

SUMMARY



International
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INTERNACIONAL
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STUDIES ON
GROWTH WITH EQUITY



KENYA

**MAKING
QUALITY EMPLOYMENT
THE DRIVER
OF DEVELOPMENT**

EXECUTIVE SUMMARY AND POLICY RECOMMENDATIONS

Economic growth in Kenya has improved in recent years...

In 2003, Kenya's economic performance accelerated: real GDP growth increased on an annual basis from 0.3 per cent in 2002 to almost 7 per cent in 2007 – on a par with growth in sub-Saharan Africa and slightly above the global growth rate of 5.4 per cent at that time. Growth during this period took place in spite of a resurgence of drought that negatively affected the agricultural sector and was a result of the emergence or revival of other sectors, notably tourism.

In 2008, however, the strong expansionary phases ended abruptly as both investment and exports collapsed. The decline was partly a result of the post-election violence that broke out at the beginning of the year, which adversely affected most sectors of the economy during the first half of 2008. The downturn was exacerbated by the global financial and economic crisis and a rise in commodity prices. Yet, after a period of instability and adjustment, a strong recovery took hold in 2010 as exports and investment fully recovered. By the end of 2010 the economy had achieved an impressive growth rate of 7.3 per cent – on par with emerging economies during the same period. Real GDP growth in the third quarter of 2012 fell moderately to 4.7 per cent and is expected to reach 5.7 per cent in 2013.

...but has been relatively unstable due in part to a narrow growth base and weak investment patterns...

Economic growth has been 2 per cent or less at least one-third of the time in the past 30 years and is considerably lower than the average of least developed countries (LDCs). Part of the relatively poor performance lies in the comparably slow transformation to an industrial-based economy.

The size of the industrial sector has remained unchanged during the past two decades. The reliance on agriculture – which represents 25 per cent of GDP – has made the economy particularly vulnerable to rising costs of inputs such as oil and inclement weather conditions – exacerbated by the fact that tea and coffee alone account for nearly one-fifth of all export earnings.

The pace of transformation has been adversely affected by a declining savings rate and stagnant investment. In fact, Kenya experienced one of the sharpest declines in the gross

domestic savings rate in the developing world. The majority of the emerging, developing and LDCs managed to steadily increase their savings rates and reduce their reliance on more unpredictable sources of external finance, such as foreign direct investment (FDI) and foreign borrowings. By contrast, Kenya's domestic savings rate fell from 18.6 per cent in 1990 to 8.9 per cent in 2010. As a consequence, gross fixed capital formation did not keep pace with the rates in other developing countries. Gross fixed capital formation has remained stagnant at around 20 per cent of GDP over the past decade.

... which has adversely affected formal job creation and hampered improvements in living standards...

The relatively weak economic performance has meant that labour market improvements have been slow. Between 1991 and 2003, the employment rate in Kenya fell by over 7 percentage points from 67 per cent to 59.7 per cent and even during the most recent period of strong and persistent growth, employment growth only kept pace with the working-age population. As a result, in 2012 the employment rate – at just over 60 per cent – remained well below the levels achieved in the 1990s and considerably lower than the average for sub-Saharan Africa (65.1 per cent).

Moreover, the majority of job creation has been in informal-sector enterprises. In the past decade alone, non-agricultural informal-sector employment rose by approximately 5.1 million or 7.2 per cent per year – far outstripping the growth in formal waged employment. As a result, employment in informal-sector enterprises constituted 64 per cent of total employment in 2011 – and 85 per cent when agricultural self-employed and workers engaged in small-scale agricultural activities are considered. Importantly, manufacturing was the second largest contributor to informal-sector employment growth. Moreover, the vast majority of formal jobs have been casual in nature: between 2003 and 2011, regular employment grew by 7 per cent compared to 87 per cent growth in casual employment.

As a result, there has been little or no improvement in the standard of living as measured by GDP per capita growth. In fact, Kenya's per capita growth rate has averaged about 0.32 per cent a year during the past 30 years, compared with 1.5 per cent a year, on average, in LDCs. The moderate improvements in living standards have been affected by the trend increase in informal-sector workers who earn, on average, less per month than the established international and national poverty lines and one fifth of what public workers earn in the formal sector (and less than half compared to private formal sector workers).

... particularly among Kenyan youth...

Youth have been particularly affected by the weak formal job creation, with adults benefiting from a disproportionate share of the jobs created. In particular, in 2012, youth

aged 15 to 24 accounted for less than 19 per cent of total employment, whereas they made up over 35 per cent of the working-age population. As such, the youth employment rate, at 32.8 per cent, is less than half the adult employment rate and one of the lowest in the region. Many youth have become discouraged and have begun to leave the labour market entirely. In 2012, the inactivity rate for people aged 15 to 24 in Kenya reached 60.5 per cent – an increase of 5 percentage points since 2000 alone. The problem is particularly acute among young women whose rate of inactivity is 8 percentage points higher than that of young men.

Yet, there has been some considerable progress in terms of literacy rates and access to primary education for both men and women. In 2009, only 13 per cent of the Kenyan population aged 15 years and over were illiterate – 13 percentage points lower than in 2000 and 24 percentage points lower than in sub-Saharan Africa as a whole. However, improvements have been slow with regard to tertiary education where the enrolment rates are far below international standards. Indeed, in 2009 only 4 per cent of the Kenyan population were enrolled in tertiary education – an increase of only 1.3 percentage points since 2000.

Importantly, high and persistent inactivity rates can impede future economic growth due to skills erosion and reduced labour participation – especially in light of the higher education rates among the Kenyan population. Labour market detachment can also have important social implications and is increasingly associated with a sense of discontent leading to social unrest – evidenced by recent uprisings in North Africa and elsewhere. Indeed, in the case of Kenya, there is growing sense of pessimism among young people regarding their employment prospects and their role in society more broadly. In 2011, only 15.8 per cent of the population aged 15 to 34 in Kenya believed the economic conditions of the area where they lived were getting better and only one quarter believed it was a good time to find a job – among the lowest in Africa.

... despite considerable efforts by the government to support the labour market.

At the national level, two major development plans were formulated during the last decade – the Economic Recovery Strategy for Wealth and Employment Creation (ERS) for the period 2003–2007 and Vision 2030 for 2008–2030 (that superseded the ERS). Vision 2030 is the long-term development plan aimed to improve the quality of life in Kenya. It includes over 120 projects implemented in five-year Medium-Term Plans with the first one being completed in 2012. In terms of employment, as formulated in Vision 2030, labour market improvements are expected to occur principally as a result of actions taken to strengthen economic growth and thus, specific job-centred measures or a labour market strategy are noticeably absent.

The Vision does however highlight the need for making young people more “competitive” and “prosperous”. Plans for youth are proposed in several areas including

improving practical skills and identifying specific barriers to youth employment. This complements a series of government programmes, institutions and policy frameworks that have been implemented in recent years to address the challenges confronting youth, notably: (i) in 2005, a new Ministry of Youth Affairs and Sports was established; (ii) in 2007, the government established the Kenya National Youth Policy, a legislative framework to enhance youth participation in national development; (iii) in 2008, the Ministry of Youth Affairs and Sports launched the Youth Employment Marshall Plan to address the long-term challenges of youth employment; and, (iv) in 2010, the Kenya Youth Empowerment Program was launched in cooperation with the World Bank. The latter absorbed some of the activities of the Marshall Plan, but included a wider spectrum of activities – e.g. training and policy development.

Recent policy platforms and growth strategies, however, have not been enough to properly integrate labour market policies as part of a coherent mutually reinforcing macroeconomic policy framework. Indeed, strong GDP growth in Kenya has not necessarily translated into improved labour market conditions, especially for youth. Therefore, in order to benefit from the high growth rates expected, a stronger link between growth, employment and equity is necessary. Going forward, the government could consider focusing on three areas: (i) promoting stable economic growth and productivity gains; (ii) increasing efforts to encourage formal job creation; and (iii) ensure there is an equitable distribution of the gains from growth.

Moving forward, international experience would lend support, first, to a greater focus on a job-centred macroeconomic framework...

Kenya will require an annual rate of economic growth of about 5 per cent, which is the forecast growth rate for 2013 to absorb the growing working-age population; and a much higher rate to ensure meaningful gains in employment, notably among youth. Further progress in ensuring job-rich growth depends on action in the following areas:

- *Creating an enabling environment for investment:* While macroeconomic policies to reduce the cost of borrowing and increase the availability of credit will be necessary, they are not sufficient. More targeted investment friendly macroeconomic policies could be envisaged. For example:
 - *Improve the savings rate:* The government could envision new and innovative instruments to encourage domestic savings, e.g. by issuing inflation-indexed as well as GDP-linked bonds. Inflation-indexed bonds are likely to encourage households to save more while the GDP-linked bonds will allow the country to pay a return that varies with the GDP growth performance. A number of countries – Argentina, Mexico, Nigeria and the Republic Bolivarian of Venezuela – issued different versions of GDP-linked bonds

during the past three decades, which helped to reduce their borrowing costs and increase access to domestic and international capital. Issuance of GDP-linked bonds can be particularly helpful to ensure that much needed social sector spending on health, education and social protection do not suffer during an economic crisis.

- *Priority sector lending:* Monetary authorities could adopt asset-based reserve requirements to encourage bank-lending to priority sectors of the economy. Such instruments can allow banks to adjust their cash reserve ratios based on the sectors that they need to lend to. For instance, the Reserve Bank of India, has introduced Priority Sector Lending (PSL) programmes to target sectors that are likely to create more formal jobs.
- *Productivity-enhancing strategy:* Kenya could stimulate labour and total factor productivity via tax incentives for firms that make necessary investments in skills and productivity enhancement. The government could also consider creating a 'Productivity Fund' that will provide grants and loans to firms to invest in training of their workers. In addition, efforts to reduce excessive sectoral concentration and promote sectors that are incrementally more productive could also be part of an overall productivity-enhancing strategy. These policies would need to ensure coherence and coordination between fiscal, monetary and exchange rate policies on one hand and employment and education policies on the other hand. In this regard, it is critical to recognise that improvements in labour productivity do not necessarily reduce labour demand. In fact, the experiences of the East Asian economies show that employment and growth in labour productivity need not be a zero sum game.
- *Diversifying the export-base:* A greater diversification of export products would allow Kenya to maintain foreign exchange earnings constant, reduce its vulnerability to the volatility of commodity prices and lessen the harmful effects of sudden falls in agricultural production due to climate conditions. Moreover, a greater diversification of production and exports would have the potential of improving the quality of jobs, especially if the sectors that have a higher value added. In order to achieve this, *priority sector lending* (as explained above) could be a solution. However, a forward-looking industrial policy will be also necessary to ensure that educational institutions are imparting the knowledge, training and skills necessary to promote those export sectors with potential.

A stable macroeconomic framework and improved growth performance, while necessary is insufficient. Special efforts are need to address the labour market challenges facing Kenya, notably as regards the trend increase in informality, as well as rising joblessness and sense of discontent among youth.

... second, to encourage the formalization of formal-sector enterprises and improve the working conditions of workers in informal-sector employment...

Efforts to reverse the rise in informal-sector employment and promote the formalization of firms will go a long way to improving the employment content of growth and complement efforts to stimulate productivity and investment. Stimulating formal job creation will also help to improve overall working conditions and reduce economic instability. To achieve this, measures along the following lines could be envisaged:

- *Promoting private sector development and the formalization of informal-sector enterprises and jobs:* One of the main obstacles to more formal job creation is the existence of entry barriers into the formal economy. This includes the presence of unfriendly legal and regulatory framework for business operations, unfavourable taxation regime and cumbersome business registration. Although considerable progress has been made in recent years in this area, continued efforts to reduce the administrative and tax burdens of businesses (especially micro and small firms) to encourage entrepreneurs to formalize their firms are needed. Additionally, the lack of sound property rights is another common barrier to formalization. Examples from other countries in these areas might prove insightful:
 - Brazil has facilitated formalization by extending credit to microenterprises, small enterprises, cooperatives and production initiatives in the informal sector. Brazil has also reduced from 41 to 7 the number of steps involved in the process of formalization and has reduced tax burdens for micro-businesses with up to one employee.
 - Peru has taken significant steps to address the lack of property rights by setting up the Praedial Registration System, which granted property titles to more than 1.2 million families and helped about 380,000 firms enter the formal economy.
 - Countries such as Liberia and Uruguay have reduced significantly start-up times by introducing the so-called one-stop-shops that bring together in one easily-accessible location all the information and forms that are needed to start a business. Efforts in this direction can also help facilitate youth entrepreneurship (see below).
 - China has promoted the development of rural productive non-farming activities in order to reinforce the linkages between the agricultural sector and the broader economy, creating opportunities for formal employment. In fact, the dynamic rural non-farming sector in China has been a major contributor to the country's growth, increasing rural household income and contributing to rural development

- *Developing social protection floors as a tool to improve working conditions of informal-sector workers:* Many of the informal-sector workers in Kenya lack access to basic social protection, leaving them vulnerable to occupational health and safety risks but also unprotected in case of unemployment, accident, sickness or old-age. Good social provisions can strengthen individual health and well-being of informal-sector workers, as well as to improve their capacity to organize themselves and make demands for better conditions of work. Some examples include the UMASIDA scheme in Tanzania – a community-based insurance model aimed to minimize the problem of accessibility to health care services by the informal-economy workers. Additionally, there is the Self Employed Women’s Association (SEWA) that was created to address the welfare of Indian women who work informally by taking initiatives to ensure health, income security and empowerment. More broadly speaking, policy makers should bear in mind that expenditure outlays on such social provision measures should be viewed as a long-term investments rather than a risk management or crisis-response tool.

... and third, to develop a national employment strategy with a particular focus on encouraging job creation among youth.

A coherent national employment strategy where labour market policies are fully integrated in strategic development and growth plans may yield important benefits. Many countries have adopted national employment strategies, including a multi-year *Action Plan for Jobs* implemented in Ireland that puts employment-friendly policies at the heart of the recovery efforts. Policymakers in Kenya could learn from the strengths and weaknesses of these initiatives for the development of their own strategy. Not only will this help to improve the content and design of programmes for youth, but it will also help to ensure a more inclusive process that views youth as central to providing solutions, as opposed to be a source of problems. Several areas of initiatives could be part of such a strategy, including:

- *Re-orient the suite of existing programmes to better align them with youth employment challenges:* While the efforts to date to address youth-employment challenges have been a welcome initiative, they remain too general in their approach. This is, they target young people in general but fail to identify those in greatest need and to address the main challenges of youth in Kenya, notably; (i) lack of job opportunities available to them; and, (ii) their low employability for the few jobs that are available. Policies and programmes that target a specific challenge – e.g. having the right set of skills – are more effective and efficient than simply targeting an age group. To improve the relevance of the existing programmes for youth, the following issues need to be addressed:

- *Improve skills matching and school-to-work transitions, including elements of soft-skills development:* There is a common view among the different stakeholders in Kenya that one of the reasons for the high proportion of the youth out of employment is the prevalence of a mismatch between the skills youth have and those needed by the labour market. The Report underlines the importance of education and training policies, but especially when adapted to the needs of the labour market. For instance, the Republic of Korea and Singapore not only addressed the issue of the quality of education (including secondary and tertiary education) but also improved vocational skills, which they rightly believed were essential factors in improving productivity and competitiveness. Both countries introduced training levies to encourage enterprises to participate in worker training. Moreover, the combination of education and training could be complemented with policies that help the youth acquire work experience to ensure their long-term integration into the labour market. The programmes *Joven* in Chile and *Juventud y Empleo* in Dominican Republic aimed to provide youth not only with technical skills, but also with necessary soft skills for the labour market.
- *Ensure equity in programme participation, especially for women and youth in rural areas:* To ensure equity in programme participation and to combat discrimination, the *Programme for the Promotion of Children and Youth* (PCY) was implemented in Uganda between 2003 and 2006. The PCY was a Ugandan–German comprehensive approach to promote the interests of disadvantaged youth living in rural areas, suffering from either unemployment or underemployment.
- *Supporting the most vulnerable:* Traditional employment policies may be ill-suited to ‘activate’ youth who are discouraged and have been out of the labour market for long periods of time. For instance, in Egypt, in an effort to promote the reintegration of youth into the labour market and society more broadly, a UNESCO-funded programme provides youth with literacy training, vocational education, life-skills, as well as computer and foreign language skills.
- *Improve the employment content of growth:* In an effort to achieve a more equitable distribution of the gains from growth, some countries have undertaken measures that provide incentives to enterprises to hire youth workers, while others have promoted entrepreneurship among youth. Examples of initiatives are detailed below:

- *Targeted subsidies and other measures to encourage the hiring of youth:* Governments can support youth labour demand by providing incentives to enterprises to hire youth workers, though subsidized wages or tax breaks. *The First Employment Programme* established in Brazil, Colombia, Paraguay and recently Mexico and the *Youth Wage Subsidy Programme* in Turkey, are examples of this type of programmes that provide subsidies to companies to encourage the recruitment of young people. For these programmes to be effective, it is important to make sure they are targeted enough to a particularly affected population, for example, by offering the training grant subsidy to firms that hire youth that have yet to complete secondary school or to offer subsidized wages to youth who are long-term unemployed. This is what the *First Employment Programme* has done targeting youth who have no labour market experience.
- *Promoting entrepreneurship among youth:* Another type of measure that can also help increase employment levels among youth is promoting entrepreneurship among the youth. Successful entrepreneurship programmes incorporate not only start-up assistance but also knowledge of how to maintain and develop business activities. For example, the *Northern Uganda's Youth Opportunities Programme* offers young people aged 16 to 35 cash grants to cover training programmes and the tools and materials needed to run a business.
- *Promote cohesion between adults and youth.* It is important to remember that youth and adults are not substitutes in the labour market, and the promotion (or discouragement) of one is not to the detriment (or benefit) of the other. All too often, it is wrongly assumed that early retirement will open up positions for youth – which has had the unfortunate effect of creating an adverse relationship between the two groups. Both young and adult workers are central to a productive and efficient labour market. Furthermore, through contact with more experienced workers via mentoring, young workers can better instil good practices at the workplace and help to dispel misconceptions regarding the attitudes of youth. The recent initiative of the Kenya government to launch an internship programme is welcome but will need to be monitored carefully to ensure that the above policy parameters and principles are integrated and taken into consideration.
- *A coherent and tripartite strategy to leverage the above complementarities will be needed:* Engaging in social dialogue with relevant stakeholders when pursuing policy initiatives for youths is also imperative to ensure that measures are tackling the needs of the labour market. Indeed, social dialogue with relevant stakeholders can

help to bridge information asymmetries between the government, employers and youth, target specific needs of workers and employers and promote strategic partnerships aimed at achieving longer term sustainable outcomes. Some areas and examples that Kenya could draw on in the future are detailed below:

- *Building partnerships with the private sector and with international organizations:* Fostering collaboration with these structures is essential, not only to facilitate the integration of partners' needs into national employment policies but also to allow private partners to integrate into the budgeting and planning aspects of employment strategies. South Africa, for example, instituted a statutory levy in April 2000 that had to be invested by employers in training and development as part of the Government's skills strategy. On the other hand, partnerships with international organizations could also play a crucial role. The ILO's *Youth Employment Programme (YEP)* follows an integrated approach that combines macroeconomic policies and targeted measures, addressing labour demand and supply, as well as the quantity and quality of employment.
- *Promote youth engagement in the process:* Youth are themselves, crucial stakeholders for the discussion, creation and implementation of youth employment policies and programmes. Youth are the future national labour force and as such represent an immense opportunity and a potential for the country's future development prospects. One example of a country that has made efforts to involve the youth or youth organizations in its youth employment policies and programmes is Sri Lanka. The *National Action Plan for Youth Employment* in Sri Lanka involved youth throughout the country in the design and running of the consultative process. As a result of these consultations, concrete inputs were met, such as the recommendation of fifteen amendments that were taken into account in the final draft of the National Action Plan.
- *Improved monitoring and evaluation of programmes:* The ability of policy makers to improve the effectiveness of existing (and new) programmes depends very much on a proper evaluation framework. Generally, however, little is known about the effectiveness of the existing suite of efforts. First, there is a need to gather and monitor pre- and post-programme information and results. To the extent possible, a vast range of information should be gathered: cost, employment status, earnings, demographic information, education level, etc. Second, it is critical to continue to monitor participants over longer periods. Given that in many cases returns to programmes, in particular training for youth, accrue over time, monitoring participants and outcomes beyond programme exit, e.g. for 3-5 years, should be part of any

monitoring and evaluation strategy. Finally, the government needs to establish at the outset, clear and measurable objectives with respect to expected outcomes in the short- and long-term.

The task is not a simple one but it is possible provided that employment goals are better integrated into current strategic growth and development plans.

The inaugural five-year Medium-Term Plan (MTP) of the Vision 2030 was completed in 2012 and the next leg of the process is taking place from 2013 to 2017. This would provide an excellent opportunity to mainstream labour market policies into development planning. More fundamentally, the new Government could take steps to ensure a more equitable growth process.

The new Government will, however, have to work closely with both workers and employers. Indeed, effective social dialogue can ensure the best possible design of reforms and increase the likelihood of equitable and sustainable policies being implemented. In this respect, the ILO through its technical and research capacity and as a facilitator of tripartite dialogue has an important role to play along with the Government and social partners to ensure growth with equity.

