuvenation of Kenya's economy is anchored on mitigating pandemic-induced social and economic causative factors and effects. The paper argues that prioritization of accelerated vaccination is the cornerstone economic recovery. It provides a better tradeoff in insulating the economy from disruptive nature of the pandemic itself and that of mitigating measures like restriction of movement and economic activities. This will ease the government's capacity to provide social and economic stimulus packages amidst the pandemic as constrains of an encumbering debt distress, widespread unemployment instigated by the pandemic and predominance of public sector procurement fraud. In this light, the normal operating Kenyan marketplace is better positioned to take advantage of investment opportunities resulting from the ongoing free trade negotiations between Kenya and United States and Kenyans in diaspora. Discussions on these issues anchor insights and policy recommendations for economic recovery amidst the COVID-19 pandemic.

~Executive Summary



Photo credit: Afrinews

Introduction

The COVID-19 pandemic poses enormous threats to national economies and health of populations. Lives and employments have either been lost or adversely affected. Policymakers have been forced to promulgate measures that impact the social and economic wellbeing of communities and governments. While the mutating nature of the virus is a fundamental concern to economic health and recovery, much of the resultant ill-effects have been due to

factors that predate the pandemic. In the Kenyan context, these exacerbating issues include debt distress, unemployment, and public sector fraud. Therefore, expediting a return to economic normalcy necessitate mitigating both the transmission of the virus and underlying economic factors. These are the foundation blocks for realizing stability in the local and global marketplaces that are innate for economic undertakings.





Background

The COVID-19 pandemic's shakedown of the global economy has been monumental and far-reaching. The impact on investment, productivity of human capital and global value chain is expected to postdate the pandemic. In the absence of targeted policy interventions, economic recovery in emerging and developing economies like Kenya are predicted to endure decade-long disruptions. Prudent and comprehensive policy efforts are therefore essential to spur robust, sustainable and equitable recovery. These social and economic policies should be geared at improving the health of populations while enhancing their employability.

Economic policy actions have to strengthen the health system to procure and accelerate inoculation. Equally, these policies have to complement initiatives that address economic concerns and promote economic investments and pro-

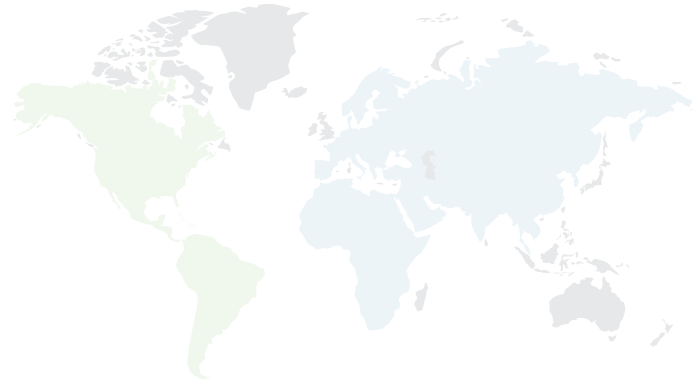
ductivity. Legislative and policy frameworks on debt negotiations for lower interest rates but longer repayment periods as well as curbed borrowing are invaluable for balanced budgeting. Similar benefits are realizable from mitigating public procurement fraud and encouraging efficiency and accountability.

In conclusion, forward-looking policies should be prioritized as attractive options for extended growth and development. They include investments in green projects and technologies as they are more equitable and adaptive to emerging environmental challenges; and long-term planning and action for transition from low-value manufacturing and agriculture. While pursuing opportunities through free trade agreements, Kenya can leverage on these opportunities to attract investments that will enhance manufacturing and agriculture.



Photo credit: Citizen TV





Key Findings

The prioritization of the following policy issues is fundamental to the recovery of the Kenyan economy in the midst of the pandemic. These policy actions are fortified by the accelerated inoculation of the Kenyan population which provides the platform for unimpeded business and social environment.



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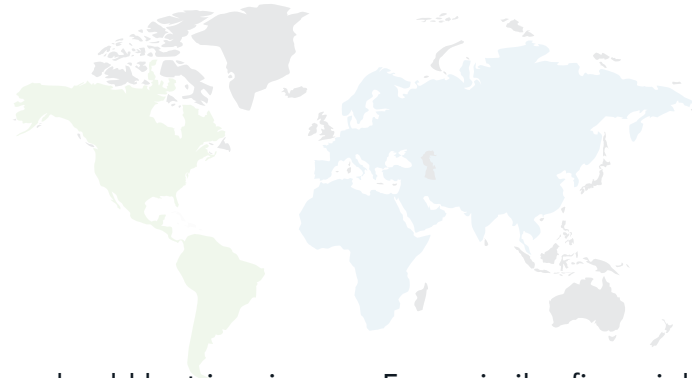
Vaccination policy equals economic policy

The cornerstone policy for a sustainable path to economic rejuvenation is one that secures an impregnable return to normalcy - an accelerated inoculation policy. Jurisdictions with higher inoculation rates are anticipated to realize a faster return to economic normalcy due to containment of transmission rates, alleviation of strain on the health system and lifting of measures on cessation of movements. Policy interventions that eschew mass inoculation are ineffectual in the face of the mutating virus and infection spikes that occur every four months. Super spreader activities are largely inevitable due to the Kenya's peculiar dynamics already engrained in the country's fabric. They include the reopening of learning institutions, large political gatherings and aberration to prevention measures in public transportation sector.

The Kenyan economy is not resilient to incessant curfews and lockdowns. Therefore, the government's plan to vaccinate 30% of the population by 2023 is inadequate for the achievement of the required herd immunity. Moreover, the economic tradeoff justifies the prioritization of inoculation policy. The procurement of the most expensive vaccine will cost an estimated \$700 million. This equates to 12.5% of tax revenue lost from April to December 2021 and 0.073% of Kenya's annual gross domestic product (GDP).

The stagnation of COVID-19 vaccination is detrimental to economic rejuvenation. Most of the financial needs and support amidst the prevailing pandemic are recurrent. Though germane in the short-term, they defer the debt





distress problem that Kenya should be trimming. Already, the International Monetary Fund (IMF) has provided \$739 million to provide for additional spending on health and social protection. An additional \$2.4 billion low interest financing has been pledged and partly remitted by the IMF towards budgetary support for the year 2021/22.

With the government experiencing liquidity challenges in balancing the 2021/22 budget, policymakers will need to be ingenious in order to scale up inoculation. The budgetary allocation of KES 14.3 billion and the anticipated KES 10 billion facility from the World Bank should be allocated to the acquisition of single dose vaccines such as Johnson and Johnson. Priced at \$10 per dose, the financial outlay can secure over 20 million doses. This is more cost effective when compared to most double dose vaccines.

For a similar financial commitment, the country can secure around 5 million pieces of double-dose vaccines. The estimated 20 million single dose vaccines are adequate for over 60% of the Kenyan population eligible for vaccination. This will enable the achievement of herd immunity as the country edges closer to the desired inoculation threshold of 60-70% of the population. In addition, policymakers in the diplomatic circles should strengthen lobbying through the African Union for a greater share of the one billion vaccine donation pledged by leaders of major industrial nations. These policy options should be pursued concurrently with the existing undertaking through the COVAX facility. In conclusion, an accelerated inoculation policy is unequivocally a safer bet to improving the population health security and boosting the drive towards Kenya's economic rejuvenation.



Photo Credit: DiaTribe





Addressing Pandemic Instigated Unemployment

Typically, the Kenyan economy creates 900,000 employment opportunities in a calendar year. However, after the initiation of lockdown and curfew restrictions, an estimated 1.8 million Kenyans lost their jobs within the April-June 2020 quarter. The amount of job lost is equivalent to two-years' worth of work opportunities created in the Kenyan economy. The loss was exacerbated by a further shrinkage of the economy by 1.2% in the subsequent quarter and a modest recovery of 1% in the last quarter of 2020. Overall, the 2020 economy is estimated to have grown by 0.6%, an indicator of its resilience amidst the pandemic. However, the recovery of jobs will be enduring due to the pandemic's devastating effect on production and work centers. Though the economy witnessed recovery at the tail end of 2020 due to a resilient agricultural sector, this should be supported in the Economic Stimulus Recovery Strategy. The implementation of the planned Post-COVID Economic Recovery Strategy should support and advance initiatives in economic sectors that hold potential for growth.

In addition, accelerated vaccination promises the potential for recovery of lost jobs in the country's traditional sector and creation of addi-

tional permanent opportunities in the digital space. Increased vaccination will bring the country back to pre-pandemic job employment levels. This is the shared hope learnt from the United States where the COVID-19 program is improving hiring for old and new positions. The US Department of Labor job report showed that as the US economy gained 916,000 and 266,000 jobs in March and April 2021 respectively. A breakdown of the new jobs bears striking similarities with Kenya's employment landscape. The biggest gainers were the construction sector (added 110,000 jobs), leisure and hospitality (280,000 jobs) and bar and restaurants (176,000 jobs).

The US job numbers are projected to be higher once government benefits for furloughed workers ends. An accelerated inoculation program is therefore a robust, speedy and cost effective way to mitigate the pandemic instigated unemployment. This policy action guarantees the return to a normal operating environment and removal of restrictions which is fundamental for the permanent recovery of two million job opportunities in the manufacturing, tourism and leisure sectors.



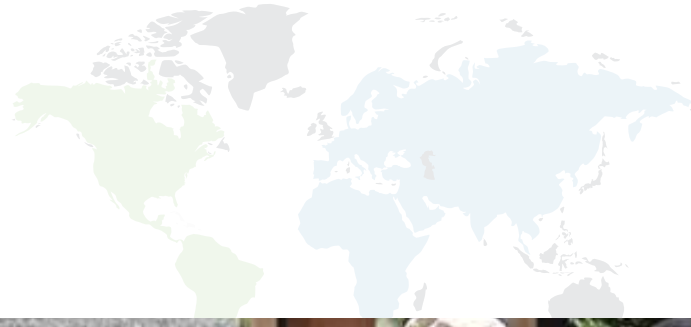


Photo Credit: Rappler

Leveraging on the Structure of Kenya's Economy

While Kenya is classified as a lower-middle income country (LMIC), her economic sectors are distinctively of low-value and low-productivity relative to the structure of the economy. With targeted policy actions and investments, potential for growth is vast. Such potential can engender job creation and enterprise development necessary for economic recovery. The analysis of Kenya's agricultural sector illustrates this argument. The sector contributes 30% of the country's annual GDP while employing a disproportionate 60% of the labor force. Due to the predominance of low value labor, the sector is indicative of the country's poverty status. Most of the people living below the poverty line are predominantly engaged in the agricultural sector. The low-value production approach corresponds to the country's 2019 GDP per capita income of \$1,816, or \$151 monthly. Likewise, the manufacturing sectors accounts for 8-9% of annual GDP, which is significantly lower than

the government's target of 15%. The rest of Kenya's GDP contribution emanates from the service sector which includes the banking, finance, information technology and the informal sector.

Prioritization of economic policies that encourage the organic transition of the drivers of key economic sectors from low to high value production should be encouraged. Based on the structure of the Kenyan economy, opportunities abound in strengthening the competitive advantages of key employment creators- the manufacturing and agricultural sectors. Value addition initiatives like the mechanization and mandated value addition of the agricultural products are key for high value productivity. Equally, policies should prioritize the transformation of the import substitution (Buy-Kenya, Build-Kenya) strategy towards export-led manufacturing. The country's manufacturing base provides the plat-





form to expand the sector's GDP contribution to the targeted levels. Increase in manufacturing output and product value are fundamental.

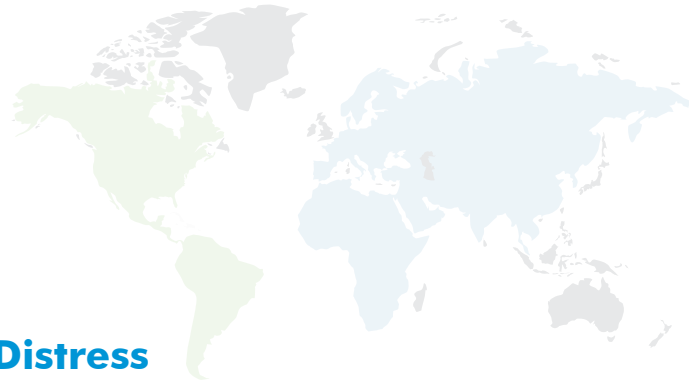
The evolution of the Vietnamese economy provides valuable lessons. Their export-orientation strategy underpins her gradual growth and integration with regional and world economies. Export processing zones, industrial zones and economic zones helped her attract local and foreign investors and improve her industrial development capacity. Relevant to Kenya's manufacturing puzzle, Vietnam restructured, consolidated and harmonized her policies to improve cost and quality competitiveness and encourage foreign investments.

In this regard, Kenya needs an export-led approach anchored on long-term approach model spanning two to three decades. This will enable the creation of competitive advantages, strategic learning and harmonious transition from agricultural to manufacturing based economy. Nonetheless, the success of this approach requires that policymakers address structural challenges that injure the country's attraction as a premier investment destination. These include a punitive tax code, multiple taxation at national and county levels, and a convoluted regulatory environment. Policymakers should leverage on the structure of the Kenyan economy and promote existent and emerging opportunities in the ongoing free trade negotiations with the European Union and the United States.



Photo Credit: ODI





Mitigating Debt Distress

The COVID-19 pandemic has exacerbated Kenya's debt distress. Economic disruptions at the global and national levels have continued unabated and at an unprecedented scale. This has coincided with the Kenya's continued budgetary deficits over the last eight years. Consequently, the country's debt portfolio has ballooned 60% of GDP. Equally, the country's average debt deficit of 7% is more than twice the recommended 3% for economies of Kenya's scale and structure.

While acquisition of debt is recommended to manage budgetary deficits and finance infrastructure development, it should be carefully planned and managed to avert debt distress. The net implication of debt distress is national financial strain. This compromises the government's ability to meet its budgetary obligations. To resolve this problem, its genesis have to be addressed. The country's situation is characterized by two causative factors - political and expenditure problems. The loan facilities by the IMF address these factors through supporting

government reforms and financial needs. These are ultimately aimed at resolving the debt deficit problem. Long-term fiscal consolidation and reduction of fiscal deficits have been proposed for implementation. Fiscal consolidation is geared towards more efficient and transparent spending and reduction of financial distress over the next three years through a balanced budget. As a policy priority, Kenya should strive to bring her expenditure in tandem with the income.

The spending rationalization plan captured in the 2021 Budgetary Policy Statement (BPS) involves a combination of revenue mobilization and spending rationalization. The plan is intended to reduce the fiscal deficit to below 4% of GDP by 2024/25. The BPS for 2021 needs to address the widening budgetary deficit. The 2021/22 daily estimates for revenue and expenditure are KES 5.4 billion and KES 8.1 billion respectively. The 2021/22 targeted revenue represents a marginal increase when compared to revenues of KES 4.8 billion and KES 5 billion in 2019/20 and 2020/21. Likewise, the target



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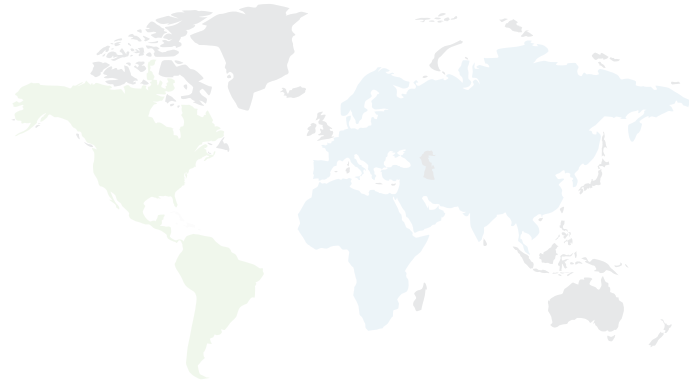


Photo credit: State House

President Uhuru Kenyatta with the World Bank Vice President for Africa Hafez Ghanem.

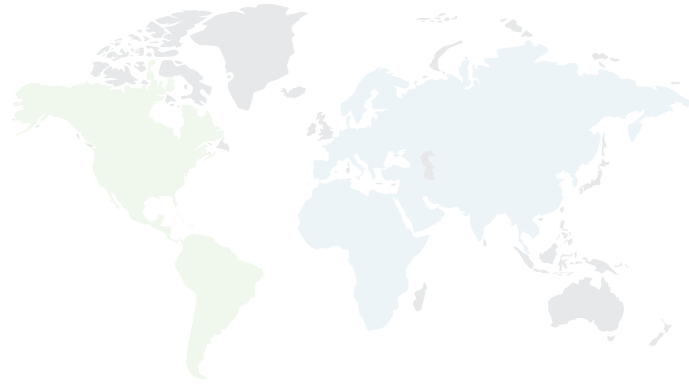
expenditure has increased when compared with the 2019/20 and 2020/21 figures of KES 7 billion and KES 7.9 billion respectively. A daily deficit of KES 2.7 billion in a pandemic impacted period is untenable. This will increase pressure for additional tax revenue and dependence on foreign debt. The debt distress especially with a significant proposition of national debt is denominated in foreign currency. This makes the country susceptible in the face of value loss of local currency. Alternative financing at cheaper rates and longer repayment periods than those offered through commercial arrangements are most sustainable for debt rationalization. Ongoing infrastructural projects should be finalized through similar facilities. Moreover, policymakers should deliberately curb commitments for new infrastructural projects until the country's financial health improves. Again, accelerated inoculation is essential in this regard. It allows for the resumption of economic

normalcy which is critical to optimal revenue generation and collection. The reduction of budgetary deficits and mitigation of debt distress have to be complimented by economic growth and spending rationalization measures, that needs a healthy and productive population.

Additionally, the government can offload shares in profitable entities like Safaricom (KES 456 billion) and Kenya Commercial Bank (KES 10 billion). The government can maintain a buy-back option that it can exercise in the future when the cash flows are in better health. Moreover, the state should divest from perennial loss making entities that constrain its resources. These policy actions are sustainable and predictable with the easing of the pandemic instigated shocks.

These large daily deficits illustrate the urgency to curb excesses in public sector expenditure.





Public procurement in petroleum, travelling and communication expenditure are some areas for budgetary rationalization. Government audit reports estimate that government Ministries, Department and Agencies (MDAs), outside the military and police pay for petroleum products worth four million kilometers every single day. On the other hand, the Stadium Management Board books of accounts spend a monthly average of 230 US dollar per employee. Solutions to these extravagant expenditures abound through

fiscal transparency of procurement information, publication of audited expenditures of MDAs and review of current legal frameworks for asset declarations of senior government officials. Transparency of information of public procurement and information of beneficial owners of companies will aid curb the proliferation of conflict of interest and profligate graft. Audit of government vote-heads provide opportunity for the realization of balanced budgeting.

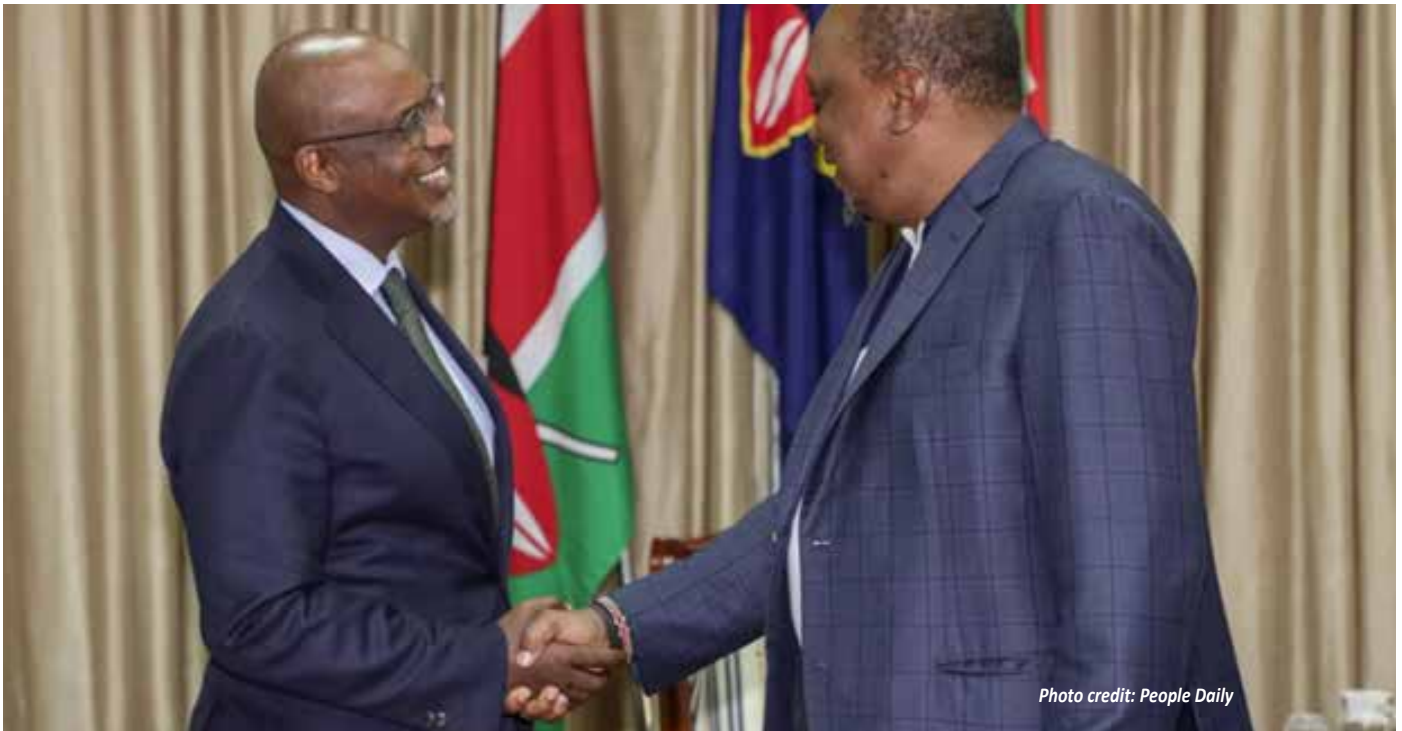


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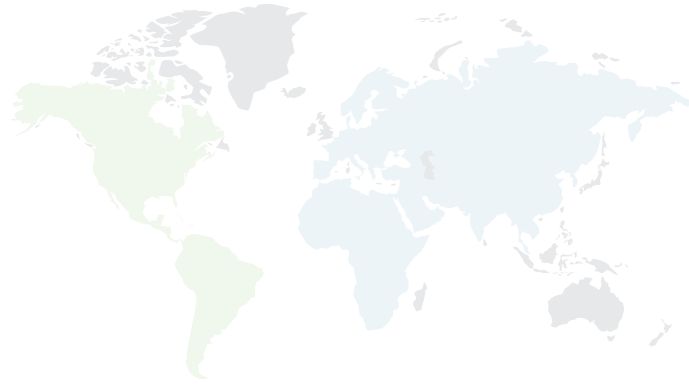
President Uhuru Kenyatta with International Monetary Fund (IMF) Director for African Department, Mr. Abebe Selassie

Encouraging Foreign Direct Investment

The potential for economic rejuvenation and transition into a manufacturing hub rests on Kenya's ability to attract foreign direct investments (FDIs). The global supply has transitioned from a singular to a multi-country manufacturing system. Product components are manufactured in different countries and later shipped into singular locations where they are assembled into complete products. FDIs therefore affords countries to benefit from the global value chains.

Kenya's policy makers need to appreciate that the global value chains have moved from singular locations to regional manufacturing. This affords opportunities for competitive manufacturing and technology sharing. The implication of this reality will be the re-evaluation of the Buy-Kenya, Build Kenya manufacturing mantra. It is inherently uncompetitive and ill-aligned to the global component manufacturing trends and Just-In-Time delivery practices. No country is able to singularly and competitively produce





all component parts and assemble them into complete products.

Kenya's free trade negotiations with the United States (KUSFTA) and the Economic Partnership Agreement (EPA) should therefore promote and pursue FDIs. The country should align FDIs sourcing with areas which she has identified as having competitive advantage and more essentially to Specialized Economic Zones (SEZs) in the coastal regions. Similar to other facilities globally, SEZs are predominantly located where geographic proximity to port facilities are abundant. The cost of transporting raw materials

inlands and then the finished products to the port only add to cost of production. Ultimately, they result into expensive products in the global markets. Therefore, the government should leverage on available opportunities that are inherent at the SEZ at Dongo Kundu, Mombasa county. The industrial park in Mombasa will improve economic recovery in the coastal region. In the future, other SEZ projects can be pursued through the LAPSSSET project. The government needs to negotiate for a part of the global value chain in which the FDIs will be utilized to drive the Kenya's export-led manufacturing.



Photo credit: The Star

President Uhuru Kenyatta at the commencement of Dongo Kundu Special Economic Zone in Mombasa county





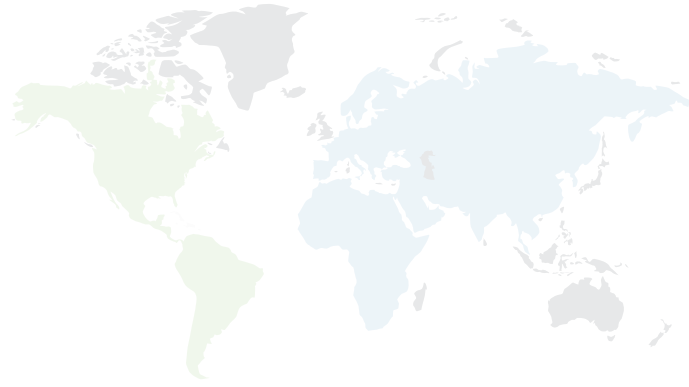
Tackling Public Sector Procurement Fraud

The challenge of corruption and its impact on economic growth are well documented. Widespread institutional and legislative reforms have been implemented to mitigate the vice. With regards to economic rejuvenation amidst the pandemic, policymakers need to address public sector procurement fraud which is directly linked to budgetary management and efficiency.

The government of Kenya controls the 30% portion of the annual national budget which is dedicated to the procurement of government goods and services. This typically translates to annual purchases of one trillion worth of goods. Instead of using this purchasing power to drive down prices, purchases are predominantly made at the highest possible prices. As the single largest buyer in the economy, such decisions greatly contribute to dysfunctional markets, price distortions and inflation.

As a policy priority, the government has the power to utilize its purchasing power to promote market efficiency. Government efficiency infused through public procurement injects efficiency in the entire market. Key to this is the need to promote transparent public sourcing for products and services at the lowest cost and the highest attainable quality. Policy options in this regard include tendering for procurement and payroll services from professional procurement firms. The prices in the procurement agreement should be capped at a fixed percentage of the prevailing market value. In instances where procurement firms charge exorbitant prices or pay wages to ghost workers, they should be legally obligated to compensate the government for resultant losses. This arrangement will allow government to concentrate on its core mandates thus improving public service delivery and financial discipline in the public sector.





Conclusion

The cornerstone of Kenya’s economic rejuvenation correlates to the acceleration of COVID- vaccination. This policy provides the platform for return to economic normalcy as it provides a guaranteed premise against the disruptive containment and restrictive approach. Policymakers should concurrently address public sector procurement fraud, pandemic instigated unemployment and debt distress while promoting FDI for the high value manufacturing and agricultural production.



Recommendations

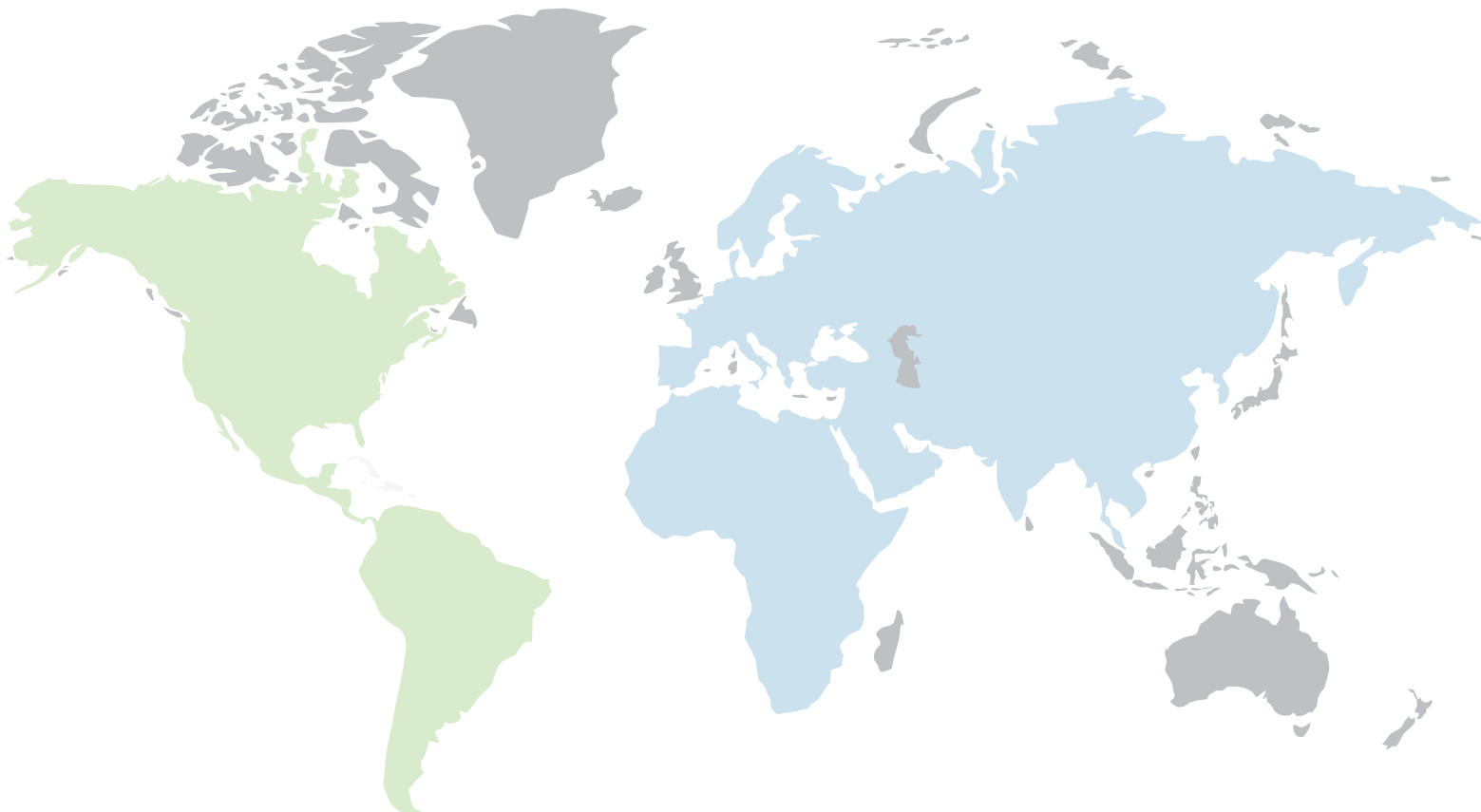
The paper recommends the following policy prioritization to be pursued for rejuvenation of the economy;

- a) The Treasury should adopt a hybrid approach to strengthen the capacity of health care system for the accelerated procurement and mass rollout of the Covid-19 vaccine.
- b) The Kenya government should prioritize export-led and trade in high value manufacturing and agricultural production.
- c) The Executive arm of government in conjunction with the Parliament to rigorously promote efficiency in the allocation and utilization of resources as the single largest buyer of goods and services. Efficiency in public finance management is a competitive advantage towards the rejuvenation of the Kenyan economy.
- d) The Kenyan government should prioritize the management of debt deficit to 3%. This can be undertaken through conducting forensic audit of public sector expenditure for balanced budgeting, outsourcing of government procurement and payroll management, offloading stakes in profitable entities with a share buy-back options and divesting from loss-making state owned entities.





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