Kenya's Trade Liberalization of the 1980s and 1990s: Policies, Impacts, and Implications[1]

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As one of the first countries to sign a Structural Adjustment Loan with the World Bank, Kenya spent much of the 1980s and 1990s liberalizing its economy. This reform program included significant changes in trade policy, as the country's post-colonial import substitution policies were replaced with an outward-looking, export promotion program. Though the country achieved targeted successes in the horticulture and apparel industries, overall Kenya's trade liberalization failed to produce sustained growth, promote decent employment opportunities, or lessen the incidence of poverty and inequality. As the country shapes its future trade policy, an effort to coordinate trade with other development strategies, to balance between global and regional trade integration, and to focus on job creation can help Kenya maximize the benefits from trade.

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I. Introduction

In 1980, Kenya became one of the first countries to sign a Structural Adjustment Loan with the World Bank. Over the next two decades, reluctantly at first but with renewed commitment from the mid-1980s on, Kenya replaced the import-substitution policies it had pursued since independence with an open, liberalized trading regime. Tariffs were decreased, controls on imports were loosened, and the government encouraged trade through a series of export-promotion platforms.

Broadly speaking, Kenya's trade liberalization experience was disappointing. Though the country enjoyed a few targeted successes in industries such as horticulture and apparel exports, overall Kenya's trade liberalization policies had little impact and failed to deliver broad macroeconomic success.

This paper analyzes Kenya's trade liberalization experience of the late twentieth century. The next section provides an overview of the policies Kenya enacted during the period, focusing on trade policy while also touching on the other concurrent policy changes which impacted the country's growth. The following section gauges the impact of these policies on Kenya's trade, growth, employment, poverty, and inequality. The final section concludes and considers implications from for Kenya's future trade policies.

II. Overview of Kenya's Economic Policies

Trade policy

At independence in 1963, the new Kenyan government inherited a trade and industrial policy from the colonial rulers that was largely aimed at import substitution. Manufacturing in Kenya dated from the early twentieth century, but had not developed much beyond processed agricultural goods; the market remained limited, and there was little local capital or skilled management. Following independence, the government pursued a policy of attracting foreign investors to produce for the domestic and regional market. Multinational corporations such as Union Carbide, Firestone, United Steel, Del Monte, Schweppes, and Lonrho began producing in Kenya (Bigsten, 2002). Effective rates of protection were very high, and many established firms enjoyed near monopolies. Between 1964 and 1969, manufacturing value added increased by 44 percent in real terms (World Bank, 2007); leading sectors included textiles and apparel, food, beverages, and tobacco.

Kenya suffered a balance of payments crisis in 1970–1971, which was exacerbated by the first oil shock two years later. In response to these challenges the government intensified import-substitution policies; tariffs increased and import licensing became more severe. Behind this protection Kenya's manufacturing sector boomed; annual growth in the sector averaged over 25 percent between 1971 and 1973 (WDI 2007). Throughout the decade import-substituting manufacturing continued to grow, and diversified to sectors including plastics, pharmaceuticals, and vehicles.

In the late 1970s Kenyan exports were buoyed by a substantial increase in the price of coffee, which more than quadrupled between 1975 and 1977 (Bevan, Collier, and Gunning, 1999). The coffee boom also had a strong impact on the price of tea, another key Kenyan export. The net effect of the coffee boom was a 54 percent increase in Kenya's terms of trade by 1977, the peak year of the boom. This spike in the value of Kenya's commodity exports allowed the government to temporarily avert a foreign exchange shortage, and thus stayed economic reform in the short term.

By 1980, however, the price of coffee had subsided and the earlier terms of trade gain had reversed. By this point Kenya's import substitution policy had essentially run its course:

imports of consumer goods were low, which meant there was little room for future substitution and thus poor prospects for future growth. Additionally, the few trade links Kenya had—notably with Tanzania and Uganda as part of the East African Community (EAC)—were evaporating. The EAC, which had been an important source of demand for Kenyan manufactures, collapsed in 1977, as Tanzania tightened its borders and import demand in Uganda waned due to internal instability. With the already small export market shrinking, pressure for reform grew as the fault lines in the economy, which had been masked by the temporary influx of foreign exchange during the coffee boom, began to reassert themselves.

Kenya signed its first Structural Adjustment Loan with the World Bank in 1980, which was conditional on the government adopting more liberal trade and interest rate regimes as well as a more outward-oriented industrial policy. A number of government documents outlined a new direction toward openness and liberalization in Kenya's trade policy; however, in practice few of these changes were actually adopted. Many of the quantitative import restrictions—which had been the primary means of protection—were replaced with tariffs, but these tariffs often remained prohibitively high. In 1982 the government turned to the IMF for further funding, vowing once again to pursue greater liberalization, yet failed to substantially implement promised reforms. Tariffs on some goods were further liberalized, but for other items import controls were reintroduced.

Thus in the first half of the 1980s, despite its liberalization rhetoric, the government made only limited attempts to reform the Kenyan economy. The share of imports not subjected to quota restrictions did increase from 24 percent in 1980 to 48 percent and average tariffs decreased by about 8%, but this had little impact on Kenya's trade (Swamy, 1994). The government only followed through on policy reforms when it was compelled to do so by outside pressures, and was quick to abandon liberalization in the face of other economic priorities: in an effort to counter the foreign exchange crisis of 1982–1984, Kenya uniformly raised all tariffs by a full 10 percent.

In the second half of the decade, however, again under pressure from donors, Kenya began a more concerted and sustained effort at significant trade liberalization. This involved shifting import restrictions from quotas to tariffs, and subsequently decreasing tariff levels. In 1987, quantitative restrictions affected 40 percent of all importable items; by July 1991, import licenses were only used for health or security reasons (Swamy, 1994). The shift from licenses to tariffs caused an initial increase in some of the higher tariff bands, but over the course of the early 1990s these were lowered substantially (see table 1). By 1997/1998 the trade weighted average tariff had fallen to 12.8 percent, and all tariffs were below 50 percent. While there were still some policy reversals during this period (notably when tariffs were raised in 1993 to cover a government revenue shortfall), the trend throughout the late 1980s and 1990s was clearly toward import liberalization.

Table 1: Distribution of Goods by Tariff Band (percentage)

Tariff rate	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96
0	6.9	7.0	5.8	6.1	3.7	2.9	3.1	3.2	3.3
1-10	0.3	0.9	1.6	1.6	4.0	4.6	5.2	4.9	1.8
11-30	30.7	29.6	37.6	37.4	47.6	47.6	56.5	67.8	71.8
31-50	45.4	43.7	23.8	21.6	17.7	20.9	35.2	24.1	23.1
51-60	3.9	5.6	6.0	6.3	3.0	24.0	--	--	--
61-70	3.8	4.1	--	--	24.0	--	--	--	--
71+	9.0	9.1	25.2	27.0	--	--	--	--	--
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Levin, 1999.

Closely correlated with the decrease in quotas and tariffs Kenya pursued in the late 1980s and early 1990s was the loosening of foreign exchange restrictions. Up until this point, the government strictly controlled all foreign currency transactions. Foreign exchange restrictions had been arguably a greater constraint on trade than direct quotas and tariffs, as import demand was dependant on the availability of foreign exchange allocations. In 1991 the government introduced the tradeable Foreign Exchange Bearer Certificates, known as Forex Cs, which was a first step toward liberalizing foreign exchange restrictions. Through a series of reforms over the next few years the restrictions on the foreign exchange market were eased, and by 1994 Kenyans could freely trade in foreign exchange. This meant the availability (or lack thereof) of foreign exchange no longer determined the quantity of imports.

In addition to the import liberalization reforms, Kenya introduced a variety of export promotion platforms to help spur greater trade, all essentially aimed at eliminating the tariffs paid for the inputs of processed exports.[3] The first of such policies was the manufacturing-under-bond (MUB) program, which began in 1988. This platform allowed for the duty free import of factory plant and equipment, as well as raw materials, for manufacturers producing for export. The MUB program had some limited success, as by 1993 there were over 70 bonded manufacturers. By the late 1997, however, most of these factories had shut down, due primarily to a reduction in Kenya's garment quota for the U.S. market and the appreciation of the exchange rate and wages of the mid-1990s (Glenday and Ndii, 2003).

Export processing zones (EPZs) were introduced in 1990. Kenya provided generous incentives to attract new firms manufacturing for export, including corporate tax holidays, waivers for import tariffs, and exemption from numerous business regulations. Despite these incentives, initially very few firms stepped forward to participate in the EPZ program; in 1997, of the total 70 built-up units available in the country's five developed EPZ parks, only 22 were occupied by operational enterprises (Glenday and Ndii, 2003). More recently, however, the program has shown greater success: today there are over 40 EPZs in Kenya, employing close to 40,000 workers and producing over 10 percent of the country's exports, up from approximately 3,000 and 1 percent, respectively, in the 1990s (Kenya Export Processing Zones Authority, 2008; Glenday and Ndii, 2003). The great majority of firms operating within EPZs in Kenya produce garments for export to the U.S.

In 1993, the Ministry of Finance began a third export promotion policy known as the Export Promotion Programmes Office (EPPO), a duty drawback scheme which fully refunds import taxes paid on inputs used in the production of exports. Unlike under the MUB and EPZ programs, firms do not need to be solely exporters to take advantage of the EPPO system: companies producing partially for the domestic market and partially for export can also reap the benefits. Largely attributable to this flexibility, the EPPO program was significantly more successful than Kenya's other two export promotion platforms. Over two-thirds of eligible exports benefited from the EPPO scheme, representing 35 percent of total merchandise exports over the 1993–1998 period (Glenday and Ndii, 2003).

Throughout the 1980s and 1990s, thus, Kenya's trade policies evolved from import-substitution toward outward orientation. Though it was by no means a straight forward journey, by the end of the period the country had a relatively low and harmonized tariff structure and numerous policies aimed at supporting the growth of exports.

Exchange rate reforms

In 1975, the Kenyan government switched the peg for the shilling exchange rate from the U.S. dollar to the IMF's Special Drawing Rights (SDR), which, as it was based on a basket of currencies, was believed to be more stable than the U.S. dollar. Kenya once again updated its

[3] An earlier export compensation scheme, designed to compensate manufacture exporters for the tariffs paid on their inputs, had actually been in place since 1974. This program suffered from severe bureaucratic inefficiencies, however, and was underutilized: in the early 1980s, four firms received one-third to two-thirds of the payments, which covered only about 5 percent of total manufactured exports (Mwega and Ndung'u, 2001).

exchange rate policy in 1982, this time adopting a crawling peg based on its own composite basket of the currencies of its principal trading partners. The country took a first step toward a market based regime in 1990, when it adopted a dual exchange rate policy. Under this system the government tracked both the official exchange rate and the rate available in the market. A few years later, in 1993, Kenya allowed its currency to freely float; just before this move to a market-determined exchange rate, the government undertook a significant devaluation of the shilling.

Exchange rate policy plays a key role in determining a country's international competitiveness, as the real (inflation adjusted) exchange rate is a measure of the relative price of tradables to non-tradables. If the real exchange rate depreciates, a country's exports become more attractive to the rest of the world, while imports become relatively more expensive, thus favoring domestic production. The reverse occurs when the real exchange rate appreciates. Figure 1 presents an index of Kenya's real exchange rate, showing that the real exchange rate depreciated slowly throughout the late 1980s and very sharply during the one-time devaluation in 1993. Once the shilling was allowed to freely float the real exchange rate quickly appreciated back up to its early 1980s level, and remained relatively stable through the remainder of the period.

Figure 1: Kenya's Real Exchange Rate, 1980–2003 (index, 1980=100)

Source: Pollin and Heintz, 2007.

Liberalizing domestic markets

Trade liberalization was part of a broader push in Kenya to decrease the government's role in the economy and give market forces greater influence. Price controls, widespread in the economy prior to the structural adjustment loans, were largely eliminated throughout the late 1980s and early 1990s. By 1995 even the wheat and oil markets, which had been the strongest resistors, were decontrolled (Swamy, 1994; Ndung'u, 2003). In conjunction with liberalizing domestic prices the government also announced it would privatize most of the country's numerous parastatal companies, though progress here has been sluggish. Some 200 non-strategic enterprises were slated for privatization in 1990, yet due to difficulties in finding interested buyers and reluctance within the government to give up politically-useful appointments within state-owned enterprises, eight years later only 25 enterprises had been privatized (Were et al., 2005).

Financial sector and monetary policy reforms

The final contemporaneous policy which will be discussed here is the financial sector reforms. Kenya's financial sector had diversified in the 1970s as government policy encouraged local participation in the sector to compete with the established banks, resulting in the proliferation of non-bank financial institutions (NFBIs). There was very little supervision or regulation of the industry, which led to a banking crisis in 1986 in which several financial institutions defaulted (Ngugi and Kabubo, 1998). In 1989 the government enacted a comprehensive reform of the financial sector, addressing both institutional and policy reforms aimed at strengthening the regulatory powers of the central bank and liberalizing interest rates.

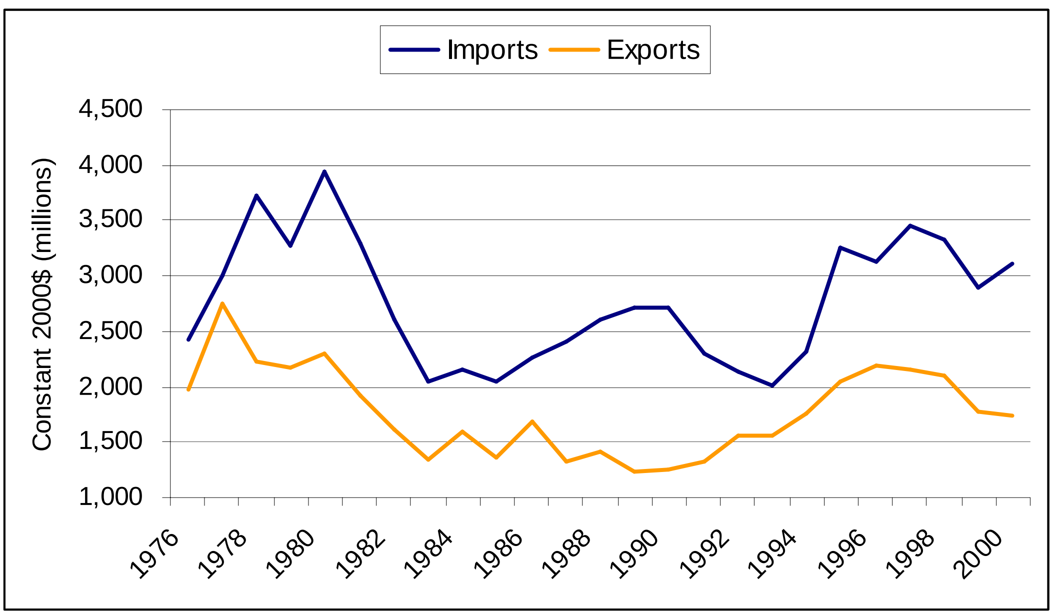
Leading up to Kenya's general elections in late 1992, however, the regulatory environment relaxed considerably, as shaky borrowing (primarily from politically connected banks) soared to finance the campaigns of the then governing party (Ngugi and Kabubo, 1998). With the influx of money inflation shot up to over 50 percent, and by late 1993 Kenya was in the midst of another financial crisis. The government responded by issuing large quantities of Treasury bills; while this tight monetary policy did ease inflationary pressures, it resulted in extremely high interest rates on treasury bills. The high interest rates discouraged private investment and restrained consumer spending, which limited the expansion of the economy.

III. The impact of Kenya's trade liberalization

Impact on trade

Figure 2 presents Kenya's merchandise imports and exports in constant dollars for the period 1976–2000. The overall trends show high levels of both imports and exports in the late 70s, driven in part by global price changes such as the coffee boom and the second oil price shock. Imports and exports declined sharply in the early 1980s, during Kenya's first period of half-hearted structural adjustment. Imports climbed steadily during the late 1980s following the stronger implementation of liberalization programs, but fell off during the recession of the early 90s. Exports experienced almost no growth up until 1992, very basic evidence that Kenya's trade liberalization had not been successful up to that point. Export growth did pick up with the implementation of the more successful EPPO export promotion scheme in the mid-1990s. Import growth resumed as Kenya came out of the recession and foreign exchange restrictions were eliminated in the mid-1990s.

Figure 2: Kenya's Merchandise Trade, 1976–2000



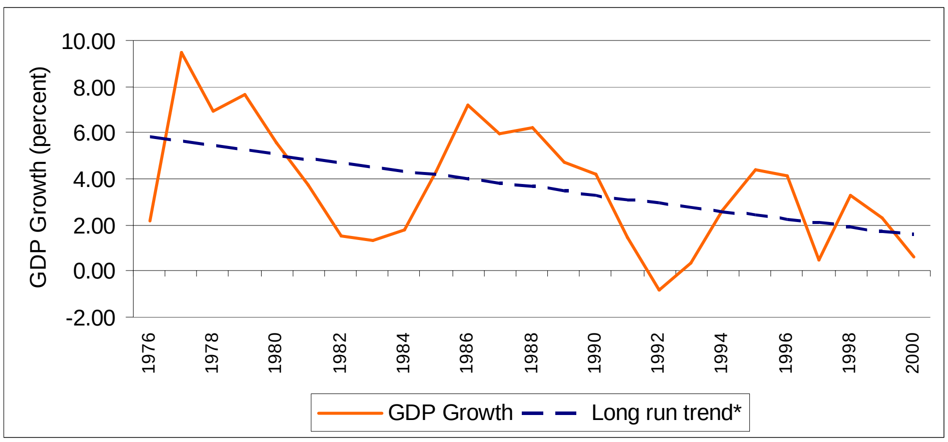
Source: World Bank, 2007.

The trends in total imports mask significant import surges in a few products, notably secondhand clothing and used vehicles. Prior to import liberalization the textile and apparel industry had been very important in Kenya, representing 30 percent of manufacturing employment, and additionally supporting hundreds of thousands of cotton farmers (Omolo, 2006). Following liberalization, the Kenyan market was flooded with imports of used clothing from the U.S. and Europe; by 2005 used clothing imports exceeded $23 million, and an estimated 80 percent of Kenyans were wearing used clothing (Njuguna, 2006). Production in cotton, textile, and apparel firms decreased significantly. A similar experience struck the motor vehicle industry, as imports of used cars from Japan, Europe, and the Middle East undercut domestic vehicle production in Kenya; less than 25 percent of registered cars on the road in 2006 were bought from local dealers (Sambu, 2007).

Impact on growth

After having experienced several years of strong growth during the early years of independence, Kenya's economy performed poorly during the trade liberalization era. Figure 3 presents Kenya's real GDP growth for the period 1976–2000. Growth was quite volatile but followed a general downward trend; after having averaged over 7 percent in the 1970s, average annual growth slipped to 4.2 percent in the 1980s, and finally fell to only 2.2 percent during the 1990s. Kenya experienced a depression during the early 1990s, brought on by a severe, drought, high inflation, and foreign aid suspension, among other causes.

Figure 3: Kenya's Real GDP Growth, 1976–2000



* Long run trend calculated using Hodrick-Prescott filter

Source: World Bank, 2007.

Of course, this sluggish growth cannot be attributed solely to Kenya's trade policies. As outlined above, the era of trade liberalization coincided with numerous macroeconomic shocks, including privatization, exchange rate reform, and domestic trade liberalization. These other determinants of economic growth undoubtedly had strong impacts on Kenya's performance, both independently and in interaction with one another.

Against such a noisy background it is difficult to isolate the impact of trade variables, and thus it is no surprise that the authors who have attempted to do so have had at best limited success. Glenday and Ryan (2003) use regression analysis to study the determinants of economic growth in Kenya during 1970–1998. They find that the only statistically significant variable that has an impact on growth is the private sector investment rate. None of the trade variables the authors tested—including dummy variables for periods of trade liberalization and the opening of the East African market, as well as exports to Tanzania and Uganda as a share of GDP—had an impact on growth. Though they find no direct relationship between trade and growth, the authors look for an indirect relationship by studying whether trade impacts the private sector investment rate. In this regression the authors do find some evidence that increased exports to Tanzania and Uganda as a share of GDP had a positive impact on private investment. As private investment was found to be the main engine of Kenya's economic growth, this suggests that increased access to regional markets likely had a slight positive impact on growth.

In another article seeking to quantify the impact of trade on Kenya's economy, Karingi and Siriwardana (2001) use a completely different approach. The authors simulate the impact of the trade liberalization and fiscal reforms of the late 1980s on the Kenyan economy using a computable general equilibrium (CGE) model.[4] The model is calibrated to 1986, when Kenya's strongest push toward liberalization was just beginning, and a series of shocks are simulated representing potential government policies. The authors test three trade liberalization shocks: one in which all tariffs are cut to a standardized level of ten percent, a second in which tariffs are cut and indirect taxes are increased to cover the resulting government shortfall, and a third in which tariffs are cut and foreign aid is increased to support the reform measure. While all three simulations had positive impacts on real GDP, only the third simulation produced a gain greater than one percent (1.79 percent). Additionally, while the first two simulations generated significant negative impacts for employment and investment, the simulation including greater foreign aid avoided these losses.

Karingi and Siriwardana's study provides some evidence that trade liberalization undertaken in 1986 likely would have had a small positive impact on Kenyan real GDP. However, the liberalization scenarios the authors simulate—cutting tariffs to a uniform 10 percent—are steeper than the policies the Kenyan government actually pursued, and thus the real impact of Kenya's liberalization on growth was probably even more muted than the small effects the authors found.

One final method of analyzing trade's impact on growth is to look for trade's impact on productivity. Over the long term sustained economic growth depends on increasing productivity, and thus evidence that trade has a positive impact on productivity would suggest that trade also improves long term growth. Joseph Onjala (2002) studies the links between Kenya's total factor productivity (TFP) and the country's trade policies. Onjala measures TFP using traditional growth accounting equations, in which increases in output are explained by increases in the stock of factors (labor and capital) and increases in TFP. He then looks at these changes in TFP and relates them to Kenya's contemporaneous trade policies. At first glance his results appear promising, as he finds TFP grew faster during broad periods of liberalizing than it did during periods of tightening. On further quantitative analysis, however, this relationship breaks down: using both simple correlations and regressions, Onjala can find no systemic connection between trade policy variables and productivity growth. Like Glenday and Ryan's and Karingi and Siriwardana's analyses, then, this paper provides some suggestion of a positive impact of Kenya's trade liberalization on growth, but falls short of conclusive evidence.

Studies of the impact of Kenya's trade liberalization on the country's economic growth fail to draw any strong causal connections. As noted above, this is not particularly surprising; even in cases of stable economies undergoing liberalization, it is often difficult to discern any significant impact of trade on growth. And given that in Kenya's case trade liberalization was pursued in a start-stop manner with frequent policy reversals and simultaneously with other significant reforms and shocks to the economy, the isolated impact of trade was likely quite small. But from the studies detailed above and the general performance of the economy during the period, it is safe to say that if trade liberalization did have a positive impact on Kenya's economy it was not enough to spur broad, wide-reaching growth.

[4] CGE models are typically used as ex-ante tools to study the potential future impact of trade policy changes, rather than as ex-post tools to draw causal connections between policies and impacts.

Impact on employment

The impact of trade liberalization on the level of employment in Kenya appears to be modest, though slightly negative. Jenkins and Sen (2006) use several different methods to study the impact of trade on manufacturing employment, including factor-content analysis, industry-level regressions, and growth accounting techniques. The first two approaches show no real link between trade and employment, and the third only a minimal one: the authors estimate that between 1990 and 1998 the net impact of trade on manufacturing employment was a loss of approximately 18,000 jobs. Jenkins and Sen conclude that trade liberalization has had a negligible effect on manufacturing employment in Kenya.

The CGE analysis by Karingi and Siriwardana (2001) cited above also considers the impact of trade liberalization on employment. Under the authors' first two simulations (tariffs cut to uniform 10 percent, tariffs cut to 10 percent while indirect taxes simultaneously raised to cover government revenue shortfall) labor demand decreases for all categories of workers, ranging from -1.35 percent to -5.37 percent. It is only in the third simulation (tariffs cut to 10 percent and foreign aid increased to cover government revenue shortfall) that the impact of liberalization on employment is essentially neutral, with semi-professional, professional and self-employed workers showing very small gains and unskilled and skilled laborers showing very small losses. Karingi and Siriwardana's study suggests trade liberalization had at best no impact on employment and possibly led to job destruction.

It is important to consider not only trade liberalization's impact on the overall *quantity* of jobs, but also the impact on the *quality* of jobs. Trade liberalization contributes to job churning, the simultaneous creation and destruction of jobs. In Kenya, this job churning has resulted in fewer full time, permanent formal positions, and many more part time, casual, and informal jobs. While informal jobs do give individuals the opportunity to earn a living, there are significant drawbacks to working in the informal sector rather than the formal sector. Informal workers are not protected by the state's labor laws, and thus face lower wages, longer hours, and no job security, and may additionally work in unsafe conditions and face greater discrimination.

Almost all employment growth in Kenya over the last two decades has been in the informal sector. The share of the informal sector in total employment increased from 20 percent in 1980 to over 70 percent by 2000 (Manda, 2002). This drastic shift is a complex phenomenon attributable to many factors, but trade liberalization likely played a role. Using manufacturing firm survey results, Manda and Sen (2004) find that between 1993 and 2000 the average number of permanent workers per firm in exporting firms decreased sharply, while in non-exporting firms the figure remained relatively stable. In his extensive review of the impact of globalization on employment in Kenya's, Manda (2002) concludes that trade liberalization, along with civil service reforms and parastatal retrenchment, was an important factor in the informalization of the labor market.

Impact on poverty and inequality

The incidence of poverty worsened during the structural adjustment era, while there was little change in the level of income inequality. Assessing changes in poverty rates is difficult due to differing methodologies in household surveys from year to year, which make poverty estimates not strictly comparable across years. However, most poverty analyses from the 1970s estimate the percentage of the Kenyan population living in poverty at around 35 percent, whereas estimates in the early 1980s climb to about 40 percent , estimates for the early 1990s are around 45 percent, and estimates for the late 1990s are greater than 50 percent (UNDP, 1999; Kimalu et al, 2002). With respect to income inequality, Kenya has long been one of the most unequal economies in the world, and no improvement was made during the period of trade liberalization. Available household survey data shows that inequality (as measured by the Gini coefficient) decreased slightly between 1992 and 1994, but then increased through the end of the decade. In

1999 the top ten percent of households earned 43 percent of total income, whereas the bottom ten percent earned less than 1 percent of total income; Kenya's Gini coefficient of 0.57 in 1999 placed it among the ten most unequal countries in the world (Society for International Development, 2004).

As with growth, it is difficult to precisely assess the relationship between trade liberalization and the changes in poverty and inequality measures. The evidence which does exist on the link between trade reforms and poverty in Kenya suggests liberalization has had mixed impacts on poverty. Odhiambo and Otieno (2006) consider the impact of trade liberalization in four sectors of the Kenyan economy—sugar, cotton, horticulture, and fisheries—selected due to their importance to the livelihoods of poor households. The authors find that liberalization in the sugar and cotton industries increased poverty, as the poor farmers in these sectors are inefficient producers and unable to compete with cheaper imports (particularly as imports from developed countries are subsidized). Conversely, the export opportunities available in the horticulture and fishery sectors have likely reduced poverty. Odhiambo and Otieno conclude that despite success in certain sectors overall trade liberalization has not succeeded in alleviating poverty in Kenya, and note that the government failed to adopt the necessary complimentary reforms to fight poverty, which would include reviewing fiscal, infrastructure, and labor market policies.

Other authors addressing the impact of Kenya's trade reforms on poverty come to broadly similar conclusions. In their extensive review of Kenya's reform experience, Were et al. (2005) note that small-scale farmers were amongst the losers of trade liberalization, particularly those who lack credit and technological skills; as it is reasonable to assume many of these farmers live below or near the poverty line, this suggests liberalization may have worsened rural poverty. Jenkins (2005) finds that though new export opportunities in the horticulture sector have alleviated poverty for some rural Kenyans, overall poverty is more likely to have increased due to trade liberalization than decreased. He concludes by stating that greater integration with the global economy cannot be a substitute for a strong anti-poverty program.

Differing authors have reached opposing conclusions regarding the impact of trade reform on inequality in Kenya, though their differences are largely explained by their choice of inequality measure. Bigsten and Durevall (2006) consider the impact of trade reforms on wage inequality using the ratio of manufacturing wages to agricultural wages as a measure of inequality. The measure of openness the authors use is the ratio of Kenyan manufacturing prices to those in the UK, under the assumption that greater effective openness is reflected in the convergence of manufacturing prices with major trading partners. Regression analysis shows that the ratio of domestic to UK manufacturing prices and the ratio of manufacturing to agricultural wages were indeed cointegrated during the period 1964–2000; in other words, the level of economic openness (measured as the ratio between manufacturing prices) played a major role in narrowing the gap between manufacturing wages and agricultural wages. This suggests that trade integration has lessened wage inequality in Kenya.

In contrast to Bigsten and Durevall, Manda (2002) presents some evidence that inequality has increased over the reform period. Using household survey data from 1978, 1986, and 1994, the author compares the evolution of real monthly earnings for individuals living in urban areas with various education levels. Highly-skilled workers did much better during this period that semi-skilled and low-skilled workers; the university-educated group was the only category for which 1994 earnings exceeded 1978 earnings, whereas the uneducated group suffered the greatest loss. The returns to university education tripled during this time, while the returns to secondary education decreased by 50 percent. Manda also looks specifically at manufacturing wages in urban areas, and finds that the same general pattern persists; the highly-skilled have done much better relative to the unskilled and semi-skilled. While this development cannot be solely attributed to trade liberalization, the author states that this was one of the major changes of the reform era. Were et al. (2005) also find that reforms were associated with growing inequality, noting that "the distributional consequences of reforms deepened the asymmetries in income and access to resources" (p. 60). While there is mixed evidence on the impact of trade liberalization on inequality, given the extreme inequities which remained in Kenyan society at the end of the reform period it is safe to say that at a minimum trade reforms failed to sufficiently redress this challenge.

Success stories: horticulture and apparel

Despite the lackluster impact on the overall economy detailed above, trade liberalization has produced some important success stories in Kenya. Case studies of the country's horticulture and apparel industries provide valuable lessons for Kenya's future international engagement.

Kenya's horticulture industry has quickly become an international leader and one of the most dynamic sectors in the Kenyan economy. The horticulture sector can be difficult for developing countries to break into, as it requires careful supply chain management and strong infrastructure in order to ensure just-in-time delivery. Kenyan companies have flourished in this industry, however, exporting $322 million of fruits and vegetables and $313 million of cut flowers in 2006, up from $79 million and $13 million, respectively, in 1990. The vast majority of these exports go the European Union, and particularly to the United Kingdom. In recent years the industry has evolved to demand greater processing and packaging work, such as chopping and bagging vegetables. Today the industry is a significant source of employment for both rural farm laborers and urban packhouse workers.

There is strong evidence that the boom in horticultural exports has contributed to human development and lessened poverty in Kenya. Three studies—Dolan and Sutherland (2002), McCulloch and Ota (2002), and Humphrey, McCulloch, and Ota (2004)—which address the impact of horticultural exports on livelihoods in Kenya have found broadly positive outcomes. Survey results presented in Dolan and Sutherland (2002) show that a majority of employees in the horticulture sector believe their living standards have improved since they began working in the industry, a sentiment which is particularly strong amongst young female workers. McCulloch and Ota (2002) use regression analysis to show that, even after accounting for other determinants of household income such as demographic characteristics, education, and ethnicity, households with workers involved in export horticulture have significantly higher incomes than those who do not. Packhouse workers had the highest incomes, once again underlying the importance of the recent market shift toward greater processing and packaging. The authors also present counterfactual simulations showing that increasing the number of households involved in the horticulture industry would significantly decrease both rural and urban poverty. Humphrey, McCulloch, and Ota (2004) estimate that the export horticulture industry directly employed 100,000 Kenyan workers in 2000. They note that prepared vegetable production is 2.5 to 5 times more labor intensive than unprepared vegetable production. Estimates of the total number of workers employed both directly and indirectly by the industry are as high as 2 million (McCulloch and Ota, 2002). The horticulture industry has been one of the driving forces in Kenya's economy in recent years, and is the country's most important non-traditional export.

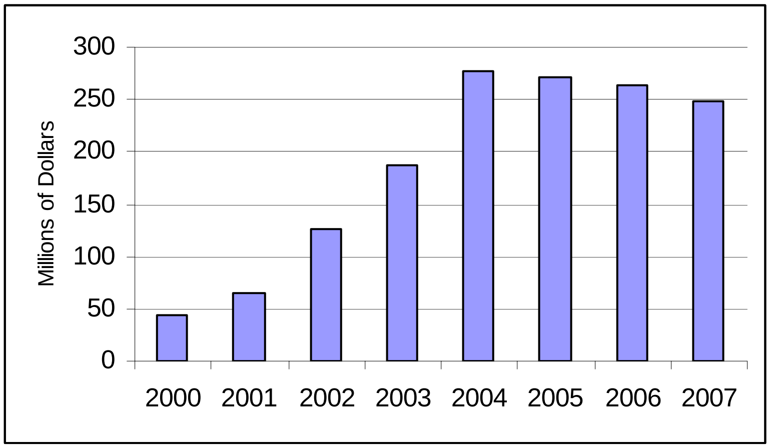
A second export industry which has achieved some success in Kenya is apparel. As noted above, the apparel industry was one of the first sectors in the country to be hit by import competition, as previously inefficient firms were wiped out by cheap imports of used clothing. More recently, however, Kenya has seen a boom in apparel exports, primarily attributable to the African Growth and Opportunity Act (AGOA).[5] AGOA, adopted by the U.S. government in 2000, allows duty-free and quota-free access to the American market in certain product lines for most sub-Saharan African countries, including Kenya. Under AGOA apparel exports to the U.S.

[5] The increase in apparel production has not led to a rebuilding of the backward linkages which once characterized the Kenyan clothing industry; cotton and textile production remains well below pre-liberalization levels. The Kenyan apparel industry relies on cheap imported inputs, and should changes in the Rules-of-Origin of trade preference programs force Kenyan firms to use locally-produced textiles their costs would increase significantly.

increased from $44 million to $277 million in just four years, with much of the production taking place in Kenya's export processing zones.

Between 2004 and 2007 Kenya's apparel exports to the U.S. leveled off, not coincidentally corresponding to the expiration of the Multi-Fibre Agreement which previously governed global apparel trade and limited competition from China. The apparel industry remains a strong source of potential growth for Kenya, however, and could expand further if wages begin to rise in low-cost Asian suppliers while Kenya's firms are able to decrease costs as they gain experience and efficiency. Targeted investment in infrastructure and generous preferential access to developed country markets are also necessary to stimulate further growth in the industry.

Figure 4: Kenyan Apparel Exports to the U.S., 2000–2007



Source: U.S. Office of Textiles and Apparel, 2008.

To what extent Kenya's success in the horticulture and apparel industries can be attributed to the specific trade liberalization measures the country adopted during the structural adjustment period is debatable. However, it is extremely unlikely that these export industries could have thrived under the import substitution trade regime, when firms were restricted by expensive imported inputs and foreign exchange controls. Thoen et al. (1999) state that foreign exchange restrictions were a great burden on export horticulture firms in the 1980s, and note that the industry has thrived since the government adopted a "hands-off" approach during the liberalization era, including importantly the end of government controls on air freight rates. The apparel industry has certainly benefited from the use of export processing zones, though the impact this has had on the working conditions for employees could be considered less positive. In any case, both industries clearly depend on engaging in trade, and thus the overall move toward outward oriented development that took place in the structural adjustment was necessary for their later success.

IV. Conclusions and Implications for Future Trade Policy

While the horticultural and apparel industries have benefited from increased integration with the global economy, Kenya's overall experience with trade liberalization during the 1980s and 90s was disappointing. Though there are few rigorous studies which quantitatively link trade reforms to economic performance in Kenya, the broad picture is clear: given the poor performance of the overall economy, the lack of job growth, and increasing poverty, trade liberalization failed to achieve the country's development goals. Exports remained constrained by poor infrastructure and institutions, and did not succeeded in diversifying much beyond a few key agricultural sectors and other low-value goods. While trade was never going to be a panacea for the country's troubles, an enhanced trade policy could have bolstered an economy-wide development plan.

Going forward, the challenge for Kenya's policymakers is how to scale-up, replicate, and diversify the targeted trade successes in horticulture and apparel to the broader economy. Drawing on the lessons from its past experience with trade liberalization, there are three goals the Kenyan government should pursue which would help it realize this aim: incorporate trade policy as part of a comprehensive development strategy, diversify the economy through balancing regional and global trade liberalization, and focus on the employment outcomes of trade policies.

Incorporating trade in a comprehensive development strategy

As noted above, during the period of trade liberalization Kenya was simultaneously pursuing multiple other economic reforms and policies. Pursuing reforms on multiple fronts can be effective when they're well-coordinated, as successes can build off one another. In Kenya's case, however, the simultaneous policy changes sometimes worked at cross-purposes, limiting the impacts of trade reforms.

For example, in the early 1990s new export promotion programs were designed to provide exciting opportunities for businesses to grow and partake in the global economy. But because monetary policies at the time strictly targeted inflation and allowed extremely high interest rates on treasury bills, credit wasn't available for the private sector at affordable rates, and businesses—particularly small and medium businesses—struggled to expand. Similarly, the country's exchange rate policies were not well coordinated with trade policies. Pollin and Heintz (2007) estimate that Kenya's real exchange rate was undervalued in the period leading up to its liberalization in 1993, but was regularly overvalued during the 1994–2000 era. Thus during the second half of the decade, when Kenya was making its strongest push to promote exports, an overvalued exchange rate was pushing in the opposite direction, making the country's exports less competitive.

Rather than pursuing policies in such a disjointed manner, the government must include trade as part of a broad agenda aimed at spurring sustainable development. Complementary policies might include improving access to credit, particularly for small and medium enterprises; strengthening labor market institutions; maintaining a competitive exchange rate; and targeted public investment in areas such as agriculture and trade facilitation. Additionally, given the country's severe inequality and lack of opportunity for many of its poorest citizens, redistributive and/or cash transfer programs may be necessary to shield the poor from negative impacts of trade liberalization and allow them to benefit from its opportunities.

The government has taken some important steps toward crafting such a wide-ranging framework of complementary policies aimed at generating growth and employment and decreasing poverty. Kenya recently launched Vision 2030, the country's long term strategic plan, which has a broad approach linking economic, social, and political goals. Only limited details have been released so far, however, and getting these right—as well as ensuring successful implementation—will determine whether the plan will be successful or not. As Kenya's past shows, hold-ups and reversals in one policy area can easily spill into problems for another; successful implementation will require progress on many fronts.

Diversifying the economy through global and regional trade integration

Kenya's options for further trade liberalization can be classified into two broad groups: policies that would increase trade between Kenya and advanced industrial countries, such as signing on to a multilateral agreement at the WTO or deals with the EU or United States, and policies that would increase trade between Kenya and other developing countries, most notably regional integration efforts in East and Central Africa. Balancing these two channels will allow Kenya to at once capitalize on its comparative advantage in agriculture and nurture a promising manufacturing sector.

Relative to the rest of the world, Kenya's abundant unskilled labor, very low levels of capital, and fertile ground situate the country's comparative advantage primarily in agricultural and natural resource production. Kenya's vegetable producers, for example, are efficient firms which can compete with those of any other country in global markets; its manufacturing firms, on the other hand, are for the most part ill-equipped to compete in global markets. A significant report assessing the competitiveness of Kenya's manufacturing sector concluded that while Kenyan firms have a slight competitive edge over Tanzania and Uganda, they are significantly less competitive than manufacturing firms in countries such as China and India (World Bank, KIPPRA, and CSAE, 2004). Given these initial circumstances, increasing trade with advanced industrial countries will likely push the structure of the Kenyan economy further toward agriculture: as found in Zepeda et al. (2009), a completed WTO Doha Round will likely produce benefits for Kenya's agricultural sectors but losses for its manufacturing industries.

The challenge for the country thus lies in balancing the goal of benefiting from its comparative advantage in agricultural production with the target it has been pursuing since the days of import substitution: the creation of a robust industrial base that can serve as a springboard for development.

One way Kenya could pursue this balancing act is to counter increased global integration with even greater regional integration. Kenya's trade position relative to East Africa is in many ways the reverse of its trade position relative to the world; within the region, Kenya is primarily a manufactures exporter, and enjoys a substantial trade surplus. Statistics from the East African Community (EAC) and the Common Market for Eastern and Southern Africa (COMESA) attest to the country's strong position in regional trade.[6] Kenya's trade surplus with other EAC members was $651 million in 2006, while its surplus within COMESA was $668 million (United Nations, 2008; COMESA, 2008). About 70 percent of Kenya's exports to the EAC consist of manufactured goods, chemical products, and machinery and transport equipment. Some of the country's top exports in East Africa include plastics, pharmaceuticals, cement, and steel. Food and agricultural commodities make up only 12 percent of Kenya's EAC exports (United Nations, 2008). Within COMESA the pattern is broadly similar, though not quite as pronounced.

Regional trade provides an excellent source of demand for Kenya's manufactured exports, which can help balance the push from multilateral liberalization toward greater agricultural production and exports. Today Kenya's manufacturing firms would not be competitive in liberalized global trade; securing preferential access to the regional market will allow Kenyan manufacturing firms to gain experience and improve efficiency, which should ultimately allow them to compete in global markets. Deeper regional integration will allow Kenya to expand its manufacturing exports and thereby encourage sustainable growth in the industrial sector, which will help offset fears of deindustrialization brought on by multilateral liberalization and increased trade with developed countries.

Focus on employment

In recent years many economists have underlined the centrality of employment to a successful development strategy.[7] Economic growth without increases in decent employment will not appreciably improve the quality of life of families, particularly for those in the lower half of the income distribution. As Kenya crafts its future trade policy, employment must be a principal concern. The focus must be on not only the quantity of jobs, but also the quality of jobs; recent analysis shows that almost 50 percent of Kenyans who are employed full time are living in

[6] The EAC consists of Burundi, Kenya, Rwanda, Tanzania, and Uganda. COMESA includes Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, and Zimbabwe.
[7] For a thorough example on Kenya, see Pollin, Githinji, and Heintz, 2007.

poverty (Pollin, Githinji, and Heintz, 2007). Creating jobs that allow workers a path out of poverty must be a top priority for Kenya's policy makers.

There are numerous trade-related policies Kenya can adopt to encourage the growth of decent employment. Targeted support to key labor-intensive export industries could help absorb the country's excess labor supply. Increasing workers' productivity will likely lead to higher wages, allowing more workers to live above the poverty line; this might be accomplished by strategic imports of capital and machinery, and by efficiency gains from learning-through-exporting. Greater public spending on trade facilitation infrastructure projects could be an important source of formal employment. Additionally, defensive trade policies—to protect the livelihoods of poor farmers from agricultural import surges, for example—may be necessary to shield some of the most vulnerable Kenyan workers.

A view to the future

The trade and development landscape today is very different from the one which faced Kenya's policymakers back in 1980. Inward-looking trade policies, such as those Kenya pursued in the years after independence, have all but disappeared, as a consensus has emerged that engaging with the global economy is the best path toward sustainable growth.[8] Yet unqualified, one-size-fits-all liberalization policies have also fallen out of favor; there is a growing recognition amongst developing country policy makers that they must engage with trade strategically, tailoring liberalization to the specific conditions of their countries' circumstances and paying attention to the pacing and sequencing of reforms.

It is against this landscape that Kenya's policy makers are now charting the course for the country's future trade policy. Kenya was influential during the Doha Round negotiations at the WTO, and should these negotiations be revived—as has been called for in the wake of the global financial crisis—the country is likely to once again vocally defend the interests of developing countries. With the other members of the EAC Kenya is negotiating an Economic Partnership Agreement with the European Union, and recently the EAC, COMESA, and the South African Development Community (SADC) announced plans for a regional free trade agreement which will bring together 26 countries and 527 million citizens.

As Kenya continues to develop its twenty-first century trade policies, the lessons from its first wave of liberalization should be kept in mind. The country can and must do better than its economic performance of this earlier era. If Kenya's policymakers incorporate trade into a comprehensive development strategy, diversify the economy through balancing regional and global integration, and focus on employment, there is no reason the successes seen in the horticulture and apparel industries cannot be expanded to the broader economy.

[8] See Commission on Growth and Development (2008).

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