

# Eastern Africa Economic Review

**New Series**

**EDITOR**

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# Eastern Africa Economic Review

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## Kenya's Industrial Exports: Market Conditions and Domestic Policies

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### Introduction

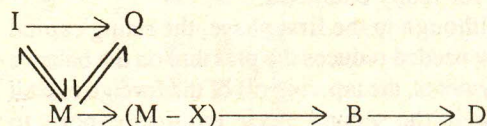
It is probably true that exporting is not an aim in itself but a means of promoting development. When we consider a particular developing economy, it is only natural to expect adequate resources (both from domestic and foreign sources) for a reasonable rate of growth. Of late, there is no dearth of literature to dwell on the sad state of affairs of several developing countries' poor economic performance. Among other problems, some of these countries find it difficult to pay for the import bill arising from essential imports for the industrial development. Creditworthiness is a much desired goal for them but the poor performance in the agricultural and industrial sectors is holding back their capability to finance the imports through export earnings in the absence of other sources of foreign exchange.

To put this dilemma in its proper perspective, I would like to examine the export promotion policies in terms of the simplified two-gap model. Once it is proved that exporting enhances industrial development, which is considered as engine for growth, data on industrial exports

from Kenya will be analysed in the light of internal and external factors that affect export performance in the country. The paper will be concluded by looking at the impact of Sessional Paper No. 1 (1986) as a springboard to accelerate economic development by the year 2000.

### The Two-Gap Analysis

Assuming that external debt accumulation is a function of the import-export gap in current prices, the following model seems to be valid for many developing countries (UNIDO, 1984).



where  $I$  = Total gross fixed investment  
 $Q$  = GDP  
 $M$  = Total Imports  
 $X$  = Total Exports  
 $B$  = Gross Loans  
 $D$  = Debt Accumulated

Two-Gap consists of two parts: (1) The savings

\*Paper presented at the Kenyan Economic Association's workshop on "Kenya's Industrial and Agricultural Strategies Towards the Year 2000", Nairobi, 21 - 25th September, 1987. The views expressed in this paper are those of the author and should not be interpreted to be representing the views of the Kenya Economic Association.

gap or investment - savings (I-S) and (2) the trade gap or the difference between imports and exports (M-X). When planned investment is greater than planned savings,  $I'-S'$ , the saving gap exists and when planned imports are greater than planned exports  $M'-X'$ , a trade gap exists. The rate of investment in any economy is ordinarily determined by its willingness and ability to mobilise savings. An increase in investment is constrained by saving, if at the margin transformation possibilities still exist, but cannot be utilised because domestic consumption has reached its minimum tolerable level. An increase in investment is constrained solely by foreign exchange if, at the margin more saving can be extracted but the possibilities of transforming consumption into investment domestically and through trade have fallen to zero (Meir, 1976). Increment in external capital finances the difference between the investment and increment in saving. Once investment reaches a level adequate to sustain the target rate of growth, marginal saving rate must exceed investment rate for the rate of foreign capital inflow to decline.

The process of growth with a varying inflow of capital requires a continual adjustment in imports and exports to make the trade gap equal the desired gap between investment and saving. The assumption that this adjustment process, whether achieved through the market mechanism or through governmental controls, does not affect the growth path or the aid requirements, is not valid for many countries.

Although in the first phase, the rising capital inflow needed reduces the pressure on the balance of payments, the tapering off of the foreign capital inflow in the second phase requires exports to rise more rapidly than imports. The basic model suggests that when exports grow faster than national income, the trade gap will be smaller with given parameters even when foreign resources form only a small fraction of exports.

Many developing countries find it difficult to bring about this required adjustment in their productive structure. In fact, actual imports (essential intermediate goods and investment goods) may exceed the minimum import level required to sustain a given level of GNP at time  $t$ . The existing economic structure at any given time also limits the feasible growth of export

earnings. A rapid increase in exports requires the development of new export products, which is limited by productive capacity as well as organisational and institutional factors. The combined trade-limit requires that the capital inflow be at least large enough to cover the minimum gap between import requirements and export earnings.

To reduce the capital inflow in the second phase, either export growth must exceed the target rate for GNP or the marginal import ratio must be substantially less than the initial average. Dominant trade limit will actually occur with some frequency as a result of either ineffective national policies or unanticipated changes in external markets (Chenery, 1971).

### Kenya

"In aggregate terms, Kenya's savings performance in the first decade has been excellent. Gross domestic savings as a proportion of GDP has been around 19-20% in most years since 1964...., this is a level of achievement few countries have matched" (World Bank, 1975). The overall savings and investment performance in Kenya has been fairly satisfactory ever since, which is responsible for the successful economic performance. Compared to the first decade since Independence, economic performance in the second decade was not as colourful, because of domestic and international economic difficulties. The beginning years of the third decade present a mixed result. The performance of the economy has improved substantially since the beginning of the 1980's, due to the Kenya government's sustained efforts to reduce domestic and external imbalances notes on IMF Study (KEN, 1987).

Savings as a percent of Investment (Gross Fixed Capital Formation) for selected years (Killick, 1981) is as shown in Table 1. 145, 86, 89, 104 and 57 for the years 1964, 1968, 1972, 1974 and 1978 respectively. Table 1 shows the GDP and financing of Fixed Capital formation in Kenya for selected years. Investment ratio (as a percent of GDP) is increasing over the years leading to the expansion of the economy. Correspondingly, Kenya's Gross domestic Savings as a proportion of GDP is also high, which is illustrated by line 7 of Table 1. Such a

Table 1. GDP and Financing of Fixed Capital Formation Selected Years K£ Million

	1975	1976	1979	1980	1981	1982	1983	1984	1985
1. GDP at factor cost	727.55	764.49	1,544.74	1,590.66	1,678.54	1,733.09	3,011.94	3,063.37	3,189.83
2. Gross fixed capital formation	242.5	298.0	540.45	622.53	725.41	688.33	720.89	765.40	848.46
3. Net borrowing from rest of the world	74.4	34.9	189.00	328.70	326.20	253.40	88.89	146.55	179.79
4. Capital transfers from the rest of the world	6.2	7.1	10.70	21.90	20.70	25.50	59.80	78.53	84.58
5. Inflow of external capital (3+4)	80.6	42	199.70	350.60	346.60	278.90	148.69	225.08	264.37
6. Domestic saving (including consumption of fixed capital)	148.2	234.9	316.55	438.59	511.91	485.81	661.66	690.81	618.20
7. Domestic saving as % of investment (2)	61.0%	78.8%	58.6%	70.5%	70.6%	72.6%	90.16%	90.3%	73.0%
8. External capital (5) as % of investment (2)	33.24%	14.1%	56.3%	47.8%	41.73%	20.6%	29.4%	29.4%	31.1%

Source: Economic Surveys (Various Issues).

high saving ratio is an indication of the fact that the economy is on a good footing and the injection of foreign capital is needed only to fill the small investment saving gap. Given the industrial structure of the economy (especially the expanding manufacturing sector relative to the same in Uganda and Tanzania) there is ample scope for further investment in this sector so as to exploit the export market. At certain stages domestic capital is not a perfect substitute for foreign exchange that will finance the critical inputs for expansion of the industrial sector, and in the investment process, it is always desirable to aspire for a trade surplus. It is true that the rate of growth of export should exceed the rate of growth of GDP for the declining flow of foreign capital to taper off, given the problems attached to foreign capital inflow in the light of the mounting international debt.

Table 2 provides data on the Balance of Trade (import-export gap). There is a steady widening

Table 2. Balance of Trade (K Million)

Year	Exports	Imports	Balance of Trade
1964	79.43	87.9	-8.5
1965	81.46	100.7	-19.2
1966	91.20	123.3	-32.3
1967	85.76	120.0	-34.2
1968	89.26	127.1	-37.8
1969	97.30	128.7	-31.4
1970	108.9	158.0	-49.1
1971	112.2	200.0	-87.8
1972	132.7	197.9	-65.2
1973	180.7	228.6	-48.0
1974	235.7	383.9	-148.2
1975	238.0	362.6	-124.6
1976	345.1	407.0	-61.8
1977	501.8	531.4	-29.6
1978	395.7	661.1	-265.4
1979	412.8	620.2	-207.4
1980	515.7	959.0	-443.3
1981	537.23	932.41	-395.18
1982	568.64	900.30	-331.66
1983	652.18	905.62	-253.44
1984	776.91	1,097.21	-320.30
1985	802.34	1,201.13	-398.78
1986*	986.85	1,337.98	-351.98

Source: Economic Survey (various issues)

\* Provisional

of the gap during the period between 1964 and 1985. Hence it is not only to balance the trade but also to earn surplus foreign exchange that the country is earnestly trying to expand production for export. Killick (1981) argues that the country needs to achieve a more dynamic export performance than occurred in the 1970's. Killick also queries that when other countries have achieved success in the face of many difficulties in breaking into world markets for industrial goods, is there any reason why Kenya should not be the first African country to do that?

While the share of imports in GDP had grown from 26.8% in 1964 to 40% in 1984, the contribution of exports had only grown from 19% to 25% during the same period (Ndegwa, 1987). Kenya is dependent on the export income of three commodities: tea, coffee and sisal. These account for over 50% of non-oil exports. In order to escape from the detrimental effects due to dependence on exports of primary commodities, Kenya has attempted a substantial shift from primary exports to industrial exports. Industry includes manufacturing, mining and construction, for the purpose of industrial exports. Since the prices of primary products deteriorate in relative terms during the long-run, it is responsible for the reduction of export earnings of countries dependent on primary exports (Prebisch, 1959).

Table 3 provides us with the percentage share of goods exported according to their economic category. The fact that the primary exports on an average account for over 50% of total exports, excluding re-exports, means that the other part is also about 50% and we also assume that this constitutes industrial exports. An examination of Tables 4 and 5 confirms a very interesting finding (Glezakos, 1973) that the instability indices for both the volume and the unit value of exports for the average less developed country (LDC) are more than twice the size of the respective indices for an average developed country (DC). On the average, export volume instability is higher than price instability for both countries. Export volume instability for manufactured goods is more prominent. Several explanations follow this type of behaviour. A change, in this particular case, a fall in the volume exported, is as a result of the combined effects

Table 3. Total Exports\* — by broad economic category for selected years — Percentage shares

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
1. Food and Beverages	49.1	43.0	36.3	35.8	47.6	65.6	58.8	54.8	43.6	45.6	51.0	56.7	61.9	63.5
2. Industrial Supplies (Non-Food)	25.8	32.5	33.0	28.3	23.4	13.5	17.8	20.5	18.5	18.1	17.4	17.4	15.0	17.7
3. Fuel and Lubricants	15.2	12.4	20.1	25.6	20.8	17.3	18.6	20.0	33.2	31.9	27.4	21.2	18.8	14.0
4. Machinery and other Capital Equipment	1.5	1.9	2.4	2.3	2.0	0.3	0.4	0.4	0.5	0.4	0.3	0.4	0.3	0.3
5. Transport Equipment	1.5	2.3	1.8	1.8	1.1	0.2	0.3	0.2	0.3	0.4	0.3	0.2	0.1	0.2
6. Consumer goods not elsewhere specified	6.8	7.8	6.3	6.1	5.0	3.0	4.0	4.0	3.8	3.6	3.6	4.1	3.8	4.3
7. Goods not elsewhere specified	0.1	1.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	—	—	—	0.1	—
8. Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

\* Excluding Re-exports

Source: Economic Survey, 1977, 1981 and 1986.

Table 4. Exports

Price Indices	1973	1974	1975	1976 <sup>a</sup>	1977	1978	1979	1980 <sup>b</sup>	1981	1982	1983	1984	1985 <sup>c</sup>
1. Food and Live Animals	110	131	137	224	167	123	117	124	95	100	126	167	155
2. Beverages and Tobacco	98	90	116	145	96	114	108	107	98	100	108	132	146
3. Crude Materials (Inedible)	141	184	160	180	112	122	127	177	96	100	107	107	117
4. Mineral Fuels	108	230	321	387	112	113	145	223	81	100	107	112	114
5. Animal and Vegetable Oils and Fats	114	174	227	262	104	127	135	149	80	100	115	127	142
6. Chemicals	115	126	160	205	105	96	134	139	76	100	120	125	134
7. Manufactured Goods	118	134	183	219	128	140	149	147	91	100	123	128	154
8. Machinery and Transport Equipment	114	131	166	211	120	127	144	144	87	100	179	223	208
9. Miscellaneous Manufactured Articles	129	149	148	209	124	125	130	155	76	100	125	170	169
All Exports	115	152	175	238	142	120	128	154	91	100	120	144	142
Non-Oil Exports	116	138	150	214	150	123	124	135	93	100	124	154	151

Source: Economic Survey (various issues)

Notes: <sup>a</sup>1972 = 100 <sup>b</sup>1976 = 100; <sup>c</sup>1982 = 100

Table 5. Exports

Quantum Indices	1973	1974	1975	1976 <sup>a</sup>	1977	1978	1979	1980 <sup>b</sup>	1981	1982	1983	1984	1985 <sup>c</sup>
1. Food and live animals	117	102	99	116	116	112	115	105	89	100	105	102	114
2. Beverages and Tobacco	126	93	62	66	155	120	129	319	81	100	155	105	231
3. Crude Materials (inedible)	112	133	120	122	85	81	93	90	116	100	101	110	116
4. Mineral Fuels	103	102	94	92	107	89	80	102	140	100	100	85	69
5. Animal and Vegetable Oils and Fats	165	152	133	192	25	13	18	16	211	100	156	460	201
6. Chemicals	123	130	91	87	85	89	75	66	125	100	92	94	106
7. Manufactured goods	121	105	103	102	74	68	66	82	89	100	83	78	77
8. Machinery and Transport Equipment	170	176	143	147	53	46	41	68	102	100	51	38	44
9. Miscellaneous	120	106	90	69	78	77	81	107	108	100	76	82	104
Manufactured Articles	117	111	101	107	104	96	94	97	103	100	96	95	99
All Exports	120	114	104	112	102	96	97	95	94	100	100	98	108
Non-Oil Exports													

Source: Economic Survey (various issues)  
 a 1972 = 100; b 1976 = 100; c 1982 = 100.

of variations in local consumption or a fall in demand for the same by importing countries. On the one hand, as the per capita purchasing power increases, demand for manufactured goods

shoots up. To cope with the situation, wither there should be excess productive capacity to be tapped immediately or to cut short export supply. On the other hand demand for our exports in the importing countries is falling as a result of economic and non-economic factors. These factors include a low purchasing power by the importer, better terms available, a deterioration in the relationship between two parties and a policy of import restriction to save the foreign exchange. In 1977 can we assume that the fall in volume is as a result of the collapse of the EAC?

Kenya's industries have been mainly concerned with satisfying domestic needs, but the export component has also been substantial (Ikiara, 1981). For example, between 1965 and 1975 exports of processed goods constituted between 40 and 50% of total exports. In earlier years, Tanzania and Uganda constituted the most important markets for our manufactured goods. The manufacturing sector expanded more rapidly in Kenya than in the other two countries. Most Kenyans are proud of the fact that since Independence, manufacturing has been one of the most dynamic sectors of the economy, growing at the average rate of almost twice that of the GDP (Wescott, 1981). Less than a fifth of the value of Kenya's manufacturing output is exported to the rest of the world and the majority of her industries depend heavily on the domestic market for their sales (House, 1981). Emphasis on export promotion will help reduce dependence on primary exports. Export substitution, the promotion of diversified manufactured exports through progressive trade regimes is both a logical extension of and a strategic opposite of import substitution (Roemer, 1981). It is an extension of import substitution in the sense that, if domestic firms can learn to manufacture efficiently for the home market, they can eventually compete in the world market. Examples abound from the experience of Germany, Japan and South Korea. The key to transition is efficiency, which means that import substitution must be carried out with low and decreasing protection, including realistic market-orientated exchange rates forcing producers to face competition from imports at close to world prices.

Exports may also have to be favoured with subsidies in various forms, the counterpart of



protection, in order to overcome the initial inefficiencies and induce manufacturers to look outward to earn more foreign exchange. The usual practice of protecting the industries under Import Substituting Industrialization (ISI) behind big tariff walls and overvalued exchange rates is to discourage the manufactured export promotions. Export substitution in its purest outward looking form has been confined especially to Asia. Emphasis on ISI alone is a rather negative approach to development; many investment projects, especially in a small economy, cannot be very profitable without being too large for the market.

If Kenya were able to export her manufactured goods on a large enough scale, the natural barriers to the entry of new firms would be overcome and there would be no reason to prevent a greater number of firms operating efficiently and enjoying the economies of scale (House, 1981). ISI involves setting up industries mainly for production of consumer items that were formerly imported.

Growth in the manufacturing sector has been primarily based on import substitution in Kenya. The ISI process was at one time characterised by industrialization by tightly separated stages (Hirschman, 1968). It was seen as a sequential process whereby countries would begin to move to intermediate goods and finally to capital goods production. In Kenya the capacity of the manufacturing sector is continually being expanded and the high level of investment in the sector over the years should pave the way for export diversification. Against this expectation, by the 1970's and the early 1980's the sector was adversely affected by a range of problems including poor demand, inadequate supplies of raw materials, and a decline in the inflow of both public and private long term capital. Underutilization of capacity due to lack of essential materials led to a number of firms closing, and gross investment in the sector declined by over 30% (KES, 1983). Despite an improved foreign exchange availability and reduction in import duties on certain essential raw materials, by 1983 levels of capacity utilization remained generally low. Perhaps the monopoly status of the industries behind the protective barriers urged them to keep the excess capacity as a normal behaviour of the firm and only the onlookers

wonder at what is happening to the cost output relation with the subsequent under-utilization of productive resources.

In Kenya, with the trade liberalization, manufacturing firms are in a better position to import critical inputs for the successful functioning of the productive units. Along with competition from imported goods, the same firms should be able to improve the quality of their products and scale of operations to reap the economies of large-scale production. This seems rather a contradictory situation where the domestic firms are either facing a small market as a constraint to reap economies of large-scale production or struggling to improve the quality due to high cost of production. The option is exporting more of their products to the international market, but their attempts are being frustrated by the spreading wildfire of protection in any guise in most of the markets. It may be necessary to allow these producers to become efficient through a combination of various measures, e.g. a break on import of similar products to protect them from crippling competition, provision of incentives to overcome some inhibitions to improve quality, etc. This means that for some time to come, more production has to take place under the ISI banner. It is a feasible alternative in the short-run taking into account the time and efforts required to overcome the hurdles to penetrate into the international market for exports from developing countries. The time period required for such a policy orientation depends on the unilateral actions to be taken by developed countries to improve their access to these markets. In the immediate future, domestic producers will be able to improve their quality and scale of operations concentrating on the production of consumer goods and intermediate goods and hence the production of capital goods.

However the future prospects for the manufacturing sector are bright given the continued foreign exchange availability and trade liberalization policies. This is quite in line with the aspiration that African economies will be engaged more than ever before in the production of intermediate imports and capital goods, making use of national or regional local resources (Wangwe, 1983).

### **Essential Incentives for Promotion of Kenya's Industrial Exports**

Manufactured products have not featured significantly in Kenya's exports except to neighbouring countries (Ikiara, 1987). Less than a fifth of the value of manufacturing output is exported outside the country.

During the period 1981 - 2000, a target growth rate of 7.5% per annum for the industrial sector is established (Sessional Paper No. 1, 1986). Expansion and diversification of the export base are essential to achieve the above target. The World Bank report on Kenya (1987) suggests that to meet the export and growth objectives, and to support the required overall growth of the GDP to achieve even small increases in per capita income, the industrial sector has to change its orientation outwards and seek new export markets. The report considers three main sets of policies. First, to establish an attractive package of incentives that balances economic efficiency of the sector with profitability for private firms and is competitive with other countries' incentives to attract foreign investment. Second, to convince the private sector that this package will be implemented effectively and maintained for the foreseeable future. Third, to reduce the government involvement in industry through divestiture and increase African-Kenyan participation in the private sector in a manner that is not threatening to Asian-Kenyans or multinational companies.

The strong anti-export bias created by ISI has saturated the possibilities for further efficient import substitution. Also it is noted that 64% of industrial growth during the 1976-1983 period was due to a displacement of imports, a welcome sign of growth in domestic demand. When the domestic demand expands, competitive production will help produce output more efficiently and make industrial goods equally competitive in the international market. Becoming efficient through world competition will be very costly for a small economy before it learns to be efficient at home first. Sessional Paper No. 1 aims to revive the liberalization process by moving towards a more open economy and allowing a stronger influence for market forces to make the sector more efficient and elicit investment in export industries.

The balance of incentives will have to change to increase the profitability of exports while reducing protection to inefficient ISI industries. There is need to create new capacity to cater for export markets because the industrial sector is already using about 80% of its attainable capacity now.

Those subsectors which are efficient (food, beverage, and tobacco) will be able to compete in the world market with policy support to overcome transport costs, quality, and packaging. At the same time, scale considerations are the stumbling blocks to keep some capital goods industries from efficiency. The solution is to arrange for a sufficiently big market in Africa itself as there is little chance for other countries to order capital goods from Africa. Despite the industrial promotion efforts by the state, the size of the industrial sector remains small in comparison to the agricultural sector (Wescott, 1981).

East African states need to develop a greater awareness of international competitive pressures so that those groups subject to the most intense competition are identified and potential investment encouraged to seek alternative products unless very significant comparative advantages can be identified. East Asian countries which have been most successful in exports have had market-led export manufacturing. Kenya could use the resources of the ACP-EEC convention to investigate exports markets and develop relevant product lines (KEN, 1987) as well as benefit from the Nairobi-based Eastern and Southern Africa Trade Promotional Training Centre (ESATT) which offers research and training programmes to exporters. The prospects for inter-African trade seem to be brighter in the light of the Lagos Plan of Action and Africa's Priority Programme for Economic Recovery (APPER). The theme of the fifth All Africa Trade Fair to be held in Kinshasa (Zaire) is going to be "Promotion of African Trade: A Factor for Integration of African Economies".

There are difficulties in increasing exports to the EEC under special arrangement of the Lome Convention (KEN, 1987): infrastructural (e.g. shortage of air freight capacity, inadequate distribution and transport means and systems, inadequate and erratic power supplies etc);

limitations of rules of origin under the Lome Convention (e.g. the proportion of raw material or value added required from the source ACP country); poor industrial training; poor product quality (e.g. leather). Marketing problems exist, for example, when ACP exporters cannot attend trade fairs which are essential to contact buyers and keep abreast of market trends due to lack of funds. Exporters are also hampered by the lack of marketing information, inability to carry out market research, and shortages of foreign exchange to buy spare parts and essential inputs.

Improved manufacturing output in 1986 is presumably largely due to a stronger demand for manufactures resulting from increased consumer spending due to better agricultural output and falling inflation. This should pave the way for a rise in exports of the same in the near future assuming the situation remains more or less the same. The higher growth rate in 1986 compared to previous years is attributed to a number of factors like trade liberalisation policies supported by higher coffee and lower oil prices (KEN, 1987). In addition, availability of foreign currency to import inputs and spares, tariff reductions on inputs and faster export compensation payments helped in the acceleration of manufacturing output and exports.

In 1986, the highest price increases in exports were for food and live animals, vegetable oils and fats, chemicals, machinery and transport equipment. Kenyan exporters have a chance to boost the output of these products, with an eye on the quality, to capture more market share in world trade.

The prospects for manufactured exports are good when the export promotion policy concentrates on selective products to selected group of countries. Research efforts should concentrate on identifying the marketability of Kenyan manufactured goods according to price advantage and penetration possibility into new market and/or additional sales to established markets. It should be possible to have selective incentives administered to industries according to their catering capability, overcoming the hurdles in international market for exports. Under such an incentive system, classification could be according to type of commodity which will easily apply to country, group of countries and regions. Export compensation for exports to countries in

the PTA region is such a measure. Manufacturing under bond will enable Kenyan manufacturers to gain a competitive advantage in international markets by producing under conditions where inputs are duty free. Similarly protective tariffs imposed on imports which are manufactured locally will also provide a stimulus on the local production of manufactured goods. As the traditional export mix itself increasingly appears to be incapable of providing sustained growth, there is a need for a new and more diversified range of products. Measures for export promotion, especially the Kenya Export Year (1984), are introduced to achieve the export promotion with diversification. If the trend over the last 10 years continues, which seems likely in the absence of concerted effort to diversify the country's export mix, the ensuing result is an economy with a growing import demand that finds it harder to finance its import appetite from export revenues.

#### Destiny of Industrial Goods for Exports

Sales to world markets are not likely to become the engine of industrial growth in many African countries in the near future (World Bank, 1981). And there is no optimism about the prospects for rapid growth of manufactured exports from Africa in the near future, given the acute scarcity of skilled labour and experienced entrepreneurs, and the reluctance of many governments to assign a prominent role to the TNCs. The skill and entrepreneurship constraints will ease over time as experience is gained and as the stock of high level manpower is augmented through education and training. These developments will set the stage for the rapid growth of African manufactured exports. Exports of industrial goods depend on foreign real GNP and the average of consumer price indices of Kenya's principal trading partners (Elliot *et al*, 1986).

When the domestic market is dominated by a monopolist, opening it to competition from imports is more beneficial to the nation than when the domestic industry is competitively organized. The same is true when export opportunities are opened for the domestic industry. The possibility for exporting to PTA countries depends on the composition of goods and the ownership pattern of the producing company. Kenya's manufacturers product goods ranging

from consumer products to machinery, many of them for export, but manufacturers have a long way to go before they earn more revenue than coffee, tea and tourism (New African, 1986). There are many hurdles to overcome in trade with PTA countries. First of all, as Kenya has normally got a trade surplus with these countries, the ability of importers to pay promptly is a crucial determinant. Importers would also have to be convinced that if they forgo the foreign exchange, they will get quality goods in return at competitive price. Another factor is the alternative cost involved in diverting their own precious goods/commodities away from buyers who would be able to pay hard currency. Since it is assumed that the multinational sector contributes more than 70% of value added in Kenya's manufacturing sector, very little of the country's manufacturing capacity is eligible for preferential market access in PTA.

Competitive conditions would be improved both by reducing the effective capital subsidy now granted to large-scale manufacturers and by making the provision of commercial credit to small-scale borrowers more attractive to lenders. The likely outcome of these policy shifts would be that small-scale and informal enterprises would become the most dynamic part of the manufacturing sector (Wescott, 1981).

Some producers are not keen to export because the domestic market is very lucrative. Overcoming the restriction on exports in importing countries is a hard task for these firms which enjoy a comfortable margin of profit behind the protective measures in the domestic market. Whereas concerns on quality and price are less of a bother within the country to realise a substantial profit, export market penalises them for the very same factors. Hence there is a well founded complaint from some manufacturers that the incentive schemes which have been introduced in Kenya are not significant enough to tempt them to undertake the necessary risks and measures to venture into export markets. World Development Report (1987) illustrates the experience of successful export policies followed by certain developing countries. Ability to trade is very important for the successful performance of the industrial sector as are reforms of trade and macroeconomic policies along with improvements on the supply response of the economy. A shift

from an inward-orientated industrial strategy to an outward-orientated one involves transitional costs. Trade liberalisation follows major shifts in resources; likewise, export performance is closely related to the level and stability of the exchange rate. Because overvalued exchange rates hurt exchange profitability and discourage investment in export industries, reforming the exchange rate and trade regimes may improve the efficiency of investment and production.

Industrial countries will act in a negative and defensive way toward increased imports of manufactures from developing countries, which would mean raising trade barriers of the more discriminatory type, i.e., non-tariff barriers (NTBs) which include Quantitative Import Restriction (QIR), Voluntary Export Restraints (VERs), measures for the Enforcement of Decreed Prices, Tariff Type measures and Monitoring measures. This would further undermine the integrity of the GATT system and would restrict the growth of a developing country's exports. From 1981-1983, NTBs became significantly more extensive. In the manufacturing sector, developing countries faced more barriers than did industrialized nations to their large volume of exports, such as in textiles and footwear, and fewer to their small-volume ones, such as electrical machinery and values (Julio, 1986). At least 27% of the 16 major industrial economies' imports would have been covered by one or more of the selected NTBs as they applied in 1983. Since this increase does not reflect the tightening or reinforcement of existing measures, the growth of NTBs and their effect on international trade should be taken very seriously. Developing countries with limited foreign exchange and facing low commodity prices may soon face even higher barriers against manufactures that have traditionally been their first industrial exports. The World Bank Report (1987) warns, should that happen, there could be widespread disillusion with the outward-orientated trade strategies.

A drift toward protectionism has obliged those most seriously affected by foreign restrictions to diversify the commodity and country composition of their exports and has distorted the pattern of trade among developing countries. In the absence of trade restrictions, exports within developing countries in the restricted sectors would have expanded faster (Anjaria *et al*, 1985).

Most industrial exports from Africa were physical capital intensive largely because the export-orientated industrialisation (EOI) strategy was based on the exploitation of natural resources. Partly because of the presence of a large share of natural intensive industrial exports, Mbogoro (1986) has found a very weak relationship between the level of economic development and the structure of industrial exports from Africa in both 1975 and 1980 and he suggests that African countries should make greater efforts to establish efficient ISI industries which use mostly local raw materials. They should also pay greater attention to the establishing export-orientated industries based on the exploitation of labour.

This suggestion should be very appealing to Kenya as well because an analysis of the exports from successful export-orientated countries reveal that their success was mainly due to concentration on labour-intensive industries. One may need population pressure for innovation in this sector.

Value of exports of manufactures from developed market economy countries to developing countries grew at an average annual rate of growth of 21.4% between 1970 and 1980 but fell at an annual rate of decrease of 3.9% during 1980-1984. The ripples reached all developing countries, thus exports to developing Africa also declined. The slower rate of economic growth in the developed countries acts as a constraint on the expected benefits of trade liberalisation in the developing countries.

Can the East Asia Model of Development be replicated by Kenya? It may work well if pursued by few countries, but may break down if a large number of developing countries seek to pursue it at the same time (UNCTAD, 1986) because the resulting volume of manufactured exports might be more than the markets of the industrial countries could absorb. This suggests that it is necessary to consider the aggregated market implications of export-orientated growth as a development strategy that can be uniquely and universally followed by the developing countries. Korea's success story is based on an export promotion strategy that combines trade liberalisation with considerable intervention. Incentives were more neutral between import substitution and exports in Korea than in most other developing countries. Korea's liberalisation of imports has been slow, with stability of the

real exchange rate (RER), an index of relative domestic and world prices expressed in terms of a common currency. This enabled them to maintain export competitiveness in spite of persistent inflation. Korea's trade liberalisation remains limited in several respects and selective import controls are still significant. Controls on the domestic financial market remain with little liberalisation of the capital account. These are some of the possible lessons from Korean experience for Kenya in her efforts toward export promotion.

Since the industrialisation for export to be developed country markets is difficult, perhaps it is feasible to adopt an alternative solution, namely trade between developing countries, but this is also not free from problems. The share of total developing country manufactured exports going to other developing countries grew from the early 1960's to 1981, but fell slightly thereafter (World Bank, 1987). While the volume of world trade in manufactures has been increasing, developing countries still trade more heavily in commodities and raw materials. This confirms the belief that the structure of the exporting sector cannot be easily manipulated so as to diversify the export. It is costly and investment for new capabilities to evolve efficiently producing units in the diversified sectors for export is time consuming. The Global System of Trade Preferences (GSTP) is conducive for promoting intra-developing country trade to reap the benefits, such as increased efficiency from economies of scale, more rapid industrialisation through efficient use of resources and stimulation of services connected with trade, including shipping, finance and communication. Yet there is no conflict in exporting to both industrial and developing countries which would be preferable because it would enable them to find markets for both high and low-skill products, attain frontier technology from the industrial countries and discourage those infant industries which would never grow up to be internationally competitive (W.B., 1987).

Kenya ranks 32nd in the 1973 Indicators of Industrial performance of developing countries based on the share of manufactured exports from developing countries (*Ibid*, p. 49). On a 1985 ranking based on growth in manufacturing value added, Kenya's position is 35, and growth in

manufactured exports is between 0-5%. In the classification of developing countries by trade orientation for 1963-1973 and 1975-1985, Kenya is placed among the countries that are moderately inward-orientated.

A shift from an inward orientation to an outward-orientation can be accomplished by removing existing trade barriers, devaluing the exchange rate and relying on the price mechanism to allocate productive resources. Successful newly industrialised countries (NICs) have used export incentives to offset bias against exports without dismantling all their import barriers or devaluing their currencies.

The inflationary component of labour cost due to devaluation will negate the possibility of efficient production for export to compete in the international market. Moreover local industries have to grow and mature to enjoy economies of scale. Export subsidization as an alternative to outward orientation in trade has its own limitations. Where the over-valuation of exchange rate caused by high import protection is large, the export subsidies required to offset the anti-export bias are too great. Not only that, subsidies in developing countries have become subject to countervailing duties in some industrial countries.

National economic management is faced with the difficult task of attaining in a dynamic setting the optimal level and structure of resources which should flow towards both the domestic and foreign markets. After the initial stages of industrial development, the emphasis in policy towards agriculture should shift from surplus extraction to surplus creation and to the generation of demand linkages for the rest of the economy. The agricultural demand led industrialization strategy may be better than simple export promotion *per se*.

A sustained willingness of donors to provide adequate and appropriate external assistance, i.e. privileged access to external credit and market as in the case of some of the South Asian industrialising countries, is imperative for the successful performance of the export industries. Overcoming the export disincentives when the industrial production expands brings no guarantee for transforming export supply capability into export supply performance when protective

measures cloud the international trade. It seems that the openness of the international market is, to a large extent, a function of the exporting countries' terms negotiated with transnational enterprises. Outside that framework, the supposed export supply capability seems much less readily convertible into export performance. Not only that, in the light of the present problem of international debt, hampered international trade is the worst consequence of the unresolved debt crisis. Improved market access could improve export performance of Kenya.

### Conclusion

A rapid increase in exports seems to be a panacea for bridging the trade gap of developing countries like Kenya. It is possible for Kenya to become as successful an exporter of industrial goods as South East Asian newly industrialised countries. The temptation to exploit the domestic market alone by some of the manufacturers is not very conducive to export promotion. This signals the necessity for an attractive package of incentives that will have to change to increase the profitability of exports while reducing protection to inefficient import substituting industries. There is a need for a keen export promotion drive encompassing additional capacity creation, greater awareness of international competitive pressures, regional cooperation, better terms negotiated with multinational corporation for exploitation of new market possibilities, easy access to investment capital, etc.

The prospects for manufactured exports are good when the export promotion policy concentrates on selective products to a selected group of countries. Export-orientated industries based on the exploitation of labour will act as a catalyst to further innovation in design and capability. A related worry should be how to devise a means to overcome the protectionist barriers in developed countries against manufactured exports from developing countries. Inter-developing country trade, especially trade with countries in the Preferential Trade Area and with neighbours, are sure ways of exporting Kenya's manufactured goods in addition to the international market.

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