Business Environment Reform Facility

Kenya: Export Strategy and BE Diagnostic

David Ong'olo

March 2017

BE RF
Business Environment Reform Facility

Department for International Development

About Business Environment Reform Facility (BERF)

BERF is funded by the UK Department for International Development (DFID) under the Business Environment for Economic Development (BEED) Programme. BERF is a central facility responding to demand from the DFID's priority Country Offices and stakeholders to initiate, improve and scale up Business Environment Reform (BER) programmes. BERF is managed by a consortium led by KPMG LLP. The programme started in January 2016 and will finish in January 2019.

We provide expert advice, analysis of lessons learned, policy research about what works and what doesn't and develop innovative new approaches to involving businesses and consumers in investment climate reform.

BERF has a strong emphasis on strengthening the Business Environment for women and girls, as well as for young adults more generally. It is also aiming to improve the relationship between business and the physical environment including where relevant through linkage to climate change analysis. BERF recognises the need for appropriate political economy analysis in order to underpin BER processes and interventions.

About this Report

Research for this study was conducted by David Ong'olo between August 2016 and February 2017.

The views contained in this report are those of the authors and do not necessarily represent the views of KPMG LLP, any other BERF consortium member or DFID.

This is a working paper shared for discussion purposes only. No reliance should be placed upon this report.

Department for International Development

Acronyms and Abbreviations

AGOA	African Growth and Opportunity Act
ASAL	Arid and Semi-Arid Land
AU	African Union
BAF	Business Advocacy Fund
BCR	Benefit Cost Ratio
BE	Business Environment
BEDU	Business Environment Delivery Unit
BEED	Business Environment for Economic Development
BE	Business Environment
BER	Business Environment Reform
BERF	Business Environment Reform Facility
BOPP	Biaxially Oriented Polypropylene
BRICK	Building a Resilient Investment Climate in Kenya
BRICS	Brazil, Russia, India, China and South Africa
CBA	Cost Benefit Analysis
CBK	Central Bank of Kenya
CET	Common External Tariff
COMESA	Common Market for Eastern and Southern Africa
DB	The World Bank's *Doing Business (Reports)*
DC	Developing Country
DFID	Department for International Development
DP	Development Partner
DRC	Democratic Republic of the Congo
EAC	East African Community
EC	European Commission
EPA	Economic Partnership Agreement
EPC	Export Promotion Council
EPZ	Export Processing Zone
ERC	Energy Regulatory Commission
EU	European Union
FDI	Foreign Direct Investment
FSWE	Firm-Size Wage Effect
FTA	Free Trade Area
GDP	Gross Domestic Product
GMM	Generalised Method of Moments
GVC	Global Value Chain
GoK	Government of Kenya
HACCP	Hazards Critical Control Point
HFO	Heavy Fuel Oil
ICT	Information and Communication Technology
IDF	Import Declaration Fee
IGAD	Intergovernmental Authority on Development

IMF	International Monetary Fund
IOR-ARC	Indian Ocean Rim-Association of Regional Cooperation
ISO 22000	International Organisation for Standardisation Standard No. 22000
ITAD	Institute for Textile and Apparel Development
ITC	International Trade Centre
ITP	Industrial Transformation Programme
JICA	Japan International Cooperation Agency
JKIA	Jomo Kenyatta International Airport
KAM	Kenya Association of Manufacturers
KENTRADE	Kenya Trade Network Agency
KETRACO	Kenya Electricity Transmission Co. Ltd.
KEPSA	Kenya Private Sector Alliance
KFC	Kenya Flower Council
KRA	Kenya Revenue Authority
KMC	Kenya Meat Commission
KNCCI	Kenya National Chamber of Commerce and Industry
KSh	Kenyan Shilling
KwH	Kilowatt Hour
LAC	Latin American Country
LDC	Least Developed Country
LITS	Livestock Identification and Traceability System
MDA	Ministries, Departments and Agencies
MIIT	Ministry of Industry, Investment and Trade (now MITC)
MITC	Ministry of Industry, Trade and Cooperatives (formerly, MIIT)
MoIED	Ministry of Industry and Enterprise Development
MoTI	Ministry of Trade and Industry
MSME	Micro, Small and Medium Enterprises
MTA	Multilateral Trade Arrangement
NAFTA	North American Free Trade Area
NES	National Export Strategy
NGO	Non-Governmental Organisation
NIP	National Industrialization Policy
NPV	Net Present Value
NTBs	Non-Tariff Barriers
NTP	National Trade Policy
NTM	Non-Tariff Measure
OECD	Organisation for Economic Co-operation and Development
OPP	Oriented Polypropylene Film
PET	Polyethylene Terephthalate
PMR	Product Market Regulation
PPD	Public Private Dialogue
PPM	Pan Paper Mills
PS	Polystyrene
PTA	Preferential Tariff Arrangement

PVC	Polyvinyl Chloride
RoO	Rules of Origin
RTA	Regional Trade Arrangement
RVR	Rift Valley Railways
SAARC	South Asian Association for Regional Cooperation
SADC	South African Development Community
SDoT	State Directorate of Trade
SEZ	Special Economic Zone
SGR	Standard Gauge Railway
SME	Small and Medium-Sized Enterprise
SPS	Sanitary and Phytosanitary Systems
SSA	Sub-Saharan African
SWG	Sectoral Working Groups
TAD	Trans-boundary Animal Disease
TMEA	TradeMark East Africa
TOE	Terms of Engagement
TPP	Trans Pacific Partnership
UAE	United Arab Emirates
WTO	World Trade Organisation

Contents

Executive Summary **1**

1 Introduction **6**

1.1 Background 6

1.2 Objective 6

1.3 Methodology 6

1.4 BERF Support 7

1.5 Structure of the Report 7

2 Regulatory Framework for Exports in Kenya **8**

2.1 The NES Preparation Process 8

2.2 Recent Performance of Kenya's Exports 9

2.3 Domestic Macro Economic Context of Regulation 10

2.4 International Trade, Value Addition and Poverty Alleviation 11

2.5 External Context of Business Environment for Exports 12

2.6 Current Collaborative Programmes Supportive of Improving BE for Exports. 17

3 Analysis of Business Environment Challenges Facing Exporters **19**

3.1 Introduction 19

3.2 Complexity of Regulatory Procedures 19

3.3 Labour Skills and Costs 21

3.4 High Cost of Energy and Non-Reliability 22

3.5 High Cost of Capital for Upgrading and Modernisation of Equipment 23

3.6 High Cost of Transport and Logistics 24

3.7 Strict Quality Requirement in the Export Markets 25

3.8 Quality of Raw Materials 26

3.9 Taxation of Inputs 27

3.10 Traceability and Food Safety 28

3.11 Summary of Issues Arising from the Study 29

4 Recommendations **30**

4.1 Overview 30

4.2 Work with AGOA to Improve Competitiveness 30

4.3 Clustering and Agglomeration 30
4.4 Fast Track the Development of a Competitive Power Market 31
4.5 Institutional Support for Value Chain-specific Training and Equipment 32
4.6 Developing New Export Markets 33
4.7 Review of Tariffs for Imported Raw Materials Used in Exports 33
Appendix 1 References 35
Appendix 2 Revised NES Process Timelines 39
Appendix 3 List of Individuals and Organisations Contacted 40
Appendix 4 Terms of Reference – Phase 2: Export Strategy and BER 41

Executive Summary

Purpose

The purpose of this report is to analyse various business environment (BE) challenges that affect the sustained growth of Kenya's exports of goods. The focus of this study is "Goods"[1], which cover all outward movement of non-service exports through a country or territory, including movements through customs warehouses and free zones. It is proposed that this report will be part of Chapter 3 entitled, "Review of Policy, Regulatory and Institutional framework" for the "Cross Cutting Thematic Working Group" report, as per the NES Proposed Template agreed upon at the NES Machakos Retreat in April, 2017.

A BERF investment climate reform scoping mission was carried out in April 2016 to establish how BERF could work with DFID-Kenya and its development partners to support the Government of Kenya's (GoK) business environment reforms (BERs). The mission concluded, "The development of a comprehensive Kenya National Export Strategy (NES) will be one of the most important short term deliverables for the then[2] Ministry of Industry, Investment and Trade (MIIT). This new export strategy needs to reflect the BER constraints impacting on exporters and continue private sector dialogue to prioritise reforms."[3] BERF resources were therefore drawn upon to identify the BER issues that need to be addressed in the NES. It was envisaged that the BERF consultant would be able to fully participate in the NES public private dialogue (PPD) sessions planned at the county and national level. However, due to funding constraints, the sessions were delayed,[4] and the scope of the assignment was adjusted to report on the desk study, field interviews and discussion with relevant stakeholders.[5] Through its contribution to TMEA, DFID is now funding the NES preparatory process, of which the preliminary consultation meetings started in mid- April, 2017.

Key Issues

A critical theme in the report is that with the right supportive policies and conducive environment, international trade has immense benefits for increasing employment and reducing poverty, particularly through the empowerment of women in cross-border trade. Various tariff and non-tariff barriers (NTBs) need to be removed. Kenya is in good standing

[1] We point out that under the thematic sectors for the National Export Strategy (NES) within which this Study is being undertaken as an contribution, BE challenges for goods are grouped under the "Cross Cutting theme. Trade in "Services" have been grouped as a distinct separate theme and hence exhaustively handled by that group.

[2] The Ministry is now called "Ministry of Industry, Trade and Cooperatives" (MITC) after having gone through various name changes with successive governmental reorganisations over the years. There are 3 directorates headed by Permanent Secretaries responsible for Industry, Trade and Cooperatives who work under the Cabinet Secretary. Under the current organisation of GoK, international trade is the responsibility of MITC having been moved in 2013 from the Ministry of Foreign Affairs (previously called Ministry of Foreign Affairs and International Trade).

[3] BERF Scoping Mission Report , 2016: p.5.

[4] See Appendix 2 for the revised timetable for NES.

[5] The original ToRs called for an analysis of BE constraints at county level as part of NES discussions.

with regard to negotiating bilateral trade agreements and taking respected positions in Multilateral Trade Arrangements (MTAs). In cases like the African Growth and Opportunity Act (AGOA), Kenyan exporters need to take advantage of benefits to diversify and improve competitiveness, making use of current government initiatives to catalyse clustering and agglomeration of activities. MITC has identified several key sectors that can be targeted to improve performance of exports.

There are key infrastructural deficiencies that inhibit the competitiveness of Kenya's exports. GoK has invested in basic infrastructure like roads and improvements to the Port of Mombasa. However, with the rapidly growing demand for electricity in Kenya, and to catalyse supply response to consumer needs, it is time to fast track the development of a competitive power market to benefit all types of consumers, but particularly industrial users who can procure electricity directly from the power generators. Lastly, the current banking sector regulation of interest rates has led to a credit squeeze across the board. The private sector needs to mobilise funds with the support of market-driven but proactive government support in new equipment and modern technologies to be competitive in export markets.

Recommendations

It is pointed out that the NES process envisages consultative sessions at the national and county-levels to get insights into key issues that should be addressed in the NES along the various thematic groups formed for the NES consultative process. It is proposed that the findings and recommendations from this report be part and parcel of that consultative process which, started in mid-April 2017. Based on the findings relating to BER for exports, the report makes the following prioritised recommendations.

Table 1: Report Recommendations

Report Recommendations				
	Recommendation	**Partner (**Identified MDA)	**Timeframe for Start**	**Priority** (High/Medium/Low)
1.	Review tariffs for imported raw materials as part of review of CET	EAC secretariat with member country trade ministries, with technical and financial support provided by e.g. TMEA	0–3 months	High
2.	Fast track the development of a competitive power market	ERC, directorate of energy, and office of attorney general	3–6 months	High
3.	Provide support to institutes (TVET and industry associations) in value-chain-specific training and equipment	Directorates of trade and industry in MITC in collaboration with Kenya Association of Manufacturers (KAM) and other private sector organisations	6–12 months	Medium

Report Recommendations				
	Recommendation	**Partner (**Identified MDA)	**Timeframe for Start**	**Priority** (High/Medium/Low)
4.	Develop new foreign markets for exports	Directorate of trade in MITC in collaboration with Export Promotion Council (EPC) and other sectoral private sector organisations	6–12 months	Medium
5.	Work with AGOA to improve diversity and competitiveness	Directorates of trade and industry in MITC in collaboration with KAM, KFC and other sectoral private sector organisations	12–24 months	Medium
6.	Catalyse clustering and agglomeration for MITC-identified value chains	Directorate of industry in MITC in collaboration with KAM, KenInvest and other sectoral private sector organisations	12–24 months	Medium

These recommendations are explained briefly below:

1) *Review CET tariffs for imported raw materials*

- The EAC CET has various tariff anomalies that are prohibitive to exporters who must import some inputs that are not available within the CET territory.
- The comprehensive review of the CET Book by the EAC Secretariat is yet to take place and needs to be undertaken as a matter of priority.
- Development Partner (DP) support for technical and financial inputs may be necessary at short notice.

2) *Fast track the development of a competitive power market*

- Exporters face relatively high costs of energy chiefly due regulatory restrictions that favour the monopoly supplier.
- Cheaper energy can be obtained through direct contracting with power generators and being charged for wheeling costs owned by current network owners.
- To rectify this key BE issue, a formal amendment of the Energy Act should follow to legally open up the power market. ERC, the State Directorate of Energy working with the office of Attorney General, should take this up as a matter of urgency.

3) *Provide institutional support for value chain training*

- The skill capacity of Kenya's labour force, though slowly improving, is still classroom based. This provides an environment that makes it costly for manufacturers to hire and train.
- Various export sectors, notably textile, leather and wood, need well trained staff with skills in new production methods to produce goods.

- Such specific value chain training needs to be provided in a partnership with respective sector associations with the support of the Government.

4) Develop new foreign markets for exports

- EPC is not sufficiently funded to provide export market support to explore and develop new export markets.
- A domestic institutional support environment that does not programmatically support export market development, unlike the case for Kenya's competitors, is detrimental to local exporters.
- A comprehensive collaborative export development programme between EPC and the private sector targeting new markets as well as deepening existing ones is needed as part of the NES.

5) *Work with AGOA to improve diversity and competitiveness*

- AGOA as a tariff preferential mechanism for exports to USA comes with various non-tariff export benefits and is effective as a learning and export market development tool for Kenyan exporters.
- AGOA should be regarded as an opportunity for exporters to consult with Government to address non-tariff barriers inhibiting growth of exports to other external markets.

6) *Fast track the operationalisation of the SEZ Act to catalyse clustering and agglomeration for MITC-identified value chains*

- The essence of the EPZ and now SEZ programme is to address infrastructural and business regulatory issues that affect exporters.
- Whereas the SEZ Act has been passed, various subsequent legal instruments and operational procedures to fully operationalise the programme are not yet in place.
- As a start, there is a need to fast track the operationalisation of the SEZ programme so as to catalyse clustering and agglomeration for MITC value chains.

1 Introduction

1.1 Background

The focus of the Government of Kenya (GoK)'s National Export Strategy (NES) is to diversify exports through deliberate promotional efforts by bringing on board non-traditional exports that have a huge potential for growth. Kenya's existing exports are concentrated in a few traditional commodities — mainly coffee, horticultural products and tea — the performance of which has not been impressive in the last few years. However, the export market in Kenya faces certain BER issues that affect export competitiveness. These issues need to be addressed in order to expand existing markets and open new ones.

1.2 Objective

The main objective of the BERF assignment was to support the on-going preparation of a new NES with a focus on delineating key business environment (BE) constraints to sustainably increasing Kenya's exports. It was envisaged that this would be done by providing advisory support to the public private dialogue (PPD) process put in place for the preparation of NES. The objective is to prioritise and address BE constraints that hinder key export sectors. Evidence-based findings from the study are expected to guide GoK's BER implementation in support of its export strategy.

1.3 Methodology

In order to get insights on BE constraints to exports, the study undertook both desk research as well as interviews with respondents dealing with several commodities. The commodities examined and discussed in this study include packaging materials, textiles and apparel, meat and meat products, flowers, processed fruits, and iron and steel products. These were selected based on fair sectoral representation of the NES process thematic sectors as well as an assessment of i) sufficient demand for commodities in the world export markets, ii) range of value-added products and services, iii) scope for sustainable production and social return on investment for the commodity, iv) apparent demand for investment in producing the commodity, and v) available information and studies on the commodities. The interviews were conducted to gain first-hand information from the businesses about current BE issues that need to be addressed. This report combines findings from the desk study and discussions.

Research for this study was conducted between August 2016 and February 2017. It was intended that the findings and recommendations from this study be presented during the NES preparation PPD sessions planned at the county and national level. However, given the timelines of this assignment and the delay of the PPD sessions per the revised NES timetable,[6] the consultant was directed to finalise this report based on the desk study and interviews. It is

[6] See Appendix 2.

proposed that the draft report[7] be presented during the NES PPD sessions, when these eventually convene.

1.4 BERF Support

A BERF investment climate reform scoping mission was carried out over the period 12–28 April 2016. The scoping mission focussed on the provision of a diagnostic assessment of GoK's industrialisation transformation programme and export strategy and set out the potential areas of support that BERF could provide to GoK.[8] The assessment was undertaken in close consultation with both Department for International Development (DFID) Kenya and the Principal Secretaries of the then Ministry of Industrialisation and International Trade and Ministry of Industry, Investment and Trade (MIIT). DFID Kenya further reviewed the specific contribution that BERF can make given the changing approach to promoting BER, recognising that the BERF assignment could focus on one thematic area, BE constraints to exports. However, this would need to dovetail with the development of the NES.

On the NES process, the mission concluded, "The development of a comprehensive Kenya NES will be one of the most important short term deliverables for the Ministry of Industry, Investment and Trade (MIIT). This new export strategy needs to reflect the BE constraints impacting on exporters and continue private sector dialogue to prioritise reforms."[9] At the request of the now-renamed MITC, formerly MIIT, resources through BERF were therefore drawn upon to identify the BE issues that need to be addressed in the NES. Support from BERF was viewed as a valuable contribution to the development of an effective export strategy, and BERF's work would need to fit together with the preparatory process for NES. Unfortunately, due to NES funding constraints, the originally planned timeline has not been met. It is understood that the funding process is now at an advanced stage, and funds will be released soon to allow the planned NES activities to continue.

1.5 Structure of the Report

This report is structured as follows.

- Section 2 presents the national context of the BE for exports, recent performance of Kenya's exports and the external context of the BE for exports.
- Section 3 analyses the BE challenges exporters face.
- Section 4 presents recommendations proposed for validation as part of the NES PPD process.
- Section 5 presents concluding remarks.

[7] Not as part of this assignment.
[8] See DFID, Kenya, 2016.
[9] BERF, 2016: p.5.

2 Regulatory Framework for Exports in Kenya

2.1 The NES Preparation Process

Kenya's first NES was prepared in 2003 by the then Ministry of Trade and Industry (MoTI) in close collaboration with the private sector and the International Trade Centre (ITC). In its first phase, the strategy covered ten sectors (horticulture, tea, livestock and livestock products, fish and fish products, food and beverages, textiles and clothing, commercial crafts, information communication technology, tourism, and transport) and six crosscutting issues (trade information, trade facilitation, export packaging, quality management, trade finance and competency development). It was acknowledged that the limited scope of coverage[10] in the strategy was due to the lack of resources available for effective implementation, and other sectors of the economy were to be covered in subsequent phases.

The strategy identifies priority sectors and recommends work programming to catalyse exports. Development partners (DPs) like the World Bank endorsed the document and partly financed some aspects of the strategy. GoK itself in its 2004/2005 budget allocated KSh13 million for the initial implementation steps. However, an evaluation of the ITC input in preparation for the strategy found that there was not "a wholehearted acceptance of the NES among key partners in the programme, especially in terms of implementation modalities and leadership".[11]

The process of preparing the second NES formally started with the launch of the NES committee on 4 August 2016, followed by the setup of an institutional coordination mechanism. The State Department of Trade (SDoT) took on the responsibility as chair and convener, working with the Export Promotion Council (EPC) as the secretariat with a dedicated support team. It was envisaged that there would be various national and county government NES development platforms to discuss emerging issues and that consensus on what needs to be addressed would be reached. Several priority sectors were selected, and subsequently eight sectoral working groups (SWGs) were established: (i) agriculture, (ii) livestock, (iii) fisheries, (iv) manufacturing, (v) handicrafts, (vi) services, (vii) emerging sectors — mining and light engineering, and (viii) cross-cutting issues. Identification of key BER issues was appropriately placed under the last category of cross-cutting issues.

Kenya's current external trade policy, as detailed in the National Trade Policy (NTP),[12] seeks to exploit the potential in Kenya's external trade through policy measures that contribute towards transforming Kenya into a competitive, export-led economy and a thriving domestic market. The policy proposes the strengthening of the Non-Tariff Barriers (NTBs) monitoring and reporting mechanism through strong public-private partnership awareness programmes among traders. In addition, it proposes capacity building for county governments on international trade policy, to promote and facilitate international trade development at the

[10] See the Minister's remarks in the Foreword, Republic of Kenya (2003: p.iv).
[11] ITC, 2006: p.24.
[12] See Republic of Kenya, 2016: p.35. The new policy document was just recently launched on 21 November 2016.

county level. The document rightly observes that the existing legal framework and institutional structure that guide trade have shortcomings, with trade policy instruments contained in various laws and regulations administered by different government ministries and institutions. This has resulted in weak coordination of policy implementation. To address these shortcomings, DFID, through TMEA,[13] has supported the SDoT in developing a legal framework for the NTP, for which the report is at an advanced stage. It is envisaged that two bills covering trade development and trade remedies will soon be finalised for presentation to the parliament.

2.2 Recent Performance of Kenya's Exports

Kenya, though the biggest and most advanced economy in East and Central Africa, still has agriculture as the backbone of its economy. Economy-wide prospects are positive, largely because of expansions in telecommunications, transport and construction and a slow recovery in agriculture. The economy has slowly expanded from 5.7 percent in 2013 to an estimated 6 percent in 2016, supported by low oil prices (see Table 2).

Table 2: Select key economic indicators

Kenya: Select key economic indicators				
	2013	**2014**	**2015**	**2016***
Real Gross Domestic Product (GDP) at market prices (% growth)	5.7	5.3	5.6	6.0
Export of goods and services (% growth)	-2.4	2.3	2.0	3.0
Import of goods and services (% growth)	9.0	9.7	8.7	8.8
Inflation (%)	5.7	7.3	6.3	5.9
Exchange rate (per US$)	86.1	87.9	98.2	101.8
Population (% growth)	41.8	43.0	44.2	45.1
External Debt Service as % of Exports of Goods & Services	4.8	9.9	11.0	12.3

* Estimate

Source: Adapted from KNBS (2016)

Despite global turbulence, Kenya experienced strong economic performance from 2015 and went on to demonstrate growth that exceeded the average of Sub-Saharan Africa (SSA). However, Kenya's economy remains vulnerable. For instance, the forthcoming August 2017 national elections already appear to be causing a slowdown in growth. This is due to investors deferring investment decisions, costly election expenses, labour strikes and calls for salary increases for school teachers, university lecturers and doctors. In addition, security remains a threat in Kenya, leading to increased national security spending.

Goods exports, the focus of this study, cover all types of outward movement of goods through a country or territory, including movements through customs warehouses and free zones. According to the World Trade Organisation (WTO), exports are valued at transaction cost,

[13] Gleaned from discussion with Mr. Joshua Mutunga of TMEA.

including the cost of transportation and insurance to bring the merchandise to the frontier of the exporting country or territory — "free on board" valuation.[14] Kenya's export growth has not led to a healthy current account situation, and imports continue to outstrip export growth, which explains the significant depreciation of the shilling.

2.3 Domestic Macro Economic Context of Regulation

As Table 3 shows, while tea exports rebounded, total Kenyan merchandise exports contracted from US$6.1 billion in 2014 to US$5.5 billion in 2015. This was due to currency volatility in the global markets that led to subdued demand for Kenyan goods in key destination markets, the largest of which is the European Union (EU). Exports are largest for the horticulture sector, which accounts for 65–70 percent of export earnings. Delays by EAC and the EU to sign an Economic Partnership Agreement (EPA) and the uncertainty created in the last half of 2014 affected performance in 2015. Because Kenya is a member of the integrated EAC, its external performance will also depend on the growth rate of East African countries, especially that of Uganda and Tanzania, with whom Kenya has significant trade ties. These blocs are key components of Kenya's trade volumes. However, exports to the EAC region started declining in 2011, particularly with manufactured exports. Tanzania and Uganda now source these products from other markets outside the region, leading to Kenya's market loss.

Table 3: Kenya's Top Export Commodities by Value

Kenya: Top Exports by Value, 2011 - 2015 (US$ '000)

HS	Commodity	2011	2012	2013	2014	2015
902	Tea, whether or not flavoured	1,176,308	1,205,146	1,218,162	1,071,547	1,185,593
603	Cut flowers and flower buds	454,349	453,100	479,998	553,503	654,300
2710	Petroleum oils and oils	239,010	245,163	203,665	606,223	413,907
901	Coffee (all types)	223,509	268,101	190,805	231,307	235,224
708	Leguminous vegetables	152,903	146,084	126,707	99,449	159,331
6204	Women's or girls' suits, and skirts	50,328	56,864	76,922	105,032	93,726
2008	Fruits, nuts and other edible parts of plants	54,083	48,002	70,765	62,763	89,808
6203	Men's or boys' suits, ensembles, and jackets	21,939	39,250	40,888	56,516	84,975
2836	Carbonates and Peroxocarbonates	145,169	118,359	107,835	94,020	77,917
802	Other nuts, fresh or dried,	22,500	28,307	1,959	43,904	70,488
2005	Other vegetables prepared or preserved	36,083	28,940	38,119	29,466	31,535
2009	Fruit juices, incl. grape must, and vegetable juices	27,876	28,452	36,467	39,038	11,934
	All Other Exports	**3,249,253**	**3,469,323**	**2,944,661**	**3,119,720**	**2,362,270**
	Total Exports	**5,853,310**	**6,135,091**	**5,536,953**	**6,112,488**	**5,471,008**

Source: ITC (2017)

[14] See WTO, 2017, p.6.

Most value chains in Kenya have potential to respond to export supply, but this must be based on an overall macro-economic framework that boosts exports. There is a robust relationship between the real exchange rate and exports, as well as income of main trading partners. A 2013 study that estimates Kenya's long-run co-integrating vectors shows that the real exchange rate has a significant effect on exports in the long-run.[15] The main conclusion is that the exchange rate policy remains important in the pursuit of an export promotion agenda. Ensuring that the exchange rate is not over valued is central to ensuring exports' competitiveness.

However, increased openness of the Kenyan economy is likely to be associated with increased volatility, especially for commodity exports. This justifies the need for strategic domestic policies to help sectors that might not be able to cope with the wave of globalisation. Additionally, there is a need for further diversification of export products and markets while improving their quality.

2.4 International Trade, Value Addition and Poverty Alleviation

Trade plays an important role in promoting economic growth. Lowering trade costs is particularly important for a country like Kenya that seeks to take advantage of the fragmentation of production through global value chains (GVCs), which offer new opportunities to generate growth and income gains through trade though rules of origin (RoO) within regional and international trade agreements are still a hindrance to catalytic development of exports from a DC like Kenya[16]. The emergence of GVCs has been an important driver of developing country participation in the global economy. Declining transportation and communications costs, along with improved technology, have made it easier for firms in developing countries (DCs) to provide particular tasks or activities (services as well as goods) to value chains that extend across countries. More than half of DC exports in value-added terms are being generated just through trade from developing to developed countries. The share of trade in parts and components (a good approximation of GVC-related trade) among DCs has quadrupled[17] over the last 25 years.

Women play a key role in trade in Africa and are essential to Africa's success in exploiting its trade potential. Their involvement in the production of tradable goods and, critically, as cross-border EAC traders, particularly for agricultural produce, is central to food security. However, much of this trade is informal, but it nonetheless is a main source of livelihood for a majority

[15] Kiptui, *et al* (2013) find that the real exchange rate elasticity at 0.29 was quite low. The immediate effects of depreciation are to reduce exports but with positive adjustments thereafter.

[16] In most trade agreements, there are complicated articles covering such issues as "Proof of origin" for DC exporters, The general conditions tend to be very restrictive for exporters. For example under the EAC/EU EPA conditions for making out invoice declaration provisions on "Validity of proof of origin, "Information procedure for cumulation purposes", etc. are not easy to be adhered to by smaller exporters. Hence an exhaustive export promotion strategy must include relevant capacity building activities for new exporters.

[17] See WTO, 2014: p.81.

of families within the region. Catalysing and removing barriers to such trade can play an important role in production growth of such traded goods and has been recommended as a focus for large scale poverty reduction. Countries can make great strides when food poverty is reduced by focusing on family-driven, small-scale agricultural production, processing and marketing of agricultural produce. These challenges have been duly recognised by various organisations working to improve regional trade, notably TMEA. Its current programming[18] emphasises the removal of cross border NTBs for small traders, as well as supporting women entrepreneurs.

2.5 External Context of Business Environment for Exports

2.5.1 International Trade Arrangements

Exporters often operate in a complex BE which is governed not only by normal regulations concerning the operation of businesses but also complex domestic and external rules and regulations that relate specifically to the business of exporting commodities, as well as others related to taxation. In this regard, Kenya's international trade policy is an important factor for exports in various ways. First, the proliferation of regional and bilateral preferential trade agreements creates complicated incentive frameworks that must be well articulated in a country's external trade policy. Second, non-tariff measures (NTMs) have increased sharply in the international trade regime to protect domestic industries, and the removal of these must be clearly negotiated within the context of a country's external trade policy framework, as well as generally within the framework of the WTO.

Kenya's new trade policy has incorporated international trade dimensions that have been formulated within the framework of multilateral, regional and preferential tariff arrangements (PTAs) that Kenya has entered into. Within these regimes, through the MTAs, Kenya aims to integrate the country's economy in the global trade arena, especially with WTO member countries. The crucial regional trade arrangements (RTAs) include EAC, Common Market for Eastern and Southern Africa (COMESA), Intergovernmental Authority on Development (IGAD) and Indian Ocean Rim Association of Regional Cooperation (IOR-ARC).

2.5.2 EAC

The EAC's expansion of the market for trade in goods and services — through the provisions of the EAC Customs Union Protocol and the Common Market Protocol, as well as other regional integration instruments and sectoral strategies and policies — is important to Kenya given that the EAC is the main destination market for Kenya's exports, accounting for 23 percent in 2016.[19] The EAC's CET, the agreed set of duties levied on imported goods entering any EAC partner state from outside the regional bloc, features a three-band tariff structure, imposing zero tariff on raw materials and capital goods, 10 percent on intermediate goods and 25 percent on finished goods. This was agreed upon by the member states on 23 June 2003.

18 TMEA, 2016.
19 Trade Map, 2017 data set.

There is an ongoing review of the EAC three-band tariff, taking a close look at the perceived excessive protection granted to sensitive goods such as maize, rice, wheat, textiles and sugar. Wheat and textiles are classified as sensitive goods, and their imports attract a higher duty to protect local industries. However, where member countries do not have the capacity to produce specific goods, they request special rates to import them from non-EAC countries. For example, Kenya has requested the application of a 10 percent duty on wheat grain instead of 35 percent, while Rwanda has requested the application of US$0.4 per kilogramme on second-hand clothes and other articles.

2.5.3 EU/ EAC/EAC-EPA

EAC-EPA is a framework that guarantees duty-free market access trade that Kenya's exports have enjoyed in the EU and brings Kenya together with the other EAC partner states of Rwanda, Burundi, Tanzania and Uganda. This market accounted for 22 percent of Kenya's exports in 2016, second only to the EAC as a destination market for Kenya's exports. Of the five EAC member countries, only Kenya, Uganda and Rwanda agreed to sign the final EPA as early as 20 October 2014. Tanzania initialled the EAC-EPA in Brussels but as of the end of February 2017 was having second thoughts, citing the perceived belief (despite the clear safeguard clauses in the EPA) that non-reciprocal and discriminating preferential trade clauses of the EPA will undermine the development of the Tanzanian manufacturing sector. The Kenyan and Rwandan trade ministers signed the EPA on 1 September 2016 in Brussels. On 28 September, Belgium and Kenya went ahead to deposit the ratified pact at the agreements section of the EU Council after Kenya's parliament endorsed it.

The leadership role that the GoK has played in making sure that the EPA was signed could provide some comfort to the European Commission (EC) about working with the government, even if the agreement is not signed by all EAC members. There is talk of a Kenyan bilaterally-negotiated agreement with the EC, particularly since the other four EAC member states are Least Developed Countries (LDCs) and already enjoy a set of benefits while exporting to the EU.

2.5.4 COMESA

COMESA provides its member states[20] with an opportunity to expand their trade with the region as a destination for exports or a source for imports on a duty-free basis. In 2016, COMESA accounted for 16 percent of Kenya's total exports, whose trend over the period 2011–16 is, however, characterised by sluggish and near constant growth rate, while over the same period, the region recorded tremendous growth in imports. However, intra-COMESA trade has challenges relating to NTBs, arising from the lack of common product standards. For example, a 13-year stalemate exists regarding Kenya's milk and palm oil exports to Zambia, due to the absence of a common COMESA standard. It has been emphasised that

[20] The member States of COMESA are Burundi, the Comoros, the Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Sudan, Swaziland, Seychelles, Uganda, Zambia and Zimbabwe.

there is need for a COMESA standard that would help producers come up with uniform products they can sell across the borders in the region and beyond.[21] Current determined efforts by SDoT will hopefully succeed in unlocking this impasse, so Kenya can further realise the potential for exports to the region.

2.5.5 EAC/COMESA/ South African Development Community (SADC)[22] Tripartite Free Trade Area (FTA)

The FTA was launched fairly recently, on 10 June 2015, covering trade in goods in its first phase of integration. A much-expanded regional market of 26 countries can now be accessed by Kenya's exporters under the new FTA arrangement. Plans for a continental-wide FTA were firmed up in Addis Ababa in November 2016 as the ministers and negotiators from the 54 members of the African Union (AU) held their fourth round of negotiations for establishing the FTA. There are indeed benefits to be gained from an FTA for Africa, given that in comparison to other regions of the world, intra-African trade is the lowest of any region in the world at 22 percent in 2016.[23] This compares unfavorably with intra-regional trade in Europe at 63 percent, and the South Asian Association for Regional Cooperation (SAARC) countries at 30 percent.

2.5.6 African Growth and Opportunity Act

AGOA benefits Kenya together with other SSA countries through a preferential trade arrangement provided by the US. AGOA was renewed on 1 July 2015 for another 15 years. Kenya has benefited from AGOA through the duty-free export of various products to the US, dominated by apparel. Kenya's textile exports to the US exhibited tremendous growth and has been most dramatic in the case of the textiles and apparel sector, which grew (as shown earlier in Table 3), by 59 percent and 22 percent annually for HS 6203 (men's suits), and HS 6206 (women's suits), respectively, between 2011 and 2015. AGOA has catalysed Kenya's apparel export industry on a scale that would not have been possible in the absence of the AGOA preferences.

However, even before the AGOA renewal, it had been argued that "the strong trade regime-based advantage" that AGOA offers has meant that Kenya has developed an industry whose competitive edge is based on policy advantages and not on firm-level advantages. The proffering of such policy-based advantages is based purely on the largess of US policy makers, leaving the textile and apparel sector very vulnerable. It needs stronger foundation[24]. Kenyan exporters need to take the time-sensitive opportunity to explore diversification of

[21] Dr. Chris Kiptoo, PS, SDoT cited in COMESA, 2017: p.1.
[22] SADC has a membership of 15 Member States, namely; Angola, Botswana, Democratic Republic of Congo (DRC), Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe.
[23] Trade Map, 2017 data set.
[24] Republic of Kenya, 2012: p.4.

exports to cover other AGOA-eligible products before the preferential treatment expires and/or is possibly repealed[25] by the new US government administration.

2.5.7 External Constraints and Challenges to International Trade

Kenya's trade raises concern that market access for Kenyan products in the regional and international markets has been limited by a host of constraints and challenges. This has led to Kenya's dismal share in global trade, in some cases experiencing decline, especially in the regional market, where some products have recorded substantial export declines. The most significant external BE constraints identified by the NTP document are discussed in the following sections.[26]

2.5.7.1 Continued Use of NTBs

NTBs particularly affect intra-regional trade within EAC and COMESA due to cumbersome and numerous customs documentation and administrative procedures; non-recognition of the certificates of origin; varying standards and stringent application of Sanitary and Phytosanitary Systems (SPS) requirements; delays at border crossing, road blocks, weighbridges, police checks and attendant costs; and non-harmonised transit charges and procedures. The main challenge confronting the country is ensuring that negotiations at bilateral, regional and multilateral trading systems lead to a reduction or elimination of all NTBs.

2.5.7.2 Ineffective application of EAC trade promotion schemes

Kenyan firms have faced challenges accessing the EAC market as a result of weaknesses in the implementation of the EAC Duty Exemption Scheme, which has been provided to promote competitiveness of industries through importation of raw material and intermediate goods on a duty-free basis. The use of imported raw material where duties as high as 10 percent to 25 percent, plus VAT, are loaded to the final cost of a product contribute to uncompetitive production of the final product by EAC manufacturers.

2.5.7.3 Effect of the EAC CET

Of importance to the domestic manufacture of exports are cases where items should be treated as finished products and intermediate goods to eliminate products that are imported as finished goods, thus attracting a higher tariff, only to end up being used as inputs in industrial production. For instance, under the current CET regime, palm oil is imported as a finished product and subjected to a duty of 25 percent, even though the product is used as a raw material in the manufacture of soap, and therefore should qualify for a 0 percent duty. Clinker, which is used in the manufacture of cement, is also imported as a finished product, thereby attracting 25 percent duty. However, the fact that the product is used as an intermediate input should allow it to attract a 10 percent duty. The review of the CET has

[25] President Trump's emerging challenge of longstanding U.S. trade policy with promises to terminate or renegotiate the North American Free Trade Agreement (NAFTA) and his proposal to withdraw from the Trans-Pacific Partnership (TPP) are grounded in U.S. trade law. Congress has granted broad authority to the President to withdraw from trade agreements, and, to date, there is not stated guarantee AGOA will not be affected. For a succinct discussion of the legal basis for unilateral termination of current preferential treatment(s), see Hogan Lovells, 2016.

[26] Republic of Kenya, 2016:39.

important ramifications for the development of exports. The review process had been held back by financial constraints, different internal rules of origin and the lack of a common position on the range at which different goods will be taxed. The goal is to finalise discussions so that the EAC secretariat can present the comprehensive review of the CET for ratification by the EAC parliament in good time for implementation from 1 July 2017. It appears that financial and technical support to expedite the negotiations is a constraint.

2.5.7.4 Export Taxes

GoK levies export taxes on certain raw material exports to encourage domestic value addition. For example, the export duty on raw hides and skins was increased from 40 to 80 percent in early 2016. Ethiopia, a success story in leather value addition, levies an export tax of 150 percent on raw hides and skins and 100 percent on wet blue leather. GoK's trade policy states that it is desirable to eliminate such export-distorting taxes.[27] Specifically, this would include domestic taxes and local authority/county taxes or cesses on all export products, with the exception of those Gazetted for application of export taxes, pursuant to the provisions of trade remedy policy and relevant laws. In addition, it will eliminate other charges having equivalent effect of tariffs or local authority/county taxes or cess, with the exception of charges for services provided in the facilitation of exports. On the EAC front, it will negotiate for harmonisation of domestic taxes in EAC and other regional economic communities that Kenya is a party of, with an aim of promoting intra-regional trade.

2.5.7.5 Tariff Peaks and Escalations

While average customs duties have come down after successive rounds of negotiations, the application of high tariffs and tariff escalations by developed countries for value-added products originating from DCs continue to restrict the exports of DCs. In effect, this practice protects domestic industries of the importing country while discouraging value addition. In the case of Kenya, processed tea exports suffer from higher import duties abroad, compared to unprocessed tea right off the auction block in Mombasa.

2.5.8 (Re)negotiating Bilateral Trade and Investment Agreements

Kenya has signed bilateral trade and investment agreements with both developed and developing countries. With the current wave of bilateralism sweeping the world, and post Brexit issues, quite a lot of very old agreements will need to be renegotiated, putting quite a bit of strain on Kenya's negotiation capacity as well as creating a sense of uncertainty among exporters.

There are indeed indications that Kenya's DPs' foreign aid budgets will increasingly be used to help deliver trade deals in the spirit of the current *Aid for Trade* agenda. Proposals being considered for presentation to the Organisation for Economic Co-operation and Development (OECD) for aid rules to be amended could result in change towards aid that supports the private sector. This would direct official aid to focus on a wide variety of "private sector

[27] Republic of Kenya, 2016: p.41.

instruments” being used as vehicles for development — meaning that aid could be used to attract investment in or to give loans to private companies, rather than the traditional directing of the majority of aid to recipient non-governmental organisations (NGOs) and governments.[28]

2.6 Current Collaborative Programmes Supportive of Improving BE for Exports.

2.6.1. Introduction

There is a distinct nexus between trade promotion and increased industrialization and investment in Kenya. Various ministries, departments and agencies (MDAs) are charged with different responsibilities that are expected to result in increased exports. They work closely with sector associations that represent their members. The following section briefly describes these MDAs and associations and how they fit into the export-led strategy for Kenya.

2.6.2. MITC

Based on the wish to realize the *Vision 2030* ambitions regarding the industrial sector’s overall goal of increasing its contribution to GDP by at least 10% per annum the Ministry developed the National Industrialization Policy (NIP) and recently, an Industrial Development Bill. This provides a detailed road map to implement the industrial policy. Significantly for export promotion, NIP focuses on value addition and has prioritized seven (7) sectors out of the twenty-two (22) identified based on their potential for growth, employment and wealth creation and availability of national resource base. The seven (7) priority sectors include: agro processing, textile and clothing, leather and leather products, iron and steel, machine tools and spares, agro-machinery and pharmaceuticals.

The above sectors dovetail into other cooperative legislative laws e.g. Special Economic Zones Act which specifically focusses on encouraging agglomeration of specific value chains notably leather and textiles. These sector specific SEZs are currently under development and various foreign investors have shown interest in investing.

The Export Promotion Council (EPC)

EPC is responsible for the development and promotion of exports of goods and services, and harmonization of export related activities. Significantly, EPC facilitates both incoming and outgoing trade and investment missions from and to various countries. The Council is the Secretariat for the ongoing preparatory process for the new NES.

Kenya Investment Authority (KenInvest)

[28] See “The Guardian”, 2016.

KenInvest provides both pre-and post-investment services to both domestic and foreign investors. Pre-investment services include assistance in obtaining necessary licenses and permits, and investment incentives whereas post investment services include facilitation of immediate start of new businesses and continuous liaison with other stakeholders who interface with investors in their day-to-day operations.

KenInvest is working on a new "National Investment Policy" that will deal with the various gaps that currently hinder growth of private investments in the country. It will aim to streamline investments in the country as well as create a seamless coordination between the National Government and County Governments. Of critical importance to exporters, it will address county levies that are adding costs to producers. The policy will also seek to revisit incentives given to both local and foreign investors to see if they bring any benefit to the country. It is planned to be launched in the course of 2017.

Kenya Trade Network Agency (KENTRADE)

This is a state agency charged with facilitation of cross border trade and establishment, management and implementation of the National Electronic Single Window System (Kenya TradeNet System). It has played an important role in ongoing efforts to synchronise the lodgement of foreign trade documentation with the foreign trade taxation system under the Kenya Revenue Authority (KRA).

Sector Associations

There are several sector associations that actively lobby for a conducive policy and legislative framework that encourages exports. These include KAM, KFC, Kenya Private Sector Alliance (KEPSA), and Kenya National Chamber of Commerce and Industry (KNCCI). Through engaging an increasingly business sector friendly Kenya government bureaucracy, these associations provide important sector specific inputs into the government's annual budgetary cycle and often successfully lobby for business-friendly policies and laws.

In summary, the government machinery to promote exports is increasingly listening to the views of the private sector on matters that affect exports. The on-going process to prepare a new NES to date has exhibited a good collaboration between the government and the private sector to chart the way forward in promoting exports.

3 Analysis of Business Environment Challenges Facing Exporters

3.1 Introduction

This section presents our analysis of the main BE constraints faced by exporters. It must be pointed out that there are several issues that affects all Kenyan producers equally, e.g. cost of electricity, but the point must be made that in the case of exporters, the local BE constraints become important factors that reduce the competitive edge for Kenya in export markets. This section provides examples where BE constraints inhibit the growth of Kenyan exports.

3.2 Complexity of Regulatory Procedures

The World Bank's *Doing Business* (DB) reports provide a good comparison of how countries rank globally in terms of different areas of doing business. In the overall ranking for 2017, Kenya jumped up the ladder in the latest *Doing Business 2017,*[29] moving to 92 out of 190 countries surveyed in 2017, up 21 places from 113 in 2016. Of the 11 categories that DB tracks,[30] further decomposition of the "Trading Across Borders" category clearly reflects the current disadvantageous position that Kenyan exporters face.

As shown in Table 4, Kenya's overall rank actually worsened in this category between 2016 and 2017, dropping 2 ranks to 107. Rwanda, which principally used the port of Mombasa for its exports and imports, is at a respectable position 87 in 2017. Whereas it takes eight hours to comply with border crossing regulations in Botswana, in Kenya it takes 28 hours (in fact, seven more than in 2016). Cost of documentary compliance in Kenya, while remaining the same at US$191 in 2016 and 2017, is still quite high. In comparison, Rwandese exporters pay US$110 for similar costs.

Table 4: Comparison of *Doing Business* Trading Across Borders Indicators, 2016-17.

Kenya: Comparison of *DB2016* and *DB2017* Trading Across Borders Indicators									
Indicator	**Kenya DB2016**	**Kenya DB2017**	**Botswana DB2017**	**Mauritius DB2017**	**Namibia DB2017**	**Rwanda DB2017**	**Tanzania DB2017**	**UKDB2017**	**Best Performer Globally DB2017**
Trading across Borders (Rank)	105	107	51	74	127	87	180	28	1
Time to export: Border compliance (hours)	21	28	8	48	120	97	97	24	0
Cost to export: Border compliance (USD)	143	143	317	303	745	183	1160	280	0
Time to export: Documentary compliance (hours)	19	19	24	9	90	42	96	4	1
Cost to export: Documentary compliance (USD)	191	191	179	128	348	110	275	25	0

Source: World Bank, 2017

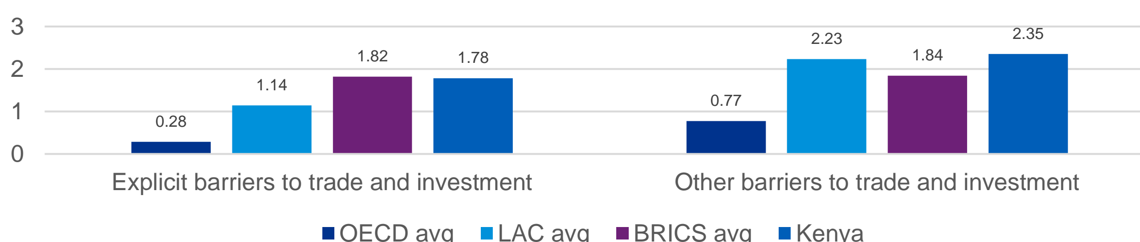
29 World Bank, 2017

30 Unlike previous DB reports that tracks changes in regulations affecting 10 areas in the life cycle of a business DB2017 covers 11. They are (i) starting a business, (ii) dealing with construction permits, (iii) getting electricity, (iv) registering property, (v) getting credit, (vi) protecting minority investors, (vii) paying taxes, (viii) **trading across borders,** (ix) enforcing contracts, (x) resolving insolvency, and (xi) labour market regulation.

A study on regulatory[31] obstacles to competition in Kenya established that the license and permits system at both the county level and at the national level affects Kenya's comparative performance. The rules and procedures for doing business particularly in relation to rationalising the licensing and permits systems can have significant impact on easing business decisions on entry and expansion. In the context of devolution, there have been additional regulations and licences imposed by county governments.

High barriers to trade have been pointed out as an impediment for competitiveness. Figure 1 below compares Kenya's score for two categories of barriers, i.e. explicit barriers to trade and other barriers to trade and investment. Explicit barriers to trade refer to tariff barriers, while "other" barriers to trade and investment refer to different treatment of foreign suppliers and barriers to trade facilitation. For example, foreign trucks are treated differently when transporting goods across Kenya. Figure 1 compares Kenya's Product Market Regulation (PMR) score with that of OECD; Latin American Countries (LAC); and Brazil, Russia, India, China and South Africa (BRICS).

Figure 1: Kenya's Comparative (Product Market Regulation) Score for Sub Indicators (scale is 0–6, from least to most competition)



Source: cited in CAK/World Bank, 2015

The higher score for Kenya stems from regulations that prescribe differential treatment of foreign suppliers in professional services and public procurement, and from the lack of mutual recognition agreements in key sectors, which act as an impediment to trade. Relatively high average import tariffs for goods, particularly agriculture products, also contribute to the high score.[32]

Regulatory cooperation with neighbouring partners who have similar regulatory objectives can catalyse the development of certain standards or the reform of licensing and permits systems. This is especially true in cases where mutual recognition agreements are already in place. It may therefore be worthwhile to gather the pace for regional regulatory initiatives, given the supporting role they can play in facilitating national reforms.

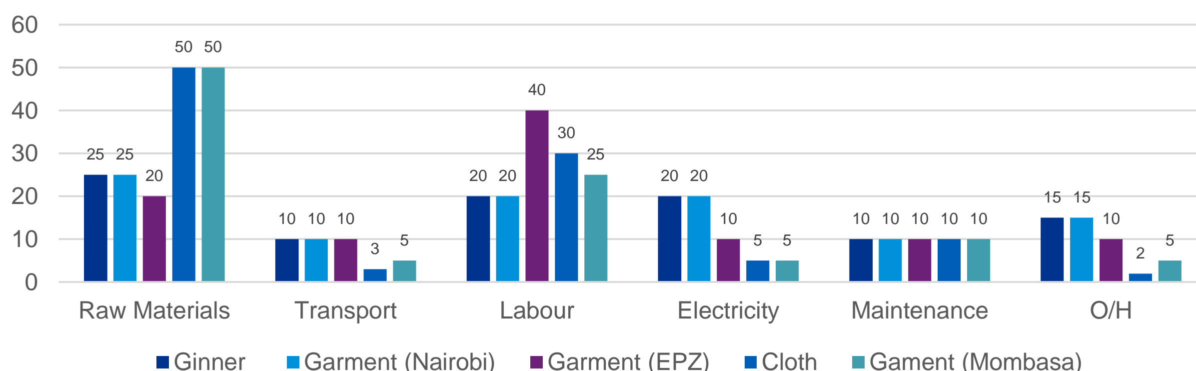
[31] CAK/World Bank, 2015.
[32] Ibid, p.42.

3.3 Labour Skills and Costs

Low labour skills can greatly influence the dynamism of a country's exports. This is clearly illustrated in Kenya's apparel value chain, where a majority of players in the value chain are characterised by inadequate institutional capacity to support adoption and absorption of modern skills. A recent study found that Kenyan labour has the lowest value added per worker among selected comparable countries, reflecting poor levels of productivity given current wage rates. It was found that labour costs in Kenya have actually increased precipitously over the past three years (by as much as 30 percent), and manufacturers are unable to pass on this increased cost to consumers, particularly for cut-and-make apparel. In comparing Kenya's labour costs, the study found that Kenya's minimum wage is higher than that in Lesotho, India and Vietnam, but lower than that in South Africa and China. For example, the average wage rate for a sewing operator in Kenya is approximately 3.7 times more than its competitor Ethiopia (US$180/month and US$60/month, respectively), and generally 214 percent greater than a global competitive wage benchmark.[33]

In discussions with stakeholders, it was found that in the textile and garments sector, labour is a significant contributor to total costs of production depending on the type of textile/ apparel under consideration. As Figure 2 shows, labour costs ranged from 20 percent in the case of ginners to 40 percent in the case of garment sewers in the Export Processing Zones (EPZs). Garment manufacturers in Mombasa have a much lower labour cost compared to their Nairobi EPZ counterparts.

Figure 2: Share of Total Cost (%) by Type of Textile Manufacturer



Source: Survey results

Therefore, the main human capacity issue requiring attention, particularly in the garments value chain, is the relatively high-cost but low-skilled labour. This should be done through addressing deficiencies in the capacities of institutions along the textile value chain. Specific attention needs to be given to providing them with access to latest market skills requirements, as well as supporting their specific sector needs in research, production, designs and

[33] See GoK, 2015b: p.17.

manufacturing. In addition, there is need for specialised on-the-job skills training at the mid-management level, especially in ginning, textiles, fashion and design.

3.4 High Cost of Energy and Non-Reliability

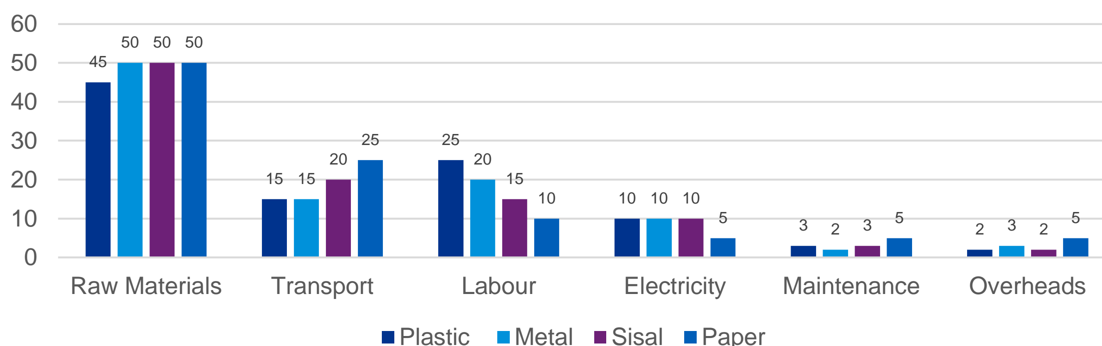
Kenya's position worsened in the DB's "getting electricity" indicator ranking, from 106 in 2016 to 1127 in 2017. Procedures for getting electricity were also made more bureaucratic, and the rankings in "time taken to get connected" indicator increased from 97 to 110 during the same period (by comparison, Tanzania ranked 109; Namibia, 37; and Rwanda, 34). Not only that, "the cost of getting connected" indicator, measured as percentage of income per capita, increased from US$642 in DB's 2016 report to US$732 in 2017.

In the specific case of textile and apparel exports among Kenyan producers, unreliable electricity increases production costs. Whereas this affects all producers, it must be seen from a comparative perspective regarding cost of electricity in countries with whom Kenya competes in the export market. This is one of the many constraints affecting the competitiveness of textile and apparel exports among Kenyan producers, as well as between SSA producers and global competitors. According to a study by the then-Ministry of Industry and Enterprise Development (MoIED), electricity prices in 2014 were particularly high, over 20 cents per kWh, and even though prices have come down significantly lately, they were and are still higher than those in other apparel and textile producing countries such as China (at seven cents per kWh) and Ethiopia (at six cents per kWh).[34] As shown in Figure 2 above, electricity accounts for as high as 20 percent for ginners and 5 percent for garment manufacturers. This puts Kenyan firms on a fundamentally unequal footing to firms in other countries.

Similarly, the packaging industry is faced with high electricity consumption. Pan Paper Mills (PPM) was, in its peak, the biggest producer of paper and paper products in the East African region. It collapsed in 2009, partly due to the very high cost of electricity, also partly arising from the antiquated machinery. As Figure 3 below shows, the cost of electricity for packaging manufacturers takes up 10 percent of the total costs for manufacturing plastic, metal and sisal packaging materials.

[34] Ibid, p. 15.

Figure 3: Share of Total Costs (%) by Type of Packaging Manufacturer



Source: Survey results

Recently, Kenya Power Company (Kenya Power), the sole supplier of electricity in Kenya, has announced plans to start importing cheaper, cleaner and more reliable electricity from Ethiopia, as the move will help reduce the cost of electricity as well as accelerate its goal of connecting over 1.5 million Kenyans to the national grid by 2020. Together with an increased supply from geothermal and other renewable sources, it is hoped that cheaper and cleaner energy from these sources will boost the manufacturing sector and connect more Kenyans to the national grid. Lauded by KAM,[35] this promises to lure more foreign and local investors to the country's manufacturing sector, which aims to increase its contribution to Kenya's GDP to 15 percent from the current 10 percent over the next five years. This is important given that industries account for more than 60 percent of Kenya Power's electricity sales revenue.

3.5 High Cost of Capital for Upgrading and Modernisation of Equipment

Kenya ranks fairly well in the DB report's "Getting Credit" indicator and improved its position from 32 in 2016 to 29 in 2017. However, the Banking (Amendment) Act, 2016, which became effective in mid-September 2016, set limits on banking lending and deposit rates. The amendment was enacted against the backdrop of general concern on the high cost of credit and followed two previous unsuccessful attempts to cap commercial interest rates in 2001 and 2011. In adjusting strategies and business models to the interest rate caps, it is evident that supply of credit is already tight and bank lending has been significantly reduced, affecting lending to productive enterprises. Though CBK holds that the effects of the rate cap are not evident to date,[36] private sector, year-on-year credit growth was 4.3 percent in December 2016, compared to 17.8 percent a year before.

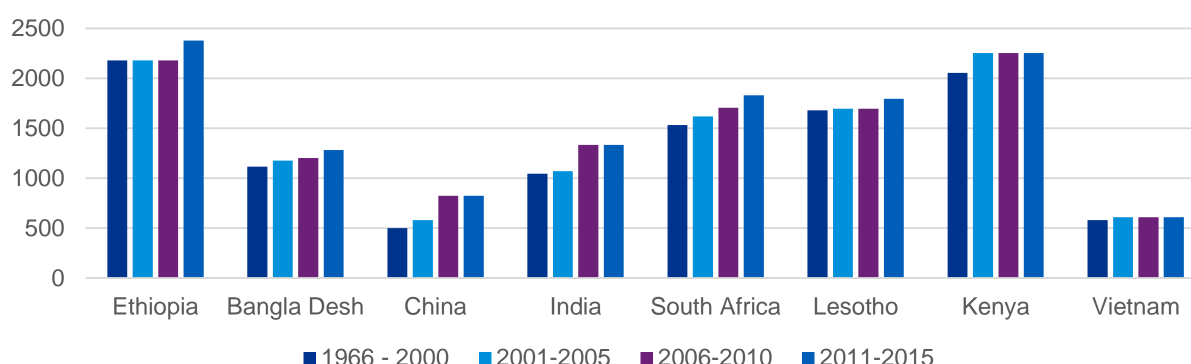
What emerges is that there is a consciousness among manufacturers for the need of modernising equipment in order to keep costs down and also to respond to competition in foreign markets in terms of modern designs and processes, but facilitative credit needs to be easily available.

[35] KAM, 2017: p.23.
[36] CBK, 2017.

3.6 High Cost of Transport and Logistics

The detailed sector survey mentioned above found that roads and transport logistics[37] in Kenya are a big constraint for export businesses which rely heavily on imported inputs. For the apparel and textile sector, they fundamentally constrain time to market, and thus, the market segments in which firms can compete. As Figure 4 shows, Kenya has the highest import-export cost among its Asian and African competitors after Ethiopia. In addition, its road transport costs are four times the globally competitive rate (KSh4/kg/km vs. KSh1/ kg/km). Although Kenya requires a high number of import-export documents, average import/export time is relatively competitive compared with African countries, but generally not with Asian countries.

Figure 4: Comparison of Export Costs among Kenya's Competitors (US$/20ft. Container)

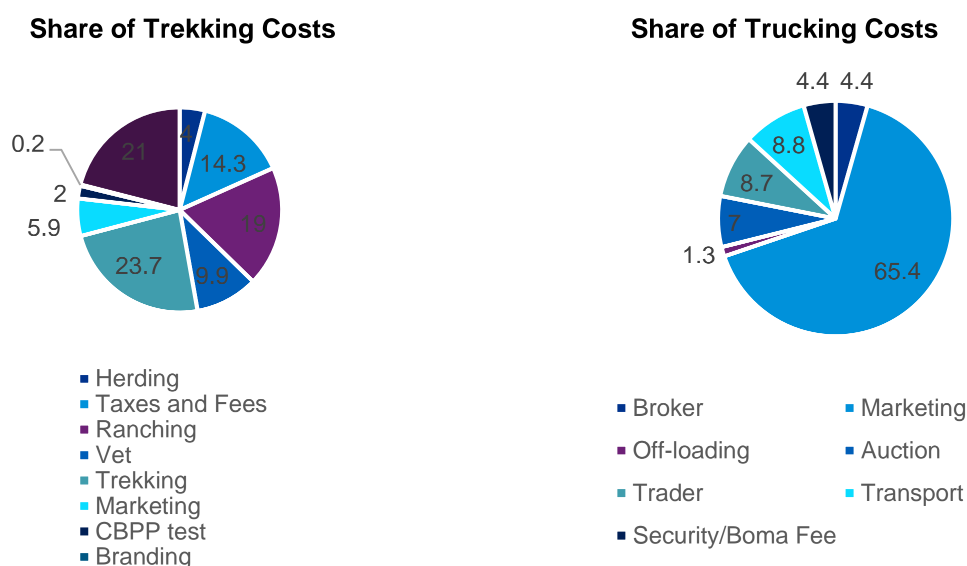


Source: World Bank, 2016

As earlier shown in Figure 2, transport costs are major costs for packaging manufacturers. All the respondents in this sector use road transport, while 20 percent also reported using sea transport for their goods (exporters). Of the respondents, 80 percent cited poor road infrastructure as a constraint to their operations, and 40 percent specifically mentioned transport challenges as an issue that needs to be resolved if they are to increase their access to foreign markets. Not surprisingly, 40 percent of the respondents in this sector cited better roads and infrastructure as major incentives needed for investing in/promoting change in the value chain.

[37] Ibid, p.34.

Figure 5: Share of Trekking and Trucking Costs for Cattle (% Shares)



Source: 2017 projections based on Makokha S., Witwer M., 2013

Government taxes and fees imposed on trekkers hinder the movement of cattle from remote pastoral areas to markets and even reduce the prices offered to producers. Unless these issues are addressed, they will continue to serve as major barriers to Kenya's stated goal of expanding its cattle export market as a strategy for poverty alleviation in Arid and Semi-Arid Land (ASAL) regions.[38]

In summary, since 2008 there have been initiatives at the port of Mombasa, international airports and border ports including administrative reforms to make procedures and processes more efficient for importers and exporters involved in international trade and trade across borders. A case in point is the National Single Window Project currently under implementation by the GoK. The introduction of this system has resulted in some reduction in delays of import cargo both at the port of Mombasa and Jomo Kenyatta International Airport (JKIA). The in-country-transit transportation also needs to be improved. In particular, there is need to reduce the number of road blocks which have turned into toll stations — an added burden for the business community. Continued operation of cross-border ports of entry, even with a fully operational customs union and common market, causes delays in the clearance of goods which do not attract any duty.

3.7 Strict Quality Requirement in the Export Markets

There is a growing concern among governments and consumers about environmental issues, and the more stringent legislations on the use of packaging materials worldwide are influencing the choice of materials. Manufacturers use more recycled content in their production and make their products more readily recyclable. The use of biodegradable plastics

[38] Makokha and Witwer M., 2013: p.36.

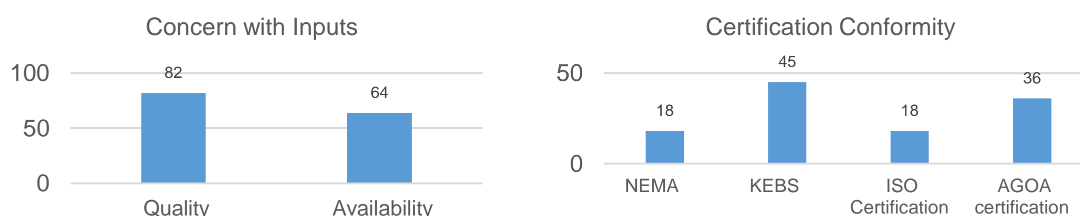
will reduce the proportion of non-biodegradable and ozone-depleting plastic bags. The major concern for food packaging is whether it contains any toxic constituents, particularly for packages which have direct contact with food. Polyvinyl chloride (PVC) has gradually faded out in packaging for direct food contact and outer packaging. Films made of other materials — e.g. Oriented Polypropylene film (OPP), Biaxially Oriented Polypropylene (BOPP), Polyethylene Terephthalate (PET) and Polystyrene (PS) — have become popular in the sector.

The emerging trade scenario at the global level has brought challenges to exporters of textiles and garments, as well as floricultural products. The broad spectrum of non-tariff trade restrictions includes issues such as child labour, human rights and environmental pollution. Specifically, these relate to product and process standards pertaining to the responsibility of manufacturers and industrialists to provide due social protection to the workers including hygiene at the work place, proper working environment, etc. In general, consumers, retailers and wholesalers are more attuned to environmental and social standards, and increasingly consumers are demanding 'green products' — products produced in energy efficient facilities.

3.8 Quality of Raw Materials

For Kenyan garment exporters, there are issues with the quality of raw materials, as shown in Figure 6 below, where almost 80 percent reported that quality is an issue for them, and availability is a problem for 62 percent of the respondents. However, in their export markets they conform to the required standards, as also shown in Figure 6.

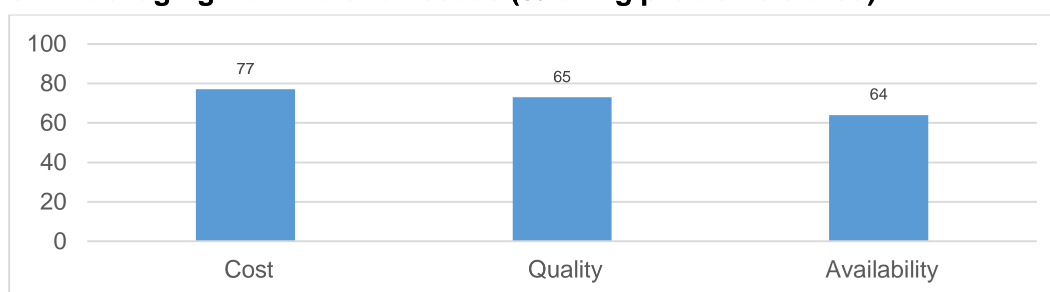
Figure 6: Quality Concerns of Garment Manufacturers



Source: Survey Results

Similarly, on the supply side, as Figure 7 shows, while availability is also an issue, the cost of raw materials as well as quality issues were cited as two critical problems by 80 percent and 65 percent of the packaging materials respondents, respectively. Kenya imports its plastic packaging stock from local (60 percent of respondents) as well as foreign suppliers (40 percent of respondents), who are typically large global producers. Commodity raw material prices are driven by global energy prices and supply capacity, which fluctuate with the global economy, regional weather conditions and many other factors.

Figure 7: Packaging Raw Material Issues (% citing problems stated)



Source: Field Survey

As shown in Table 5, for the manufacturing of packaging materials, raw marerials constitute the highest proportion of total costs followed by labour and transport costs. Amongst the different types of packaging materials, calculations based on unit costs of exports and average compostion of cost of production is shown. It is clear that there are differences even in transport costs, depending on the type of packaging material. For example, glass would be expected to be exceptionally high in transport costs, as stated by the glass manufacturer who was one of the respondents based in Mombasa. Unit transport costs for exports are much lower, for example, than for paper, as would be expected given the brittle nature of the product.

Table 5: Estimated Packaging Materials Unit Production Costs

Estimated Packaging Materials Unit Production Costs (US$/tonne)

	2016 Unit Cost of Exports	Unit Production Cost	Raw materials	Transport	Labour	Electricity	Maintenance	Overheads
Product: 3923 Plastic packing goods	2335	1401	630	210	350	140	42	28
Product: 4819 Paper, paperboard packaging	2214	1328	664	332	133	66	66	66
Product: 6305 Sisal Sacks and bags	1431	859	429	172	129	86	26	17
Product: 7010 Glass containers	1747	1048	630	210	262	73	31	52
Product: 7309 Iron & Steel reservoirs,tanks	2315	1389	625	278	347	97	42	52
Product: 7611 Aluminum reservoirs and containers	2571	1543	694	309	386	108	46	77

Source: Calculated from Trade Map (2017) data base and field survey results.

3.9 Taxation of Inputs

In October 2014, GoK increased the duty on paper packaging raw materials not made in the EAC from 10 to 25 percent (see Box 1 below). This led to an increase in the price of local packaging materials and threatened the survival of the sector and raised costs for the industry at large, especially for essential consumer goods such as maize and wheat flour, bread, food and beverage products, books, pharmaceuticals and tea products. In addition, this went against the basic duty structure of zero for raw materials, 10 percent for intermediate products and 25 percent for finished products and the rest of the value chain. In the case of Kenya, paper, which is an intermediate product, is being charged 25 percent instead of 10 percent, compared to other EAC countries which are charging a 10 percent duty. In addition, Tanzania is able to import paper from SADC at zero duty, while Uganda applies COMESA rates of 10 percent, and all the other countries in the COMESA region charge 10 percent duty, except for Kenya.

Similarly, in the 2015–16 budget, manufacturers of plastic tubes had the import duty rate on plastic tubes for packaging toothpaste and cosmetics increase from 10 to 25 percent.

Box 1: Tax on Imported Paper May Kill Packaging Industry

Barely three months after a collective decision by EAC ministers to correct the duty structure on paper to reflect the correct value chain position and make the EAC packaging industry more competitive, GoK reversed the decision. Kenya has curiously decided to take the backward step of making its own packaging industries and converters uncompetitive by reintroducing a higher duty of 25 percent on products not made in EAC. The correction of the duty structure to reflect the intermediate status of paper in the value chain was achieved after numerous petitions and comprehensive studies in the EAC, which correctly advised that the duty rate be put at 10 percent.

Kenya has, however, reversed this and quickly moved to gazette the new rate without consulting the sector. The reintroduction of duty on imported paper and paper board not made in EAC within Kenyan packaging industries means that Kenya is the only country which will be importing paper at 25 percent duty.

Source: Nation Group (2015), Tuesday, October 21, 2014

Applying duty on raw materials at the same rate as that of finished products does not make economic sense. EAC and COMESA manufacturers enjoy a duty differential between raw materials and finished goods. It is understood that the decision was premised on the EAC ministers agreeing to maintain a few grades of paper previously made in East Africa by the collapsed PPM and other paper mills in the region at 25 percent in recognition of the high costs of doing business. But they applied the correct tariff of 10 percent for all other grades of paper used in packaging. The reason given for backtracking was that there were plans to revive PPM, which would be most welcome. However, this measure was taken before the paper mill was operational and covered grades of paper not previously produced by the miller and of which there is no proof of sufficient supply, quality and price to foster competitiveness. PPM remained closed until a new owner bought it out in late 2016.

3.10 Traceability and Food Safety

Meeting food safety standards is a precondition for the further growth and development of the poultry meat sector. This means that the various broiler producer associations must come up with a solution to the problem. Most changes in the meat sector in Kenya have been made by the government through legislation. If a ban is imposed on the way broilers are currently slaughtered on-farm, the associations could develop a mobile slaughter facility that moves from farm to farm. The larger farms should eventually create their own cold rooms (second-hand cooling containers were seen being used as cold stores), from which they supply the markets.

Our discussions with stakeholders in the meat and meat product sector indicated that they are aware of the traceability issue and take measures to ensure that their products can be

identified by the purchasers. An earlier study[39] had the objective to assess the feasibility of implementation for an electronic Livestock Identification and Traceability System (LITS) in Kenya. It was envisaged that LITS would enable Kenya to ascertain origin and ownership of livestock and to discourage stock theft and thus livestock-related insecurities; support disease surveillance and minimise the spread of Trans-boundary Animal Diseases (TADs); and improve external market access through exports. In the case of beef, the study established that the cost, when calculated for the nearly three million beef cattle in ASALs, was US$7.4/head for registration and US$7.3/head for annual maintenance. The Cost Benefit Analysis (CBA) revealed that the Net Present Value (NPV) was approximately US$350 million at 2007 prices and the Benefit Cost Ratio (BCR) was 4.73 — implying that the return on investment was computed at nearly five times the unit cost per dollar. These efforts to popularise traceability should be encouraged throughout by the government.

3.11 Summary of Issues Arising from the Study

The fluctuation in prices and the high cost of inputs, where raw materials on average take up 50 percent of costs, are two related and important issues. Transport and labour costs vary across the different packaging products. Except for paper packaging, electricity accounts for 10 percent of costs. Paper packaging has high maintenance costs due to old machines. Added to the fact that cumbersome Kenya Revenue Authority (KRA) import procedures were cited as specific government policy/regulation obstacles to growing respondents' businesses, this needs to be addressed.

Kenya has acquired a negative association with the Middle East and other export targets, where Kenyan traders and processors are largely viewed as unreliable in supplying consistent quality, promised volumes or competitive prices. Kenya will, therefore, need to strengthen its image, systems and facilities to meet quality control standards and demand in high-potential markets, such as Saudi Arabia and Egypt.

This must include strengthening livestock traceability systems, eliminating disease and strengthening disease-free zones, improving stock management in order to offer consistent supply, and adhering to strict Halal and Hazards Critical Control Point (HACCP) requirements. In the meantime, the EAC — with its lower standards and lower volume requirements — poses a stronger near-term export opportunity.

[39] Matete, 2010

4 Recommendations

4.1 Overview

This section of the report presents the recommendations arising from the study. The recommendations are made in the spirit of acknowledging current activities and programmes to reduce BE constraints and with the sole ambition of further improving the environment for catalysing exports. As explained in the introduction, it would be important to present these at the PPD sessions, given that these are urgent issues that need to be taken up in the NES. In this regard, suggestions are given herein on possible ways of operationalising the recommendations and making them implementable.

4.2 Work with AGOA to Improve Competitiveness

Currently, except for the firms in the EPZs, domestic products are not competitive among high-priced products due to the quality gap with competing imports that is largely attributable to the quality of fabrics. AGOA will be the preferential access route for Kenya to deepen investment and increase exports, but the experience over the next 10 years should be used to explore other regions and deepen the domestic market for fairly priced garments. There are of course regulatory restrictions on sale of EPZ goods into the local market. The recent move by the Government to allow for limited sale of EPZ goods into the local market after payment of token taxes, is one way to catalyse this.

To operationalise this recommendation, the current NES preparatory process of identifying selected high potential products for exports by specific destinations should include specific implementable timelines in its Action Plan.

4.3 Clustering and Agglomeration

The issue of high energy costs has been highlighted and needs to be addressed holistically. Generally, agglomeration and clustering of productive activities provide benefits through learning by being in close proximity to peers, sharing common infrastructural services and related economies of proximity. Mombasa and its environs have been identified by TradeMark East Africa (TMEA) as locations that can catalyse the county governments to develop Special Economic Zone (SEZ)-type agglomerations for agro-processing, electronics and related industries. Similarly, MITC is considering setting up a Textile City in the EPZ along Athi River to attract investments from textile firms and has interested a few international firms. Though capital costs to set up the SEZs are high, the plan is expected to create many new jobs when operational. Related to the establishment of Naivasha as a textile cluster are the plans for the SGR to be extended to Naivasha. This will be an important bonus that will greatly reduce the cost of transport for manufacturers. In addition, agglomeration will provide significant value addition. In the case of textiles, it would enable a wider range of fabrics and cotton products which could catalyse higher domestic consumption and enhance exports. MITC should fast track these initiatives.

Whereas the SEZ cannot cover all exporters, there is need to improve infrastructure to catalyse exports for various other non-SEZ attractive sectors. For example, meat and meat products sector. Livestock traders complain of the high cost of moving animals as a result of poor infrastructure. Road investments, to improve trucking, are already underway. The GoK is currently in the process of tarmacking the major trade routes for cattle. However, there is particular need to improve infrastructure along trekking corridors, which are the critical routes through which animals move from primary to secondary markets. In addition, there is need for improved hygiene and better service in slaughter houses that are well-equipped and supervised. For the horticultural sector, there has been commendable improvements in cold storage facilities at JKIA, but more is needed as a wider variety of fresh fruits in need of cold storage are exported.

To operationalise this recommendation, the envisaged policy change to transform the Export Processing Zones Authority into the Special Economic Zones Authority needs to be implemented. The new Authority would thence have a mandated mission to operationalise the EPZA Act.

4.4 Fast Track the Development of a Competitive Power Market

Section 3.4 discusses the constraints faced due to the comparatively high cost of energy and non-reliability on its supply. Kenya's competitors in the export markets obviously have much lower costs of electricity. With current plans to massively increase the supply of electricity in Kenya, consideration should be given to liberalising the supply of electricity in Kenya and opening it up to competition at the retail/commercial consumer level. This is an imperative to provide a more competitive basis for the future retail sale of the increasing supply of electricity in Kenya. Current efforts[40] to provide a local currency costing for the Purchasing Power Agreements (PPAs) is a good step that should be followed by re-negotiating the current PPAs with the objective of freeing Kenya Power from being the sole purchaser of electricity. This is both in the interest of Kenya Power not to be burdened by expensive PPAs, but also to the power generators who will have alternative direct customers.

In light of the above, it has been recommended[41] that the electricity market in Kenya should be opened up to competition at the retail/commercial consumer level. The existing Kenya Power and Kenya Electricity Transmission Co. Ltd. (KETRACO) infrastructure would be used to "wheel" the supply at mutually-agreeable costs paid to Kenya Power and KETRACO. This would significantly provide a competitive electricity market in Kenya, given the increasing sources and capacity of supply of electricity. The Energy Regulatory Commission (ERC) has recently set the pace by licensing small, localised generation and distribution of renewable energy, chiefly solar. A formal amendment of the Energy Act should follow to legally open up

[40] An assignment is soon to be commissioned on Kenya's wholesale electricity tariff structuring with a focus on establishing local currency component in future PPA tariffs (see GuarantCo,2017).

[41] See Ministry of Energy (2015).

the power market. ERC, the State Directorate of Energy working with the office of Attorney General, should take this up as a matter of urgency. The beneficiaries would be power consumers, both large and small, as well as a more market-responsive Kenya Power.

To operationalise this recommendation, the **urgent and simple** act is to table and enact the Energy Bill's current proposed amendment to establish a competitive market for electricity in Kenya.

4.5 Institutional Support for Value Chain-specific Training and Equipment

There is a need to establish high-level practical training institutions. For example, in the case of the textile and apparel sector, an industry-wide institution is needed to build a platform to engage major buyers and investors in the development and growth of the sector in Kenya. The proposed suggestion by key stakeholders in an earlier study[42] to establish an Institute for Textile and Apparel Development (ITAD) may be important and will help towards upskilling local labour and increase productivity. Building skills to address productivity issues — at the managerial, technical and factory floor level — is important. In addition, it would help link them to international buyers and help Kenya develop new markets at the high end of cotton garment demand. There is a need to catalyse the establishment of a focused industry-wide packaging institution to help ensure sustainable support of the sector. A study done by the ITC in 2008[43] recommended the establishment of a regional Packaging Resource Centre as a learning Centre for Excellence to cover selected African countries. It would act as a focal point through which micro, small and medium enterprises (MSMEs) can acquire packaging-related knowledge. This should be discussed between MITC and Japan International Cooperation Agency (JICA).

In addition to training, there is emerging willingness among manufacturers to purchase modern equipment and technology that can respond to fast changing consumer needs in garments. Equipment that is energy efficient is an imperative given the growing consumer demand for environmentally-sustainable production processes. Exporters, particularly smaller garment exporters, find it difficult to fund new plant and equipment. The textile study[44] recommended that it may be useful to explore how establish a dedicated government-funded programme to support purchase of new plant and equipment.

To operationalise this recommendation, the on-going NES preparation process should link the targeted export promotion products to be identified, with clear programmes that can support both improved access to funding for capital development and capacity building for new skills and technologies.

42 See Republic of Kenya. (2015b).
43 JICA, 2010: p.89.
44 See Republic of Kenya. (2015b).

4.6 Developing New Export Markets

Kenya's Export Promotion Council (EPC) is grossly underfunded and not able to perform its export market development role effectively. Compared to her competitors in key export markets, e.g. Sri Lanka, Vietnam for textiles, EPC funding and performance puts Kenya's exporters at a disadvantage. Kenya's current market needs to be deepened in countries throughout the region, and several specific products were discussed in the study to illustrate this need. A strong consultative and market development programme should be part of the NES. For livestock, Kenya should first focus on strengthening its domestic value chain, while developing the previously successful markets of the UAE, Somalia, Tanzania, Oman, Qatar and Egypt. The country will need to strengthen its export image, systems and facilities to meet such high food quality control standards and demand in high potential markets, such as Saudi Arabia and Egypt. This must include strengthening livestock traceability systems, eliminating disease and strengthening disease-free zones, improving stock management in order to offer consistent supply, and adhering to strict Halal and HACCP requirements.

This is a key activity under the new NES. It is expected that there will be product and country specific strategies and Action Plans to increase exports to specific export destinations. It is therefore expected that the operationalisation of this recommendation will be part and parcel of the Action Planning for a comprehensively new NES for Kenya.

4.7 Review of Tariffs for Imported Raw Materials Used in Exports

Manufacturers of export products are faced with inconsistent duties on imported raw materials. In an era where there is a clear delineation of EAC duties on raw material imports, these obvious tariff anomalies need to be corrected. As discussed in sections 2.3, 2.4 and 3.9, the CET is under review, but completion has been delayed due to technical and financial constraints. It would appear that financial and technical support to expedite the negotiations and reach a common EAC member state position on a revised CET list is an imperative for promotion of EAC international trade.

To operationalise this recommendation, the delayed reconfiguration of the EAC CET list can be expedited through targeted financial and technical support.

Table 6 below summarises the recommendations of this report and provides an indicative timetable for implementation.

Table 6: Summary of Report Recommendations

Summary of Report Recommendations				
	Recommendation	**Partner (**Identified MDA)	**Timeframe for Start**	**Priority** (High/Medium/Low)
1.	Review tariffs for imported raw materials as part of review of CET	EAC secretariat with member country trade ministries, with technical and financial support provided by e.g. TMEA	0–3 months	High
2.	Fast track the development of a competitive power market	ERC, directorate of energy, and office of attorney general	3–6 months	High
3.	Provide institutional support for value-chain-specific training and equipment	Directorates of trade and industry in MITC in collaboration with KAM and other private sector organisations	6–12 months	Medium
4.	Develop new foreign markets for exports	Directorate of trade in MITC in collaboration with Export Promotion Council (EPC) and other sectoral private sector organisations	6–12 months	Medium
5.	Work with AGOA to improve diversity and competitiveness	Directorates of trade and industry in MITC in collaboration with KAM, KFC and other sectoral private sector organisations	12–24 months	Medium
6.	Catalyse clustering and agglomeration for MITC-identified value chains	Directorate of industry in MITC in collaboration with KAM, KenInvest and other sectoral private sector organisations	12–24 months	Medium

Appendix 1 References

Adam Cobb, J.A, Ken-Hou Lin, and Paige Gabriel. (2016). *Growing Apart: The Changing Firm-Size Wage Effect and Its Inequality Consequences.* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2785868 (Accessed 15 February 2017).

BERF. (2016). *Business Environment Reform Facility Investment Climate Reform Scoping Report: Kenya.* 13 May 2016,

CAK/World Bank. (2015) *Dismantling Regulatory Obstacles to Competition to Unlock Growth Potential in Kenya.* October 2015.

CBK. (2017). *"Kenya holds rate, still too early to assess impact of rate cap*". *Central Bank News,* January 2017*.* http://www.centralbanknews.info/2017/01/kenya-holds-rate-still-to-early-to.html*.*

COMESA, (2017). "Kenya, Zambia in fresh bid to resolve long standing trade barrier*"*, *e-COMESA Newsletter*, 28 February 2017. http://www.comesa.int/wp-content/uploads/2017/03/e-COMESA-Newsletter-Issue-No.-509.pdf..

DFID, Kenya. (2016). *Investment Climate Reform Scoping Report, Kenya*. 13 May 2016.

European Commission. (2015). "*Export Performance and Poverty Reduction, Volume II".* June 2015. http://trade.ec.europa.eu/doclib/docs/2015/july/tradoc_153596.pdf . (Accessed 22nd January 2017).

GuarantCo (2017) *Local Currency Tariffs for Kenyan Power Purchase Agreements Consultancy Services to Carry out a study – Request for Proposals*, May, 2017. http://guarantco.com/media-centre/local-currency-tariffs-for-kenyan-power-purchase-agreements. (Accessed 13th. May 2017).

IMF. (2017). "Kenya: First Reviews Under the Twenty-Four Month Stand-By Arrangement and the Arrangement under the Standby Credit Facility and Requests for Waivers of Applicability, Rephrasing of Disbursements, and Modification of Performance Criterion"*. IMF Country Report* No. 17/25, February 2017. http://www.imf.org/en/Publications/CR/Issues/2017/02/02/Kenya-First-Review-Under-the-Twenty-Four-Month-Stand-By-Arrangement-and-the-Arrangement-44607.

ITC. (2006). *"Evaluation of International Trade Centre (UNCTAD/WTO)"*, Volume 3, Country Reports, KENYA. File No. 104.A.1.e.37, April 2006 http://www.itcevaluation.org/filedir/Reports/Country%20Reports%20A/Kenya%20Country%20Report.pdf.

ITC. (2017). Trade Map Data Base. http://www.trademap.org/Index.aspx.

KAM. (2017). *Manufacturing Priority Agenda 2017* http://www.kam.co.ke/Docs/KAM-MPA-2017.pdf.

KenInvest. (2017). *Promoting Investments in Kenya*. http://www.investmentkenya.com/index.php?option=com_phocadownload&view=category&id=2&Itemid=123.

KenInvest (2016) Draft National Investment Policy. Mimeo

Kiptui, M. C., Wambua, J. and Ndirangu, L. (2013). "Impact of the real exchange rate on Kenya's exports". *KSMS Working Paper* No. WP/2013.004 http://www.ksms.or.ke/KSMS_WP_Impact%20of%20the%20real%20exchange%20rate%20on%20Kenya's%20exports.pdf..

Kiringai, J. W., Sanchez Puerta, M. L. (2016). *Kenya* — Economic update: kazi ni kazi - informal should not be normal. *Kenya economic update*, No. 13. Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/888091467988907587/Kenya-Economic-update-kazi-ni-kazi-informal-should-not-be-normal.

KNBS. (2016). Economic Survey, 2016. Nairobi. Government Printers.

Lovells, H. (2016) "President Trump Will Have Broad Presidential Authority to Terminate Trade Agreements and Impose Punitive Duties on U.S. Trading Partners". 3 November 2016. https://www.hoganlovells.com/en/publications/the-next-president-will-have-broad-authority-to-terminate-free-trade-agreements-and-impose-punitive-duties-on-foreign-countries

Makokha, S., Witwer, M. (2013) "Analysis of incentives and disincentives for live cattle in Kenya". Technical notes series, MAFAP, FAO, Rome. file:///G:/2015/JICA%202/DELLOITTE.pdf.

Matete, G. (2010). "An assessment of the opportunities and constraints to enhanced animal identification, traceability and quality verification in a beef marketing chain in Kenya". Mimeo.

Ministry of Energy. (2015). "Kenya - Options for the Development of a Power Market." *CPCS Consultancy Report* No. 11062. Mimeo.

MIIC (2016) The National Industrialization Policy. Nairobi, Government Printers

Nation Newspapers (2015a). "Devki opens Sh7bn roofing sheets plant" *Nation*, 2 July 2015, pg. 35. http://www.nation.co.ke/business/Devki-opens-Sh7bn-roofing-sheets-plant/-/996/2772436/-/pf5hr0z/-/index.html.

Nation Newspapers. (2015b). Kenya Livestock & Meat Market Analysis: For Cattle, Goat & Sheep. 5 January 2016. KMT (2014) 22 September 2014 http://www.kenyamarkets.org/download/get/kenya-livestock-meat-analysis1/35
.

PSMED. (2015). Compliance with International Standards - Guidelines for Textile Industry Standard Newspapers. 7 December 2015.

Republic of Kenya. (2003). *National Export Strategy, 2003 - 2007.* November 2003. http://www.intracen.org/Workarea/DownloadAsset.aspx?id=68921..

Republic of Kenya. (2012). *Kenya National AGOA Strategy*. Ministry of Trade/USAID COMPETE. June 2012. https://agoa.info/images/documents/5943/kenyaagoastrategyfinaljune2012.pdf

Republic of Kenya. (2015a) "Kenya's Industrial Transformation Programme." Ministry of Industrialization and Enterprise Development, July 2015. http://www.industrialization.go.ke/images/downloads/kenya-s-industrial-transformation-programme.pdf.

Republic of Kenya. (2015b). "Kenya Apparel and Textile Industry: Diagnosis, Strategy and Action Plan." Ministry of Industrialization and Enterprise Development, August 2015.

Republic of Kenya (2015c) Laws of Kenya, Special Economic Zones Act (No.16 of 2015. Nairobi, Government Printers http://kenyalaw.org/kl/fileadmin/pdfdownloads/Acts/SpecialEconomicZonesNo16of2015.pdf

Republic of Kenya. (2016). *National Trade Policy.* 21 November 2016.

The Guardian. (2016). "Aid reforms could see big increase in private sector subsidies." *The Guardian*, 10 October 2016. https://www.theguardian.com/global-development/2016/oct/10/aid-reforms-could-see-big-increase-in-private-sector-subsidies.

TMEA. (2016)."TMEA Keen to Boost Women Entrepreneurs in the Region" https://www.trademarkea.com/news/tmea-keen-to-boost-women-entrepreneurs-in-the-region/.

UNIDO. (2013). Emerging trends in global manufacturing industries. UN: Vienna https://www.unido.org/fileadmin/user_media/Services/PSD/Emerging_Trends_UNIDO_2013.PDF.

OECD. (2015). The next production revolution..

Were, M. and Kayizzi-Mugerwa, S. (2009). "Do Exporting Firms Pay Higher Wages Evidence from Kenya's Manufacturing Sector*"*. July 2009. https://www.researchgate.net/publication/227828823_Do_Exporting_Firms_Pay_Higher_Wages_Evidence_from_Kenya's_Manufacturing_Sector.

World Bank. (2017). *"Doing Business 2017: Kenya Economic Profile 2017"* https://openknowledge.worldbank.org/bitstream/handle/10986/25565/WP-DB17-PUBLIC-Kenya.pdf?sequence=1&isAllowed=y.

World Bank/WTO (2015b). *The Role of Trade in Ending Poverty*. World Trade Organization: Geneva. World Bank Group and World Trade Organisation (2015)

http://documents.worldbank.org/curated/en/2015/06/24708511/role-trade-ending-poverty.

World Bank (2016). "Cost to export (US$ per container)." World Bank dataset. http://data.worldbank.org/indicator/IC.EXP.COST.CD?order=wbapi_data_value_2014+wbapi_data_value+wbapi_data_value-last&sort=asc.

WTO (2014). *World Trade Report 2014: Trade and Development: Recent Trends and the Role of the WTO*. Geneva, Switzerland: WTO.

WTO (2017) *Composition, Definitions & Methodology*. Available at https://www.wto.org/english/res_e/statis_e/its2011_e/its11_metadata_e.pdf.

Appendix 2 Revised NES Process Timelines

DRAFT WOR 'NG SECTOR GROUPS MEETING PR'GRAMME

MONTH	NOVEMBER	DECEMBER	JANUARY'17			FEBRUARY'17				
WEEK	From 28th	From 1st	From 16th	From 23rd	From 30th	From 1st	From 6th	From13th	From 20th	From 27th
MONDAY	28/11/2016 Manufactured products Fisheries		16/1/2017 Services sector	23/1/2017 Manufactured products Fisheries	30/1/2017 Cross cutting issues Emerging sectors		6/2/2017 Livestock & Livestock products	13/2/2017 Handicrafts	20/2/2017 Manufactured products	27/2/2017 Handicrafts
TUESDAY	29/11/2016 Agriculture		17/1/2017 Cross cutting issues Emerging sectors	24/1/2017 county consultation	31/1/2017 county consultations		7/2/2017 Agriculture	14/2/2017 Services sector	21/2/2017 Fisheries	28/2/2017 Services sector
WEDNESDAY	30/11/2016 Handicrafts		18/1/2017 county consultations	25/1/2017 Agriculture		1/2/2017 Services sector	8/2/2017 Fisheries	15/2/2017 county consultations	22/2/2017 Agriculture	
THURSDAY		1/12/2016 Livestock & Livestock products	19/1/2017 Handicrafts	26/1/2017 Livestock & Livestock products		2/2/2017 Handicrafts	9/2/2017 Manufactured products	16/2/2017 Cross cutting issues Emerging sectors	23/2/2017 Livestock & Livestock products	
FRIDAY		2/12/2016 Cross cutting issues Emerging sectors	county consultations	27/1/2017 county consultations		county consultations	county consultations	county consultations	24/2/2017 county consultations	

Appendix 3 List of Individuals and Organisations Contacted

List of Individuals and Organisations Contacted		
Name	**Position**	**Organisation**
Mr. Joshua Mutunga	Senior Programme Manager (Kenya)	Trade Mark East Africa
Ms. Margaret Ngare	Administrator	New World Stainless Steel
Mr. Anil Patel	Manager	Nairobi Ironmongers Ltd
Dr. Chris Kiptoo	Permanent Secretary	State Directoreate of Trade
Mr. Eric Ronge	Deputy Director	State Directorate of Trade
Mr. Felix Okatch	Convenor	APSEA
Mr. Kelvin Nkai	Programme Officer	Export Promotion Council
Ms. Christine Mwaka	Finance Manager	Export Promotion Council
Mr. Peter Ochieng	Research Manager	Export Promotion Council
Mr. James Karanja	Manager	Evian Kenya Ltd
Ms. Carol Muumbi	Manager	HCA
Mr. Steve Maina	Manager	Specialised Fibre Glass Ltd
Mr. Freancis Wario	Manager	FPEAK
Mr. Peter Biwott	Research Manager	KAM
Mr. Patrick Tonui	Programme Manager	KEPSA
Mr. James Musau	Manager	KenIvest
Mr. Francis Kariuki	Director General	Competiton Authority of Kenya

Appendix 4 Terms of Reference – Phase 2: Export Strategy and BER

Terms of Reference – Phase 2: Export Strategy and BER

1. Overview

Export promotion initiatives in Kenya have concentrated on a few traditional exports, mainly coffee and tea. Unfortunately, the performance of these exports has not been impressive, and it is widely acknowledged that there is need to diversify export promotion efforts to bring on board non-traditional exports that have a huge potential for growth.

A reshuffling of government in early 2016 has resulted in the redesign of certain ministries within government. The Ministry of Industrialisation and Enterprise Development (MoIED) is now known as the Ministry of Industry, Investment and Trade (MIIT). This institutional change has led to a reinvigorated business environment and trade strategy effort. The Industrial Transformation Programme (ITP) is anchored within MIIT.

The priority sectors for development include agro products (coffee, tea, horticulture), leather, textiles and apparel. Value addition is a key pillar of the ITP, especially as far as tea and coffee are concerned. However, these goals will only be realised through a sustainable export-led strategy. The development of a revised NES will be a roadmap to this end and is an immediate priority for MIIT.

The ministry is keen on solidifying gains made over the last year and has identified the development of a comprehensive NES as a priority for the MIIT. A NES concept note has already produced and identifies key sectors in which Kenya continues to hold a competitive advantage and that could be further developed to help grow the country's export base.

The revision of the NES will provide an opportunity to consider the issue of exports holistically and review the BER that act as a constraint. There are a number of immediate BER issues identified by the Kenya Manufacturing Association that affect export competitiveness. These include (i) a review of the application import duties on input materials for manufacturing, (ii) the application of VAT exemption and refunds to horticultural exports and (iii) the implementation framework for the proposed SEZs.

It is recognised by government that this will require streamlining the institutional framework to avoid duplication of efforts and overlaps across existing agencies involved in export promotion at the national level and coordination with county governments.

2. Objectives

To provide advisory support to the revised NES to reflect BER constraints to exporting; and

To provide advisory support to the private sector dialogue process to prioritise BER reforms that constraint key export sectors.

3. Link with BER/Investment/Jobs/Poverty

The evidence being developed will inform further work and provide guidance to the GoK for implementing BER in support of its export strategy which will in turn impact upon the theory of change for BERF.

Evidence gathered will allow deeper assessment of the link between export-led industrial policy BERs, and how this affects job creation. Findings will help influence the design and implementation of BER programmes across the counties of Kenya, as well as in other DFID target countries.

A more competitive business environment will improve the investment outlook for Kenya in general, and promote higher and sustained levels of investment and growth, reducing poverty levels, including for marginalised communities and counties.

4. Client and Beneficiaries

The client is DFID Kenya with support provided directly to the GoK. Individual beneficiaries within GoK, including local government officials that are already requesting support, include (MIIT) and private sector representative bodies. Wider beneficiaries are private sector stakeholders and the urban and rural poor of Kenya, who will benefit from job creation in selected sectors, particularly industries targeted in the industrialisation strategy.

The work will explicitly consider gender issues in the approach to PPD and recommendations on interventions that flow from the technical assistance.

This assignment provides expert external assistance and does not replace the work of DFID civil servants.

5. Scope

Following discussions with MIIT principal secretary for trade, BERF can play an important role in the production of a revised NES which takes full account of the business environment.

The advisory support provided by BERF will assist the development of a comprehensive Kenya NES document by providing advice to articulate BER issues around the NES and particularly the key clusters/sectors and issues that may constrain export development at the county level. This will include a focused private sector dialogue programme.

This will build on work undertaken on key value chains identified in the strategy both in terms promoting local value add in traditional sectors and other sectors such as leather and textiles. These assessments have considered the impact of regulations, taxation and infrastructure on development.

6. Method

The consultant will be working directly with MIIT counterparts and will be embedded within the international trade section of MIIT. The consultant will report to the PS international trade, Dr

Chris Kiptoo. The consultant will also engage with the DFID lead for international trade, Dennis Kwena.

The following tasks will be carried out:

- Discuss the scope of work and method with PS international trade within MIIT and DFID lead for international trade.
- Work with the MIIT team engaged in the developing the revised NES.
- Undertake PPD with key stakeholders to examine BER constraints to export-led priority sectors, identifying key weaknesses in current strategy and legislative frameworks (taking into account political economy and government co-ordination issues).
- Hold BE strategy and action planning workshop(s) with MIIT to agree on the priority areas for business reform affecting key export sectors.
- Initiate a public and private sector consultation process on BE priority areas for reform.
- Deliver a report presentation to MIIT and other reform champions.

7. Deliverables

The output for this project will be a report on the BER constraints to implementing the revised NES by early October to be integrated into the revised NES. The report should include a reform action plan around selected county-sector issues and the opportunity for replication by other counties. The PS international trade has indicated that the NES document should be prepared by MIIT.

8. Timeframe

The assignment will take place between July and October 2016, totalling 30 days in country (over 12 weeks). The work will need to dovetail with the preparation of the NES and the work of other teams examining sector opportunities and constraints. MIIT will be meeting on the 29 July 2016 to discuss how the steering committee will operate and the support required.

The final report will be produced by early October 2016.

9. Dissemination

The main deliverables will be disseminated and/or published, including local dissemination amongst the donor community and publication on the BERF website. The dissemination of these deliverables will be agreed with DFID Kenya, who will further share the documentation with the GoK. Work will take place directly with industry counterparts.

Contact us

Kru Desai

Government and Infrastructure

T +44 (0) 20 73115705

E kru.desai@kpmg.co.uk

Peter Wilson

BERF Team Leader

T +44 (0)7850329362

E peter.wilson@kpmg.co.uk

Kongkona Sarma

Technical Adviser

T +44 (0)1442202400

E kongkona.sarma@dai.com

Department for International Development