The Evolution of Kenya's Trade Policy

Nyaga Nathan Gitonga

Department of Economics, Tilak Maharashtra Vidyapeeth, 1242, Sadashiv Peth, Pune 411030, Maharashtra, India.
gitonganyaga@gmail.com

Abstract

Background: This paper discusses the development of Kenya's trade policies have evolved through four major phases, namely, Import substitution period, The Period of SAPs and Export Promotion Schemes, The Period of Export Oriented Policies and Vision 2030 & National Trade Policy.

Method: This study, being qualitative and analytical in nature, shall employ various descriptive, theoretical and where feasible, simple statistical analytical tools to explain the facts as borne out by available data. The study sought to make valid discussions by going through various literature related to Kenya's trade policies. The data used was secondary data mostly from various issues of Kenya's Economic Surveys. Based on the data, calculations were made and tabulated to show relevance of various indicators.

Results: Trade policies in Kenya have evolved through four distinct stages namely: 1) Import substitution period (1960s – 1980s), 2) The Period of SAPs and Export Promotion Schemes (1980s), 3) A Period of Export Oriented Policies (1990s) and 4) Vision 2030 and National Trade Policy (from 2004 to-date). Policies adopted in the 90s till now can be described as the way to go but not the only way if Kenya has to reach its potential as a global competitive and a prosperous nation by 2030. The new National Trade Policies which are drawn to help Kenya reach a higher potential internationally by 2030 are good. What is needed now is for the government to implement them and keep thinking of how to make them better in order to fit in the ever changing future.

Conclusion: This is a simplified study of trade policies in Kenya and will help those seeking information on this topic as well as various stake holders to make vital policy changes.

Keywords: Kenya, Trade Policies, Vision 2030, Import Substitution, National Trade Policy, Export Oriented Policies

1. Introduction

Kenya is a country that faces many challenges including economic challenges. Since attaining independence in 1963, Kenya has been struggling to maintain a constant positive economic growth year by year. This has been due to many reasons including political upheavals, external debts, unfavourable balance of trade, problems of balance of payments, lack or weak trade policies etc [1]. Trade is an important aspect of a country's economic development. With foreign trade, a country can deal with issues of price instability, increase its national income, improve its capital flows, improve its citizen's quality of life etc.

The government is the custodian of the social-economic development activities of the country. Due to an ever changing paradigm in economic development, governments therefore adopt a planned system of economic development as a tool for progressive growth.

The process is fundamentally held together by the role the government plays through the designed policies to effect change and development. As need arises, the policies keep changing and hence this dynamic attribute. Therefore, it is through government incentives that sound policies can be affected in regards to fiscal policy, macroeconomics and growth of the economy. To this end, the basic legal and institutional infrastructure must be in place to foster economic development.

In the last 50 years, many of the developing nations, including Kenya, have recognized the deep role that international trade plays in the process of economic development. Trade policies will then play the fundamental role that governs the movement of foreign trade from the local market into the international markets. For this end to be achieved, a varied number of instruments will be employed to facilitate the desired economic activities as according to the desires of the government. These measures operate within the prevalent price mechanism and they include tariffs such as subsides to local industries, export duties and quotas.

The trade policy administration could be either protectionist or liberal. A protectionist trade administration is where the government takes deliberate action to protect or rather shield the local manufacturing industries from the competition created by the influx demand for technologically advanced products of foreign origin. In contrast, the latter trade regime is one with willingness to trade in the foreign market. It is graced with a high intensity in export promotion schemes. It is of significance to note that a liberal trade policy is generally easy to implement owing to its open nature. This stimulates improvements in the implementation process. As it is, a transparent liberal trade policy encourages the release of administrative resources that can be reallocated for further development.

Kenya as a nation, has suffered periods of political and economic upheavals. It is a country that has struggled to strike a balance between dominance from the Western powers and maintenance of her sovereignty. But with the country not able to fully sustain herself economically, there was always a need to seek aid from the Western counterparts, who in their part dictated or 'strongly advised' on various issues that needed to be changed. It is expected therefore that trade policies that Kenya adopts will in way or the other be influenced by this balance.

Kenya has seen four major regime changes since independence. With each change comes shift or introduction of new policies that affect, among other economic areas, trade. Nevertheless, shunning politics and administration aside, it is important to note that trade policies in Kenya have evolved through four distinct policy orientations, which will be discussed below. These orientations include: Import substitution period, the Period of SAPs and Export Promotion Schemes, a Period of Export Oriented Policies and Vision 2030 and National Trade Policy (from 2004 to-date).

2. Review of Trade policy in Kenya

After independent in 1963, the new government of Kenya formulated ways in which the economy would stand on its own without much help from the British government, which was the immediate colonial power. Fear of losing grip on the economy and involvement in its political affairs made the government of Kenya to be 'careful' in dealing with Western powers. At the same time, the government wanted to maintain a good relationship with these powers as they are the ones that would provide foreign aid and market for Kenya's good [2].

'Africanization' was the emotive slogan adopted that time to instil upon the citizens the need to be proud of what they were achieving. In the spirit of trying to 'Africanize the economy' of Kenya, the government moved to adapt trade policies that were geared towards empowering the citizens and control what goods foreigners would trade in [2].

In the pursuit for sustainable economic growth and development, Kenya has gone through a series of trade policy episodes since her independence in 1963. This paper will highlight the path taken by the government in drawing, formulating and developing of its trade policies through the years under the three different Presidential Administrations. The first one being the Kenyatta Administration, which began when Kenya earned her Independence in 1963 and stretch to 1978 at the time of his death. It is useful to mention though that the trade policies of the Kenyatta Administration extended to the Moi's Administration in the early 1980s.

The subsequent administration was the Moi's Administration which spanned from 1978 to 2002. It is during this time that the Kenya economy experienced its worse trade turbulent storms. Therefore, the trade policy regime during Moi's Administration is of importance as it will show the direction of trade and the policies that influenced the same. The last phase for consideration is during the Kibaki's Administration, 2002 to 2013. The Kibaki Administration frantically implemented many comprehensive reforms that aimed at promoting and improving the environment for export led growth within the framework of regional and multilateral trade agreements. The Kibaki Administration emphasized on foreign trade as the drive for economic growth and development.

But more than looking at the evolution of trade policies in Kenya in terms of political regimes, it makes more sense to look at it in terms of phases or policy orientations. Majorly, Kenya's trade policies have evolved through four phases, namely: 1) Import substitution period (1960s – 1980s), 2) The Period of SAPs and Export Promotion Schemes (1980s), 3) A Period of Export Oriented Policies (1990s) and 4) Vision 2030 and National Trade Policy (from 2004 to-date). These phases will be elucidated further below.

2.1 Import substitution period (1960s – 1980s)

The first phase that commenced after independence and took us to the early 80s was a period of import substitution. After independence, the Kenyan government embarked on protecting the economy by heavily controlling trade. Kenya's trade efforts were mainly guided by import substitution strategy. The first major document on trade was the Sessional Paper No. 10 of 1965, which mainly centered on trade development and pursued enhanced protection of the domestic market to help develop industries.

Immediately after independence in 1963, the Kenyan government moved to put in place trade policies that would protect the domestic economy at the same time boosting it. Like many African countries of the time, Kenya opted for Import Substitution which she felt would somehow wade off strong control from the Western powers yet not shunt them completely off as they were needed to help the new nation stand on its feet [2]. The strategy was adopted as a means of promoting industrialization. The objectives of the Strategy were; rapid growth of trade, easing balance of payment pressure, increased domestic control of the economy and generation of employment [3].

Details from the Sessional Paper No. 10 of 1965 clearly show the government thoughts and reasons that made it adopt the policy of import substitution. One of the reasons was to avoid future foreign exchange problems. According to the paper, Kenya could borrow money and buy capital goods from other nations but must use these borrowed funds and imported capital goods efficiently and in the production of more goods and services, either for export or for import substitution [4]. The paper went on to give a detailed plan of how this policy would help the country and how it would be implemented. The paper noted that foreigners were welcome to do business in Kenya or get involved in foreign trade but they had to do so in close association with the citizens of Kenya. Further, the government was to regulate what goods would be exported and what good would be imported so that the citizens would benefit the country.

The idea was to promote local manufacturing by using foreign exchange measures. Though the government noted that there was no need to press a panic button as far as foreign exchange was concerned, the nation was still young and there was a need to have enough or sufficient foreign exchange reserves. The government therefore formed Foreign Exchange Allocation Committees to administer foreign exchange quotas for imports for which a limited quota had been established to protect local producers. These committees would only allocate foreign exchange to those who only would import certain goods or industries that would produce goods that would bring in foreign exchange [5].

Another salient feature of this phase was the use of tariffs as an instrument of protection. During this phase, the overall look of tariffs showed that they were used to back up import substitution. For example, finished goods were charged higher tariffs than capital goods and intermediate goods. A good example is the tariff rates for textiles and clothing whose unweighted scheduled tariff rates were twice those of capital and intermediate goods like machinery and building materials. Use of tariffs as an instrument of protection in the long run seemed to fail and so the government turned to quantitative restrictions. Here, the main instrument used was import license requirements where preferential treatment was accorded while issuing import licenses to certain goods [6].

2.1.1 Impact of Import substitution policies

This phase of import substitution policies was the longest in Kenya as compared to the longevity of other policy regimes. The policies associated to his phase brought in mixed results with industrial and manufacturing sectors experiencing high rates of growth the first decade after independence but failing to create as many jobs as it was expected. Table 1.1 shows that manufacturing sector grew at an average rate of 8.0 per cent in the first decade after independence as compared to a rate below 5.0 per cent in the 80s and 90s. Industries that were just small establishments initially grew to become large industries producing more products and employing more people. Such industries included paper, garment and textile manufacturing, food processing, leather tanning and footwear [7].

Table 1.1. Growth rate of selected economic indicators 1966-1994

Growth rate %	**1966-70**	**1970-75**	**1975-80**	**1980-85**	**1985-90**	**1990-94**	**1994-98**
Industrial	-	8.6	8.7	12.9	7.3	9.6	17.4
Manufacturing	6.2	5.2	7.8	3.7	5.0	2.5	0.7
GDP	11.5	11.8	12.2	10.4	11.3	12.1	12.4

Source: Republic of Kenya, Economic Surveys and Statistical abstracts, various issues

Industries and manufacturing sectors did well due to availability of market for the goods produced. Kenya sold most of its produce to the neighbouring countries of Tanzania and Uganda partly due to the agreement between East African Community (EAC) members. Trade up the late 70s between Kenya and other EAC members was soaring, and a strong fiscal policy contributing greatly to the export growth to Tanzania and Uganda under the East African Community (EAC) common market [8].

But this good phase would suddenly fold with the collapse of EAC in 1977 and Kenya's economy performing poorly in the late 70s. One of the reasons that contributed to poor economic performance was the slowdown in industrial production that could not be sustained by the small size of domestic market. Industrial policies were inclined towards producing only for domestic markets, creating an inward looking regime that could no longer support production. This resulted in slow down in job creation or even loss of jobs [5].

The oil crisis of 1973 will seem like the beginning of an end to a good phase. The oil crisis resulted in very high cost of production and exertion of pressure on balance of payments, which in turn made it hard to acquire imported raw materials and equipment. The government also seemed ill prepared to deal with changes that were happening to the economy and lacked fiscal discipline. With another oil shock coming in 1977 and failure to deal favourably with external terms of trade following the coffee boom of the late 70s, the government could only watch fortunes slipping away [9].

2.2. Structural adjustment policies (SAPs) and Export promotion schemes

The second phase was the period of Structural Adjustment Policies (SAPs) and Export Promotion Schemes. This period that was prevalent in the whole of 80s to early 90s was introduced to address the structural rigidities, price instability and macro-economic imbalances that had become embedded in the economy and led to poor delivery of services by the public sector. The domestic market was highly protected with the government adopting a policy that was inward looking. The first period of import substitution seemed to work but with time it failed. There was a need therefore to move to a more competitive environment that was more outward looking and would result in expansion of exports as well as creating more jobs.

As the 80s kicked in, it was becoming clear that import substitution development strategy was not working to improve trade and add value to the economy. The government was already facing steep budgetary constraints and pressure was mounting to find a quick fix to the ailing economy. Forced to make amends, the government began a shift from import substitution policies to trade reforms under SAPs. These reforms would see a shift from import-substitution to an export-promotion strategy. The government moved to convert quantitative restriction to tariffs equivalents. These changes, which were drawn in the Fourth Development Plan (1979 -1984), recommended that tariff rates be rationalized and reduced over time and that there should be a more liberal exchange rate policy and promotion of export schemes [9].

Unfortunately, as the 80s passed by, the new policies didn't seem to yield results and there was nothing to show in terms of increased exports or utilization of export schemes. Swamy [10] noted that import liberalization policies introduced at this time could not work as the timing coincided with a period of macroeconomic crisis, which made the trade policies lack a stable platform for implementation. This is further echoed by Were et al [11] who observed that the government lacked commitment and that there was a general lack of compliance to the policies.

The government still wanted to show that it was committed to reforms and in 1986 prepared the Sessional Paper No.1 of 1986 on Economic Management for Renewed Growth as a major platform for liberalising the economy. The paper recommended several reform measures, which included replacement of quotas by tariffs and, lowering of duties on industrial inputs and final products. Though these steps showed little positive reactions with general tariffs rates showing a little decline in the second half of the 80s, the tariffs rates were still relatively high and the level of progress limited [10].

By the late 80s, it was becoming clear that the government had failed to make any substantial implementation of trade policies and the economy was dangerously slowing down. As the 90s dawned, Kenya was plunged into deep political and economic crisis. In 1991, donors withdrew their aid to Kenya for failure to comply with suggested reforms, leaving the economy seriously crippled. But it was at this period that major reforms took place in Kenya as well. The government introduced major reforms which included privatization of parastatals, liberalization of financial and energy sectors, price decontrols and phasing out of import controls [5].

With pressure mounting from the donors and an economy that needed a quick fix, the government came up with several major adjustment plans and reforms, notable among them the introduction of Manufacturing under Bond (MUB) in 1988, Export Processing Zones (EPZs) in 1990 and the revival of the Kenya Export Trade Authority. The government also introduced Export Guarantee and Credit Scheme, and duty and Value Added Tax (VAT) exemption scheme administered under the Export Promotion Programmes Office (currently TREO) for tax rebates on imported inputs for exporters and essential products like drugs. In a bid to make export process smooth, the government established the Export Promotion Council (EPC) in 1992 to address bottlenecks exporters were facing [7].

3. Period of Export oriented policies

The third phase was a Period of Export Oriented Policies. This period took over the 90s and early 2000s. These policies were recommended in the Sixth Development Plan (1989-1993). The policy was to adopt an export promotion strategy that would create a more conducive trading environment for export growth. This was to be achieved through institutional reform, reduction and restructuring of tariffs, abolition of export duties, introduction of export retention schemes, improvement of foreign exchange and insurance regulations and the establishment of the National Export Credit Guarantee Corporation.

90s was a time when Kenya was facing probably the worst political and economic period. Politically, the multiparty campaign was heating up and the government faced a huge pressure to make the history changing reform of shifting from one party system to multiparty system. Economically, the economy was on a slow down and the situation seemed to deteriorate with each day. Macroeconomic performance indicators showed a sorry state of the country. The GDP growth rate was recorded at an all time low at -0.4 between 1991 and 1992. The per capita GNP fell from $350 in 1992 to $270 in 1993 with the real annual growth rate of the manufacturing sector falling from 3.8% in 1991 to 1.8%. Inflation more than doubled to 46.8% from 19.63% between 1991 and 1993 [11].

The government had no options but to introduce policies that would open up the economy and shift completely from inward looking policies to outward looking policies. One way to ensure this was to come up with policies that would promote exports rather than sticking to those that were only meant to substitute imports. The first major change made in this phase was the the introduction of Foreign Exchange Bearer Certificates (Forex-Cs) in October 1991. This was the first step towards liberalization of the foreign exchange market. Holders of Forex-Cs could use them automatic import licenses. In additional to that, the government established a secondary market for Forex-Cs in 1992 and retention schemes were introduced in August of the same year.

Retention schemes meant that one was allowed 100% retention of foreign exchange earnings from the non-traditional exports such as manufactured goods and horticulture. Exporters could now have free access to their foreign exchange earnings, which they could hold in accounts with local banks, or sell to the Central Bank. Though the retention accounts were suspended in March of 1993, they were again reinstated in May the same year. 1993 was a good year for exporters in Kenya. Trade licensing requirements were abolished and exporters had control of foreign exchange earnings. The tariff structure was harmonized and tariff dispersion lowered substantially. The number of tariff bands (including duty free) was reduced from 15 in 1990/91 to 4 in 1997/98 and the top regular tariff rate from 100% to 25% over the same period [11] [12].

Apart from reforms made at a country level, Kenyan export and import scenario was poised to gain more from the new ties from the revived EAC and improvement of terms with Common Market for Eastern and Southern Africa (COMESA). Manufactured exports received the much needed boost as exports to COMESA increased from an average of 15% for the period 1990-1992 to 34% in 1996-98 [13]. The revived EAC introduced common external tariff (CET) in 2005 and the moved seemed to show positive changes. For example, in the case of Kenya's applied tariffs, there was a noted reduction from the simple average of 16.8% in 2004 to 12.7%. Kenya has continued to use EAC CET as its main trading policy instrument since 2005.

3.1 The Vision 2030 and National trade policy

The fourth phase is the current one that started in 2004. This is the Vision 2030 and National Trade Policy. In 2008, Kenya launched an ambitious development program called Vision 2030 whose main objective is to help transform Kenya into a "newly industrializing, middle-income (income exceeding World's average currently at US$10000) country providing a high quality of life to all its citizens by 2030 in a clean and secure environment [14]."

This program also features trade and so there are trade policies adopted to ensure that the visions goals are achieved. For example, the policies were geared towards Promotion of decent, protected and recognized informal trade; establishment of vibrant business supported by well established and functioning infrastructure and social amenities, Expansion of Kenyan exports and thereby generate jobs and prosperity for the people of Kenya, transformation of Kenya into a regional service hub; and enhancement of opportunities and increase the digital opportunity index from access (0.17) to medium access (0.5) [14].

There are no major reforms in trade policies suggested at this stage though the government seems committed to continue its exported oriented and outward looking policies adopted earlier. The new National Trade Policy has stated that the government will continue to support the trade policy instruments available for exports, which include export taxes and charges, export prohibitions, restrictions, and licensing; export subsidies and incentives; export promotion and marketing assistance, and export finance, insurance, and guarantees. The government will also continue to actively participate in international and regional trade forums like WTO, COMESA and EAC with an aim of boosting trade with other countries [15].

4. Summary Conclusion and Suggestions

Trade policies in Kenya have evolved through four distinct stages. The most dominant aspect of the journey has been the policies of import substitution that were prevalent right from independent till the 80s. While import substitution helped to stabilize the economy of Kenya after independent and a few years after that, it could not sustain the economy long enough to cope with the changing scenario in the economic world. Tariffs have been the most dominant source of protection, which has helped to liberalize and rationalize the import regime. Over the years, we have witnessed a significant reduction of tariff rates and tariff peaks. At one point, tariffs were as high as 100% on some products but the simple average applied tariff is now only about 13%, though there are marked rise in various sectoral averages and substantially higher tariff peaks in some sectors.

There are some in the government who still feel import substitution would work to improve industrial and manufactures sectors. Their argument is that countries like China and India have flooded the local market with items that could have been produced locally. However, it should be noted that this was what the first government targeted but could not be realized in the long run. Having an economy that put exports at a huge disadvantage will only put strain to the local industries as they will lack market for their produce. Industries also need to receive not only raw materials from abroad but technology as well.

Policies adopted in the 90s till now can be described as the way to go but not the only way if Kenya has to reach its potential as a global competitive and a prosperous nation by 2030. Those changes which included Manufacturing under Bond (MUB, Export Processing Zones (EPZs) and the revival of the Kenya Export Trade Authority sure did add value to the manufacturing and export areas but there are still more changes needed. While imports have done well under various trade policies and promotional schemes, exports have made little growth making Kenya suffer negative balance of trade overall. This is the question that needs to be addressed if the next phase of Kenyan's economic history will tell a happy tale.

One reason why some policies failed though they were good for the economy was failure of the government not to implement them fully and lack of 100% commitment towards implementing them. Apathy on the side Kenyan government has been pointed out in other areas of governance as a stumbling block and so it is now up to the current government or the government to come to put in place mechanisms to execute passed policies regardless of political affiliations associated with them. Trade policies should be seen as important as border instruments associated with them like tariffs, export promotion agency activities etc.

Though regional integration is important and trading between regional block partners like COMESA or EAC members is vital, the government should not be contented with the figures coming from these blocks and forget that Kenya need to do well in the larger international arena as well. The government should find ways of opening other market for Kenyan goods rather than depending on regional market which in the long run will not be able to sustain local production or increase competitiveness of the local industries.

The new National Trade Policies which are drawn to help Kenya reach a higher potential internationally by 2030 are good. What is needed now is for the government to implement them and keep thinking of how to make them better in order to fit in the ever changing future.

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