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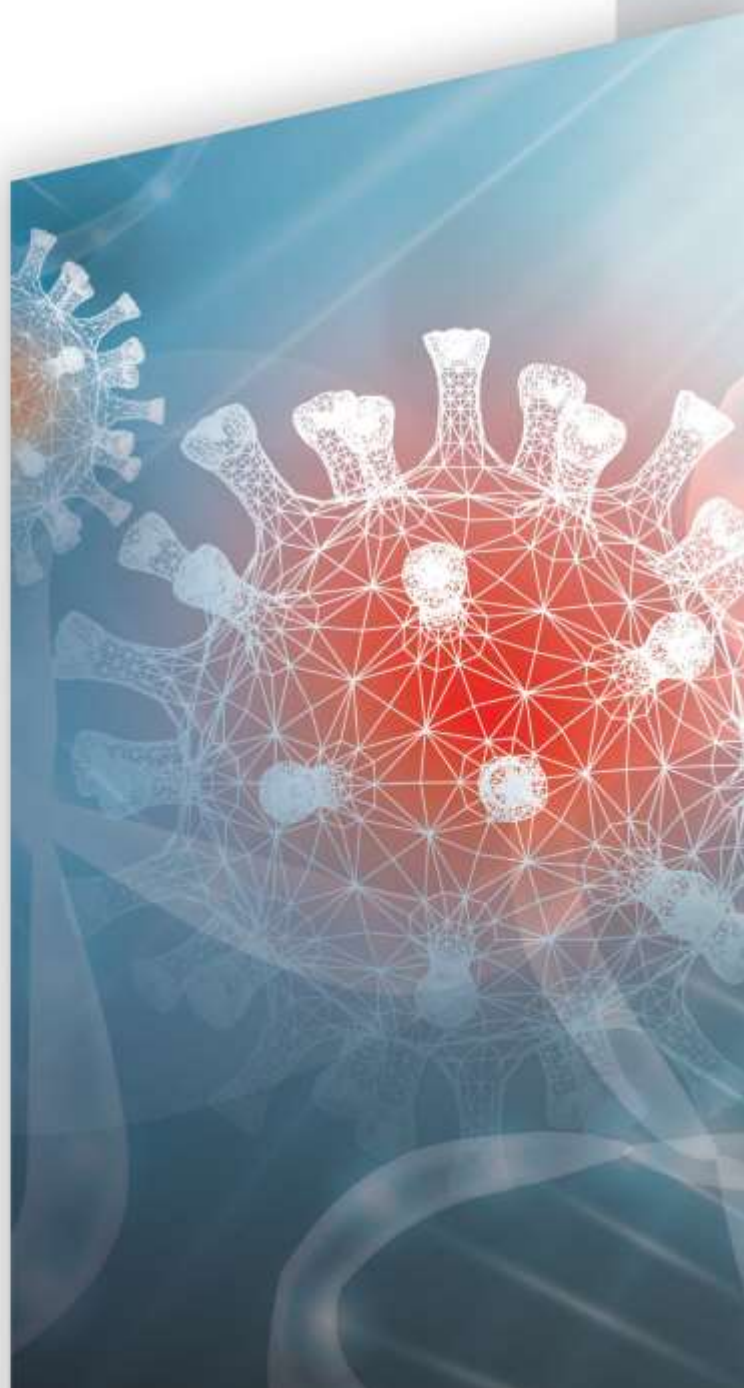


MARCH 2022

# COVID-19

## Response and Recovery Mobilizing financial resources for development

DA-COVID-19 project led by Debt and Development Finance Branch, Division on Globalization and Development Strategies (DDFB/DGDS)



# The Macroeconomic and Social Impact of COVID-19 in Kenya

Background Study for UNCTAD

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## About the COVID-19 Response and Recovery project

This paper is an output from the project “**Response and Recovery: Mobilising financial resources for development in the time of COVID-19**”, which is co-ordinated by the Debt and Development Finance Branch of UNCTAD and jointly implemented with ECA, ECLAC and ESCAP. This project is one of the five UN Development Account short-term projects launched in May 2020 in response to the COVID-19 crisis.

In this work, a framework to assess external debt and financial sustainability and public sector sustainability through the lens of the achievement of the Sustainable Development Goals (SDGs) is presented. The approach differs in some key areas **from the International Monetary Fund’s (IMF) Debt Sustainability Analysis (DSA)**, placing the external constraints and the resulting possible growth rate at centre stage. This in turn provides information on the fiscal space available to policy makers with which to achieve the SDGs through public investment.

## Abstract

The COVID-19 shock was a major factor behind a contraction of the Kenyan economy of 0.3 per cent in 2020, after the robust growth rates of 5 and 6 per cent in the two years before the pandemic. The fall in activity was, however, much milder than in many countries of the African continent, whose growth decelerated by 2 per cent, on average. This is the result of Kenya's relatively more diversified and resilient economy. It also reveals a more proactive government management of the macro economy, although, from a distributional perspective, the brunt of the economic adjustment to the pandemic was left to fall more disproportionately on small and micro firms and poor households. These groups, who are the majority, suffered much and got little support from the government's fiscal and monetary responses. The year 2021 saw a start of a strong recovery where GDP is expected to grow at 6.6 per cent. Again, the rapid rebound on the back of an aggressive fiscal deficit and a resulting higher debt burden, is deepening the regressive distribution of income and the rise in poverty. IFIs in Kenya argue that the fiscal space had reached beyond its limits and was aggravated by the pandemic. Hence, they call for tight fiscal and monetary policies. However, this study argues that such policy shift will be contractionary, endangering the ongoing recovery and with the ultimate effect of making the poor to absorb even more hardship. What Kenya needs is concessional financial support in the short run, and a commitment of IFIs to accompany strategic efforts to address its structural problems such as export diversification and productivity growth. These in turn require robust growth of investment (both public and private) along the mid-term, and where incomes of the majorities raise at par with productivity. Rather than cutting investment and social spending, a strategic development plan should focus on efficiency and better public sector management. Admittedly, for that not only institutional changes in Kenya but also in the international political economy set up and the global financial system are called for.

## Acknowledgment

I am grateful to Alex Izurieta for his insightful and detailed comments on the first draft that improved this paper, as well as for his editorial suggestions. Any errors are, however, mine.

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## I. Introduction

Kenya is one of the relatively sophisticated and well-diversified economies in the sub-Saharan Africa. With the population size of 49.7 million (2021) and a GDP of USD 99 billion in 2020 it is also one of the strongest economies in the Eastern Africa region. Its per capita income of USD 2,037 in 2020 grants a lower middle-income status. It has not only a well-educated labour force but also one of the most advanced financial sectors in the continent, at a comparable level with the financial sectors of the emerging economies in Asia. Except from occasional instances of violence during election periods, it is also generally a politically stable country, having a regular election every five years; the next election being in 2022. Kenya's post-independence economic growth trajectory is characterized by three phases: buoyant growth after independence; a growth slump in the 1980s and the 1990s structural adjustment period; and a robust rebound since the early 2000.

According to the data of the Central Bank of Kenya (CBK, 2021), between 2001-2009 the Kenyan economy grew at an average annual rate of about 4 per cent, and accelerated further to 5 per cent between 2010-2019. The latter growth rate is one of the highest growth rates in the continent. The current government, re-elected in 2016, claims to have growth and employment generation as main targets, as framed in its Vision 2030. Its overall objective is attaining middle income status by 2030. The government lays out this long-term plan through preparations of successive medium-term plans (**MTPs**) that outline the policies, programs and projects that the government intends to implement over a five-year period. The latest, third MTP (2017-2021) aims at achieving a high, inclusive and broad-based economic growth, increasing the share of industry (especially manufacturing) and exports (especially manufacturing exports) in GDP, enabling employment generation and a sustainable balance of payments position. The government has generally succeeded in realizing the growth objective but has not been equally successful in promoting manufacturing and exports. Likewise, growth has not led to commensurate poverty reductions either. According to a recent World Bank growth diagnostic study, the bulk of the GDP acceleration in recent decades has combined capital deepening and labour force growth -thus factor accumulation explaining 85 per cent of the growth between 2004 and 2017. From a sectoral growth perspective, the service sector has been the major growth driver, explaining 62 per cent of the aggregate growth in that period (World Bank, 2020; KNBS, 2020).

The most salient limitation of Kenya's growth story is its disappointing record on poverty reduction, especially in urban areas. Based on the USD 1.9 PPP poverty line, about 36 per cent of the Kenyan population is poor. This figure jumps to 67 per cent if the USD 3.20 PPP is used instead. What is more, the 'headcount multidimensional poverty rate' reaches a staggering 80 per cent. This is aggravated by high inequality, with a Gini coefficient of about 40 in 2015 (World Bank, 2020a; KNBS, 2020). The World Bank's (2020a) growth diagnostic study has also further noted that Kenyan sustained growth is challenged by the problem of attaining sustained productivity growth at micro level and by an increasingly vulnerable fiscal space. The mentioned study stresses that the biggest threat to macroeconomic stability is captured by the dramatic growth of the Debt-to-GDP ratio, from 39 per cent in 2013 to 60 per cent of GDP in 2019 (Table 1), with the composition of that debt shifting toward more onerous commercial sources over the years. Although the fast growth attained during the period would have been difficult without such debt creating capital inflows, the resulting high debt ratios and

debt servicing will imply increasing pressures from international financial institutions and investors towards deflationary adjustments, forcing unsustainable sacrifices on other essential items such as social and infrastructure investment, and further calls for privatization of public services, etc. Such pressures, which will endanger a strategic growth recovery, represent a policy dilemma for the government.

As shown in Table 1, the immediate years before the pandemic saw high growth rates, of 6.3 per cent and 5.4 per cent in 2018 and 2019, respectively. The COVID-19 shock triggered a GDP contraction of 0.3 per cent in 2020. On a quarterly basis, the biggest fall occurred in the 2<sup>nd</sup> quarter of 2020, amounting to 4.7 per cent, as the first effects of the pandemic became visible. The growth rate remained negative in the 3<sup>rd</sup> quarter and began to pick up in the last quarter of 2020. The recovery gained a very strong momentum in the 2<sup>nd</sup> and 3<sup>rd</sup> quarters of 2021, yielding GDP growth rates of about 10 per cent. Together, growth for the year 2021 reached 6.6 per cent. Notwithstanding the negative impact of COVID-19 on GDP growth, macroeconomic stability as measured by inflation, exchange rate variability and level of reserves in months of imports remained fairly stable throughout the depth of the pandemic.

**Table 1: Major Macroeconomic Indicators Before and During the Period of COVID-19 in Kenya**

			The COVID Period									
	2018	2019	2020				2020	2021				2021
			Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
GDP Growth (percent)	6.3	5.4	4.4	-4.7	-2.1	1.2	-0.3	0.7	10	9.9	5.6	6.6
Inflation (average annual, percent)	5.6	5.0	5.6	5.3	4.3	5.3	5.8	5.8	6.0	6.0	5.9	5.9
Average Exchange rate (Ksh/\$)	101.3	102.0	101.9	106.5	107.94	109.49	106.5	109.75	107.76	109.2	111.4	109.5
Trade Balance (US\$ million)	-10284	-10,681	-2152	-1759	-2122	-2316	-8349	-2569	-2519			
Current Acct Balance (US\$ million)	-4518	-5,541	-1093	-782	-1333	-1323	-4531	-1481	-1381			
Reserve in Month of Imports	5.3	5.7	5.2	5.9	5.4	5.1	5.4	4.8	5.2			
Debt (per cent GDP)	59.0	60.1	59.7	59.0	59.02	63.0	60.2	67.0	67.7	66.2	67.5	67.1
Domestic per cent GDP,	29.0	29.1	28.6	28.7	28.9	29.9	29.0	32.5	32.4	32.2	32.4	32.4
External, per cent GDP	30.0	31.0	31.1	30.3	30.3	33.1	31.2	34.5	35.3	34.0	35.1	34.7

Source: Author's compilation based on Central Bank of Kenya (CBK) data, Quarterly Economic Review (various years) and Kenya National Bureau of Statistics (KNBS) data, 2021.

The above lays out the general macroeconomic conditions against which this study examines the growth and socio-economic effects of COVID-19 in Kenya and derived challenges. Section two focuses on aggregate and sectoral GDP growth patterns, with special attention to the service and the external sectors which played a major part in shaking the macroeconomic stance. Section three addresses the responses of both the government and the private sector and highlights the resulting inequalities. Section four is devoted to an examination of the socio-economic effect of the pandemic, including its gender dimension. Section five draws conclusions after considering the scope for a demand-led recovery.

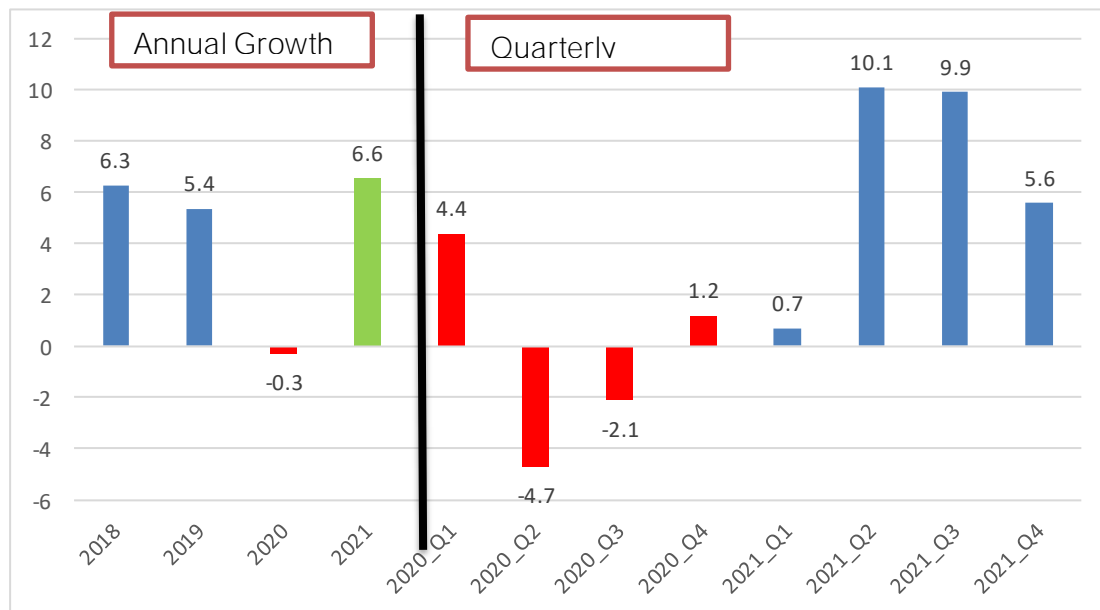
## II. The Macroeconomic Effects of COVID-19 on Kenya

As noted above, prior to the pandemic, the Kenyan government was pursuing a comprehensive policy program informed by its third MTE framework, aiming at diversification of its economy as well as its exports as means to sustain growth pattern under stable balance of payment conditions. This third MTE framework, as articulated by the National Treasury (Ministry of Finance), hinged around four themes - “the big four”: (i) to accelerate and sustain inclusive growth, (ii) to create opportunities for decent jobs, (iii) to reduce poverty and income inequality and (iv) to ensure that the country has created a healthy and food-secured society in which Kenyans have access to affordable and decent housing. The COVID-19 shock, which emerged in full force in mid-2020, triggered a chain of disruptions that played an important part in frustrating the attainment of these four national policy objectives.

### 2.1 GDP and Sectoral Growth Effects of COVID-19

The drastic gyrations of growth during the pandemic are shown in Figure 1. As discussed above, economic performance was robust during nearly two decades, and especially since 2010. GDP growth in 2019 was 5.4 per cent, moderately weaker than the earlier year, which stood at 6.3 per cent but respectable nonetheless. During the first quarter of 2020, which encompassed a few weeks of lockdowns and restrictions in some of the advanced economies, economic growth in Kenya remained relatively strong. It then fell sharply to negative 4.7 and negative 2.1 in the 2<sup>nd</sup> and 3<sup>rd</sup> quarters of 2020, respectively. This is attributed to the deepening of partial lock-down measures in major economies, disruptions of the supply chain, a severe weakening of external trade, as well as the direct effects of the outbreak of the pandemic in Kenya, eroding domestic economic activities and income and depressing demand. A modest recovery began in the 4<sup>th</sup> quarter of 2020 where GDP grew at 1.2 per cent, followed by a slightly weaker rate of 0.7 per cent at the start of 2021. The significant recovery emerged in the 2<sup>nd</sup> and 3<sup>rd</sup> quarters of 2021, where GDP grew at about 10 per cent in each quarter, creating a momentum for growth rates of 6 per cent or above in both 2021 and 2022, according to the National Treasury. These will be among the fastest and strongest growth recoveries in the continent. Such an exceptional performance is attributed to the rapid rebound in the service sector which was, in the pre-pandemic, the dominant contributor to GDP growth (which represented about 70 per cent of the aggregate growth in 2019, as detailed below).



**Figure 1: The Effect of COVID-19 on Kenya's GDP Growth (Annual and Quarterly Growth)**

**Source:** Author's computation based on Central Bank of Kenya (CBK) and Kenya National Bureau of Statistics (KNBS) data, 2021

**Note:** the 2021 annual growth rate is the simple average of the 4 quarters in 2021. The data for the 3<sup>rd</sup> & 4<sup>th</sup> quarter of 2021 is from KNBS

Table 2 shows the growth configuration of the main sectors of the Kenyan economy during this period. The economy is dominated by the service sector. Its share in GDP stood at 55 per cent in 2019. Industry and agriculture are marginal in comparison, at 18.6 and 17.4 per cent, respectively. Growth in the agricultural sector is vulnerable to weather conditions, given its strong dependence on rainfall. Meanwhile, growth in the industrial sector has relied heavily on construction rather than manufacturing activities.

Within Services, the dominant sub-sectors are "Transport and Storage", "Real-estate", "Wholesale and Retail Trade" and "Financial and Insurance", with contributions to GDP that range from 7.7 to 10.3 per cent (Table 2). Beyond these, "Construction" and "Manufacturing" in the industrial sector and "Crops Production" in agriculture are the dominant sub-sectors.

This sectoral composition of GDP helps explaining the shock to GDP growth during the year 2020. The economic effects of COVID-19 were felt hard in the non-agricultural sector in general and the service sector in particular, through the last three quarters of 2020 (Table 2). It is interesting to note that, despite the pandemic, there was a positive and even higher growth in the agricultural sector in 2020, compared to 2019. However, this didn't add to a meaningful contribution to overall GDP growth, because the sector's contribution to GDP and GDP growth is relatively small, unlike the much higher contribution of the non-agriculture sector which was about 72.5 per cent in 2019.

On a quarterly basis, during the first quarter of 2020 the agriculture and the non-agriculture sectors grew by 4.3 and 4.5 per cent, respectively; with industry reaching 4.8 per cent and services 4.2 percent, even if the pandemic began to cause frictions in Asia (especially China), Europe and North America (see Table 2). When the economic effects of the pandemic began to emerge strongly by March, 2020 (which is the beginning of second quarter of 2020 for Kenya), only the agricultural sector maintained a robust growth through the three remaining quarters, to the tune of 5, 4 and 6 per cent. By contrast, growth of the non-agriculture sectors as a whole turned negative in the 2<sup>nd</sup> and 3<sup>rd</sup> quarters (-7.2 and -3.4 per cent, respectively). Within these, the industrial sector experienced a recovery in the last two quarters of 2020, but for the service sector the negative growth rate continued throughout the year. Within the service sector, the “accommodation and food service” sub-sector, followed by the “professional and administrative services”, the “education” and “transport and storage” sub-sectors, in that order, were hard hit by the pandemic. These sub-sectors, except the education sub-sector, did not begin to recover until the 2<sup>nd</sup> quarter of 2021. Among the other sub-sectors within Services, even those that grew during the pandemic period of 2020 experienced considerably lower growth rates in the last three quarters of 2020, compared to the pre-pandemic periods - the only exception understandably being the health sector in 2<sup>nd</sup> quarter.

**Table 2: GDP and Sectoral Growth (Annual and Quarterly Growth in Percent)**

	Share in GDP (2019)	Growth Rate (Annual, in%)			The COVID Period 2020 (Growth percent)				2021	
		2018	2019	2020	Q1	Q2	Q3	Q4	Q1	Q2
<b>Agriculture</b>	<b>18.6</b>	<b>6.4</b>	<b>2.6</b>	<b>4.8</b>	<b>4.3</b>	<b>4.9</b>	<b>4.2</b>	<b>5.8</b>	<b>(-0.1)</b>	<b>(-0.9)</b>
<b>Industry</b>	<b>17.4</b>	<b>5.3</b>	<b>3.4</b>	<b>4.0</b>	<b>4.8</b>	<b>(-0.3)</b>	<b>3.5</b>	<b>7.8</b>	<b>4.4</b>	<b>8.5</b>
Mining and Quarrying	1.0	2.8	4.3	6.7	6.4	4.4	7	9.2	16.4	17.7
Manufacturing	8.7	4.2	2.5	(-0.1)	2.2	(-4.7)	(-1.7)	3.8	1.6	9.4
Construction	5.3	7.9	5.6	11.8	10.4	8.2	12.5	16.2	7.9	6.5
Electricity & Water Supply	2.5	6.6	1.7	0.1	1.5	(-4.7)	0.2	3.5	2	5.2
<b>Services</b>	<b>55.1</b>	<b>6.9</b>	<b>6.5</b>	<b>(-2.2)</b>	<b>4.2</b>	<b>(-7.1)</b>	<b>(-4.7)</b>	<b>(-0.9)</b>	<b>2.2</b>	<b>16.8</b>
Wholesale and retail trade,	8.4	6.3	5.3	(-0.4)	4.9	(-4.2)	(-5)	2.6	7.4	9.5
Transport and Storage	10.3	8.8	6.3	(-7.8)	2.2	(-16.8)	(-10.1)	(-6.1)	(-9.1)	17.4
Accommodation & Food Services	1.2	16.6	14.3	(-47.4)	(-8.1)	(-56.8)	(-63.4)	(-62.2)	(-48.6)	9.4
Public Administration	5.8	6.1	9.9	5.3	4	2.7	6.3	8.4	9.1	13
Real estate	9.8	4.1	6.7	4.1	5.4	4.6	3.7	2.7	4.5	4.9
Financial and Insurance	7.7	5.6	6.9	5.6	7.5	4.4	3	7.4	8.3	12.3
Information and Communication	3.0	11.4	7.5	4.8	5.6	2.6	3.2	7.6	16.1	25.3
Profession, Administration & Support System	3.0	5.9	6.9	(-15.0)	0.3	(-27.5)	(-19.7)	(-12.1)	(-14.4)	17.7
Education	4.7	5.8	4.7	(-10.8)	1.8	(-22.4)	(-17.4)	(-5.3)	10	67.6
Health	2.1	4.5	6.2	6.7	7.4	9.8	5.2	4.7	9.1	10
<b>GDP Growth (Constant Market price)</b>	<b>100*</b>	<b>6.3</b>	<b>5.0</b>	<b>(-0.3)</b>	<b>4.4</b>	<b>(-4.7)</b>	<b>(-2.1)</b>	<b>1.2</b>	<b>0.7</b>	<b>10.1</b>

**Source:** Author's computation based on Central Bank of Kenya (CBK) and Kenya National Bureau of Statistics (KNBS) data, 2021.

**Note:** \* doesn't add-up to 100 because taxes, net of subsidies, which on average makes up about 9% of the total are not included.

**Macroeconomic Implications:** Such growth deceleration as shown above could normally have led to a severe macroeconomic imbalance as witnessed in many African economies. In Kenya, however, inflation increased just by about one percentage point during the pandemic year (as well as in 2021) from the previous year. This is not a significant increase compared to the pandemic's inflationary effect in other Africa countries such as Zambia and Ethiopia where prices nearly doubled (Geda, 2021a, 2021b). Looking at the other critical macroeconomic stability indicators, the currency also depreciated at marginal 6 per cent in the pandemic year (from KSh 102/\$ in 2019 to KSh 106.5/\$ in 2020; Table 1) and Kenya had also a fairly stable level of import cover of reserves. Thus, macroeconomic conditions remained broadly stable. The only exception could be the rise in the national debt to GDP ratio, which grew to a high level (beyond what is normally considered sustainable). On this basis, it could be said that while growth performance and macroeconomic stability suggest that the Kenyan economy was relatively more resilient than other African economies, the pandemic has added considerable stress on debt accumulation and the current account balance, as examined in detail in the next section.

## 2.2 The Effect on the External Sector and Financialization Implications

**External Trade:** Like most developing countries, the external sector (international trade and finance) of Kenya was shaken by the COVID-19 shock. The trade balance carried a structural weakness up to 2019, as imports are generally about twice as large as exports. As the pandemic hit, merchandise exports, which are dominated by primary commodities (tea, horticulture and coffee, among others) fell considerably in the second quarter of 2020 and remained at a lower level than the first quarter of 2020 up until the second quarter of 2022 (see Table 3). If the trade balance showed relatively smaller deficits than those of 2019 throughout the same period it was because imports fell more sharply. Export performance was better when measured in volume terms, though, as the major exports (tea, horticulture) experienced sharp price falls during the pandemic year of 2020. Among imports, the decline in the oil import bill was the most significant that helped limit the deterioration of the current account balance, thanks to the fall in oil prices.

Compared with many other economies where one to three primary exports significantly dominate exports (see Geda, 2019; Geda, 2021b), Kenya has a relatively well-diversified export basket, its major export being tea with a share of about 20 per cent (measured over a 5-years period). This is followed by cut flowers, with a share of about 10 per cent, refined petroleum (re-export), with a share of about 6 per cent, and coffee, with a share of 3.6 per cent. Of the other export products, representing together about 60 per cent of the total, each has a share below 2 per cent. In terms of destination of exports, a third are destined to African countries. By contrast, imports are more concentrated geographically. The bulk of its imports (67 per cent in 2019, and 60 to 65 per cent in the five years before the pandemic year) came from China. This is followed by Japan (7 per cent) and South Korea (5 per cent).

The diversified structure of exports could have shielded Kenya from severe external shocks, but because the bulk of these are in the agricultural sector synchronous shocks from international markets or domestic weather conditions are likely. In addition, in the past years there was no meaningful growth in its exports -and as share of GDP merchandise exports fell from 19.9 per cent in 2013, to 14.3 per cent in 2016 and further to 12 per cent in 2019 (KNBS, 2020c). What is more, import demand is of a rather strategic nature, (and, hence, of inelastic demand), as most are intermediate inputs for domestic production (where petroleum alone accounts for about 16 per cent of the total), which are not amenable for reductions. Indeed, the Kenya economy has experienced significant and persistent trade balance deficits for over a decade, where imports were (and still are) more than twice larger than exports each year (rendering an average annual trade deficit to GDP ratio of about 12 per cent per annum in the five years before the pandemic). The pandemic, however, brought about idiosyncratic challenges, as the shock to exports was driven by a global contraction of activity that caused price falls across the whole spectrum, and intermediate inputs (affected by the known stresses in global value chains and transport) were harder to secure and became costly; the only relief being due to lower oil import prices.

Next to traded goods, Kenya's service account and net transfers received are generally positive and with a strong performance year on year, which contribute to render a current account balance that is half the deficit in the goods account in each quarter, as shown in Table 3. Importantly, there is a stable inflow of remittances and other current transfers (with such transfers accounting for about 75 per cent of the service sector positive balance). If it were not for the resilience of these items, added to the also observed increased external borrowing, there would not have been a sufficient accumulation of reserves (measured in months of imports) and a contribution to a relatively fast recovery of GDP growth.

**Table 3: Major Trends of the External Sector during COVID-19 in Kenya**

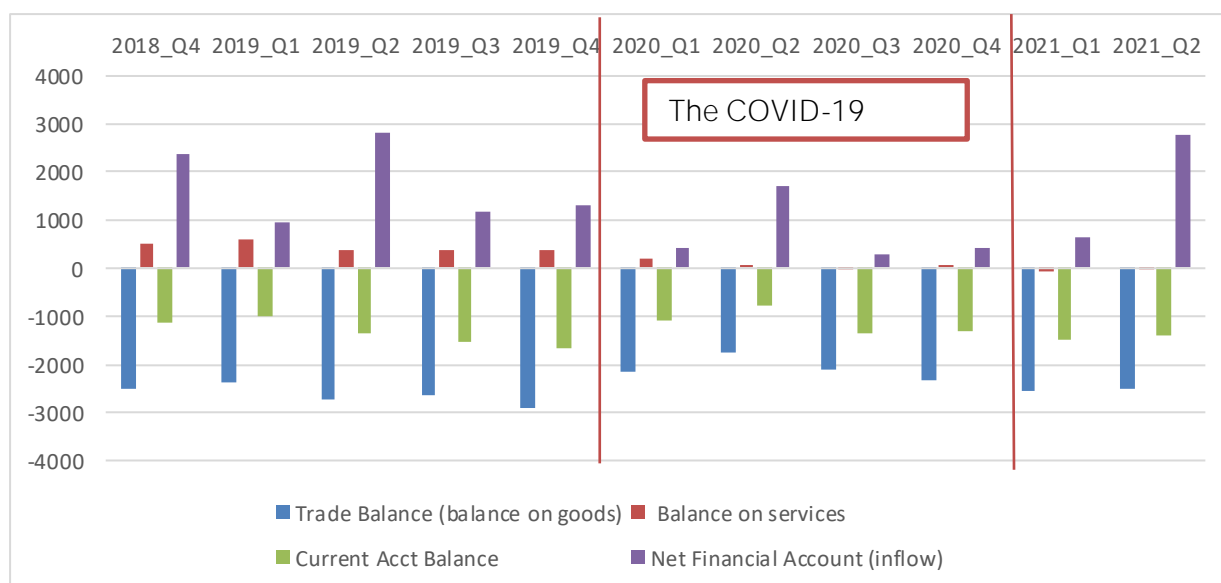
(US millions)	2018	2019				The COVID-Year -2020				2021	
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
<b>Exports (fob, Millions of US\$)</b>	1411	1566	1453	1424	1558	1764	1307	1516	1474	1739	1670
Tea	315	311	248	249	311	335	327	282	282	326	299
Horticulture	225	303	259	221	284	273	210	233	265	334	289
Manufactured goods	98	96	100	109	96	94	69	111	107	106	131
Re-Exports	144	192	174	204	192	331	108	174	114	197	150
<b>Imports (fob, US\$ millions,)</b>	3930	3955	4196	4066	4181	3916	3066	3638	3790	4308	4189
<b>Trade Balance (balance on goods)</b>	-	<b>-2372</b>								-	-
	<b>2519</b>		<b>-2743</b>	<b>-2642</b>	<b>-2907</b>	<b>-2152</b>	<b>1759</b>	<b>-2122</b>	<b>-2316</b>	<b>2569</b>	<b>2519</b>
Balance on services	496	598	380	399	375	200	54	-25	9	-81	-26
	-	-1774								-	-
Balance on goods and Services	2023		-2363	-2243	-2532	-1952	1705	-2147	-2307	2650	2545
Balance on goods, services & primary	-	-2269								-	-
Income	2183		-2809	-2771	-2978	-2311	2030	-2552	-2614	2871	2967
Secondary income, net	1271	1276	1477	1244	1304	1218	1248	1218	1290	1390	1586
	-	<b>-998</b>								-	-
<b>Current Acct Balance</b>	<b>1143</b>		<b>-1341</b>	<b>-1527</b>	<b>-1675</b>	<b>-1093</b>	<b>-772</b>	<b>-1333</b>	<b>-1323</b>	<b>1481</b>	<b>1381</b>
<b>Reserves (months of import cover)</b>	5.3	5.4	6.0	5.8	5.5	5.2	5.9	5.4	5.1	4.8	5.2
Net Capital Inflows (Credit)	51	42	86	27	52	24	42-	36	28	84	273
FDI Inflows	836	284	410	284	359	104	93	93	150	63	143
Portfolio investment inflows	-65	1	2136	42	89	-101	-91	-6	11	75	1098
Other Investment inflows	900	988	765	1230	1380	791	2123	409	1608	1185	1974
<b>Net Financial Account (- is inflow) *</b>	-	<b>-937</b>	<b>-2811</b>	<b>-1167</b>	<b>-1322</b>	<b>-419</b>	-		<b>-424</b>	<b>-649</b>	-
	<b>2373</b>						<b>1690</b>	<b>-295</b>	<b>-424</b>		<b>2779</b>
Total External Debt (billions, USD)				31.1	31.1	32	35	36.6	37.9	37.7	40.2
(Per cent GDP)				31.1	30.3	30.3	33.1	34.5	35.3	34.0	35.1
Total Domestic Debt (billion, USD)				28.6	29.4	30.7	31.8	34.6	34.9	35.7	37.0
(Per cent of GDP)				28.6	28.7	28.9	29.9	32.5	32.4	32.2	32.3
<b>Memorandum Items (major exports)</b>	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-19	Jun-19	Sep-19	Dec-19	Mar-19	Jun-19
Tea, (thousands, metric ton)	38.68	42.46	29.36	36.9	39.31	51.44	46.4	44.7	46.17	53.43	43.99
Tea Price (Ksh,000/ton)	252.9	233.4	243,7	233.1	241.2	226.8	228.1	223.1	237.2	217.0	235.9
Horticulture (thousands, metric ton)	29.19	42.13		41.06	31.92	46.3	36.64	44.35	53.15	62.27	47.5
Horticulture Price (Ksh, 000/ton)	277.2	234.9		273.0	223.9	215.4	224.9	214.0	212.2	216.9	224.1

**Source:** Author's computation based on Central Bank of Kenya, QER data (various issues1) \* includes errors and omissions.

In sum, to the challenge of a structural trade deficit that invariably leads to indebtedness and a hazardous path of financialization, the COVID-19 shock accentuated the external vulnerability as receipts in net primary income remained sharply negative and its service trade (dominated by exports of transport, travel and ITC exports), turned negative due to disruptions and slowdowns of economic

activity in the global economy. More specifically, the surplus on the service account that used to be common before the pandemic (for instance, reaching about USD 500 million in the last quarter of 2018 and ranging from USD 375 to 600 per quarter in 2019), had deteriorated to USD 200 million (about 60 per cent decline) in the first quarter of 2020. The deceleration continued to the point of turning to a negative USD25 million in the 3<sup>rd</sup> quarter, and after hovering close to balance in the 4<sup>th</sup> quarter the balance of Services remained negative in the first half of 2021 (mostly due to the meagre receipts from transport and travel services).

**Figure 2: The Evolution of the Kenyan External Sector During the COVID-Period (in millions of USD)**



**Source:** Authors computation based on Central Bank of Kenya data, QER (various issues).

**Capital Inflows:** An interesting pattern that is observed in the balance of payment of Kenyan during the pandemic year of 2020 is the significant decline in net capital inflows to the country (Figure 2, Table 3). Compared to the corresponding quarters in 2019, net capital inflows declined by 40 to 75 per cent (except in the 2<sup>nd</sup> quarter of 2020 which was relatively better). This is primarily attributed to a dramatic shortfall in FDI flows from the level of USD 1,337 million in 2019 to USD 440 million in 2020 – a fall of 68 per cent. FDI inflows did not recover to the pre-COVID-19 level even in the first half of the year 2021 (Table 3). Similarly, portfolio investment flows also drastically declined in the pandemic period, most significantly in the 2<sup>nd</sup> quarter, falling from USD 2.14 billion a year earlier to -91 million. Finally, “other investment flows”, which are generally related to liabilities assumed by corporations have also declined, the exception being the 2<sup>nd</sup> quarter of 2020, which saw an increase (presumably due to short term credit as the COVID-19 shock hit). In sum, the net financial account in the aggregate experienced declines through the pandemic and only started to recover to levels similar to those of 2019 in the 2<sup>nd</sup> quarter of 2021, where inflows reached USD 2.8 billion, significantly higher than the record of USD 1.7 billion of the 2<sup>nd</sup> quarter of 2020. This was largely a reflection of an improvement in “other investment” and “portfolio investment” inflows, while FDI remained sluggish (CBK, QER, 2021). Clearly, the rapid recovery of GDP growth in 2021 owes to a significant degree to external borrowing

in the form of “other investment flows” and “portfolio investment”, which in turn allowed increases in domestic borrowing, not without implications in terms of heightened financial fragilities, as discussed next.

**External Debt and Financialization during COVID-19:** McKinley (2021) and Cripps (2021), using the UN Global Policy Model (GPM), note that, in view of the inability of most developing countries to issue internationally traded currency and rely on unlimited quantitative easing, the one available source of finance to regain pre-pandemic levels of investment is capital inflows. On the other hand, this increases the risks usually derived from unfettered financialization (see also UNCTAD, 2020). Kenya’s experience gives credence to this argument.

The expansion of investment, where both public spending and private activity rise allowing the attainment of high growth, reflects well the patterns of the Kenyan economy of more than a decade, with sustained growth of GDP above 5 per cent since 2010. But it has also led Kenya to accumulate a significant level of debt. During this high growth period (2010-2019), according to government data (CBK, 2021), the public deficit has increased by an average annual rate of 23.1 per cent (and if the outlier year of 2014 is left out, where the deficit declined by 34 per cent compared to 2013, this annual growth average would be 30.3 per cent). Correspondingly, government debt as percentage of GDP has surged from 39 per cent in 2013 to 60 per cent of GDP in 2019 (World Bank, 2020a). The rise in the debt ratio continued throughout the pandemic, for the reasons explained above, reaching 67 per cent in early 2021 (Table 1). What is more, the composition of such debt has been shifting towards more expensive commercial sources, as noted in the mentioned World Bank study. Both the high debt burden and the changing composition give lenders, that includes IFIs such as the World Bank, bilateral official lenders such as China, as well as private lenders a considerable leverage over the country’s destiny, which is characteristic of pervasive financialization trends seeing elsewhere (UNCTAD, TDR 2020; McKinley, 2021).

Along this process, external and domestic debt of the public sector increased by similar amounts. The former, which stood at USD 31 billion in each of the first two quarters of fiscal year 2019/2020 (i.e. last two quarters of calendar year 2019), reached USD 38 billion at the end of 2020. Domestic debt rose from USD 29 billion to USD 35 billion in the same period. Hence, government external debt rose by 23 per cent throughout the pandemic, and domestic debt by 21 per cent. The only marginal difference between these sources is that while domestic debt remained barely stable in 2021, external government debt continued to rise in 2021, reaching USD 40 billion by the 2<sup>nd</sup> quarter (CBK, QER, 2021). Given the rise of total debt and the stagnation of GDP during the pandemic, the debt ratio increased to 67.5 per cent by the 2<sup>nd</sup> quarter of 2021 from about 60 per cent in 2019 (Tables 1 and 3). Debt owed to WB’s International Development Association (IDA) was the largest among multilateral lenders, representing 26.8 per cent of the total. This is followed by debt owed to China, Kenya’s largest bilateral lender, which amounts to 19 per cent. Debt to the two largest commercial banks together represents nearly 30 per cent of the total. Thus, not only the high proportions of commercial creditors, including Eurobond, but also their invariably expensive lending terms, represent an aggravation of the debt situation in Kenya and its implications in terms of narrowing down the country’s fiscal space.

The IMF Debt Sustainability Analysis (DSA) of March 2021 classified Kenya's public debt as 'sustainable' but having a *high risk* of debt distress. This was a downgrade status from the classification of *moderate risk* of debt distress of February 2020. The revision responded to a series of criteria in addition to debt-to-GDP ratio, such as debt service-to-exports ratio and modelling scenarios under either standard stress tests or added scenarios that include a one-off breach of the debt service payments (CBK, QER, 2021). In other words, the 'high risk' classification of Kenya's debt situation incorporates the plausibility of shocks to exports and market financing conditions, in addition to GDP slowdown.

Against this background of heavy debt burdens, financialization conditions in Kenya carry constraints that could be assessed in three forms. The first one is similar to the general pattern of developing countries where IFIs determine the path of development and macroeconomic policy to be pursued through aid-conditionality. The significant share of IFIs (especially IDA) lending in Kenya's debt portfolio shows the country's exposure to this type of finance-led impositions on macroeconomic management. The second one relates to the role of influential bilateral lenders, such as China. This may have a positive effect in as far as it is an additional, non-traditional source of financing for development and at generally lower costs than commercial banks. However, if it is not well managed it may put a country and its assets on a debt trap, which even if no subject to policy conditionalities and informed by a South-South cooperation vision, it could become unsustainable, nevertheless. Third, Kenya most worrying burden of financialization derives from the fact that the dominant lenders are foreign commercial banks which operate guided by purely profit motives and whose servicing costs are set at increasingly more onerous rates as the indebtedness continues. Since it is clear that these high debt ratios are not payable in the short to mid-term at least, this kind of risk to financialization should be cause of great concern.

### 2.3 UNCTAD's Global Demand-led Recovery Path and Kenya's Recovery

UNCTAD (TDR 2020), and related global modelling work using the UN GPM, argue for demand management as a needed policy option for a sustained recovery of the world economy from the effect of the pandemic. However, this and previous studies by UNCTAD note such policy alternatives are seen by many policy-makers and international organizations with a strong bias against government intervention and more generally any interference with market-driven outcomes. A government-managed, demand-led recovery of the global economy would be crucial for Africa because growth of most economies in the continent are strongly associated with global prices of primary commodities which, being fully market-determined are in turn related to the growth of demand and financial conditions in the advanced and large emerging economies such as China. The relationship between the terms of trade improvement of Africa between 2002-2013 and Africa's impressive growth during this time as well as its growth collapse by more than 50 per cent following the sharp decline in global commodity price in 2013-16 attests to this fact (Geda, 2019 for detail). Thus, a sustained recovery of the world economy seems nearly a pre-condition for growth of commodity-dependent countries such as Kenya. But there again, as outlined in UNCTAD (TDR 2020), the growth path of the major economies



cannot be made to rely purely on market forces, especially in a highly financialized system (often characterized as ‘hyper-globalization’ in the mentioned study). Altering this structure would require a considerable effort of international policy coordination that should not only contemplate government-led management but a reliable international financial system and strong commitment of all countries to support industrialization in the global South to reduce dependency on commodity prices.

While global commodity prices for all commodity declined by about 22 per cent during the pandemic year 2020 (compared to the previous year), prices of food and mineral products that constitute an important part of the import bill in many African countries, has increased by 5 and 8.2 per cent, respectively during the same period. Fuel prices, however, has declined by 37 per cent. Although the latter has benefited Kenya as net oil importer, the fall in prices of agricultural commodities (Table 3), like tea (average quarterly declines of 4 percent) and horticulture (average quarterly declines of 12 per cent) triggered net negative terms of trade effects. Definitely, a strong demand-led recovery in developed as well as in emerging economies such as China would have helped Kenya to the extent that global demand for its commodities would rise and at a relatively stable prices. Yet, it was difficult, if not impossible to trigger a globally coordinated recovery (not even regarding an effective plan for vaccination in Africa). Looking ahead, there is a lot to learn from the experience; the case of Kenya’s rapid recovery clearly delineates the options: either to continue to seek a globally managed demand-led solution, or a path of increasing debt dependency from international finance and greater vulnerabilities in the mid-term, even if effective in allowing fast growth of GDP in the short run, as detailed in the next sections.

## 2.4 Summing up on Kenya’s Growth during the Pandemic and the Recovery

In the last two years before the pandemic, Kenya’s growth stood at 6.3 and 5.4 per cent (Table 1), continuing its strong performance registered since 2010. This was primarily propelled by growth in the service sector that contributed about 48 to 67 per cent for overall GDP growth in the eight quarters of the two years before COVID-19. Agriculture and industry were positive contributors to growth but less strongly than the service sector. As noted from early on, the latter was the hardest hit sector by the pandemic, within services, tourism was crucially affected. Proxy indicators such as “arrivals” and “food and accommodation” sub-sectors collapsed by 72 and 60 per cent, respectively, in 2020 (Table 2; Onsomu et al, 2021). The importance of this sub-sectors cannot be ignored, as tourism contributes, on average, about 10 per cent to GDP, 15 per cent to exports, and constitutes 9 per cent of wage employment, with an estimated impact of about 3.5 per cent of total employment when feedback effects on other sectors are taken into account (Onsomu et al, 2021).

The GDP growth deceleration in 2020 would have been much larger than this had it not been abated by agricultural sectors growth which grew by about 5 per cent in the 2<sup>nd</sup> quarter and continued having a positive effect (Table 2). As also shown in Table 1, a GDP growth recovery started in the final quarter of 2020, and the acceleration was particularly sharp towards the 2<sup>nd</sup> and 3<sup>rd</sup> quarters of 2021 (reaching 10 per cent in each quarter), to then maintain a respectable 5.6 per cent in the fourth quarter of 2021.

Mining and Construction were important growth drivers in the first quarters of the recovery, with Services picking up from the 2<sup>nd</sup> quarter of 2021 onwards.

Given the strong momentum from 2021, Kenya's growth prospects for 2022 are generally positive (Table 4). The government of Kenya expects the recovery of 2021 to be maintained at the same pace of 6.6 per cent in 2022. Projections from other institutions, parting from earlier, preliminary growth assessments for 2021, yet converge towards expecting a strong growth performance close to the rate proposed by the government. All these assessments are somehow dependent on the recovery of both advanced and emerging economies such as China – underscoring the importance of the global demand-led recovery path suggested in the GPM-based analysis and the UNCTAD (TDR, 2020) study noted above.

**Table 4: Forecast of GDP Growth by Different Institutions for Kenya**

GDP Growth (Various Estimates, in percent)	2020 (Actual, percent)	2021 (Forecast, percent)	2022
World Bank	-1 to -1.5*	4.9	4.9
International Monetary Fund (IMF)	1.0*	7.6	5.7
African Development Bank	-1.5*	5	5.9
<b>Government of Kenya</b>	<b>-0.3</b>	<b>6.6</b>	<b>6.6</b>
<b>This study**</b>		<b>6.6</b>	<b>6.0</b>

**Source:** Author's compilations based on government of Kenya (National Treasury and KNBS) as well as the following IFIs sources:

World Bank (2020b) Kenya Economic Update, November 2020: Navigating the Pandemic. World Bank, Nairobi at <https://openknowledge.worldbank.org/handle/10986/>

IMF, World Economic Outlook, at <https://www.imf.org/external/datamapper/datasets/WEO>

African Development Bank at <https://www.afdb.org/en/countries-east-africa-kenya/kenya-economic-outlook>

**Note:** \* these were forecasts before the 2020 data was available. \*\* the average growth of five-years before COVID-19 and the government's estimate of 6.6 per cent using data for all quarters in 2021.

The growth performance of the Kenyan economy described above calls for a more detailed analysis of the roles of the public and private sectors, which may have had some incidence in averting a sharper contraction during the pandemic and more anemic subsequent recovery, as observed in other economies of the continent. Such institutional analysis, conducted in the next section, will help clarify the scope and limits of a demand-led, financially sustainable growth recovery in Kenya, as well as the socio-economic and distributional implications, discussed further below.

### III. Policy Response and Recovery: The Government, the Private Sector and Resulting Inequities

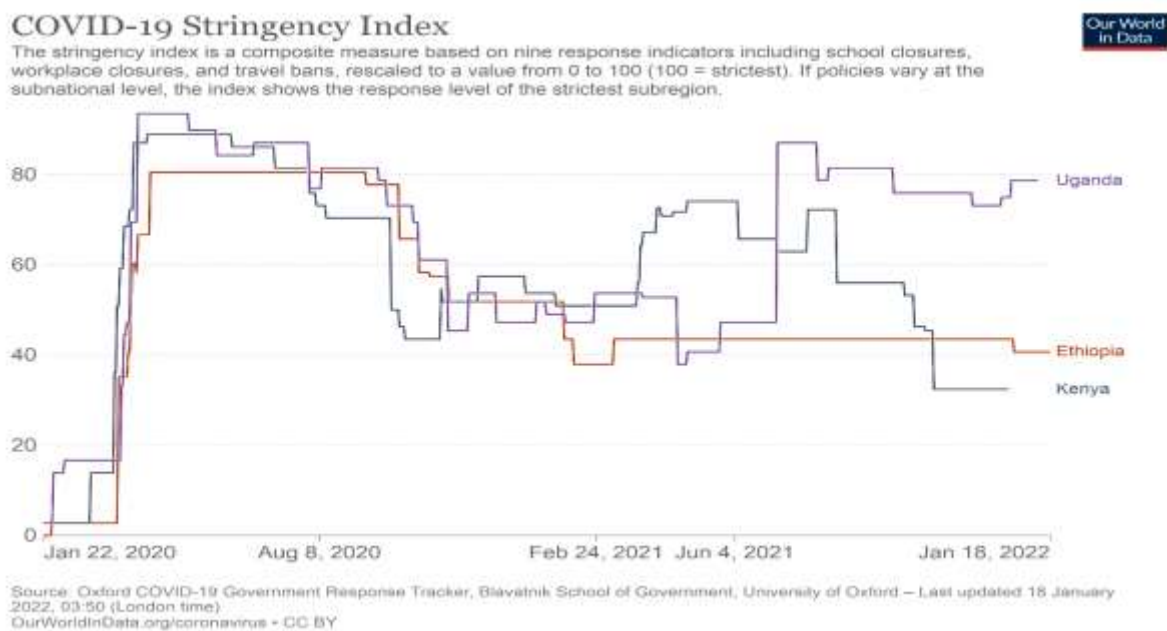
While the GDP contractionary shock in 2020 is mostly attributed to the measures undertaken to contain the pandemic in Kenya and abroad, the character and pace of the recovery can be traced to the responses of the government and the private sector, as detailed below.

#### 3.1 Government Response

Following the outbreak of the pandemic (in March 2020) the Kenyan government introduced a set of restrictions and social-distancing protocols, such as the closure of educational institutions, the suspension of international flights except cargo (while imposition of a 14-day quarantine for returning residents), a reduction of public transportation capacity to below 60 per cent, movement restrictions from and to the counties of Nairobi, Kwale, Kilifi, Mandera and Mombasa, suspension of domestic flights and passenger railway travel, the requirement for all persons to wear face masks while in public places, the recommendation for people to stay at home (including night curfews and work from home), as well as the banning of public gatherings including places of worship, hotels, bars and restaurants,. These measures certainly help to curb the spread of the virus.

The extent of these measures can be captured using the “Stringency Index”, developed by the University of Oxford, a composite measure of the nine response protocols common in many countries, thus including those mentioned above. The index (normalized to range from zero to hundred) is graphically presented Figure 3, Kenya’s response was sharp and restrict as soon as the pandemic was declared, and started to relax from August 2020. Some of the restrictive measures were reinstated towards the first half of 2021, after relaxing again from June onwards, allowing firms and public sector activities to resume nearly normal levels.

**Figure 3: Government Response in Kenya: The Stringency Index**



**Source:** Phillips, Samuel Webster, Emily Cameron-Blake, Laura Hallas, Saptarshi Majumdar, and Helen Tatlow. (2021). A global panel database of pandemic policies (Oxford COVID-19 Government Response Tracker). at <https://www.bsg.ox.ac.uk/research/research-projects/oxford-covid-19-government-response-tracker>.

In addition to such health-related measures, the government of Kenya has also undertaken a number of fiscal and monetary policy measures to support the economy. Importantly, fiscal responses were somehow limited as these accentuated the pre-existing financial vulnerabilities, including high debt levels as discussed above. Most relevant among these are (World Bank, 2021; Nechifor et al, 2020; The Treasury/ Ministry of Finance):

- On expenditure and transfers, a fund of 44.8 billion KSh (0.46 per cent of GDP) was destined to healthcare, COVID-19 monitoring, enhanced social protection, cash transfers and food relief programmes. In addition, the International Finance Corporation disbursed a US\$50 million loan to Equity Bank Kenya to support small and medium size enterprises (SMEs)
- Tax measures, encompassed in the “Tax Laws (Amendment) Act”, 2020 effective 1 April, 2020:
  - i. Reduction of VAT on most goods and services from 16 per cent to 14 percent
  - ii. Tax relief for low-income earners, by increasing the tax exempt base to monthly incomes of up to KSh 24,000.
  - iii. Reduction on top income earnings by cutting the highest rate from 30 per cent to 25 per cent.
  - iv. Reduction in the corporate tax rate from 30 to 25 per cent for residents, while allowing an increase in the withholding tax rates on dividends payable to non-residents from 10 per cent to 15 per cent.

- v. Reduction in turnover tax from 3 per cent to 1 per cent with taxable turnover thresholds increased from an income of between KSh 1 million (US\$ 10,000) to KSh 50 million (US\$ 500,000) for Micro, Small and Medium Size Enterprises (MSMEs).
- Credit facilitation measures, such as allowing banks to waive fees for individuals who move money between their bank account and a mobile wallet (in effect from March 17, 2020). The upper limit for mobile money transfers was also increased.
- Loans and grants were made available through the created National Business Compact on COVID-19 (NBCC), or private entities like the Stanbic Bank and Standard Chartered Bank,
- Debt restructuring: authorities reached a deal with commercial banks to restructure nonperforming loans caused by COVID-19 layoffs, as well as instituting a temporary suspension of the listing of loan defaulters: persons or enterprises of any size (from micro to corporations) in arrears as of April 1, 2020.

The precise impact of this set of measures on the overall economy and on growth in particular cannot be done without a model, which would be in turn subject to the model assumptions and framework of analysis. One such analysis was conducted using an economy-wide computable general equilibrium model (Nechifor et al, 2020). While this is a neoclassical model based on unrealistic assumptions about perfect competition, where all markets clear for price, supply creates its own demand and the economy tends towards full employment in the mid-term, at least the GDP growth results for 2020 and 2021 can be contrasted with the already known growth outcomes for that period. The main observations are as follows:

- The shock during the pandemic year was estimated to cause a fall in the GDP growth rate of 6.4 per cent and a 14 per cent decline in employment, relative to pre-COVID values. As the pre-COVID growth rate was 5.4 per cent, the result would be a GDP contraction of one percent in 2020, could be considered a reasonably good approximation, since the observed figure for the year was a contraction of 0.3 per cent, but after the fiscal measures started to make effect.
- Indeed, a simulation exercise on top of such baseline without policy responses, which then accounted for the measures listed above, found that the combination of fiscal injections and external loans would add one percent growth in the year 2020. While slightly overshooting in terms of domestic impacts, and undershooting in terms of trade activity rebound, the overall GDP result was notably correct.

Beyond the announced measures listed above, the examination of published government budget figures of 2020 later in 2021 is revealing (Central Bank of Kenya, CBK, QER, 2020; 2021). Government receipts declined by 15.5 per cent in the 4<sup>th</sup> quarter of the calendar year 2020 relative to 4 quarters earlier, with taxes falling by 8.6 per cent (of which income taxes fell by 3.6 per cent), and non-tax revenues and external grants declining by 63.9 and 37.6 per cent, respectively. Overall, the falls in revenue, from a planned 8.3 per cent of GDP to an effective 7.3 per cent of GDP, reflect not only the effects of the deceleration of activity but also the domestic fiscal stimuli as well as the changes in donor countries' fiscal adjustments.

On public expenditure side, there was an increase of 4.6 per cent in the fourth quarter of 2020 relative to fourth quarters earlier, of which the rise in current expenditure was the largest, with a 6.6 per cent increase.

The combined effect leads to an increase in the public deficit. While the deficit to GDP ratio remained broadly stable between the two fiscal years in the pre-pandemic year, in the fiscal year 2019/2020 net borrowing to GDP rose by 46 per cent. Such a larger borrowing requirement could not be financed, as initially targeted, by equal participation of domestic and external bondholders, and effectively 80 per cent of this was covered by domestic indebtedness, according to the Kenya National Bureau of Statistics (KNBS),

The rise in public debt is a problem that is being carried over many years, hence the recent sharp increase comes on top of an unsustainable pattern. Ryan and Maana (2014) caution about the increased external vulnerability resulting from a continuing reliance on foreign financing of public deficits (with a greater role of more expensive commercial lenders) and called for more effective measures to promote export earnings, Ryan and Maana's (2014) advice is still valid today and is clearly emphasised in a recent World Bank diagnostic study (World Bank, 2020a).

In this context, two dilemmas emerge. The first one was mentioned briefly in an earlier section. It brings to the fore the crucial policy strategic question of whether government policy should continue to rely on foreign indebtedness to trigger fast growth in the short run and accumulate unsustainable debt burdens, or rather there should be more emphasis on a combined strategy of industrial policy towards export diversification and generation of domestic income supported by concurrent demand-led efforts in the major economies. The second issue is that aside from the additional constraints that the greater external debt burden would impose on the 'fiscal space' and macroeconomic outcomes, the fiscal policy measures also carried adverse distributional implications. The reduction in the VAT rate was just 2 percentage points, but the corporate tax rate declined by 5 percentage points. Furthermore, as observed in the more detailed layout of firms in the next section (Tables 5a - 5d) COVID related loans did not reach the Small and Medium Scale Enterprises but offer a considerable relief, if not a windfall gain, to big firms.

### 3.2 Private Sector Response and Performance

Private sector responses are assessed with the help of two types of surveys. The first one, the "Micro and Small Enterprise (MSE) COVID-19 Tracker Survey" is produced jointly by the KNBS, the CBK and FSD Kenya, was conducted in two instances, in May 2020 involving 603 business owners, and the second one, with 430 business owners in November 2020. These surveys in turn use an underlying FinAccess household survey sample of 1,610 respondents across 47 counties who indicated that their main source of income was from their own business or self-employment (CBK et al, 2021). The second data source is a 'Rapid Business Response' phone survey conducted by the World Bank (World Bank, 2021) between June and August, 2020, in which a representative sample of 2070 firms were randomly

selected from the year 2017 Census of Establishments of the KNBS. The sample was stratified by firm size and sector of activities across over 50 counties. Both surveys focused on MSEs, which account for 24 per cent of GDP, 90 per cent of private sector firms and 93 per cent of total labour force in the economy.

**Table 5a: Firms' Challenges and Response to COVID-19 in Kenya**

Percentage of Respondents	
<b>Top Business Challenges</b>	<b>Per cent of Respondents</b>
Suppressed demand/sales	44%
Access to Credit	11%
Business expenses	9%
Unpaid customer credit	8%
Accessing stock/suppliers	7%
Paying rent	7%
<b>Other Indicators of the Impact</b>	
Business cited increased cost of suppliers as their biggest challenge	40%
Percentage of business closed by March, compared to those active in pre-COVID	20%
<b>Extent of Revenue Recovery by March 2021 and Government Support</b>	<b>Per cent of Respondents</b>
<50 per cent of Pre-COVID Revenue	45%
50-99 per cent of Pre-COVID Revenue	26%
Revenue the same or better than pre-COVID	30%
<b>Government Support during the 2020 lockdown</b>	
No Support	73%
VAT Reduction and Turnover Tax reduction	19 and 18% each
Suspension of Credit Reference Bureau Reporting	8%
<b>Main Source of Support during the 2020 lockdown period</b>	<b>Per cent of Respondents</b>
Friends and Families	54%
SACCO (a key source of finance for MSEs)	19%
None	7%
Customers and groups/Chama	4 & 3% each
Banks, MFI	2% each

*Source: Author's compilation based on CBK et al (2021) Fin Access Survey Data Result*

The results, summarized in Tables 5a and 5b for each survey, confirm that about half of the firms have experienced significant drops in sales (and hence revenue loss) following directly from the outbreak of the pandemic and the government's responses (lockdowns, travel bans, etc). The proportions of firms affected and the reported revenue losses in Kenya stand on the high end of results recorded by WB surveys in other African economies, close to results reported for South Africa and much higher than those reported for Côte d'Ivoire, Senegal, and Tanzania.

Both surveys also report that a meaningful proportion of firms had to close operations by March 2020, a significant part of which involved female employees. Among those, the greater proportion were micro firms (1–4 employees), followed by small firms (5-19 employees) with closures around 50 per cent. In the larger firms, around 80 per cent remained open throughout the pandemic. Likewise, other indicators like difficulty to access credit, rising costs of business operations, unpaid customer credit and lack of access to stock/supplies depict a grim picture, especially to micro and small firms.

**Table 5b: Firms' Challenges and Response to COVID-19 in Kenya**

Sales and Demand Conditions	
Average Sales of Firms Declined by 65%t (by June-August 2020). - More than 50% of firms reported decreases in demand (65%), cash flow and available finance (65%), hours worked (62%), and available inputs (54%)	This is large compared with other African countries. South Africa reported an average decline in sales of 76%, In Côte d'Ivoire, Senegal, and Tanzania the average decline was below 40%.
Firms that saw a decline in sales (by June-August 2020)	93%
Sales dropped for the median Kenyan firms	By 51%
Sales dropped for 25% of firms.	By >70%
Sales decline for the bottom 10% of firms	90% (for the median firm' sales have fallen by 70 percent)
Small and micro-sized firms are more severely affected by the pandemic than larger firms.	80% of large firms (100+ employees) were fully open. Only 50% of small (5–19 employees) and medium-sized (20–99 employees) firms were fully open. Micro-sized firms (0–4 employees) are more often forced to permanently close or temporarily cease operations by their own choice
The pandemic is disproportionately affecting businesses with a large share of female employees	Over 40 per cent of businesses with a large female workforce are temporarily closed
The majority of agricultural and manufacturing firms have been able to remain open. Within the service sector there are large differences in the operating status of firms.	

*Author's Computation from World Bank (2021a) Phone Survey Data*

In addition, Table 5c points to worrying degrees of erosion of savings (which under circumstances of credit restrictions are essential for the survival of the firm or to pay employees, many of which in micro firms are household members). This in turn contributed to increase food insecurity of households, which rose from 14 per cent before the pandemic to 47 per cent by November 2020, and which moreover remained trice as high, at 42 per cent, in March 2021. Recalling that firms with large proportions of female employees were affected, these outcomes reinforce the notion that the pandemic had a disproportionately disturbing gender-bias.

**Table 5c: Firms' Challenges and Response to COVID-19 in Kenya**

Indicators of the Impact of COVID-19 on Businesses (on the MSEs)	Feb 2020 (Pre-COVID Period)	April-June 2020 (Locked-down period)	November 2020	March 2021
Reduced Revenue (Revenue level indexed to 100 per cent in Feb 2020) *	(Index=100%)	38%	56%	79%
Reduced Saving (Percentage of MSE with saving)	60%		32%	37%
Self-employment (paid & unpaid) index, indexed to 100 % in Feb 2020	100%t	59%	100%	108%
Food Insecurity (percentage of MSE households who missed a meal)	14%	61%t	47%	42%
Percentage of MSE using mobile money for transaction (was 18% in 2018)	59%			62%

**Source:** Author's compilation based on CBK et al (2021) Fin Access Survey Data Result

\* Note: this average picture hides the variation in revenue recovery across firms reported in Table 5b above.

**Government Support and Coping Mechanisms:** From the discussion earlier in the paper, the depressed situation by mid-2020 affected particularly activities of the Service sector (the agricultural sector was largely unaffected and the majority of manufacturing firms remained open). By March 2021, only 30 per cent of firms obtained revenues equivalent to their pre-COVID-19 levels, 26 per cent



of the firms regained 50 to 99 per cent of their pre-COVID revenue, and 45 per cent reached below 50 per cent (Table 5a). But aggregating the revenues across all firms, total gains represented 80 per cent of the pre-COVID level by March 2021 (Table 5c), which suggests that the recovery was highly concentrated among a relatively small number of the most profitable firms.

**Table 5d: Firms' Challenges and Response to COVID-19 in Kenya**

<b>Employment Condition and Coping Mechanism of Firms</b>	
More than 20% of businesses in Kenya laid-off workers. Labour adjustments on the intensive margin were smaller on average;	Relatively few firms reduced the working hours of at least one employee (12%) and reduced wages (8%), or granted a leave of absence with or without pay (5 and 11%, respectively) in all sectors
33% of workers are in firms facing high levels of vulnerability. Firms are defined as vulnerable if they are partially open or temporarily closed, as these firms could potentially run into liquidity problems and are more likely to permanently close. Using this definition:	48% of workers in small firms were vulnerable 50% of workers in medium-sized firms were in vulnerable firms, Only 26% of those working for large firms were vulnerable More than 50% of jobs are vulnerable in the tourism sector, compared to 8% in manufacturing firms Workers in older and non-exporting firms, as well as firms with more than 50% of employees being female were also more vulnerable
Number of workers that lost their jobs due to the pandemic.	20% (Laid off in other service sector 25%; in tourism firms, 20%, Firms in manufacturing and retail trade (10%))
Firms that have reduced their working hours	62%
Firms faced a lower availability of inputs.	54%
Workers in businesses that are temporarily closed	20%
Workers in businesses that are only partially opened	16%
Firms expect a decrease in sales in the first six months of 2021 compared to the previous year	Average (27%); Pessimistic Scenario (56%)
<b>Coping Mechanisms and Government Support</b>	
Per cent of all firms with five or more employees are starting to use, or increase the use of digital platforms	Almost 50% (Investment in digital solution 13 percent; Increased working from home, 12%)
Firms that have received public support,	About 20% (40% received cash transfers and 33% received tax deferrals)
Firms that call for loans with subsidized interest	50%
Firms that call for money transfer	42%
Firms that called for tax deferrals	25%
Micro-sized and small firms were less likely to receive public support, compared to larger firms. While 27 % of large firms got assistance, only 16% of micro-sized reported having access to assistance measures	

**Source:** Author's computation from World Bank (2021a) Phone Survey Data

The aforementioned inequities explain the generalized dissatisfaction with the government support measures, as 73 per cent of firms reported getting no support from the government (Table 5a). Hence, a majority of firms (54 per cent) relied on family and friends, while for about 19 per cent of firms the main source of support was indirect, resulting from the reductions of VAT. On the other hand, only 19 per cent of firms reported to benefit from the financing programme SACCO (sourced by MFIs), that despite the fact that over 50 per cent of firms were calling for subsidized loans and another 42 per cent for money transfer, with 25 per cent of these financed-constrained firms calling for tax deferrals (Table 5d).

In the conditions stated, the inequity in terms of government support and the inadequacy of financing forced SMEs to seek relief by attempting to minimize the costs of labour, by either outright lay-offs, or by cutting labour hours, or by extending leave of absence, or else by cutting wages (Table 5d).

Consistently with the findings reported above, employment or wage-income vulnerabilities were far more pervasive among the smaller firms (only 26 per cent of workers in large firms and 8 per cent of those working in manufacturing conglomerates were found to be vulnerable), and among those where more than 50 per cent of employees were female.

## **IV. The Socio-Economic Impact and Gender Dimension**

### 4.1 The Poverty Impact from Covid-19 and Its Gender Dimension

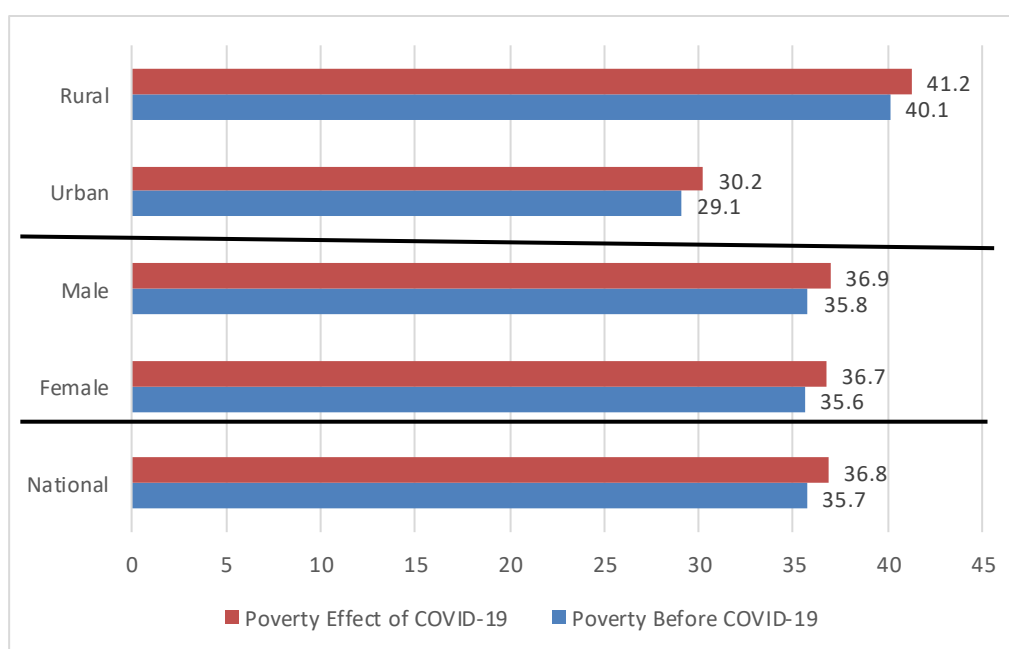
Both poverty and inequality are historically very high in Kenya. Using the local poverty line which is based on the latest integrated household budget survey of 2015-16, the monetary-based poverty rate is found to be 35.7 per cent (KNBS 2020a; World Bank, 2020a). Poverty is also concentrated in rural areas with a poverty rate of 40.1 per cent, compared to urban areas that is just 29.1 per cent. With the poverty rate of 35.6 and 35.8 per cent for males and females (KNBS, 2020a), there seems to be no fundamental difference in poverty across the gender divide. Although this is true for all age groups and at national level, for adults (age 35 to 59) the poverty rate for females is about 3 percentage points higher than for males. Poverty rate is also very high among children (42 per cent),

The survey results discussed above show that the pandemic and the biased character of the policy responses had the effect of worsening inequalities, moreover hitting females in stronger ways. Furthermore, weather shocks affecting food supplies tend to hit women more severely, because of lay-offs from temporary agrarian occupations or in export-oriented activities, and women have to make greater sacrifices to feed their families, care for the young and the elderly, etc. These effects arise on top of the fact that studies of poverty by marital status show that the poverty rate is higher for females than males, with a very high gap for widows, with poverty incidences of 38 and 25 per cent, for males and female, respectively (Hyun, et al, 2020). Similarly, using estimates of multidimensional poverty, the national incidence is 67.1 per cent, with an extremely high value in the rural population, at 81.1 per cent which is twice that of urban areas, at 40.4 per cent (KNBS, 2020a). Finally, the Gini coefficient of 40.8 denote a very high inequality (Pape and Mejia-Matilla, 2019).

Poverty line analyses based on international standards point to similar findings. Even if poverty levels in Kenya is below the average in sub-Saharan Africa and are amongst the lowest in the East African Community, the estimated incidence in 2019 was 37 per cent using a 'extreme' poverty line of US\$1.90 per day at purchasing power parity (PPP), and a staggering 67 per cent if the US\$3.20 PPP threshold is used instead. These rates suggest improvements over estimated incidences of 46 per cent in 2005/06 and 41 per cent in 2013 using the 'extreme' poverty indicator (World Bank, 2020a), but it is known that such changes absorb mostly the overall effect from economic growth, leaving distribution mostly unaffected. Reductions of poverty incidence have been moderately greater for the rural areas, reflecting rises in consumption from a very low level (Pape and Mejia-Matilla, 2019) and, again, fast growth of aggregate income in the agricultural sector (KNBS, 2020c), which must have contributed for this rural poverty result.

In 2020, the pandemic has reversed earlier gains in poverty reduction. Even after accounting from the fact that the Kenyan economy recovered quickly and strongly from the COVID-19 shock, World Bank (2020a) noted that the Kenyan pace of poverty reduction will not be enough to eradicate extreme poverty by 2030 – a target that Kenya is aspiring to attain. To do so, Kenya’s poverty rate would have to fall by an unrealistic 6.1 percentage points each year, while the country’s decade average poverty reduction rate was just 1.6 percentage points per year. If poverty reduction continues at its current pace, the poverty rate will remain around 24 per cent in 2030—or higher if longer term negative effects of COVID -19 are taken into account, such as delays in industrialization and diversification. By looking specifically at the broader pattern of GDP growth, temporarily derailed by the COVID-19, and notwithstanding the lack of information about the elasticity of poverty with respect to inequality during the pandemic, basic computations of poverty impacts using the latest KNBS (2020a) data are shown in Figure 6. On average, the COVID-19 economic impact was estimated to result in an increase the number of poor people in Kenya by about 592,000 persons (i.e. by 1.1 percentage points). Though recorder here for full disclosure, no significant difference was obtained by gender differentiation, as these calculations did not introduce gender specific factors as those noted in the survey-based discussion. Similarly, there is no major difference in the rate of poverty increment in rural and urban areas either.

Figure 6: The Poverty Impact of COVID-19 in Kenya



Source: Author’s computation based on KNBS (2020a) data (with poverty elasticity of 0.57 and population growth of 2.3 percent). With the population estimated at 53.8 at 2020, COVID has raised the number of the poor by 592,000 people.

Such straightforward calculations have limitations and may yield a more optimistic scenario when compared with full or partial modelling exercises, which in turn may carry other sorts of methodological limitations. For example, World Bank (2021b) micro-simulations that is based on a sequence of rapid phone call surveys suggests that the increase in the number of poor over the pandemic (estimated at over 3.5 million people) might have removed all the poverty reduction success attained in the last 10 years in Kenya. But another microsimulation in the same study, which incorporates the cash transfers by the government of Kenya, reduces the size of the poverty impact by one percentage points only (equivalent to half a million additional Kenyans becoming poor). As poverty increased overall, inequality worsened as well, with Gini calculations of the increase of inequality being twice as large in urban, compared with rural areas.

Coping mechanisms of adversely hit households include the usual reliance on meagre savings or reduction of food consumption (reported by 38 per cent of households), and in a few cases asset sales (poorer units) or loans against collateral assets (relatively richer units). As a result, almost half of households reported going hungry (World Bank, 2021b). Compared to our findings and to Nechifor et al (2020) CGE model-based simulation exercise, the WB study paints a seriously worrisome picture.

## 4.2 Employment and the Gender Dimension of the COVID-19 Economic Effects

Of a total population of nearly 50 million (of which about 20 million under 15 years ) (KNBS, 2020c) the 18 million employed, the employment to population ratio represent about 60 per cent in 2019. Such employment to population ratio is one of the lowest in the region, being 14 percentage points lower than the Eastern African region (DUTDA, 2020). Further, 35 per cent of the labour force are engaged as employees (nearly half of those being wage-earners), and a similar proportion includes “contributing family workers”. “Own Account Workers” are 17 per cent and employers 8 per cent (Table 6b). The greatest proportion of the labour force, 57 per cent, is engaged in the agricultural sector, with services and the industry involving 36 and 8 per cent of the total, respectively. Excluding those engaged in small scale agriculture and pastoralists, informal employment in Kenya was estimated at 84 per cent of the total employment in 2017. This rate is closer to Sub-Saharan Africa average that was estimated at around 80 per cent of the labour force (DTUDA, 2020).

Two main sources, the mentioned KBNS and the CBK which offers a more detailed sectoral classification, and computations with the help of global structural change data of Groningen University, served to examine the employment effects of the pandemic. Empirical tests assumed no changes in productivity during the pandemic year; agriculture and “mining and quiring” were excluded because declines in employment occurred despite growth in output, which reflect mixed factors such as labour-saving and productivity rises. Agriculture is also a case of ambiguous results using standard models as small-holders and subsistence farmers are not expected to stop working during the pandemic period either.

Main results that are based on the latest government data available are shown in Table 6a. Unemployment increased significantly during the pandemic period, especially in 2<sup>nd</sup> quarter of 2020, doubling the pre-pandemic rate of 4.9 per cent to 10.4 per cent, and slowly declining towards 5.4 per cent in the final quarter of 2020, representing an 11.3 increase in the unemployment rate of the last quarter of 2019. The employment rate shows a parallel pattern, as also confirmed by the ex-ante study of Nechifor et al, (2020), which suggests that the decrease in the employment rate could be between 11.8 and 14 per cent. The latest available data confirms that the relative recovery observed by the end of 2020 was not sustained into 2021, as the unemployment rate rose to 6.6 per cent.

**Table 6a: The Effect of COVID-19 on Employment/Unemployment in Kenya**

In millions (growth rates in percent)	2019 (in millions, growth in percent)			The COVID Period 2020 (in millions, growth in percent)				2021
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Population (Age 15-64)	26.77	26.95	27.13	27.31	27.49	27.67	27.84	28.03
Growth, in %		0.67	0.67	0.66	0.66	0.65	0.61	0.68
Labour Force (in Millions)	18.67	18.81	19.03	18.55	17.71	19.04	19.13	19.11
Growth, in %		0.75	1.17	(-2.52)	(-4.53)	7.51	0.47	-0.10
Employed (in Millions)	17.79	17.82	18.1	17.59	15.87	17.67	18.1	17.84
Growth, in %		0.17	1.57	(-2.82)	(-9.78)	11.34	2.43	-1.44
Unemployed (in Millions)	0.878	0.995	0.930	0.932	1.841	1.368	1.035	1.264
Growth, in %		13.3	-6.5	0.2	97.5	(-25.7)	(-24.3)	22.1
Unemployment rate in %	4.7	5.3	4.9	5.2	10.4	7.2	5.4	6.6

*Source: Authors computation based on KNBS Quarterly Labour Force Survey*

Table 6b shows results specific to the narrower section of wage employment. From 2.9 million of wage-earners in 2019, the pandemic was found to lead to a loss of 124,751 wage employees, concentrated in the service sector, sub-sector “accommodation and food services (which corresponds with the observed collapse in the tourism sector). Other subsectors affected included “education” and “transport and storage”.

**Table 6b: The Effect of COVID-19 on Wage Employment by Sector, Kenya**

	Share in GDP (2019)	Growth Rate (Annual, in percent)			Wage Employment 2019	Employment Elasticity 2015-19	Employment Impact of COVID (in %t)	Employment Impact of COVID (in Number)	Notes on Assumptions
		2018	2019	2020					
<b>Agriculture</b>	<b>18.6</b>	<b>6.4</b>	<b>2.6</b>	<b>4.8</b>	<b>338,576</b>	<b>-0.78</b>	-3.74		
<b>Industry</b>	<b>17.4</b>	<b>5.3</b>	<b>3.4</b>	<b>4</b>	<b>629877</b>	<b>0.77</b>	3.09	Is average of the elasticities of the sub-sectors	
Mining and Quarrying	1	2.8	4.3	6.7	15875	-0.10	-0.67		
Manufacturing	8.7	4.2	2.5	-0.1	353328	1.61	-0.16	(568.5)	
Construction	5.3	7.9	5.6	11.8	221495	0.37	4.36		
Electricity & Water Supply	2.5	6.6	1.7	0.1	39179	1.21	0.12		
<b>Services</b>	<b>55.1</b>	<b>6.9</b>	<b>6.5</b>	<b>-22</b>	<b>1796762</b>	<b>0.42</b>	-0.92	Is average of the elasticities of the sub-sectors	
Wholesale and retail trade,	8.4	6.3	5.3	-0.4	269201	0.52	-0.21	(559.7)	
Transport and Storage	10.3	8.8	6.3	-7.8	92536	1.77	-13.84	(12,806.3)	
Accommodation & Food Services	1.2	16.6	14.3	-47.4	82946	1.77	-84.10	(69,757.7)	
Public Administration	5.8	6.1	9.9	5.3	304602	0.54	2.86	Assumed to be similar to the elasticity of the transport sub-sector	
Real estate	9.8	4.1	6.7	4.1	4379	-0.27	-1.10		
Financial and Insurance	7.7	5.6	6.9	5.6	77,607	-1.31	-7.32	Average of business services (-1.6) and financial services, -1.0 is used	
Information and Communication	3	11.4	7.5	4.8	132,330	-0.45	-2.17	The elasticity of the "Other services" sub-sector is used	
Profession, Administration & Support System*	3	5.9	6.9	-15	77,160	0.54	-8.09	(6,239.4)	
Education	4.7	5.8	4.7	-10.8	598051	0.54	-5.82	(34,819.3)	
Health	2.1	4.5	6.2	6.7	157950	0.54	3.61	Same as above [EPA] used	
<b>GDP Growth (Constant Market price)</b>	<b>100</b>	<b>6.3</b>	<b>5</b>	<b>-0.3</b>	<b>2,928,349</b>	<b>0.22</b>	<b>-0.07</b>	<b>(124,750.9)</b>	

Authors computation based on KNBS and CBK data as well as Groningen University data on Structural Change for the years, 2014-19.

Although this analysis doesn't show data disaggregated by gender, there should be no doubt that the pandemic has affected women more severely, as the subsectors most hit are precisely those where female employees are the large majority. On top of losses of employment and earnings, women were also hit hard because of inherent gender biases in the Kenyan property laws, which do not favour land-ownership or heritage of women (only 12 per cent of women aged 20-49 years report owning land on their own, compared with 39 per cent of men; World Bank, 2018b). Furthermore, the World Bank (2021b) phone survey discussed earlier also shows a significant gender gap in earnings, where on average male wage worker earns 30 per cent higher than female wage workers and profits of male-run household enterprises are about twice as high as profits of female-run enterprises. This study also reveals further twists on the different impacts of the pandemic by gender. The lockdowns led to more women stop working than men, and assumed far more hours than men on child care. Over 20 per cent

of women in employment in May-June 2020 had stopped working by July-September 2020, compared to 16 per cent of men. The share of employed women stopping work also remained higher in each subsequent wave of the survey (there were five waves of surveys) with a difference of around 5 percentage points compared to men. In addition, another survey confirmed the general observation of increases of domestic violence during the pandemic KNBS (2020b), affecting to about 24 per cent of the respondents.

## **V. Conclusion: Can Kenya Stimulate Domestic Demand for a Sustained Recovery?**

Given the analysis of the Kenyan economy and the way the pandemic affected its performance, this study concludes by addressing the fundamental question of whether the recovery path taken was appropriate and, going forward, whether there is scope for a demand-driven growth, as enunciated in UNCTAD's TDR (2020), as described in section 2.3 above.

### **5.1 Demand Composition and the Challenges for Economic Growth in Kenya**

Traditional studies of growth patterns are analysed using production functions à la Solow. One such studies (World Bank, 2020a) estimates that Kenya growth is mostly attributed to capital and labour accumulation, whereas total factor productivity is just about one percentage point out of the five per cent growth in the period 2004 to 2017.

But to the extent that the Kenyan economy can be said to be operating with excess capacity (especially labour), income and demand matter, which in the sections above were shown to be inadequate. Table 7 shows the main contributions of demand to economic growth. With an average annual contribution of 81 per cent in the period 2014-2019, private consumption is the main driver, followed by aggregate investment with 18 per cent and then government current expenditure with 13 per cent. The external sector historically had a negative contribution of 10 per cent, confirming earlier arguments about import dependency and adverse terms of trade. In addition, the contribution of exports to growth has also declined over time, from 16.6 per cent in 2015 to 12 per cent in 2019.

A first observation to be made is that while private consumption and investment are privileged factors of growth, they also have high import propensity. This is mostly for two reasons; first as income distribution is highly unequal (see section 4 above), the fast growth of consumption occurs among the upper classes, with consumption baskets privileging imported and expensive goods. Second, except for self-subsistence goods in rural areas, the Kenyan economy is not diversified enough to produce the goods and equipment along the growth path. This junction of inequality and lack of industrial capacity brings up a common feature of developing economies and especially in Africa: except for a

few ‘export success stories’, typically the economies that happen to be specialized in primary commodities whose demand and prices are sustained for a sufficiently long time, the Kenyan economy suffers from a chronic ‘balance of payments constraint’: unless that there is a way to trigger a robust and sustained pace of export growth, a demand-led strategy will exacerbate the structural deficit problem.

**Table 7: Demand Side Sources of Growth in Kenya and Challenges of Recovery (2015-2019)**

Components of Aggregate Demand	Contribution to GDP Growth (in percent)					
	2015	2016	2017	2018	2019	2015-19 Average
Final consumption expenditure, households	78.8	78.8	81.6	82.4	82.5	80.8
Final consumption expenditure, government	14.1	12.9	12.9	13.1	13.1	13.2
Gross capital formation	21.6	17.6	18.3	17.3	16.8	18.3
Net exports (X-M)	-11	-9.1	-11	-9.8	-9.4	-10.1
<b>Momo Items</b>						
Exports of goods and services (% of GDP)	16.6	14.3	13.2	13.2	12	13.9
Less: Imports of goods and services (% of GDP)	27.6	23.4	24.2	23	21.4	23.9
<b>GDP Growth (at constant market price, in %)</b>	<b>5.7</b>	<b>5.9</b>	<b>4.8</b>	<b>6.3</b>	<b>5.4</b>	<b>5.6</b>

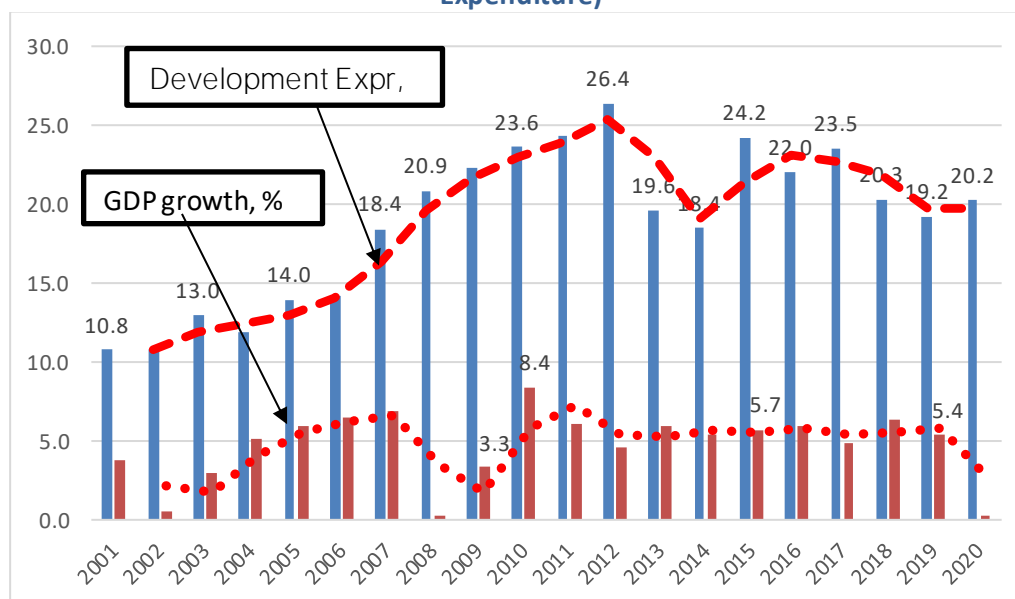
*Author's computation based on Kenya National Bureau of Statistics, 20201.*

*\*Note Change in inventory (about 0.5% contribution and depreciation (with contribution from -0.1 to 0.8% are left out as their five-year average contribution is negligible. Similar analysis using World Bank, Development Indicators data gives similar but different values for all demand components and is given in AnnexA.*

A second and important finding is that one factor which had a strong positive correlation with aggregate growth is public development expenditure (estimated at 0.54, after taking out the 2009 year which was a global, exogenous event, Figure 7). This is because it creates employment and domestic demand growth, and is also positively associated with private investment. Thus, pulled by public involvement in critical areas of physical and social infrastructure, together with private investment there is a net contribution to increase productive capacity by adding to the two factors of production (employment and labour).



**Figure 7: GDP Growth (%) and Government Development Expenditure (% total Government Expenditure)**



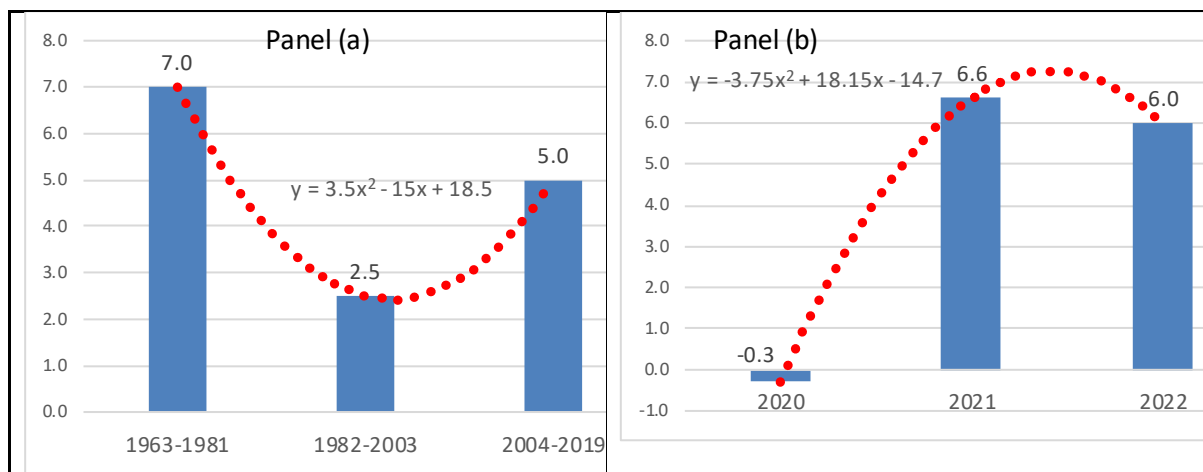
*Author's computation based on CBK data, 2021*

The role of public investment raises however the question of the risk of rising government deficits and an unsustainable accumulation of external debt, as noted also in section 3. The growth pattern, therefore, lacks a clear way forward. This is specially so after considering that usually under circumstances of rising public indebtedness, governments also tend to experience increasingly narrower 'policy space', as investors and lenders claim austerity and expenditure cuts in return. For example, World Bank (2020a) argues that the "narrowing of the fiscal space poses the single biggest threat to macroeconomic stability" and goes on stressing that the public sector (and its debt-driven public investment drive) is unlikely to remain a driver of growth as it has reached its limits.

Yet, the analyses that look only to the accumulation of debt and the relative importance of one single sector tend to ignore the interactions and feedbacks with the rest of the economy (in so far as public investment multipliers in developing economies are generally very high), as well as with foreign investors (which are also attracted by the prospects of well-developed infrastructure networks and education capacities).

A simple statistical observation helps to corroborate the fact that it is the overall effects of a public sector strategy onto economic growth that matter, where private sector activities come to exert a robust contribution to growth when accompanied by government investment. As Figure 8a shows, the recent episode of fast growth (2004-2019) was nearly as buoyant as the growth experience of the immediate post-independence period (1963-1981), coincident, as per Figure 7 above, with a similarly robust pace of public sector development spending. By contrast, the period 1982-2003, the years in which structural adjustment measures were imposed, of a similar kind now recommended by international institutions to resolve the debt problems, were years of anaemic growth, also known as the African Great Depression Period.

**Figure 8: Kenya's Episodes of Growth: From Post-independence to 2022**  
 (Panel a, 1963-2019, before the pandemic; and panel b during and after the pandemic, including projection for 2022)



Source: Author's Computation based on World Bank and NKBS data.

While it cannot be denied that public-investment led growth is exacerbating the external debt problem, it should also be recognized that such is not the real issue, since a drastic adjustment will bring about another cycle of depression. Rather, the real challenge for a demand-driven sustained path of growth lies on three faults of the economic structure: (i) grave income inequality (not only because of meagre income of workers, but also because the tax structure is neither progressive nor sufficient to help finance spending); (ii) lack of industrialization; and (iii) inability to ensure sustained export growth due to adverse external conditions on trade and finance for the type of commodities the country is exporting. These are the bottlenecks that some of the emerging economies of East Asia managed to overcome, where a central role of the government and more favourable regional and global demand conditions created the environment for an “export-growth based stabilization strategy”, as that of Vietnam in the post 1990s, and of other East Asian economies in the earlier decades (Weeks, 2001; Weeks et al, 2004; Geda, 2020).

It is now useful to approach these concrete limitations from the approach proposed in UNCTAD (TDR 2020). As noted earlier, such an approach, to be successful, requires a considerable degree of international coordination on both North-South and South-South perspectives, given the fact that, for economies like Kenya where the debt burden constraints policy space, it is essential to act on the international setup, addressing both financing and demand limitations. In this light, the relevant issues for Kenya are:

**a) The Foreign Currency/External Finance Problem:** financing for development needs to be revisited, to move away from either conditionalities, which are typical of IFS, or loans that impose on the economy the need to serve the debt with the exploitation of primary resources, as it may happen with China or European investment companies. Investment-led growth requires financing, but it should be geared to maintain a development strategy, which implies allowing the management of the

economy, and of monetary and exchange rate policies in ways that can alleviate inflationary pressures by mitigating external shocks and diminishing the pressures from imported prices.

**b) Industrial Capacity:** unless the economy develops its industrial sector (which in Kenya not only represents a feeble 9 per cent of Value Added, but also operates under very low productivity; see Chege et al, 2016), the economy will not overcome its balance of payments problem. The development of the industrial sector is not only conducive to increase productive potential, but to generate the wage incomes, the profits and the tax revenues for a balanced growth of the economy, and for making a substantial and durable contribution to export growth. A strong industrial sector will also pull demand growth of wage-goods, which is critical for also the most needed increase of productivity in the agricultural sectors, thus liberating the labour resources to feed into the industrial sector, à la Lewis. Else, a demand stimulation in such structurally supply-constrained conditions will simply add significant inflationary pressures (and real exchange depreciation), reducing even further the scope for export orientation, and making trade deficits and external indebtedness an endemic, structural problem worse than at present.

**c) Financialization and policy space:** If demand and productivity growth are not strengthened as laid out in the previous point, the economy will continue to require financing, not as noted in point (a) to sustain an investment led strategy but rather to feed into endless loops of external debt service payments, rolling back ever increasing levels of debt, calling for more inflows and constraining, at each step of the way, the policy space that is required to lead a development strategy. Hence, it is essential that the global financial system is transformed, from a private-only global commercial venture, to a system that can coexist with another role of global finance that can serve the development strategies of countries in the global South. That requires efforts both from the major economies as well as from a variety of South-South initiatives including development banks, currency stabilization funds, swaps and agreements to trade among Southern partners in domestic currency. Not all of this will be realizable in the short run, but by putting forward reliable and credible mid-term plans, the current pressures from global finance to reduce policy space will be certainly contained. African economies, in particular, have a lot to gain from a continental strategy in this direction.

## 5.2 Concluding remarks

This study has shown that for countries in Africa which are dependent on export of primary commodities and services such as Kenya, the recovery of the global economy and a conducive global financial environment are crucial for a sustained growth path, especially after the devastating effects of the pandemic. What is more, the milder shock experienced in Kenya relative to many other countries in Africa, was mostly at the expense of ever higher levels of indebtedness and shift in terms of distribution of income that has left the smaller firms, poor households, and women in serious disadvantageous positions from which an inclusive recovery becomes implausible. Indeed, the pandemic hit Kenya at a time when its fiscal space was in the course of being narrower each year, but to reverse the damaging social effects of this crisis requires even more fiscal space than before. And even if a small window of policy space was opened to address social concerns, that, under current conditions where global finance has the upper hand, will not allow *also* space for industrial

transformation. A radical re-draw of the international setting and of domestic policy is needed to trigger a public-sector investment led strategy of development, export-orientation and inclusive gains in income distribution and welfare.

In other words, the policy re-direction for a steady and sustained high growth needs to be framed in such a way that it avoids or at least minimizes the potential macroeconomic instabilities that have hinder the Kenyan strategy in the last decades. Coherently with the spirit of the recommendations proposed in UNCTAD (TDR 200), some of the elements of such policy re-direction may include:

- **Expenditure switching and rationalization.** The fiscal measures undertaken to withstand the pandemic's effect as well as the necessity of increasing spending due to the pandemic has already put significant pressure on the fiscal space and is going to put this pressure further, partly because revenue had also declined. Since reducing public spending has a determinantal impact on growth recovery, the available option is to optimize expenditure management, raise the efficiency of public spending and, importantly, revise the tax system to make it more progressive and to ensure a more meaningful contribution to budget, so that multiplicative gains from spending revert strongly onto public revenues.
- **Address external financing bottlenecks to support investment growth.** While some of the problems of financing the public spending drive can be resolved by rationalization and tax progressiveness, additional borrowing requirements can be address by both increases of domestic debt and of international financing for development. This, in turn, requires support from global macroeconomic conditions, and new mechanisms of debt-restructuring, new forms of external financing, and new forms of financial insurance and development banks, both regional and global.
- **Of all financing mechanisms, external borrowing from commercial lenders, and policy-conditioned borrowing from IFIs, should be minimized.** One of the lessons of recent history, for Kenya and many other developing economies in Africa and elsewhere, is the main trigger of macroeconomic imbalances and the shrinking of the fiscal space are related to high debt payment obligations from commercial ventures and deflationary conditionalities form IFIS. Thus, these two mechanisms for supporting an investment-driven strategy have to be minimized. Inevitably, this approach calls for an alternative, development-conducive global financial architecture that can be deployed along the efforts towards export-orientation and industrialization, and as other South-South cooperation mechanisms are developed.
- **Employment-centered social development and inclusiveness.** Macroeconomic adjustments, as those reviewed in this study during the pandemic, have worsened income distribution and have led to job losses while also lowering the scope for productivity growth as larger proportions of the labour force shift to informal or subsistence activities and women are also forced to devote increasingly more time for child care. To reverse these tendencies, it is essential that public policy is oriented both to social development, income policies and gender equality, and to industrial policy to allow for the generation of jobs of higher productivity and hence earnings.

Overall, economies like Kenya are facing a policy dilemma going forward. Either it choses a path ahead where the economy in isolation becomes trapped in vicious cycles of fast growth dependent on burst of external indebtedness, reduced policy space and drastic adjustments with effects in terms of growth slowdown (or depression) and inequality, Or, it opts for a path reliant on a different paradigm, driven by an inclusive public investment drive towards industrialization and export diversification. For

this path to become a feasible strategy, international policy coordination, of global demand and financing, are necessary. As UNCTAD (TDR 2020) suggests, nothing of this is simple or will happen suddenly, but it can be advanced by strengthening regional cooperation venues, which for African countries should be a priority.

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