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The African Lions

Kenya country case study

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Abstract: This paper mainly analyses the drivers of economic growth in Kenya and the linkages to the labour market dynamics, with a focus on population growth, its structure, and the prospects of reaping a demographic dividend. This is in recognition that Kenya, as the ninth largest economy in Africa and the fourth largest in sub-Saharan Africa and with a locational advantage, presents some policy lessons and challenges that can boost its capacity for growth and take advantage of its location and the policy environment to drive growth in the region. The results show earnings to vary widely across sectors, reflecting barriers to labour mobility. The rising labour productivity (since 2009) indicates an improvement in the efficiency of labour use, although growth-employment elasticities have slightly declined in recent years. Whereas formal wage employment growth has closely tracked gross domestic product growth since 2004, such a relationship is absent with respect to employment in the informal sector, which dominates the economy.

Keywords: economic growth, youth employment, population divided, labour productivity

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1 Introduction

Following recent rebasing of its economy, Kenya is now classified as a lower-middle income country. With a 2013 gross domestic product (GDP) of USD53.4 billion and per capita income of USD1,246, the country is ranked the ninth largest economy in Africa and the fourth in sub-Saharan Africa (SSA). As it stands now, Kenya is the dominant economy in the East African Community (EAC) and the primary source of foreign direct investment (FDI) for some of the countries of the Community. In recent years, Kenya has made major progress in financial deepening and financial inclusion. Increasingly, Kenya has become a centre of innovation especially in mobile phone-based financial services, whose growth and employment opportunities have ignited economic growth in the economy. Kenya has also been an important player in the horticulture export market. The country has a youthful population and is well positioned to reap the population dividend. In addition, the country has recently discovered oil and it is likely to be an oil exporter in the near future and will join Uganda and South Sudan. But even without oil discovery, the Kenyan economy stands at a very strategic location in the Eastern Africa region. It serves five landlocked countries that are relatively resource-rich (Ethiopia, South Sudan, Uganda, Rwanda, and Burundi). So its comparative advantage lies in improving its port facilities, road and railway networks, and transit airports as trade routes for these five countries. Even more significant has been the strengthening of the institutions of governance through the 2010 enactment of a progressive constitution that has radically altered the previous dominance of the executive. At the core of the new constitutional dispensation is devolution of decision-making powers to 47 county governments. All these factors augur well for continued strong economic performance.

However, the country's future growth faces several pitfalls even with the above set of opportunities. Some of the risk factors include: first, the emerging terrorist attacks by the Al-Shaabab group based in Somalia which has adversely impacted the country's economy; second and increasingly, although the country has recorded high rates of economic growth, joblessness especially among the youth remains very high and a likely source of instability; and third, poverty and inequality both at individual and regional levels remain high and pose threats not only to sustained growth but also to stability. In addition, internal institutional weaknesses and governance challenges threaten the gains of the new constitution. For example, Kimenyi and Ndung'u (2005) show the political power-play in sporadic ethnic violence during election cycles since the advent of multi-party political competition in 1992. These and other risk factors are of concern to the country's ability to sustain growth and retain its position as a dominant economy.

This study seeks to analyse the drivers of economic growth both in the past and the more recent period and also to evaluate the impact of economic growth on labour market prospects, the population structure, and growth, and how they impact on poverty reduction. We also review opportunities and pitfalls that are likely to influence the country's growth trajectory. The section that follows starts with a background of Kenya's economy and some important policy and political developments that have a bearing on economic performance. In Section 3, the study presents a discussion of the country's population growth, structure, transition, and demographic dividend prospects. The interest here is primarily on those aspects of the population that have a bearing on economic performance and specifically on the labour markets. The section also looks at Kenya's labour market with a focus on the structure of employment and the growth-employment dynamics. We discuss the distribution of employment by industry and also by formal and informal sectors. We then discuss some aspects of the labour supply side including wage earnings, labour productivity, and returns on human capital. The section concludes with some evidence of the growth-employment and growth-poverty nexus, and a discussion on the financial sector. In Section 4, we briefly review some of the supporting policies, that is, social

protection policies. Section 5 discusses some of the emerging challenges and opportunities to growth and employment and Section 6 provides conclusions that tie the study together to show why Kenya qualifies to be an African Lion, but with immense challenges to overcome.

2 Kenya's growth profile

2.1 Background

This section explains Kenya's economic growth performance since 2000, updating an earlier study that covered the period from the 1960s to the 1990s (Mwega and Ndung'u 2008). This earlier study attempted to explain why the good economic performance in the 1960s and early 1970s was not sustained in the 1980s and 1990s. The latter period was characterized by persistently low growth and limited economic transformation, despite the fact that the country maintained a large measure of political stability and pursued a fairly consistent development strategy. In the 1960s, growth averaged 5.7 per cent, accelerating in the 1970s to 7.2 per cent. It declined in the 1980s to 4.2 per cent and in the 1990s to 2.2 per cent (World Bank 2015).

In analysing the persistent growth slowdown that got under way in Kenya around the 1980s, a shortlist of plausible determinants include the global recession, commodity price decline, delayed structural adjustment policies, and political succession in the country, as well as slow-moving candidates such as institutional quality and distributional politics (O'Connell 2008). The country also experienced several negative shocks that, for example, undermined growth and contributed to the weak performance. Measures to reduce Kenya's susceptibility to exogenous shocks hence are necessary for improved economic growth (World Bank 2013). However, the scope for untangling the contributions of a large number of potentially relevant determinants is limited in a country case study (O'Connell 2008). For this reason, we focus on a few factors that will help to explain the current period.

2.2 Kenya's economic performance since 2000

In explaining Kenya's economic performance since 2000, we focus on three dimensions: first, the role of political economy; second, the macro-growth story that sheds light on how much of Kenya's experience is explicable in terms of growth regressions; and finally, the role of markets in explaining Kenya's growth process.

Since the early 2000s (Figure 1), the economy has experienced some recovery consistent with the Africa Rising narrative of a resurgence of economic growth in the region in the new millennium supported by the emergence of strong institutions and increasing demand for political accountability. The rapid growth in Africa has been attributed to a whole range of factors (Robertson 2013): better government finances and fiscal policies reflected in reduced debt and general government expenditures ratios; booming commodity exports, especially to China, although the region runs a trade deficit with the country; increased FDI; new discoveries of oil and other minerals; the increased role of telecoms; ease of doing business reforms; and increased investment in education as well as democratization of the continent. Some of these factors have also applied to Kenya, especially the rapid expansion in telecommunication and financial services, although the country started from dismally low growth rates.

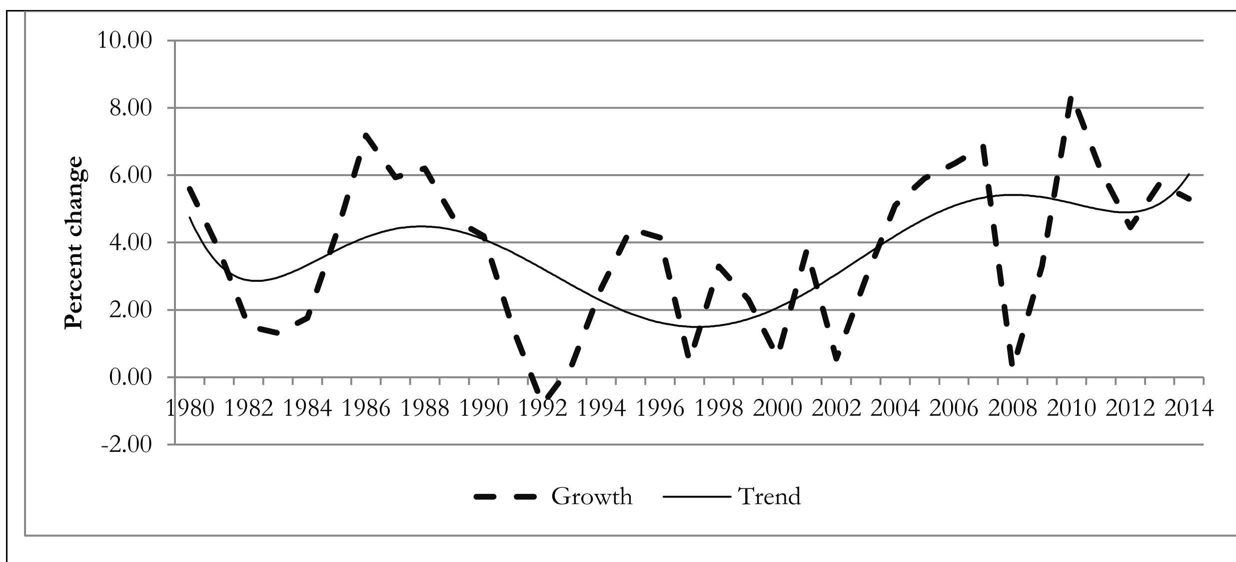
Political economy of Kenya's growth process

In 2000, the economy recorded an all-time low growth rate of 0.6 per cent, increasing to 3.8 per cent in 2001, but declining to 0.5 per cent in 2002. Following a peaceful change of government

in December 2002 from the Kenya African National Union, which had ruled the country since independence, to the National Rainbow Coalition (NARC) under Mwai Kibaki, the growth rate accelerated. The economy expanded steadily from 2.9 per cent in 2003 to 5.1 per cent in 2004, 5.9 per cent in 2005, and 6.3 per cent in 2006, to reach a peak of 7.1 per cent in 2007, the highest in over two decades and the only episode of five-year growth acceleration in Kenya's independence history (World Bank 2014). The good economic performance was bolstered by the implementation of bold economic and structural reforms under the Economic Recovery Strategy (ERS) and a favourable external environment. The ERS was a five-year blueprint prepared to address Kenya's macroeconomic vulnerabilities and structural weaknesses.

The Kibaki government put in place economic policy and governance reforms that enhanced economic performance. The average World Bank Country Policy and Institutional Assessment (CPIA), which rates 20 aspects of governance and policies, published since 2005, for example, generally improved over the study period: it improved in 2005–06 (from 3.52 to 3.58); declined in 2007–08 (to 3.55 and 3.52 respectively) as a result of the post-election violence, drought, and the global financial crisis; and improved in 2009–13 (from 3.67 to 3.80).[1] In the absence of poverty measurements, the World Bank (2014) estimates that poverty declined from 46 per cent in 2006 to around 42 per cent by 2013.

Figure 1: Economic growth in Kenya since 1980



Source: Authors' computations from Republic of Kenya Economic Surveys (Kenya National Bureau of Statistics Various Issues).

Despite the relatively good performance, the failure to develop an inclusive political agenda widened divisions in the country. The coalition of parties that formed NARC splintered after only three years following disagreements over proposed constitutional reforms (Collier et al. 2010). The subsequent 2007 elections were followed by a serious outbreak of ethnic violence, significantly disrupting the economy. About 1,300 people were killed and nearly 600,000 displaced. A group of eminent persons, led by former United Nations Secretary-General, Kofi Annan, brokered a peaceful solution to the political stalemate, leading to a power-sharing agreement between Mwai Kibaki and Raila Odinga. The events that followed the 2007 general election left a difficult legacy by exacerbating inter-ethnic mistrust and lack of confidence in the rule of law, which can be expected to have detrimental economic effects (Collier et al. 2010).

[1] In 2014, Kenya had an average score of 3.76, above Africa's average of 3.20.

Collier et al. (2010) therefore recommend revamping efforts at building supervisory institutions such as the electoral commission and judiciary in which the country's citizens can have confidence. The efforts in strengthening the country's institutions since the promulgation of the new constitution in 2010 partly led to a peaceful change of government in March 2013.

Consequently in 2008, the growth rate declined to 0.23 per cent as a result of the post-election violence, drought, and the global financial crisis eroding the achievements of the previous half-decade. Following counter-cyclical demand management policies and favourable weather conditions that improved agricultural performance, growth subsequently picked up to 3.31 per cent in 2009 and to 8.41 per cent in 2010. As a result of a surge in global food and oil prices as well as a drought in the country, growth declined to 6.12 per cent in 2011, to 4.45 per cent in 2012, to 5.74 per cent in 2013, and was 5.30 per cent in 2014. With an average economic growth of only 4.37 per cent over 2000–14, not very significantly above the population growth rate of 2.7 per cent, the country continued to operate below its potential.[2] This growth was lower than the average for SSA (4.88 per cent).

Macro-growth performance

The Kenyan story is one of missed opportunities. Kenya, for example, did not exploit globalization to increase manufactured exports, given its coastal location, relatively cheap labour, and basically market-friendly orientation. The share of manufactured exports in manufacturing output has historically remained quite low (at less than 15 per cent). While the economy was liberalized in the 1980s and 1990s, the trade liberalization policies were not credible and were often subject to reversals. Manufactured exports were also subject to serious supply constraints such as unavailability and/or high cost of credit, foreign exchange, infrastructural deficiencies, and an adverse regulatory framework, increasing transaction costs and undermining the country's competitiveness. This makes it difficult to overcome the threshold of cost-competitiveness to sell in the global market arising from the Asian countries' agglomeration economies (Collier 2008). There is agreement that manufactured exports are mainly constrained by high transaction costs, not endowments, at least in the medium term. The poor performance has not been confined to manufactured exports only but exports in general. What differentiates Kenya from peer countries, in particular those outside the East Africa region, is the clogged 'exports engine' (World Bank 2014). Exports of goods as a percentage of GDP have been declining since the mid-2000s, from 21.7 per cent in 2006–10 to 18.9 per cent in 2011–14 while imports of goods have been increasing. In contrast, services exports have been expanding but not enough to offset the widening gap between exports and imports of goods. Kenya has in the last decade therefore experienced a large increase in the current account deficit. The current account recorded an average deficit of 1.75 per cent of GDP in 2006, generally widening in the subsequent years. By 2012, the deficit had risen to an average of 10.6 per cent of GDP and by the year to July 2015 to 10.8 per cent of GDP, mainly due to increased imports in the context of a stagnant export sector. Imports of machinery and other equipment have, however, continued to account for a higher proportion (about one-quarter) of the import bill. These are essential for enhancing future productive capacity of the economy.[3]

[2] Recent growth rates have been revised as a result of the rebasing of the economy in September 2014. This involved revisions in sector classifications and the base year to 2009. Rebasing increased the GDP by 25 per cent in 2013 so that indicators such as the debt/GDP, current account balance/GDP, and fiscal deficit/GDP improved (Central Bank of Kenya 2014).

[3] According to a Central Bank of Kenya estimate, excluding heavy machinery and industrial equipment would reduce the current account deficit to a sustainable 4.2 per cent of GDP in the year to July 2014.

The high overall current account deficit is mainly financed by short-term net capital inflows, except in a few episodes when net long-term official flows dominate. Short-term capital flows have typically accounted for more than 50 per cent of total financial flows. This is a major source of potential vulnerability for the economy and for financial stability. The easy reversibility of these inflows increases the risk of a 'sudden stop' or a reversal as a shift in market sentiments creates a flight away from domestic assets (O'Connell et al. 2010). This could lead to depletion of reserves, sharp currency depreciations and a decline in stock prices, as happened during the 2007–08 global financial crises (Mwega 2010).

The growth literature, however, takes cognizance that economic growth is a multi-faceted process and that the rapid economic growth in East Asia from the 1960s to 1990s is attributable to a wide range of factors. Rapid economic growth requires the positive interaction of multiple factors such as the 'prevalence of primary education, agricultural development, macroeconomic stability, the role of public policies, the existence of regional dynamism, and so on' (Kurihara and Yamagata 2003: 6). Achieving rapid growth and shared prosperity requires continued action on multiple fronts. Improving on the key determinants to growth necessitates not only enactment of legislation, but also its enforcement; more public investment, and better execution of capital projects; greater political and economic stability; and improved governance (World Bank 2014).

The rate of investment is one of the most important influences on economic growth in Kenya. As seen in Figure 2, there is close correlation between growth and the gross capital formation ratio (0.3), with causality running from the investment ratio to growth.[4] Since 2000, there was a general increase in the investment ratio, from 17.4 per cent in 2000 to 21.3 per cent in 2014. These are, however, relatively low investment rates, driven by low private and public savings rates, as well as low FDI. Savings for example did not keep up with investment. The gaps increased from near zero to a deficit equivalent to 8.9 per cent of GDP in 2011 (World Bank 2013). An obvious policy implication is that macroeconomic policies should be geared towards stimulating more private and public investment rates (World Bank 2013). The Second Medium Term Plan of Vision 2030 (Republic of Kenya 2013) sets ambitious targets for augmenting public and private investment. To this end, it envisages an increase in the investment rate to 31 per cent of GDP by 2018, an ambitious 11 percentage point increase from the 2013 level. While foreign savings can finance some of the investment, the stated target cannot be achieved in a sustainable manner without higher national savings.

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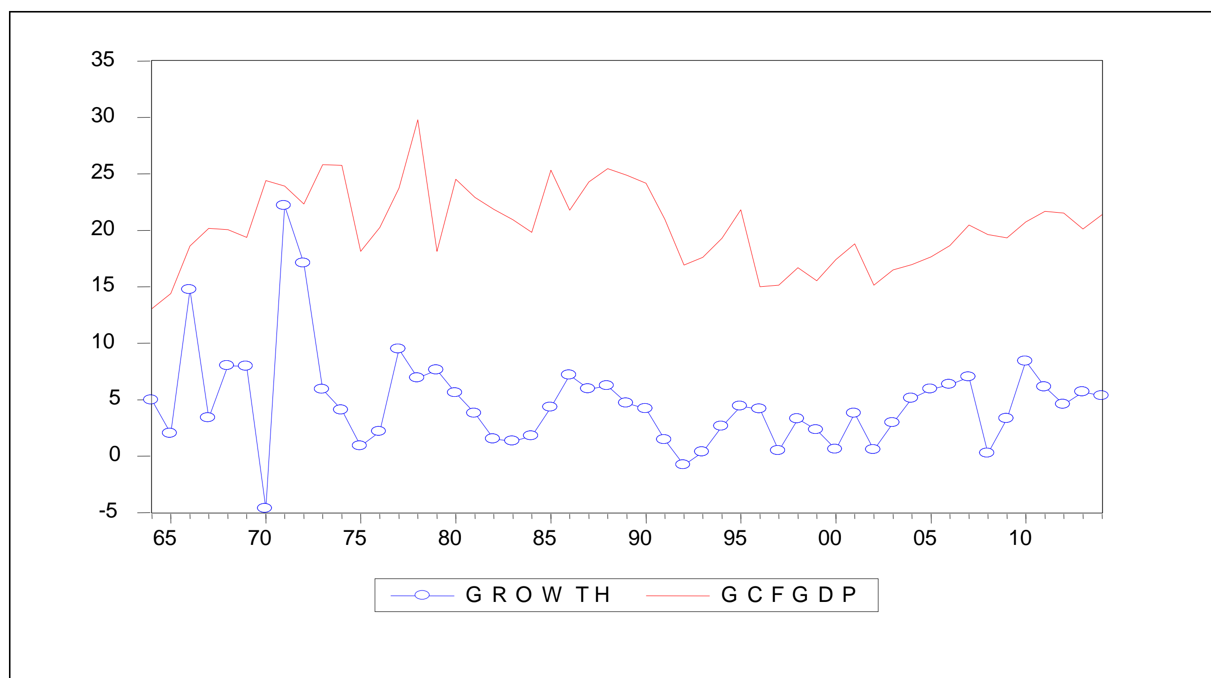
[4] This is based on our own analysis. Only at six lags is there a two-way causality between growth and gross capital formation.

Figure 2: GDP growth rate and gross capital formation/GDP ratio: 1964–2014



Source: Authors' computations from World Development Indicators, 2015 (World Bank 2015).

The conclusion linking investment and growth is supported by a number of studies on the Kenyan growth process (e.g., Azam and Daubreé 1997; Glenday and Ryan 2000). Glenday and Ryan, for example, conclude that private investment has been the 'strongest and the most significant contributor to growth' in Kenya. Azam and Daubreé conclude that private investment lagged behind accumulation of human capital, slowed by excessive competition from public investment in a context of financial repression. Hence, there is a need to increase investments to overcome constraints to growth such as public infrastructure.

Role of markets in the growth process

Markets are crucial for providing the incentive structure of the economy and shaping the direction of economic change towards growth, stagnation, or decline (Oyejide 2000). Markets and their accessibility are important for inclusive growth. It is difficult to map out specific policies for each of the markets in Kenya but the general trend was that major controls were introduced in the 1960s and 1970s and dismantled in the 1980s and 1990s. From being largely syndrome-free in the 1960s, regulatory syndromes of soft (mild) controls were introduced in the 1970s, which persisted into the 1980s (Collier and O'Connell 2008).[5] These controls acted as an easier response in controlling balance of payments and inflationary pressures in the economy. However, the 1980s and 1990s are characterized by economic reforms to aid markets to work better—the structural adjustment policies. There were also parastatal and civil service reforms.

[5] 'Syndrome free' refers to a situation where a country avoids four broad anti-growth regimes: (i) severe controls or regulations that distort production activities and reward rent-seeking behaviour; (ii) ethno-regional redistribution that compromises efficiency in order to generate resource transfers to sub-national political interests; (iii) inter-temporal redistribution that aggressively transfers resources from the future to the present especially in resource-rich countries; and (iv) state breakdown characterized by civil war or intense political instability during which the government fails to provide security or to project a coherent influence in a substantial portion of the country.

Whereas the market reforms started in the 1980s with a slow pace and then accelerated in the 1990s, institutional reforms were phenomena of the 1990s.

By the new millennium, therefore, most of the markets were fully liberalized, although, more recently, price controls were re-introduced in the oil industry in December 2010. In addition, legislation that allows the government to determine and gazette price controls on essential commodities like maize flour, kerosene, and cooking oil was passed by parliament. In other areas, liberalization has continued. Privatization of state corporations like the defunct Kenya Post and Telecommunications Company, for example, which resulted in East Africa's most profitable company (Safaricom), has led to their revival because of massive private investment. But removing controls does not guarantee rapid economic growth (Collier and O'Connell 2008). First, there are lags between reforms and private investment. Second, agglomeration economies by Asian countries make it difficult for African countries to break into international markets for manufactures and services. Third, success requires 'big push' actions by the state such as provision of physical and social infrastructure.

How the labour market operates is central to understanding how employment and incomes are generated and hence economic growth. In Kenya, recent regulations have constrained the labour market (World Bank 2014). Labour legislation was drastically revised in 2007, with many of the introduced changes disputed by employers and their business associations, who continue to voice their concerns to the strict regulations. These concerns have been reflected in enterprise surveys. In 2007, only 4 per cent of firms found labour regulations to be a major constraint to doing business; by 2013 the share of firms rose to 20 per cent. The revised regulations have also seen an increase in industrial disputes. The number of man-days lost as a result of such disputes skyrocketed from 15,000 in 2008 to 175,000 in 2011. The main grievances concern the strict medical surveillance requirements, health and safety audits, as well as the high minimum wage (World Bank 2014).

To summarize, there are various lessons to be learned reviewing Kenya's growth experience over the past decade; while the economy has become fairly dynamic and innovative, the economic outcomes have not been transformative. Agriculture remains the mainstay of the economy and three-quarters of the population continue to live in rural areas; manufacturing has been disappointing; and service industries, such as finance or communications, account for only a marginal share of employment. Kenya's modest growth performance is not surprising when the country is benchmarked against the most important determinants of growth (World Bank 2014). Countries at similar levels of development typically have greater macro-stability, higher urbanization, are more open, invest more, spend more on health, have better governance, and have more developed higher education systems than Kenya. Kenya's challenges in enhancing its growth performance as noted by Robertson (2013) include: identifying competitive advantages; delivering the energy and transport infrastructure required to achieve the Vision 2030 development goals; enhancing investment in education to support rapid growth; ensuring sustainable fiscal policy; and a stable macroeconomic environment. Achieving the desired growth targets therefore entails improvements simultaneously on two fronts: increased physical and human capital, and faster productivity growth.

3 The promising future

3.1 Kenya's population structure, transition, and demographic dividend

Kenya has been disadvantaged by a more rapid population growth (Mwega and Ndung'u 2008). Up to the 1980s, Kenya had one of the most rapid population growth rates in the world. The

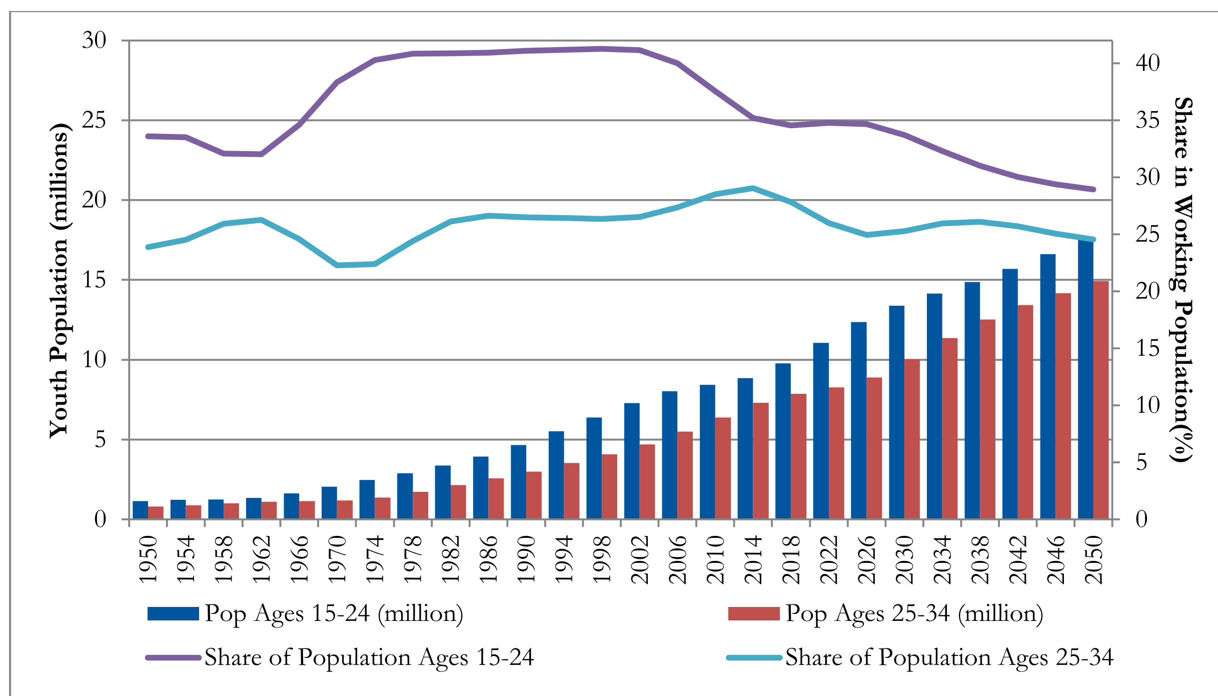
population growth rate increased from 3 per cent in the 1960s to 4 per cent in the 1970s and 1980s whereas that of high performing Asian economies (HPAEs) declined from 3 per cent in the early 1960s to 2 per cent thereafter. In the 1990s, the average population growth rate was 2.9 per cent, declining to about 2.7 per cent in the new millennium.

World Bank statistics show that the population aged 0–14 years, 15–34 years, and 35–64 years has been on an increasing trend since 1960 while the population aged 65 years and above has stagnated. The population aged 0–14 years continues to remain higher than the other age groups, followed by the youth population (ages 15–34 years) and those aged 35–64 years. This trend indicates that Kenya is likely to experience a youth bulge as more of those aged 0–14 years move into the youth age group. In 2014, the population aged 0–14 years stood at 19.1 million while that aged 15–34 years stood at about 16.1 million. The population aged 35–64 years stood at about 8.9 million. On the other hand, the population aged 65 years and above has remained at below 3 per cent of the total population since 1981 with the 2014 figure being 1.2 million.

Kenya has also experienced a steady rise in urbanization. In 1950, the share of urban (rural) population was 5.5 per cent (94.41 per cent). In 2014, the share of urban population was estimated at 25.20 per cent of the total population. So urbanization has steadily increased in Kenya. It is projected that by 2030, the urban population will be at 32.83 per cent while the rural population will have declined to 67.17 per cent of the total population due to rural-urban migration resulting from the pull factors in urban areas (quality of life and economic opportunities in the urban areas among others). The trend reveals that, while indeed urbanization will continue at a steady rate, rural areas will remain home to the vast majority of the population for the foreseeable future.

An important feature of the population structure that relates to labour market outcomes is the relative size of the youth population to that of the total working age population (ages 15–64). The United Nation defines youth as a person aged between 15 and 24 years, while in Kenya youth is defined as a person aged between 15 and 35 years according to the Kenya National Youth Policy (Republic of Kenya 2008). The youth population has constituted more than half of the working age population in Kenya since 1950. In 1950, the youth population comprised of 57.5 per cent of the working age population. The share of the youth population increased steadily over time reaching a peak of 67.7 per cent of the working age population in 2002. Since 2006, the share of the youth population to the working age population has been declining. In 2014, the share of the youth population to the working age population stood at 64.2 per cent and is projected to decline gradually to 59.0 per cent in 2030. The youth population can be disaggregated into two cohorts, that is, those who are aged 15–24 years (most of whom are still in school and are considered inactive in the labour market) and those aged 25–34 years (most of whom have completed school and are employed or actively looking for jobs). Figure 3 presents the trend and projections for these cohorts of youth population in the country.

Figure 3: Share of youth population

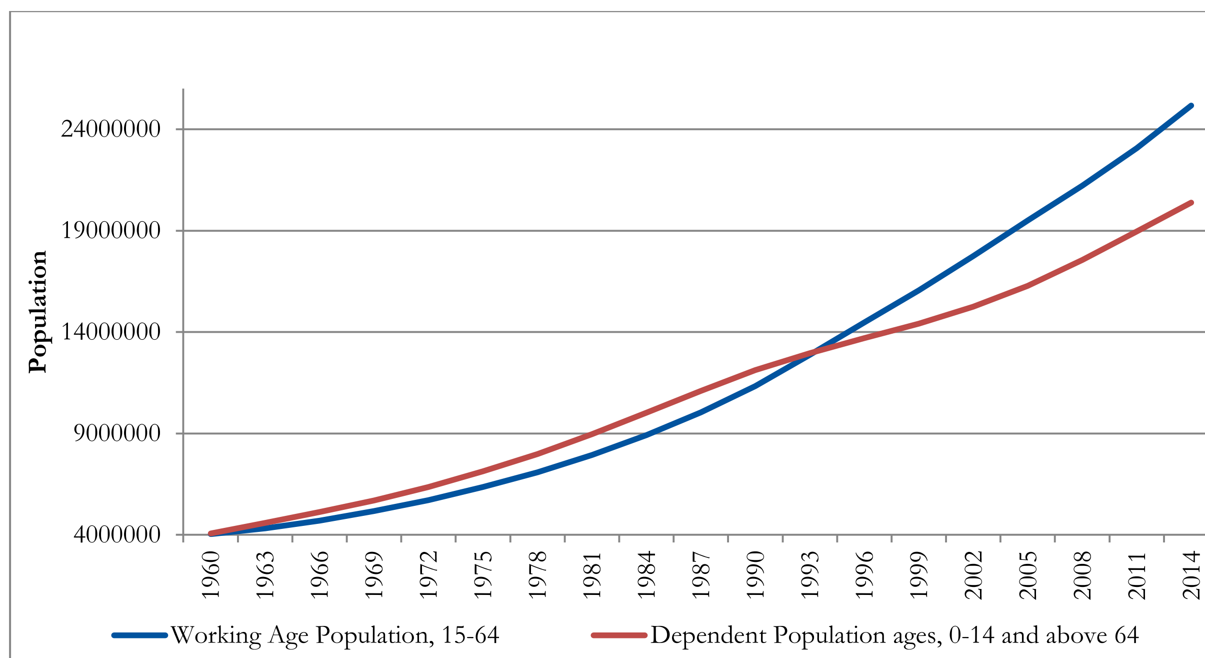


Source: Authors' computations from United Nations (2013).

Figure 3 shows that the population of youth aged 15–24 years has been higher than that of those aged 25–34 years since 1950 and this is projected to continue towards 2050. In 2014, the share of the youth population aged 15–24 years was 35.2 per cent of the working age population while the share of the youth population aged 25–34 years was 29.1 per cent of the working age population. The share of both cohorts of youth population in the working age population has been declining since 2006 and is projected to decline further as we move to 2050. This decline is expected to reduce the youth dependency ratio as more of the working age population will be composed of those aged between 35 and 64 years as we move to 2050. The fact that the working age population is not homogeneous is important to note in developing policies to ensure that most of them are actively involved in labour market activities in one way or another.

The second feature of the population structure related to the labour market is the share of the working age population (ages 15–64) to the dependent population (ages 0–14 and above 64). In 1950, the dependent population was 2.7 million. In 2014, the dependent population was estimated at 20.4 million (44.75 per cent of the total population) while the working population was 25.2 million (55.25 per cent of the total population). Figure 4 shows the trends in the working age population and the dependent population in Kenya.

Figure 4: Trends in Kenya's working age and dependent population



Source: Authors' computations from World Development Indicators, 2015 (World Bank 2015).

From 1960, the dependent population was slightly higher than the working age population until 1994 when the working age population overtook the dependent population. The figure indicates that since 1994, the working age population has been growing faster than the dependent population and this trend is projected to continue into the next decades. As noted earlier in this section, the population aged 0–14 years continues to remain higher than the other age groups followed by the youth population (ages 15–34 years) and those aged 35–64 years. As more of those aged 0–14 years move into the youth age group, the working age population is expected to continue expanding leading to further decline in the dependent population and a larger working age population that would accumulate savings and increase investment in the economy.

It is also worth noting that Kenya has witnessed declining fertility rates from eight births per woman in the 1960s to seven births per woman in the 1980s, and finally to 4.4 births per woman in 2013. In 2014, Kenya had a 46 per cent contraceptive prevalence rate (all methods) and a fertility rate of 4.6 children per woman (Republic of Kenya 2014). The crude mortality rate has also declined from 20 per 1,000 people in 1960 to 8 per 1,000 people in 2013. Consequently, the life expectancy has improved from 46.4 years in 1960 to 61.7 years in 2013. With the increase in share of the working age population which has accelerated since 1993 from 49.8 per cent of the total population to 55.1 per cent in 2013, these trends indicate that demographic transition has taken effect in Kenya. This sets the country on the path to realization of demographic dividend if other contributing factors are adequately provided for. Bloom and Canning (2008) observe that as the dependency ratio falls, opportunities for economic growth tend to rise, creating a demographic dividend.

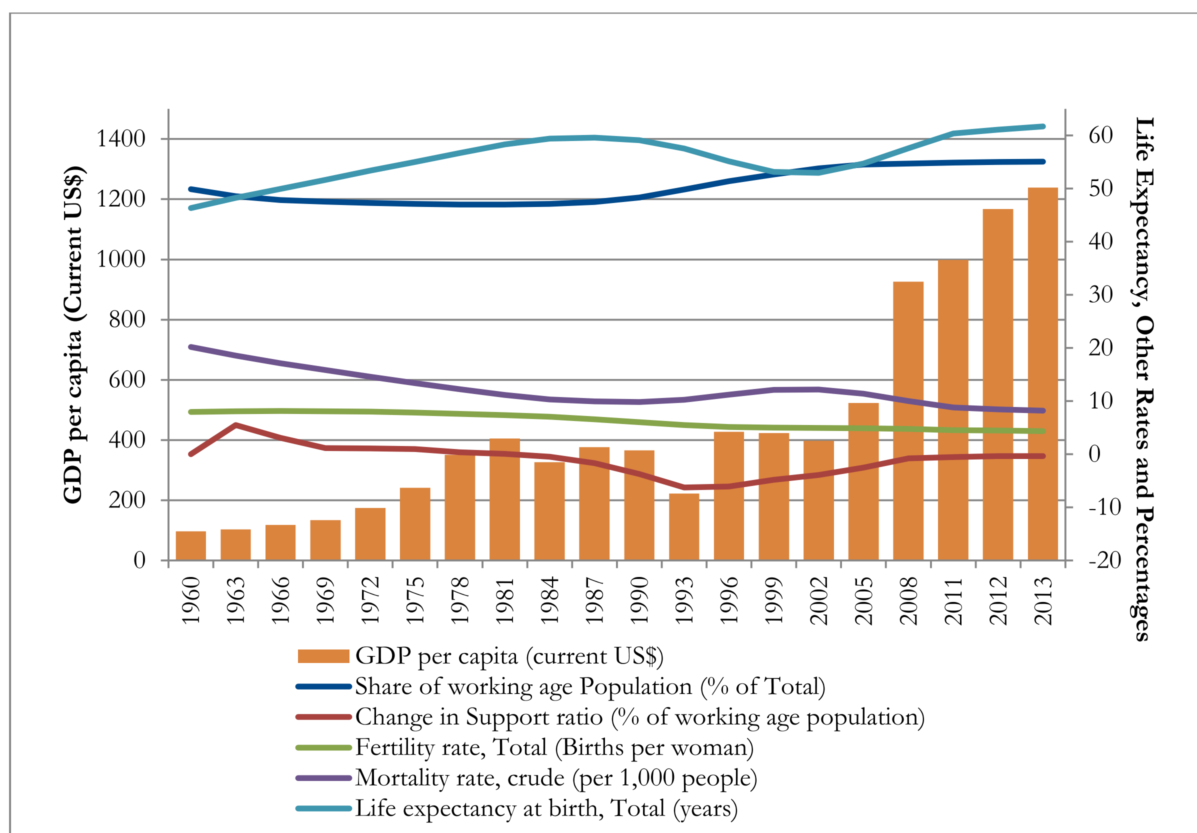
A demographic dividend is a temporary opportunity for faster economic growth that begins when fertility rates decline, leading to a larger proportion of working age population compared to young and retired dependent population (NCPD 2012). Bloom et al. (2014) note that factors that can facilitate the reaping of demographic dividend for a country include integrated family planning, education, and economic development policies. From Bloom et al. (2014), the emphasis is that for a demographic dividend to be realized there should be a decline in birth rates and mortality rates followed by an increase in labour supply. This seems to describe what

Kenya has gone through, as evidenced by the trends in Figure 4. The increase in labour supply must then find a macroeconomic setting that will absorb this labour force (Gribble and Bremner 2012). With a low share of the dependent population, the larger working age population would be able to save and invest more in the economy. At the same time, they are able to produce more per worker hence boosting the national income per capita.

Computation of the demographic dividend focuses on the relative changes of the dependent and working age populations. Based on the data of the working age and dependent populations, the support ratio is obtained by dividing the dependent population with the working age population. The support ratio shows the average number of dependents per worker. Figure 5 presents the prospects of Kenya earning demographic dividend, to which the change in support ratio is a key contributing factor.

Figure 5 shows that the change in support ratio has been positive but declining from 1960 to the early 1980s when it became negative. Since then, the change in the support ratio has remained negative with a negative change of about 0.6 per cent in 2011, 0.3 per cent in 2012, and 0.4 per cent in 2013. The consistent negative change in support ratio implies that the dependence on the working population is declining. With less dependence, the working age population is able to save and invest more in the economy hence creating opportunities for economic growth.

Figure 5: Prospects of earning demographic dividend



Source: Authors' computation from World Development Indicators, 2015 (World Bank 2015).

Lee and Mason (2006) and Bloom et al. (2003; 2007) acknowledge the fact that demographic transitions do not in themselves guarantee a demographic dividend unless there is a quality institutional environment to enhance the productivity of the working age population. Bloom et al. (2007) argue that the measure for quality institutions can be developed generally by looking at the rule of law, efficiency of the bureaucracy, corruption, political freedom and expropriation

risk, openness (political system, trade barriers, black market premium), freedom of political representation, and freedom of speech. Alternatively, they note that a broader measure for quality of institutions would include infrastructure (health care systems, schooling, and transport network among others) and a formal labour market with unions and laws protecting both employees and employers (Bloom et al. 2007). By looking at these measures, Kenya has made positive steps in strengthening its institutions since the promulgation of the new constitution in 2010. Significant steps have been made in reforms in the public service, the police, the judiciary, electoral system, and in devolving power. The CPIA public sector management and institutions cluster average[6] (1=low to 6=high) for Kenya has averaged at 3.58 since 2005, improving to 3.80 in 2014. Though more still has to be done, Kenya can be said to be on the right path in strengthening its institutional quality, a move which will enhance the chances of the country realizing the demographic dividend even before the year 2050.

The sustained increase in GDP per capita since 2008, after the post-election violence shock, is an indication that the prospects of Kenya reaping demographic dividend by 2050 is real with an improved political and economic framework. A demographic dividend model (DemDiv), developed by the USAID-funded Health Policy Project, predicts that Kenya will benefit from demographic dividend by 2050 if the institutional qualities alluded to earlier are ensured. The DemDiv model integrates key elements needed for Kenya to achieve demographic dividend that include family planning, education, and economic policies especially on financial efficiency, information and communications technology (ICT) use, imports, labour flexibility, and public institutions. The DemDiv model presents a base scenario with no investment in family planning and a combined scenario of investments in family planning, education, and economic policies. In the base scenario, with no investments in family planning, the fertility rate would be the same in 2050 as it is today— more than four children per woman. Kenya's age structure would remain very young and be dominated by dependents. In contrast, the combined scenario, which includes increased use of family planning, produces a youth bulge, which moves into the working age years in 2050. An increase in healthy, educated, and productive working age population will put Kenya on the path to realization of a demographic dividend (Republic of Kenya 2014).

Another notable feature of Kenya's working age population that should be factored into the growth debate is the emerging middle-class population and its role in driving economic growth. According to the African Development Bank (AfDB 2011) the middle class are those who spend between USD2 (approximately KSh200) and USD20 (approximately KSh2000) a day or earn an annual income exceeding USD3,900 (approximately KSh390,000). In 2011, the middle-class population in East Africa was estimated to be about 29.3 million, representing an average of 22.6 per cent of the population: 44.9 per cent of Kenya's population, 18.7 per cent in Uganda, 12.1 per cent in Tanzania, 7.7 per cent in Rwanda, and 5.3 per cent in Burundi (AfDB 2011). The emergence of the middle class presents an opportunity for social and economic growth in Kenya since the middle class has been argued to play a key role as a conduit for advancing social progress, an agent of change for institutional reforms, and a catalyst for the realization of inclusive growth, innovation, and entrepreneurial drive (Ncube and Shimeles 2012). The rise in the middle-class population in Kenya has boosted purchasing power in the country, leading to the thriving of the wholesale and retail sector (evidenced by the growing shopping mall culture). Additionally, the rise in the middle-class population has led to an increase in demand for housing giving rise to the boom in the housing market. It has also contributed to the growth and innovations in the financial sector that finance the increased consumption by the middle-class

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[6] The public sector management and institutions cluster includes property rights and rule-based governance, quality of budgetary and financial management, efficiency of revenue mobilization, quality of public administration, and transparency, accountability, and corruption in the public sector.

population. Moreover, the growing middle class is increasingly appealing to both domestic and foreign investors thereby presenting Kenya with an opportunity for wealth creation and increased investment.

The analysis of Kenya's population trends reveals a number of factors that have major implications for the labour market and economic growth. We make three summary points from this analysis. First is the high rate of population growth. Although the rate of population growth has declined over time and is expected to continue on a downward trend in the period to 2030, the average growth rate still remains above 2.0 per cent. In addition, urbanization in Kenya will continue to rise at a steady rate, even though the vast majority of the population will remain in rural areas. Increased urbanization and expanding cities have been shown to increase economic growth if accompanied with enhanced infrastructural development and decongestion of the urban areas.

The second notable feature of the population relates to the dynamics of the working age population and dependent population. This has implications on the prospects for a demographic dividend. Related to the above is the large population of youth in the working age population. The sizeable proportion of the youth population in the working age population suggests that the labour market policies should particularly focus on harnessing the potential presented by the youth population and turn the population structure into a dividend instead of a curse.

Finally, beyond these factors is the emergence of a middle class with the positive economic and socio-political outcomes. Kenya, as one of the African Lions, has a chance to reap benefits from these opportunities for sustained economic growth.

3.2 The labour market, employment, and growth

In this section, we focus on some important aspects of the Kenyan labour market. We note that analysis of the Kenyan labour market is severely constrained by the paucity of data necessary to fully capture and analyse its dynamics and especially the link between economic growth, employment, and poverty reduction. Nevertheless, the available data reveals some key features of the labour market and points to some specific policy proposals.

Labour market structure, employment, and wages

In order to provide a broad picture of Kenya's labour market, we start by looking at the trend of total employment and sectoral distribution of wage employment as shown in Table 1 and Figure 6 respectively. The Kenyan work force is categorized into the modern (or formal) sector, the informal sector, and the small-scale agriculture and pastoralist sector. This section focuses mainly on the modern (formal) sector alongside the informal sector employment in view of the challenges on availability of data on the small-scale agriculture and pastoralist sector. Table 1 shows that, in 1985, total employment, excluding employment in small-scale agriculture and pastoralist activities, was estimated at 146,200 persons. Out of this, 80.33 per cent were in wage employment, the self-employed and unpaid family workers were about 2.26 per cent, while those in informal employment were estimated to be about 17.41 per cent of total employment.

Table 1: Shares of Kenya's total employment (1985–2014)

Year	Modern sector: wage employment (%)	Modern sector: self-employment & unpaid family workers (%)	Estimated informal employment (%)	Total employment
1985	80.33	2.26	17.41	146,200
1988	77.47	2.54	20.00	173,140
1991	56.38	2.04	41.58	255,710
1994	44.86	1.74	53.41	335,620
1997	35.06	1.36	63.57	469,840
2000	28.68	1.10	70.22	591,160
2003	23.53	0.90	75.57	733,940
2006	20.66	0.75	78.60	899,340
2009	19.13	0.65	80.23	1,045,650
2012	16.87	0.60	82.53	1,278,110
2013	16.89	0.62	82.49	1,351,700
2014	16.56	0.72	82.73	1,431,670
Average for the period 1985–2014	169,582 (26.55%)	6,179 (0.97%)	463,036 (72.49%)	

Source: Authors' computations from Republic of Kenya Economic Surveys (Kenya National Bureau of Statistics Various Issues).

Over the period under review, wage employment grew by an annual average of 2.5 per cent, the self-employment and unpaid family workers grew by an annual average of 3.7 per cent, while informal employment grew by an annual average of 11.6 per cent. Over the same period, the share of wage employment declined to 16.56 per cent in 2014 and that of self-employment and unpaid family workers declined to 0.72 per cent of total employment in 2014. On the other hand, the share of estimated informal employment increased from 17.41 per cent in 1985 to 82.73 per cent in 2014. Informal employment increased from 1989 into the 1990s, surpassing wage employment in 1994. Since then, the composition of employment in Kenya has progressively tilted towards informal employment. Generally, since 1985, the trend in informal employment has defined the overall trend in growth of total employment. This increased rate of growth of the informal labour force is attributed to the liberalization policies, government promotion of the informal sector, and also better data capture (Omolo 2010), but above all to the inability of the formal sector to adequately generate jobs for the increasing labour force.

The informal sector, commonly referred to as the *jua kali* sector, therefore currently dominates and plays an important role in the labour market in Kenya. Over the years, the sector has expanded into activities of manufacturing, transport and information, communication, and technology (Republic of Kenya 2015). However, there has been a lot of debate on the quality of employment in the informal sector. Additionally, Kenya's informal sector enterprises tend to remain small with limited labour absorption capacity. A look at the informal sector units in the period reviewed shows an increasing number of informal business units rather than expansion of the existing units. Perhaps, this could be as a result of increased self-employment in the sector, an indication that the sector has not been dynamic enough to absorb the excess labour. This suggests that the focus should be on how to make the informal sector more dynamic while at the same time seeking to make it easier to do business in the formal sector. Bigsten and Wambugu (2010) argue that the formal sector employment expansion, on the other hand, has been constrained by the inability of the country to achieve rapid capital accumulation to improve on the capital-labour ratio and the labour market regulations that have tended to increase labour costs relative to productivity in the sector. They noted that the increase in informal sector firms

leading to employment expansion in the sector is mainly made possible by the limited capital requirements for new jobs in the sector.

In the modern sector employment, a notable feature has been the increasing number of casual workers as opposed to regular employment workers. Casual workers are individuals whose terms of engagement provide for payment at the end of each day and who are not engaged for a period longer than 24 hours at a time (Republic of Kenya 2007b). This category of workers enjoy the same rights as other employees to a large extent, but may be excluded from certain crucial benefits, such as leave entitlement, medical cover, and pension contributions. Most employers in Kenya, including the public sector have resorted to the increasing use of casual, temporary, part-time, contract, sub-contracted, and outsourced workforces to reduce labour costs, achieve more flexibility in management, and exert greater levels of control over labour (Omolo 2010). According to a report by the International Labour Organization (ILO 2013), regular employment grew by only 7.0 per cent between 2003 and 2011 while casual employment grew by 87 per cent over the same period. Additionally, the proportion of casual formal jobs increased from 20 per cent in 2003 to 30 per cent in 2011 (UNDP 2013).

Until the end of the 1980s, the expansion of employment in the modem sector of the economy was largely attributed to the absorption of employees into the public sector. However, in 1994, there was a turnaround in this trend with employment in the private sector expanding faster than that in the public sector. The share of the private sector in wage employment has been on the rise since 1991, dominating the wage labour progressively to stand at 70.4 per cent of wage employment in 2014. On the other hand, the share of the public sector in wage employment has declined from 49.6 per cent in 1991 to 29.6 per cent in 2014. A comparison of the wage earnings in the public and private sector is presented in Table 2 which shows the real average annual earnings per employee in selected sectors in the Kenyan economy.

Table 2: Estimated real average wage earnings per employee, 2014 (KSh per annum)

	Private sector	Public sector	Divergence (%)
Agriculture, forestry, and fishing	153,904	217,789.60	70.7
Mining and quarrying	229,400	205,021.70	112.0
Manufacturing	233,304	472,230.60	49.4
Electricity, gas, steam, and air conditioning supply	831,991	747,447.10	111.3
Construction	366,160	365,919.60	100.1
Wholesale and retail trade	346,494	1,042,822.50	33.2
Transportation and storage	702,651	819,062.60	85.8
Financial and insurance activities	1,003,456	950,288.80	105.6
Education	553,722	270,131.30	205.0
Human health and social work activities	436,270	600,710.20	72.6
Arts, entertainment, and recreation	353,746	424,133.10	83.4
Information and communication	498,375	410,726.60	121.3

Source: Authors' computation from Republic of Kenya Economic Survey 2015 (Kenya National Bureau of Statistics 2015).

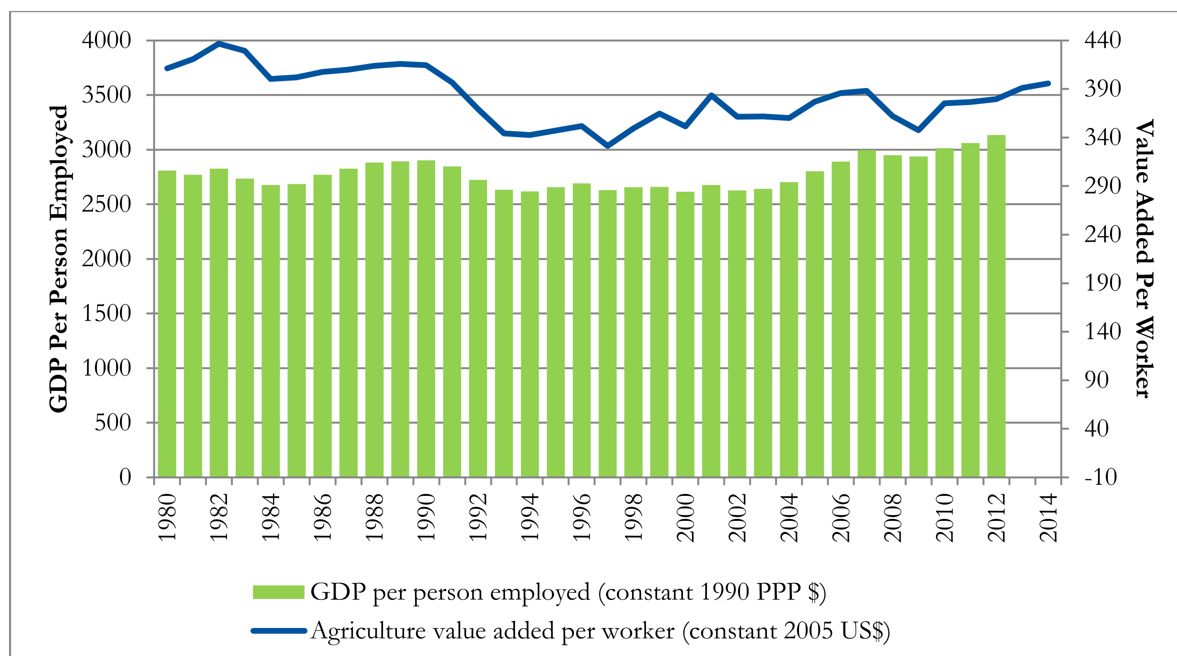
As is evident, there is a wide variation in earnings across sectors with workers in financial and insurance activities earning the highest and those in the agriculture, forestry, and fishing sector earning the lowest. In essence, workers in agriculture, forestry, and fishing who are mainly composed of the rural population have low earnings and hence dominate the bracket of the working poor. Furthermore, the gap between public and private sector earnings varies widely

within the sectors. Earnings in the public sector are relatively higher than in the private sector for most of the selected sectors, as evidenced by the percentage divergence in Table 2. The sectors of specific concern are the wholesale and retail trade sector and the education sector. In the wholesale and retail sector, the private sector employees' real average earnings are approximately a third of their counterparts in the public sector. In the education sector, the private sector employees' real average earnings are slightly more than twice that of their public sector employees. The wage inequalities explain the frequent agitation for wage adjustments by trade unions such as Kenya National Union of Teachers which has seen the public wage bill spiral in the last two decades. The high wage bill in the public sector has turned out to be a constraint to economic growth as it tends to crowd out resources available for development expenditure in the country. A study commissioned by the Salaries and Remuneration Commission and carried out by the Kenya Institute for Public Policy Research and Analysis (KIPPRA) found out that the general public sector pays slightly higher than the private sector when comparing basic salary and allowances. However, the private sector pays a higher basic salary. The study also found out that there is a large vertical wage inequality in both the public and private sectors between the lowest and highest cadres (KIPPRA 2013). The wage differentials between the public and private sectors indicate that there are barriers to mobility of labour between the sectors and that the Kenyan labour market is not efficient in the allocation of labour.

Labour productivity and human capital returns

In this section, we focus on labour productivity and human capital returns. Labour productivity measures the amount of real GDP produced by an hour of labour. In Kenya, labour is the abundant factor of production for the various economic activities. Labour productivity growth is important in measuring the efficiency of labour and in signalling an improvement in the country's standards of living. Figure 6 shows productivity in terms of GDP per person employed (for the period 1980–2012) converted to 1990 constant international dollars using purchasing power parity rates and agriculture value added per worker in constant 2005 dollars (for the period 1980–2014). Agriculture value added per worker is a measure of agricultural productivity. In the analysis, agriculture comprises of value added from forestry, cultivation of crops, hunting, fishing, and livestock production. Since agriculture is the dominant sector of the Kenyan economy, agricultural productivity provides a good estimate of the country's labour productivity.

Figure 6: Labour productivity



Source: Authors' computations from World Development Indicators, 2015 (World Bank 2015).

In the period under review, GDP per person employed has experienced a sluggish inconsistent growth, dropping from 2,810 in 1980 to a low of 2,615 in the year 2000, then rising to 3,134 in 2012. Since 2008, GDP per person employed has been on a consistent upward trend—an indication of growth in labour productivity in the economy. On the other hand, agricultural productivity has been quite erratic over the period under review, dropping inconsistently from a high of 429.5 in 1983 to a low of 331 in 1997. Since 2009, agricultural productivity has consistently grown from 347.5 to 395.8 in 2014. The trends of GDP per person and agricultural productivity in recent years are an indication of growing labour productivity in Kenya. This is essential for enhancing the economic growth of the country.

Kenya's growing labour productivity is reflected in the improvement in education attainment since independence. Barro and Lee (2010) show that the educational attainments (average years of schooling) in Kenya increased significantly from 0.3 years in the 1960s to about 4.4 years in 2000, then to 6.5 years in 2010. This was mainly driven by attainments in primary education (47.8 per cent) when compared to secondary education (7.9 per cent) and tertiary education (2.8 per cent), due to the introduction of 'free' primary education in 2003. Tertiary education has also expanded rapidly in the last two decades, mainly driven by demographic pressures and pressures from the high subsidization of primary and secondary education as well as the upgrading of colleges to universities and the introduction of what is referred to as 'parallel programmes' where students pay tuition for part-time or distance learning programmes (World Bank 2014). These trends suggest an improvement in supply of quality labour that has positive effects on growth.

Information on the human capital returns is scarce. Kimenyi et al. (2006) use data from the 1994 Welfare Monitoring Survey to estimate human capital returns for workers with different levels of education. The sample used in the study includes only individuals in the working age group 15 to 65 years and who are full-time employees. The sample size used consisted of 6,140 observations covering individuals both in the rural (4,878) and urban (1,262) areas. They employed the following semi-logarithmic earnings function:

$$ln(W_i) = \propto + \sum \beta_k S_{ki} + \gamma A_i + \delta Z_i + \mu_i \quad (1)$$

where Wi is monthly earnings for worker i; S_k are dummy variables representing the highest level of schooling attained by a worker; A is potential experience; Z is a vector of control variables such as sex, regional dummy variables, including proxies for average human capital; and μ is an error term. Kimenyi et al. (2006) calculate the private rate of return to education (benefits of education in the form of higher wages) from equation (1) using the following equation (2):

$$Rate\ of\ return\ of\ education = \frac{exp(\beta_h - \beta_l) - 1}{E_h - E_l} \qquad (2)$$

where β_h is the estimated coefficient of a higher level of education (e.g. a dummy for completed secondary education); β_l is the estimated coefficient of a lower level of schooling (e.g. a dummy for completed primary education); E_h is the total number of years taken to attain a particular level of higher education; and E_l is the total number of years spent schooling at a lower level of the education system.

Table 3 shows private returns to education for different levels of education by region and gender categories determined by Kimenyi et al. (2006). The results reveal large differences in returns between levels of education with the largest difference in returns observed between primary and secondary education. The human capital returns for those who have completed primary schooling was estimated at 7.7 per cent while returns for those with secondary schooling was estimated at 23.4 per cent. Returns to education for females were found to be greater than that for males. For example, the return for females with primary education was 13.2 per cent compared to 4.4 per cent for males. Human capital returns to females with secondary education were estimated at 36.3 per cent while returns to males were 13.2 per cent. The returns are higher for urban workers except for the case of females with primary education where returns are higher for those in rural areas. The rising productivity since 2009 and the results for returns on human capital indicate an improvement in the efficiency of labour in the country. With the improvements in labour quality and efficiency, additional capital accumulation will propel the country to a rapid economic growth path.

Table 3: Human capital returns; private returns to education (percentage)

	Completed primary	Completed secondary	College	University
National	7.7	23.4	23.6	25.1
Urban	9.3	34.4	26.2	34.8
Rural	7.8	21.0	22.4	14.2
All males	4.4	21.2	12.8	23.3
Urban males	6.1	25.6	17.9	30.7
Rural males	4.2	20.2	12.4	12.6
All females	13.2	36.3	43.5	62.5
Urban females	6.2	44.9	28.0	66.0
Rural females	16.0	30.3	51.5	18.6

Source: Adapted from Kimenyi et al. (2006).

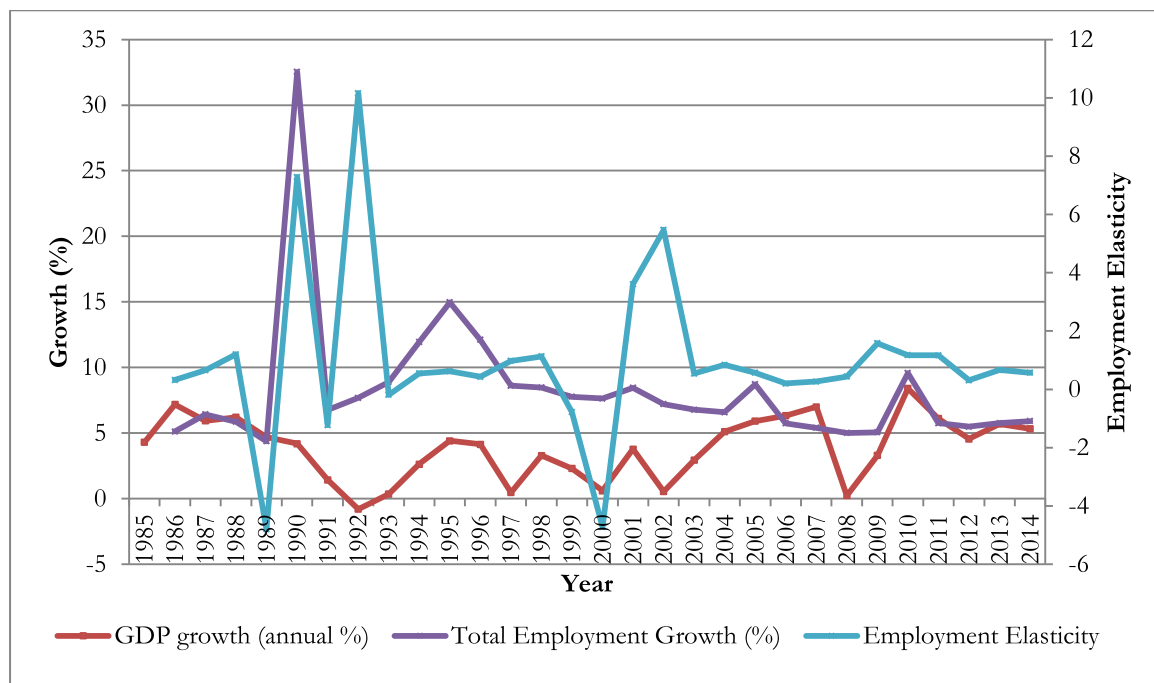
Growth, employment, and poverty

In Section 2, we outlined Kenya's growth profile and recent performance. One important question is whether growth has been effective in creating employment and reducing poverty. In this section, we provide evidence on the relationship between growth, employment, and poverty. As noted previously, this analysis is severely hampered by accurate and updated data; hence we rely on available data and anecdotal evidence to draw some conclusions. Policies aimed at

generating employment opportunities in Kenya have consistently promoted economic growth as the panacea to employment creation. The relationship between economic growth and employment is estimated using a simple employment elasticity (which is a measure of the percentage change in employment associated with a one-percentage point change in economic growth). The employment elasticity summarizes the ability of a country's economy to generate employment opportunities for its population as its economy grows and can also provide an insight into trends in labour productivity. According to the ILO (2009), employment elasticity for Kenya has been generally higher than those for the world and also SSA. Nevertheless, employment elasticity varies greatly over different periods with the highest elasticity of 1.77 recorded for the period 1996–2000 when the growth rate was low (-1.6 per cent). The lowest employment elasticity of 0.5 was recorded during the period 2004–08 when the economic growth rate was high at 5.3 per cent. Thus, in the latter high-growth period, the employment response was weak. This has been explained by the fact that growth in this period was driven by efficiency gains.

It is evident from Figure 7 that employment elasticity for Kenya has been quite erratic especially in the late 1980s and early 1990s, after which it stabilized between 1993 and 1998, before declining to a low of -4.7 in the year 2000. It then rose again to 5.4 in 2002. Since then, the employment elasticity of Kenya has stagnated, ranging between 0.5 and 1.6. In 2014, the employment elasticity was at 0.56. This means that a one-percentage increase in the country's GDP would trigger a 0.56 percentage point increase in employment in the economy. The decline in employment elasticity since 2009 shows the declining responsiveness of Kenya's employment to growth in GDP as more labour is pushed into the informal sector. From the analysis earlier, the informal sector is a reservoir of self-employed, unemployed, and underemployed and so may have a weak relationship to economic growth (see Figure 8).

Figure 7: Growth-employment elasticity



Source: Authors' computations from Republic of Kenya Economic Surveys (Kenya National Bureau of Statistics Various Issues).

Figure 8 also shows that the growth in total employment has closely tracked its economic growth from 2004 to 2014. However, the country's unemployment rates still remain high. The employment and GDP growth dynamics indicate that the nexus between economic growth and

reduction of unemployment is weak. This can be explained by the fact that labour force growth (mainly attributed to the increase in working population and increased labour participation) outpaces employment growth, leading to an increase in unemployment despite the positive economic growth witnessed in most of the years in the period under review (which averaged at 3.87 per cent in the period 1986–2014 and 5.45 per cent in the period 2003–07 which had the highest growth episode). However, economic growth seems to be a key factor in generating wage employment. The GDP growth witnessed between the years 2003–07 can be related to the strategies employed by the government as per the Sessional Paper of 2003 on Economic Recovery for Employment and Wealth Creation (Republic of Kenya 2003). But the growth experienced up to 2007 was related to the efficiency gains in the economy.

Figure 8: Employment and GDP growth dynamics

Source: Authors' computations from Republic of Kenya Economic Surveys (Kenya National Bureau of Statistics Various Issues).

The relationship between growth and employment seems to vary across the formal and informal sectors. Figure 8 shows that the growth in wage employment tracks GDP growth closely. However, there is no clear pattern in the relationship between GDP growth and growth in informal sector employment as well as growth in self-employment and unpaid family workers.

Growth and poverty education

Related to the relationship between growth and employment is the link between growth and poverty reduction. Economic growth is expected to generate adequate and well-paying employment opportunities, which are in turn expected to lead to poverty reduction via savings and investment/capital accumulation. Therefore, a high rate of economic growth is considered as one of the most effective strategies to reduce poverty. However, economic growth does not always result in commensurate reduction in poverty. Here we specifically explore whether growth in Kenya has been pro-poor. Pro-poor growth is defined as growth that associates with a

larger share of the growth going to the poor. Therefore, pro-poor growth is mainly related to labour-intensive growth since the key asset available to the poor population is their labour. According to Jones et al. (2001), Kenya has experienced persistently high levels of poverty even during the earlier periods of more rapid growth, with the incidence of poverty appearing to increase over the 1990s. The study by Jones et al. notes that while Kenya has enjoyed spells of rapid growth over its post-independence history, these have neither had a significant impact in reducing poverty, nor have they brought about structural economic change to permit growth to be sustained through diversification and increasing productivity. This trend has persisted into the current period as depicted in Table 4. The table relates the figures for economic performance in recent years (2010–13) and the predicted poverty head counts for the same period. Poverty estimates for 2005/06 are based on the national survey conducted in 2005/06, that is, the Kenya Integrated Household Budget Survey (KIHBS 2005/06). The predicted poverty head counts which were computed using the KIPPRA Poverty Predicting Model as well as the information on the poor population are adapted from KIPPRA (2014). The predictions were done using the KIHBS 2005/06 data.

Table 4: Economic performance and poverty reduction

	2005/06*	2010	2011	2012	2013
Economic performance					
GDP (current USD) (billion)	25.82	39.99	41.95	50.41	54.93
GDP growth (annual %)	6.33	8.40	6.11	4.55	5.68
Poverty head count (percentage)					
National	45.9	49.8	49.7	49.8	49.5
Rural	49.1	55.0	55.0	55.0	54.6
Urban	33.7	35.5	35.5	35.5	35.4
Poor population (million)	17.7	20.1	20.6	21.1	21.5

Source: Authors' computations from World Bank (2015) and KIPPRA (2014).

Table 4 indicates that the GDP growth has been positive though inconsistent over the reviewed period. However, the number of people living below the poverty line has persistently increased over the same period. In 2013, Kenya's GDP in current US dollars had doubled from the 2005/06 figure. However, the figures for the national poverty headcounts indicate that there is an increase in the percentage of the poor population. In 2013, about 21.5 million people lived below the poverty line, which is about 49.5 per cent of the total population. These figures re-affirm that, even in the recent past, economic growth in Kenya has not resulted in a commensurate reduction in poverty levels. For employment-intensive growth to translate into poverty reduction it must occur in a 'more productive' sector, while 'less productive' sectors may require productivity-intensive growth to ensure a decline in head count poverty (Hull 2009). Since the poor are most likely to be in rural areas and the urban informal sector, the performance of the agriculture and construction sectors has a great bearing in enhancing pro-poor growth in Kenya (Jones et al. 2001).

To summarize, the information available shows that the Kenyan labour market is dominated by informal sector employment which has been rising since the early 1990s. On the other hand, employment in the modern (or formal) sector has remained stagnant over the period. This affirms the argument by Bigsten and Wambugu (2010) that it is mainly the changes in factor endowment over the years that drives the structural change in the labour market in Kenya. The explanation is that with the rise in population (increased labour supply) and land scarcity, more labour has been pushed off the agricultural land. However, there has been insufficient capital accumulation implying that the labour pushed from the land could not be absorbed in the

relatively capital-intensive agricultural activities or in the capital-intensive formal sector. Therefore, labour has moved into the informal sector and self-employment, which employs limited capital. This explains the rise and rise of the informal sector as the main source of employment for Kenya's working age population in recent decades. Therefore, to enhance the long-term growth prospects of the Kenyan economy, the rapid growth in labour supply should be accompanied with rapid growth in capital accumulation.

Labour market growth and dominance of informal employment has reduced the capacity of the economy to deliver quality employment and output. Over the years, the informal units have increased in numbers with minimal expansion of the existing ones. Strategies and programmes should be put in place to make the informal sector more dynamic and for the formal sector to deliver quality employment opportunities. For wage employment, we note that the private sector has increasingly dominated the supply of employment opportunities over the public sector (whose share has been in decline since 1991). Therefore, continued implementation of measures towards reducing the cost of doing business in the formal sector should be highly encouraged. Public investments in infrastructural development will encourage complementary private investments by lowering their transactions cost, thus enhancing their profitability.

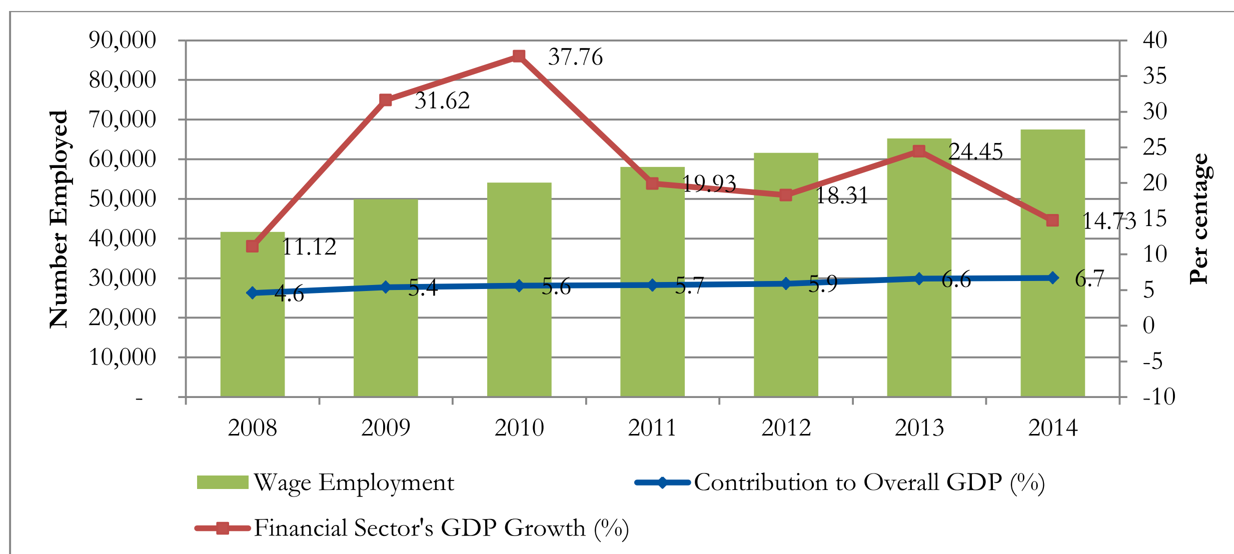
The earnings across the various sectors of the economy and even within the sectors (between public sector employees and private sector employees) were found to vary widely. This means that there are barriers to mobility of labour between the informal and formal labour market resulting into labour with similar skills being rewarded differently in the two markets. This is an indication that the different segments of the labour market in Kenya are not fully integrated and are less efficient since labour mobility is important in ensuring efficient allocation of the labour force in the market.

Employment elasticity has been on a slight decline in recent years. However, growth in wage employment and, by extension, growth in total employment has tracked GDP growth closely since 2004 while there has been no clear pattern in the relationship between GDP growth and growth in informal sector employment as well as growth in self-employment and unpaid family workers. This seems to reflect the fact that the key to growth in formal sector employment is capital deepening which is fundamental for economic growth.

The financial sector in Kenya

The growth of the financial sector in Kenya, evidenced by improvement in financial inclusion among other indicators, has been shown to have a positive effect on growth and, subsequently, poverty reduction. This is because financial inclusion allows accessibility to the financial market for savings and investment. The strong performance of the financial intermediation sector, which has been bolstered by financial inclusion activities and a stable macroeconomic environment, contributed significantly to the growth recovery witnessed since the post-election downturn in 2008. The sector's growth averaged 7.6 per cent between 2009 and 2012 and has consistently outpaced the overall 12-month real GDP growth (which has been in the 4–5 per cent range), pulling growth with it. Figure 9 presents the financial sector's contribution to growth and wage employment in the country.

Figure 9: Financial sector's contribution to growth and employment



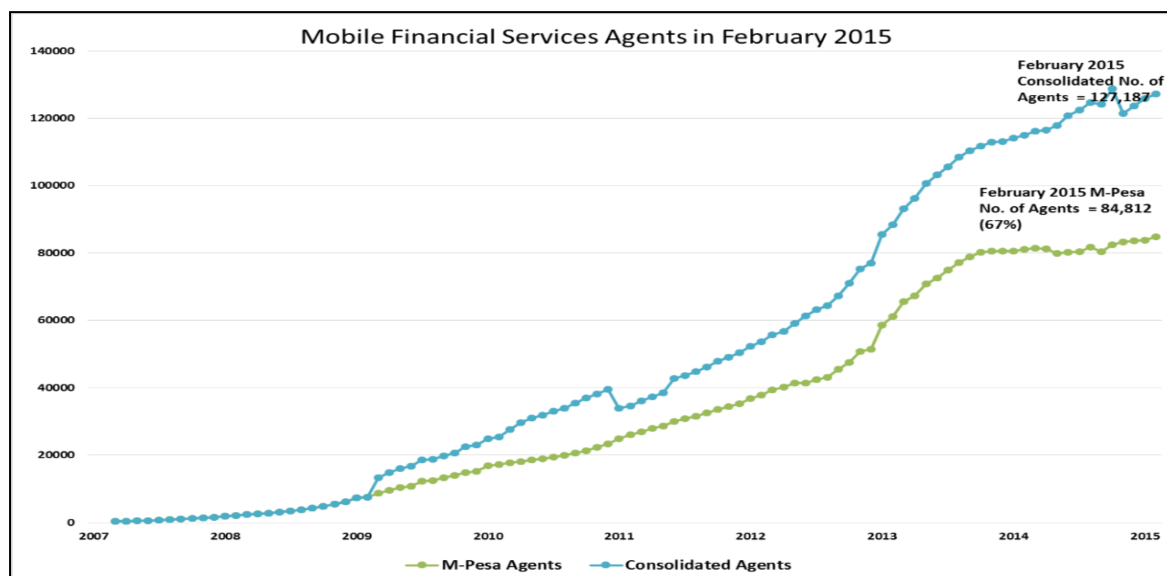
Source: Authors' computation from Republic of Kenya Economic Surveys (Kenya National Bureau of Statistics Various Issues).

Figure 9 shows that growth in the financial sector's GDP has been positive but inconsistent over the period under review, registering a high GDP growth of 37.76 per cent in 2010 from 11.12 per cent in 2008. The sector's contribution to GDP has improved consistently from 4.6 per cent in 2008 to 6.7 per cent in 2014. Additionally, wage employment in the sector rose from 41,700 persons in 2008 to 67,500 persons in 2014. The increased banks' network, apart from expanding financial services, has created employment opportunities and facilitated various economic activities across the country. For instance, employment in the banking sector stood at 34,059 employees by December 2013 while that by deposit-taking microfinance institutions stood at 3,903.

Due to the robust nature and convenience of the mobile phone, it has been used as a platform for facilitating financial transactions, creating jobs across the country mainly with regard to mobile money transfer services. According to the Financial Access Survey carried out in the year 2013 (Central Bank of Kenya and Financial Sector Deepening Kenya (FSDK) 2013), 67 per cent of Kenyans were able to access financial services, an improvement from 26.4 per cent in 2006. By 2013, only 7.8 per cent of Kenyans were served by informal financial services while 25 per cent remained excluded from accessing the financial services. According to Central Bank of Kenya (2015) statistics, in February 2015, mobile phone money transfer accounts stood at 25.46 million, for an adult population of about 31 million.

The strong growth in mobile money transfers has been supported by an expanding agent network across the country. Figure 10 presents the trend in growth of mobile financial services agents from 2007 to February 2015.

Figure 10: Growth in number of mobile financial services agents (2007–15)



Source: Authors' computations from Central Bank of Kenya (2015).

Figure 10 shows that the number of mobile financial services agents in Kenya has grown tremendously since 2007, providing employment opportunities to about 127,187 agents by February 2015. Among these, M-PESA agents led the pack with 84,812 agents, 67 per cent of the consolidated number of agents in the country. On the other hand, Orange had 15,419 agents (12 per cent), Mobicash had 12,677 agents (10 per cent), Airtel had 10,279 agents (8 per cent), while Tangaza had 4,000 agents (3 per cent).

The impact of mobile phones on growth can be generalized together with that of changes in ICT. This has provided a technological platform that supports a transaction value of 4.2 per cent of annualized GDP per day in Kenya. The direct effects of ICT include contribution to domestic output and employment creation, increased government revenues through various taxes, and improved balance of payments through facilitation of efficient trade transactions and current transfers such as emigrant remittances. Indirectly, ICT has spurred capital accumulation, improved productivity in firms and contributed to rural development. Recent studies indicate a positive impact of mobile telephone penetration in Africa on real GDP per capita. Mobile telephone penetration has also been shown to have a positive impact on financial inclusion suggesting that ICT has stimulated financial inclusion and economic growth. In addition, studies have shown that small-scale farmers use mobile phones to pilot for better prices for their produce in the market thereby reducing price differentials in segmented economies. Since the growth has been more inclusive, we can conclude that ICT has delivered a national welfare improvement via savings investment platforms, improved access to credit, and efficient payments platforms.

4 Supporting policies: social protection in Kenya

Social protection can be an effective strategy to insulate the welfare of poor people if properly designed and well-implemented and targeted. Although Kenya has initiated several social protection programmes, the country's experience with social protection is limited. The country only enacted a social protection policy in May 2012 after approval by the cabinet. This followed the promulgation of the 2010 Constitution that 'binds the state to provide appropriate social security to persons who are unable to support themselves and their dependents'. Social

protection is defined as policies and actions, including legislative measures that enhance the capacity of and opportunities for the poor and vulnerable to improve and sustain their lives, livelihoods, and welfare through decent work and access to affordable health care, social security, and social assistance. In this section, we focus on three social protection components: (i) social insurance; (ii) social assistance; and (iii) affirmative action funds targeted at youth, women, and the disabled; as well as devolved funds for constituencies and marginalized areas.

Social insurance mitigates risks mainly associated with employment, injuries, and old age. It comprises programmes in which benefits are conditional on prior contributions such as workers' pensions. Social insurance in Kenya therefore mainly applies to the formal sector workers. The government provides a non-contributory pension to its workers (covering about 500,000 civil servants and teachers out of a population of 40 million), although there are plans to make it contributory. Other formal sector workers are covered by the contributory National Social Security Fund. Membership is mandatory unless a worker is covered under another industry or occupation-specific scheme. Coverage of social security is therefore quite narrow, with formal sector workers comprising about 20 per cent of the labour force. There are, however, efforts to encourage the self-employed and those in the informal sector to join the National Social Security Fund and other insurance schemes such as the National Health Insurance Fund.

Social assistance in Kenya mainly comprises non-contributory cash transfer programmes targeted at the poor and vulnerable persons including the elderly; orphans, and vulnerable children; the severely disabled; and the food insecure in the arid areas of the country. Kenya as a developing country does not rely much on cash transfer payments, and coverage is still very limited. It is estimated that these payments cover only about 13 per cent of the population (excluding civil service pension). Only about 28 per cent of orphans and vulnerable children (OVC); 0.38 per cent of persons with severe disability; and 3.52 per cent of the elderly are for example covered by these cash transfer programmes, such that, even with perfect targeting, only about 25 per cent of the poor would be covered (Economic and Social Rights Centre 2015). The programmes have, however, grown over the last decade, from coverage of about 500 households in 2004 to about 500,000 in 2014/2015 (UNICEF 2015). Implementation of the cash transfer schemes has faced many challenges such as limited resources and poor targeting of intended beneficiaries. Lack of harmonization of the different cash transfer schemes has reduced the efficiency of service delivery.[7]

Among the affirmative action funds is the Youth Enterprise Development Fund (YEDF). To address the youth unemployment challenges, YEDF was introduced in December 2006 with an initial allocation of KSh1 billion. YEDF focuses on enterprise development as a key strategy for increasing economic opportunities for, and participation of, Kenyan youth in nation building. YEDF seeks to increase access to capital by young entrepreneurs in order to reduce the level of youth unemployment. By 2012, about KSh5.96 billion had been disbursed to 315,076 enterprises (Oduol et al. 2013).

Another affirmative fund is the Uwezo Fund. The fund was launched in 2013 by President Kenyatta for the youth, women, and the disabled. The fund money came from the KSh6 billion meant for Presidential run-off that was left unused. The fund is structured to provide youth and women with access to grants and interest-free loans, as well as mentorship opportunities. The Uwezo Fund had a rather low take-up rate. By May 2015, only KSh3.3 billion of these funds had

[7] The recently created National Safety Net Programme (NSNP) is expected to put all the five cash transfer schemes under one coordinating agency.

been disbursed to 32,405 individuals and groups (19,690 women, 11,802 youth, and 735 persons living with disability). The main barriers in setting up businesses are the lack of knowledge on how to use the fund and what to do with it. Training would be effective in enhancing the effectiveness of the fund.

The Constituency Development Fund (CDF) was introduced in 2003 and was designed to support constituency-level, grassroots development projects. It aimed to achieve equitable distribution of development resources across regions and to control imbalances in regional development brought about by partisan politics. The CDF Act provides that the government set aside at least 2.5 per cent of its ordinary revenue for disbursement under the CDF programme. Three-quarters of the amount is divided equitably between Kenya's 210 constituencies while the remaining quarter is divided based on a poverty index to cater for poorer constituencies. It targeted all constituency-level development projects, particularly those aiming to combat poverty at the grassroots. The CDF programme has facilitated the creation of new water, health, and education facilities in all parts of the country, including remote areas that were usually overlooked during funds allocation in national budgets.[8]

Lastly, the Equalization Fund was mandated by the 2010 Constitution to provide basic services including water, roads, health facilities, and electricity to marginalized areas to the extent necessary to bring the quality of services in those areas to the level generally enjoyed by the rest of the nation, so far as possible. The amount set aside for the Equalization Fund is 0.5 per cent of all revenue raised nationally. The fund is meant to improve marginalized areas for a period of 20 years. The fund has been criticized for the relatively small amount of funds dedicated to it.

5 Emerging opportunities and pitfalls to economic growth and employment

As discussed earlier, Kenya has recorded robust growth over the last decade and is expected to sustain growth rates above 5 per cent in the next few years. However, the growth achieved so far is still below what is necessary to achieve the targets set out in the country's vision of making Kenya an upper-middle country by 2030. But there are many opportunities that the country can exploit to maintain and raise its growth performance. An important one is to take advantage of being a regional financial hub and having a transit set of port and airport facilities and an efficient road and railway network. As the largest economy in the East Africa Community, Kenya stands to gain from removal of barriers to trade. Advancement with the trilateral agreement between SADC, EAC, and COMESA is bound to boost opportunities for trade and boost economic growth in the entire region including Kenya. Kenya has also diversified its commercial relationships with a wide array of partners especially in Asia and increasingly in the Middle East. These new relationships offer new opportunities to boost economic growth through expanded trade and investment and also other dimensions of development co-operation.

Kenya has embarked on the implementation of an ambitious new constitution—Constitution of Kenya 2010. The key aspect of this constitution is devolution which has resulted in the creation of 47 constituent county governments. The devolution process is a significant shift from the previous system where power was concentrated with the central government. Devolution is particularly important because it provides for individual counties to deliver specific services and also design policies to promote growth. The counties have different resource endowments that

[8] With the setting up of county governments in 2013, the courts have declared the management of the CDF programme by members of parliament as unconstitutional.

can be utilized once devolved policies and resources are efficiently employed. If well implemented, devolution holds the potential to significantly support growth. These counties have different resource endowments and so policies and the provision of services closer to the populace will spur economic vibrancy at the periphery.

Kenya has also discovered new natural resources, with oil being the most important. The exploitation and possible exportation of oil by Kenya is expected to support the country's transformation process by reducing the cost of energy and stimulating the manufacturing of petrochemicals, plastics, and related products. These are expected to drive economic growth and generate more employment opportunities.

The large youthful population presents the country with an opportunity to accelerate its growth. There is an increasing number of educated youth and this group has been active in various mobile phone-based financial services innovations that have created job opportunities. With a supportive environment, Kenyan youth holds great potential for economic growth. Coupled with the growth in youth population, the emerging middle class in Kenya forms a large market, group of innovators, investors, consumers, and early adapters. The middle-class population prefers and preserves stable policy and political environment. They have everything to lose with violence and civil wars and hence are major contributors in creating a supportive environment and market which drive investment and employment creation.

Nevertheless, the country also faces serious pitfalls that present real risks to growth potential. A serious challenge to economic growth in the long-run pertains to the limited transformation of the economy. Although there have been important shifts in terms of sectoral contribution from agriculture to services, the economy has undergone only limited transformation. In agriculture which is the primary source of livelihoods to the vast majority of the population, productivity remains low and most sub-sectors are characterized by traditional production methods. Likewise, productivity in manufacturing is low and the growth in this sector has been stunted. The share of manufacturing output to GDP has remained relatively flat. The expectation, given the resource endowment pattern in Kenya, was that agri-industries would have transformed agricultural production downstream and expanded the manufacturing sector and product demand upstream. The failure to transform the economy is a major threat to economic growth and job creation.

The fragile democracy in Kenya is also a challenge to sustained economic growth. The sporadic ethnic violence observed during elections has been a major concern and private investors seem to adopt a waiting option, driven by election cycles. These are the patterns that were observed in most ethnically heterogeneous constituencies in 1992, 1997, and 2002 and even in the 2007 general elections (see Kimenyi and Ndung'u 2005). This can only be resolved by strong institutions of governance and adherence to the rule of law. The other risk factors include the emerging terrorist attacks by the Al-Shaabab group based in Somalia which has adversely impacted the country's economy and directly affected the tourist sector. The youth bulge could also easily turn out to be a curse instead of a blessing if enough jobs are not created for the increased youth population. Likewise, poverty and inequality, and more so inequality at the regional levels, remain high and pose threats not only to sustained growth but also to stability. Empirical evidence has shown that inequality can choke growth momentum. In addition, internal institutional weaknesses and governance challenges threaten the gains of the new constitution. These and other risk factors are of concern to the country's ability to sustain growth and retain its position as a dominant economy.

6 Conclusions

The objective of this study was to analyse the recent drivers of economic growth in Kenya and to evaluate the impact of growth on labour market prospects, population growth dynamics, and the impact on poverty reduction. This is in recognition that Kenya, as the ninth largest economy in Africa and the fourth largest in SSA, presents some lessons that can boost its capacity and take advantage of its location and policy environment to drive growth in the region. We advance from Mwega and Ndung'u (2008) but also review the challenges as well as the opportunities that are likely to influence the country's growth trajectory. We have provided a background to Kenya's economy and some important policy and political developments that have a bearing on economic performance. The discussion and analysis dwell on the macroeconomic performance and the role of political economy and markets in Kenya's growth process. The study then focuses on the country's population growth, its structure, transition, and prospects of reaping the demographic dividend. The interest here was primarily on those aspects of the population that have a bearing on economic performance and specifically on the labour markets. We focus on the working age and youth population, and the implication for population dividend in addition to analysing the trends in urbanization and the implication for economic growth.

The analysis of Kenya's population trends reveals a high rate of population growth, though the rate of population growth is expected to continue on a downward trend. Urbanization is expected to continue at a steady rate, even though, the vast majority of the population will remain in rural areas. Increased urbanization and expanding cities have been shown to increase economic growth if accompanied with enhanced infrastructural development and decongestion of the urban areas. The demographic transitions experienced over the years were found to have put Kenya on the path to reaping demographic dividend. If measures are put in place to enhance institutional quality and provide productive employment opportunities to the large working population, Kenya is likely to realize her demographic dividend even before 2050. The emergence of the middle class, driving innovations, is also increasingly appealing to investors and presents an opportunity for economic and social-political growth through advancement of social progress, realization of inclusive growth, innovation, and entrepreneurial drive.

The Kenyan labour market is found to be dominated by informal sector employment which has been rising since the early 1990s. On the other hand, employment in the modern (or formal) sector has remained stagnant over the period. In view of the insufficient capital accumulation in the country, labour tends to move into the informal and self-employment sectors that require limited capital, as opposed to the capital-intensive modern sector and capital-intensive agricultural activities. To enhance long-term growth prospects, the rapid growth in labour supply should be accompanied with rapid growth in capital accumulation. Labour market growth and the dominance of informal employment has reduced the capacity of the economy to deliver quality employment and output growth via productivity. Over the years, there has been an increase in the number of informal units rather than expansion of existing ones. The private sector is best positioned to drive labour demand in the future having increasingly dominated the provision of employment opportunities over the public sector. Therefore, continued implementation of measures to boost private sector investment should be highly encouraged.

The earnings across the various sectors of the economy and even within the sectors (between public sector employees and private sector employees) were found to vary. This reflects barriers to mobility of labour between the informal and formal labour market resulting in labour with similar skills being rewarded differently in the two markets. This is an indication that the different segments of the labour market in Kenya are not fully integrated and are less efficient since labour mobility is important in ensuring efficient allocation of the labour force in the market. The rising productivity since 2009 and the results related to returns on human capital

indicate an improvement in the efficiency of labour in the country. With the improvement in labour efficiency, additional capital accumulation will propel the country to a rapid economic growth path.

Growth-employment elasticity has slightly declined in recent years. However, growth in wage employment and by extension growth in total employment has tracked GDP growth closely since 2004. On the other hand, there has been no clear pattern in the relationship between GDP growth and growth in informal sector employment as well as growth in self-employment and unpaid family workers. This affirms the fact that the key to growth in formal sector employment is capital deepening which is fundamental for economic growth.

Kenya has succeeded in financial inclusion, and in the last ten years or so and in the financial sector, growth has pulled overall growth with it. In addition, the adoption of digital finance has supported a financial inclusion profile unparalleled elsewhere in the world. The link between financial inclusion and poverty reduction is important since financial inclusion can be regarded as a form of market access that recognizes that the poor are willing to save and invest but are sensitive to the type of financial services products, their costs, and their delivery modes or channels. The observed pattern in the financial sector is that it has provided direct and indirect employment, has improved the payments infrastructure (greatly reduced the transactions costs in this area), and has increased savings and investments. This has enhanced prospects for a more inclusive growth in Kenya. Finally, it is the middle class that seems to drive the demand for such financial products and even investments in the country. A developing country with a large middle class is likely to enjoy peace, stability, and increased private investments that will drive overall growth. That is where the Kenyan economy is at the moment.

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