

# The GLOCEPS

## — Daily Influential Brief —

Research and Analysis in Development Pillar



### Improving ease of doing business in Kenya: lessons from Vietnam

**Michael Owuor**

Kenya continues to struggle with key issues surrounding investor motivation amidst the desire to significantly increase the contribution of the manufacturing sector to more than fifteen percent of the annual gross domestic product. Our Research Fellow for Development Pillar, Michael Owuor, points out some lessons the country can learn from Vietnam in relation to improving the ease of doing business for the investor.

Dr. K.O. Asembo, Editor-in-Chief



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### Introduction

The appeal of growing economies as a preferential manufacturing destination is dependent on attracting resources and capabilities. Advantageous business regulations and operating environments are accruing fundamental importance in the interconnected global value chain. As such, the annual evaluation of national economies along metrics of ease of doing business is growing in popularity. However, despite Ken-

ya's efforts to improve and even overtake Vietnam along these parameters, salient evidence highlights that the former is yet to amass the related social and economic benefits. This brief evaluates the policy actions that Vietnam prioritizes with regard to the metrics and what developing countries like Kenya can learn and employ in upscaling foreign investment and capacities to escalate her manufacturing output.





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Kenya's President Uhuru Kenyatta welcomes Vietnam Ambassador to Kenya, Nguyen Nam Tien.

## The context

The success of Vietnam as an emerging economy and a global manufacturing hub highlights the importance of establishing sound business environment and policies. Since the progressive transition from a socialist economy to a market-oriented model, the country has experienced tremendous social and economic growth. In fact, she has been marked as an economic growth champion with gross domestic product (GDP) consistently above 7%. Fundamental building blocks to the country's progression include reduced tariff rates, opening of borders to trade and foreign investment and amplified investment in human capital. These parameters are broadly highlighted as ease of doing business. They encompass more than ten areas of business regulation – ease of starting business,

registering property, and acquisition of relevant permits; access to electricity and credit; taxes; trading across borders; enforcing contracts and resolving insolvencies. While Vietnam ranks lower than Kenya in the ease of doing business, she has noticeably prioritized and aligned components of the metrics to improve her stature as a destination of foreign investment and technology. She has also built her profile as a leading supplier of high-quality products to the global markets of the US, EU and UK. These form important discussion points for Kenya as she aligns her manufacturing sector to generate more than 15% of GDP as espoused in the Big Four Agenda and Vision 2030 economic blueprints.





## Ease of Doing Business

Vietnam's recent economic journey emulates those of many developing countries. It has been characterized by wars, agrarian-dominance and prevalence of loss-making state owned enterprises (SOEs). The country's transition has been progressive from agricultural to assembly of manufactured products, and later reinforced by the development of technologies and capabilities. These developments have transformed the structure of her economy. The manufacturing sector is the major contributor to GDP (86.5%), followed by mining and quarrying (8.5%) and electricity, gas and water (5%).

The Vietnam government has enacted policies that are targeted at attracting foreign direct investment and capacities, and reduction of cost of doing business. The competitive costs and receptive investment environment have enabled the country to replicate China's success as a

global manufacturing hub. These advantages have been reinforced through the enactment of the legislative framework- Law of Enterprise. This favorable legislation accords investors varied location-specific incentives, capital expenditure grants, preferential tax treatments and employment-related subsidies. Equally, specialized supportive frameworks have been instituted to support industries in the supply of raw materials, spare parts, and manufacturing components.

While measures by Vietnam belie Kenya's predisposition to taxing promising economic sectors, subsequent gains in job, wealth and tax creations are worthwhile. This point is clear while comparing the two countries' information communication technology (ICT) sectors. Whereas Kenya's ICT sector is valued at \$4 billion and contributes 8% to the country's GDP



Photo Credit: Vietnam Investment Review





and 250,000 jobs, Vietnam's average annual ICT revenue stands at \$110 billion and contributes an estimated \$ 2.1 billion to exchequer, has created over one million jobs and contributed to over 14% of her GDP. The comparative analysis of these countries tariff frameworks, as illustrated in Table 1, highlights differences in orientation. While Vietnam's policy is simplified and cost-conscious, Kenya's Tax Laws (Amendment) Act, 2020 appear convoluted and hinged on enhancing revenue collection through radical reductions of tax incentives and benefits.

The anticipated net effect is the reduction of Kenya's attractiveness as a cost-effective investment destination for both current and future manufacturing projects. Such measures only encourage the closure of local and foreign enterprises. Historical lessons indicate that similar tax initiatives were employed in the liquor manufacturing industry. The imposition of a 50% increase in excise tax on sorghum-based beer succeeded in killing the keg beer value chain.

For a developing country whose manufacturing success is reliant on attracting foreign investments, such policies appear regressive. It is imperative for policy makers to appreciate that competitive costs and attractive operating environment has the potential of reviving Kenya's stagnating industrial and technology parks projects such as Konza City and Nairobi Industrial and Technology Park. These have been positioned as key hubs for fostering collaboration and innovations that support the growth of Kenya's knowledge economy.

Kenya should cultivate these investments as selling-points in her ongoing free trade negotiations with the United States and the European Union which are critical for attracting investments for high-value manufacturing. The country's manufacturing sector needs additional capacity and resource investments to enrich the development, transfer and commercialization of these technologies for the global marketplace.



Photo Credit: Kenya wall street





**Table 1: Comparison of applicable tarrifs on the manufacturing sector as charged in Kenya and Vietnam**

	KENYA		VIETNAM	
	Tarriff	Rate	Tarriff	Rate
1.	Corporate tax- resident firms	30%	Corporate income tax	20%
2.	Corporate tax- nonresident firms	37.5%	Preferential tax rate –foreign investors in industrial parks and economic zones	2 to 4-year tax exemption; 50% reduction in next 9 years; 10% after for duration of project
3.	Preferential tax rates for newly listed entities firms	20%-27%	Tax on capital investment (interest and dividend)	5%
4.	Corporate tax for recycling firms	25%	Securities/share transfer	0.1% on sales proceeds
5.	VAT status for various plants and machinery changed from exempt to standard rated	25%	Securities/share transfer	0.1% on sales proceeds
6.	Repeal of electricity rebate for entitled manufacturer-sm exempt to standard rated	Up to 30% deduction in power costs repealed.	Tax on exports of goods and services	0%
7.	Reduction in the various rates of capital allowances	Average of 50% reductions	Standard VAT on remaining products	10%
8.	Turnover tax reduced (charged regardless of profit or loss)	1 %	None	None
9.	Nonresident rate withholding tax	20%	None	None
10.	Increase in tax on dividends payable to non-residents	10% to 15%	None	None
11.	Non-resident reinsurance premiums	5%	None	None
12.	Introduction on charges (excise duty, fees and other charges) in computation of VAT of petroleum products.	16%	None	None





## Prospects

Emerging economies like Kenya have greater room for economic growth compared to industrialized nations. The cost of labor is lower while the potential to attract foreign investments from Kenyans in diaspora and foreign firms is immense. The country has a much diversified manufacturing economy than her peers in addition to a skilled workforce. The ongoing free trade agreement negotiations provide a perfect avenue to upscale the manufacturing sector for export markets. Lessons from Vietnam point to the fact that policy actions that address investor concerns will advance Kenya's potential as a global manufacturing hub and improve her GDP as envisioned in the economic and development blueprints.



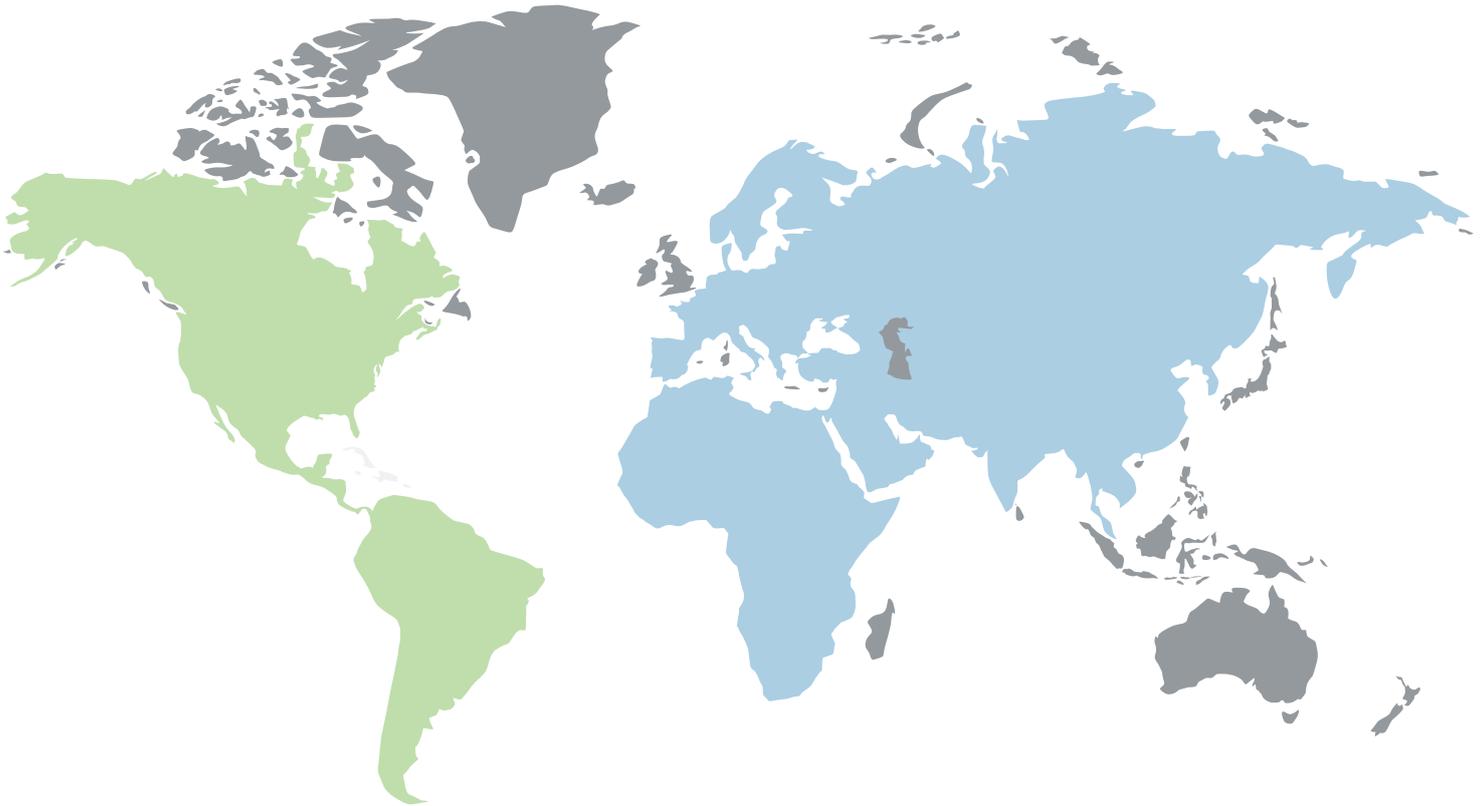
Photo Credit: trends.directindustry.com

**Mr Michael Owuor** is GLOCEPS Research Fellow for Development Pillar. He has over ten years' experience in running multidisciplinary development programs and research with international public benefit organizations, universities and government agencies for policy action. His research priorities include business strategies, economic development and political economy. He holds Bachelor's degree in Business Management; a Master of Business Administration and MSc in Health Systems Management.





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