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STUDIES ON
GROWTH WITH EQUITY



KENYA

**MAKING
QUALITY EMPLOYMENT
THE DRIVER
OF DEVELOPMENT**

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FOREWORD

It is often argued that the cost of social equity is less economic growth, highlighting the supposed trade-off between these two goals. The global financial and economic crisis that erupted in 2008 – which was preceded by rising social inequalities – has shown that this is simply not the case. In fact, if properly designed, equity-enhancing policies can also promote prosperity and reduce the risk of future crises.

The purpose of this report on Kenya, published under the series *Studies on Growth with Equity*, is to show how such policy complementarities can be achieved. Given the complementarities between macroeconomic policy on the one hand and employment and social policy on the other, the International Institute for Labour Studies (IILS) has joined forces with the United Nations Department of Economic and Social Affairs (UN DESA). The report is an outcome of a joint project of the French Ministry of Labour, Employment, Vocational Training and Social Dialogue and the IILS of the ILO.

In particular, the report examines how employment and social policies can contribute to a more stable and equitable growth pattern. Indeed, growth in Kenya has been characterized by considerable volatility due in part to a narrow growth base and weak investment patterns. This has adversely affected formal job creation and hampered improvements in living standards, particularly among Kenyan youth, despite considerable efforts by the government to support the labour market.

Moving forward, Kenya needs, first, additional efforts to support a job-centred macroeconomic framework. A stable, employment-oriented macroeconomic strategy that addresses the current vulnerabilities will be essential in order for Kenya to attain a level of growth that will allow for sufficient employment creation. Second, Kenya needs to encourage the formaliza-

tion of formal-sector enterprises and improve the working conditions of workers in informal-sector employment. Finally, it is of utmost importance to develop a national employment strategy with a particular focus on encouraging job creation among youth. To that end, this report highlights a number of policy areas and recommendations intended to help guide the government and social partners, namely the Central Organization of Trade Unions (COTU) and Federation of Kenya Employers (FKE), in achieving growth with equity.

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LIST OF ABBREVIATIONS

AfDB	African Development Bank
BEST	Business Environment Strengthening for Tanzania
COTU	Central Organization of Trade Unions (Kenya)
CRA	Community Reinvestment Act
C-YES	Constituency Youth Enterprise Scheme
ECA	European Commission for Africa
ERS	Economic Recovery Strategy for Wealth and Employment Creation
ESP	Economic Stimulus Programme
EU	European Union
FAO	Food and Agriculture Organization
FDI	Foreign Direct Investment
FDSE	Free Day Secondary Education
FKE	Federation of Kenya Employers
FPE	Free Primary Education programme
GDP	Gross Domestic Product
GNI	Gross National Income
GTZ	Gesellschaft für Technische Zusammenarbeit
ICLS	International Conference for Labour Statisticians
ICT	Information and Communication Technologies
IEA	Kenya Institute of Economic Affairs
IILS	International Institute for Labour Studies
ILO	International Labour Organization
IMF	International Monetary Fund
KCB	Kenya Commercial Bank
KEPSA	Kenya Private Sector Alliance
KIHBS	Kenya Integrated Household Budget Survey
KILM	Key Indicators of the Labour Market
KKV	KaziKwaVijana
KNBS	Kenya National Bureau of Statistics
KNYP	Kenya National Youth Policy
KSh	Kenyan Shilling
KYEP	Kenya Youth Empowerment Program
LDCs	Least Developed Countries
MDGs	Millennium Development Goals

MOYAS	Ministry of Youth Affairs and Sports
MTEF	Medium-Term Expenditure Framework
MTP	Medium-Term Plan of Kenya Vision 2030
NBK	National Bank of Kenya
NGOs	Non-Governmental Organizations
OECD	Organization for Economic Cooperation and Development
ODA	Official Development Assistance
OLS	Ordinary Least Squares
PCA	Principal Component Analysis
PCY	Promotion of Children and Youth
PIN	Personal Identification Number
PPP	Purchasing Power Parity
PPG	Public and Publicly Guaranteed
PRGF	Poverty Reduction Growth Facility
PRSP	Poverty Reduction Strategy Paper
PSL	Priority Sector Lending
SETAs	Sector Education and Training Authorities
SEWA	Self Employed Women's Association
SLYP	Sri Lanka Youth Parliament
SMEs	Small and Medium Enterprises
SSA	Sub-Saharan Africa
STI	Science, Technology, and Innovation
TVET	Technical Vocational Education and Training
UMASIDA	Umoja wa Matibabu Sekta Isiyo Rasmi Dar es Salaam
UNDESA	United Nations Department of Economic and Social Affairs
UNDP	United Nations Development Programme
UNESCO	United Nations Education Social and Cultural Organization
UNICEF	United Nations Children's Fund
USAID	U.S. Agency for International Development
VAT	Value Added Tax
WDI	World Development Indicators
YEDF	Youth Enterprise Development Fund
YEMP	Youth Employment Marshall Plan
YEN	Youth Employment Network
YEP	Youth Employment Programme
YESD	Youth Employment for Sustainable Development Project

EXECUTIVE SUMMARY AND POLICY RECOMMENDATIONS

Economic growth in Kenya has improved in recent years...

In 2003, Kenya's economic performance accelerated: real GDP growth increased on an annual basis from 0.3 per cent in 2002 to almost 7 per cent in 2007 – on a par with growth in sub-Saharan Africa and slightly above the global growth rate of 5.4 per cent at that time. Growth during this period took place in spite of a resurgence of drought that negatively affected the agricultural sector and was a result of the emergence or revival of other sectors, notably tourism.

In 2008, however, the strong expansionary phases ended abruptly as both investment and exports collapsed. The decline was partly a result of the post-election violence that broke out at the beginning of the year, which adversely affected most sectors of the economy during the first half of 2008. The downturn was exacerbated by the global financial and economic crisis and a rise in commodity prices. Yet, after a period of instability and adjustment, a strong recovery took hold in 2010 as exports and investment fully recovered. By the end of 2010 the economy had achieved an impressive growth rate of 7.3 per cent – on par with emerging economies during the same period. Real GDP growth in the third quarter of 2012 fell moderately to 4.7 per cent and is expected to reach 5.7 per cent in 2013.

...but has been relatively unstable due in part to a narrow growth base and weak investment patterns...

Economic growth has been 2 per cent or less at least one-third of the time in the past 30 years and is considerably lower than the average of least developed countries (LDCs). Part of the relatively poor performance lies in the comparably slow transformation to an industrial-based economy. The size of the industrial sector has remained unchanged during the past two decades. The reliance on agriculture – which represents 25 per cent

of GDP – has made the economy particularly vulnerable to rising costs of inputs such as oil and inclement weather conditions – exacerbated by the fact that tea and coffee alone account for nearly one-fifth of all export earnings.

The pace of transformation has been adversely affected by a declining savings rate and stagnant investment. In fact, Kenya experienced one of the sharpest declines in the gross domestic savings rate in the developing world. The majority of the emerging, developing and LDCs managed to steadily increase their savings rates and reduce their reliance on more unpredictable sources of external finance, such as foreign direct investment (FDI) and foreign borrowings. By contrast, Kenya's domestic savings rate fell from 18.6 per cent in 1990 to 8.9 per cent in 2010. As a consequence, gross fixed capital formation did not keep pace with the rates in other developing countries. Gross fixed capital formation has remained stagnant at around 20 per cent of GDP over the past decade.

... which has adversely affected formal job creation and hampered improvements in living standards...

The relatively weak economic performance has meant that labour market improvements have been slow. Between 1991 and 2003, the employment rate in Kenya fell by over 7 percentage points from 67 per cent to 59.7 per cent and even during the most recent period of strong and persistent growth, employment growth only kept pace with the working-age population. As a result, in 2012 the employment rate – at just over 60 per cent – remained well below the levels achieved in the 1990s and considerably lower than the average for sub-Saharan Africa (65.1 per cent).

Moreover, the majority of job creation has been in informal-sector enterprises. In the past decade alone, non-agricultural informal-sector employment rose by approximately 5.1 million or 7.2 per cent per year – far outstripping the growth in formal waged employment. As a result,

employment in informal-sector enterprises constituted 64 per cent of total employment in 2011 – and 85 per cent when agricultural self-employed and workers engaged in small-scale agricultural activities are considered. Importantly, manufacturing was the second largest contributor to informal-sector employment growth. Moreover, the vast majority of formal jobs have been casual in nature: between 2003 and 2011, regular employment grew by 7 per cent compared to 87 per cent growth in casual employment.

As a result, there has been little or no improvement in the standard of living as measured by GDP per capita growth. In fact, Kenya's per capita growth rate has averaged about 0.32 per cent a year during the past 30 years, compared to 1.5 per cent a year, on average, in LDCs. The moderate improvements in living standards have been affected by the trend increase in informal-sector workers who earn, on average, less per month than the established international and national poverty lines and one fifth of what public workers earn in the formal sector (and less than half compared to private formal-sector workers).

... particularly among Kenyan youth...

Youth have been particularly affected by the weak formal job creation, with adults benefiting from a disproportionate share of the jobs created. In particular, in 2012, youth aged 15 to 24 accounted for less than 19 per cent of total employment, whereas they made up over 35 per cent of the working-age population. As such, the youth employment rate, at 32.8 per cent, is less than half the adult employment rate and one of the lowest in the region. Many youth have become discouraged and have begun to leave the labour market entirely. In 2012, the inactivity rate for people aged 15 to 24 in Kenya reached 60.5 per cent – an increase of 5 percentage points since 2000 alone. The problem is particularly acute among young women whose rate of inactivity is 8 percentage points higher than that of young men.

Yet, there has been some considerable progress in terms of literacy rates and access to primary education for both men and women. In 2009, only 13 per cent of the Kenyan population aged 15 years and over were illiterate – 13 percentage points lower than in 2000 and 24 percentage points lower than in sub-Saharan Africa as a whole. However, improvements have been slow with regard to tertiary education where the enrolment rates are far below international standards. Indeed, in 2009 only 4 per cent of the Kenyan population were enrolled in tertiary education – an increase of only 1.3 percentage points since 2000.

Importantly, high and persistent inactivity rates can impede future economic growth due to skills erosion and reduced labour participation – especially in light of the higher education rates among the Kenyan population. Labour market detachment can also have important social implications and is increasingly associated with a sense of discontent leading to social unrest – evidenced by recent uprisings in North Africa and elsewhere. Indeed, in the case of Kenya, there is growing sense of pessimism among young people regarding their employment prospects and their role in society more broadly. In 2011, only 15.8 per cent of the population aged 15 to 34 in Kenya believed the economic conditions of the area where they lived were getting better and only one quarter believed it was a good time to find a job – among the lowest in Africa.

*... despite considerable efforts by the government
to support the labour market.*

At the national level, two major development plans were formulated during the last decade – the Economic Recovery Strategy for Wealth and Employment Creation (ERS) for the period 2003–2007 and Vision 2030 for 2008–2030 (that superseded the ERS). Vision 2030 is the long-term development plan aimed to improve the quality of life in Kenya. It includes over 120 projects implemented in five-year Medium-Term Plans with the

first one being completed in 2012. In terms of employment, as formulated in Vision 2030, labour market improvements are expected to occur principally as a result of actions taken to strengthen economic growth and thus, specific job-centred measures or a labour market strategy are noticeably absent.

The Vision does however highlight the need for making young people more “competitive” and “prosperous”. Plans for youth are proposed in several areas including improving practical skills and identifying specific barriers to youth employment. This complements a series of government programmes, institutions and policy frameworks that have been implemented in recent years to address the challenges confronting youth, notably: (i) in 2005, a new Ministry of Youth Affairs and Sports was established; (ii) in 2007, the government established the Kenya National Youth Policy, a legislative framework to enhance youth participation in national development; (iii) in 2008, the Ministry of Youth Affairs and Sports launched the Youth Employment Marshall Plan to address the long-term challenges of youth employment; and, (iv) in 2010, the Kenya Youth Empowerment Program was launched in cooperation with the World Bank. The latter absorbed some of the activities of the Marshall Plan, but included a wider spectrum of activities – e.g. training and policy development.

Recent policy platforms and growth strategies, however, have not been enough to properly integrate labour market policies as part of a coherent mutually reinforcing macroeconomic policy framework. Indeed, strong GDP growth in Kenya has not necessarily translated into improved labour market conditions, especially for youth. Therefore, in order to benefit from the high growth rates expected, a stronger link between growth, employment and equity is necessary. Going forward, the government could consider focusing on three areas: (i) promoting stable economic growth and productivity gains; (ii) increasing efforts to encourage formal job creation; and (iii) ensure there is an equitable distribution of the gains from growth.

Moving forward, international experience would lend support, first, to a greater focus on a job-centred macroeconomic framework...

Kenya will require an annual rate of economic growth of about 5 per cent, which is the forecast growth rate for 2013 to absorb the growing working-age population; and a much higher rate to ensure meaningful gains in employment, notably among youth. Further progress in ensuring job-rich growth depends on action in the following areas:

- *Creating an enabling environment for investment:* While macroeconomic policies to reduce the cost of borrowing and increase the availability of credit will be necessary, they are not sufficient. More targeted investment friendly macroeconomic policies could be envisaged. For example:
 - *Improve the savings rate:* The government could envision new and innovative instruments to encourage domestic savings, e.g. by issuing inflation-indexed as well as GDP-linked bonds. Inflation-indexed bonds are likely to encourage households to save more while the GDP-linked bonds will allow the country to pay a return that varies with the GDP growth performance. A number of countries – Argentina, Mexico, Nigeria and the Bolivarian Republic of Venezuela – issued different versions of GDP-linked bonds during the past three decades, which helped to reduce their borrowing costs and increase access to domestic and international capital. Issuance of GDP-linked bonds can be particularly helpful to ensure that the much needed social sector spending on health, education and social protection does not suffer during an economic crisis.
 - *Priority sector lending:* Monetary authorities could adopt asset-based reserve requirements to encourage bank-lending to priority sectors of the economy. Such instruments can allow banks to adjust their cash reserve ratios based on the sectors that they need to lend to. For instance, the Reserve Bank of India, has introduced Priority Sector Lending (PSL) programmes to target sectors that are likely to create more formal jobs.

-
- *Productivity-enhancing strategy:* Kenya could stimulate labour and total factor productivity via tax incentives for firms that make necessary investments in skills and productivity enhancement. The government could also consider creating a 'Productivity Fund' that will provide grants and loans to firms to invest in training of their workers. In addition, efforts to reduce excessive sectoral concentration and promote sectors that are incrementally more productive could also be part of an overall productivity-enhancing strategy. These policies would need to ensure coherence and coordination between fiscal, monetary and exchange rate policies on one hand and employment and education policies on the other hand. In this regard, it is critical to recognise that improvements in labour productivity do not necessarily reduce labour demand. In fact, the experiences of the East Asian economies show that employment and growth in labour productivity need not be a zero-sum game.
 - *Diversifying the export-base:* A greater diversification of export products would allow Kenya to maintain foreign exchange earnings constant, reduce its vulnerability to the volatility of commodity prices and lessen the harmful effects of sudden falls in agricultural production due to climate conditions. Moreover, a greater diversification of production and exports would have the potential of improving the quality of jobs, especially in sectors that have a higher value added. In order to achieve this, *priority sector lending* (as explained above) could be a solution. However, a forward-looking industrial policy will be also necessary to ensure that educational institutions are imparting the knowledge, training and skills necessary to promote those export sectors with potential.

A stable macroeconomic framework and improved growth performance, while necessary are insufficient. Special efforts are needed to address the labour market challenges facing Kenya, notably as regards the trend increase in informality, as well as rising joblessness and sense of discontent among youth.

... second, to encourage the formalization of informal-sector enterprises and improve the working conditions of workers in informal-sector employment...

Efforts to reverse the rise in informal-sector employment and promote the formalization of firms will go a long way to improving the employment content of growth and complement efforts to stimulate productivity and investment. Stimulating formal job creation will also help to improve overall working conditions and reduce economic instability. To achieve this, measures along the following lines could be envisaged:

- *Promoting private sector development and the formalization of informal-sector enterprises and jobs:* One of the main obstacles to more formal job creation is the existence of entry barriers into the formal economy. This includes the presence of unfriendly legal and regulatory framework for business operations, unfavourable taxation regime and cumbersome business registration. Although considerable progress has been made in recent years in this area, continued efforts to reduce the administrative and tax burdens of businesses (especially micro and small firms) to encourage entrepreneurs to formalize their firms are needed. Additionally, the lack of sound property rights is another common barrier to formalization. Examples from other countries in these areas might prove insightful:
 - Brazil has facilitated formalization by extending credit to microenterprises, small enterprises, cooperatives and production initiatives in the informal sector. Brazil has also reduced from 41 to 7 the number of steps involved in the process of formalization and has reduced tax burdens for micro-businesses with up to one employee.
 - Peru has taken significant steps to address the lack of property rights by setting up the Praedial Registration System, which granted property titles to more than 1.2 million families and helped about 380,000 firms enter the formal economy.

-
- Countries such as Liberia and Uruguay have reduced significantly start-up times by introducing the so-called one-stop-shops that bring together in one easily-accessible location all the information and forms that are needed to start a business. Efforts in this direction can also help facilitate youth entrepreneurship (see below).
 - China has promoted the development of rural productive non-farming activities in order to reinforce the linkages between the agricultural sector and the broader economy, creating opportunities for formal employment. In fact, the dynamic rural non-farming sector in China has been a major contributor to the country's growth, increasing rural household income and contributing to rural development.
 - *Developing social protection floors as a tool to improve working conditions of informal-sector workers:* Many of the informal-sector workers in Kenya lack access to basic social protection, leaving them vulnerable to occupational health and safety risks but also unprotected in case of unemployment, accident, sickness or old-age. Good social provisions can strengthen individual health and well-being of informal-sector workers, as well as to improve their capacity to organize themselves and make demands for better conditions of work. Some examples include the UMASIDA scheme in Tanzania – a community-based insurance model aimed to minimize the problem of accessibility to health care services by the informal economy workers. Additionally, there is the Self Employed Women's Association (SEWA) that was created to address the welfare of Indian women who work informally by taking initiatives to ensure health, income security and empowerment. More broadly speaking, policy makers should bear in mind that expenditure outlays on such social provision measures should be viewed as a long-term investments rather than a risk management or crisis-response tool.

... and third, to develop a national employment strategy with a particular focus on encouraging job creation among youth.

A coherent national employment strategy where labour market policies are fully integrated in strategic development and growth plans may yield important benefits. Many countries have adopted national employment strategies, including a multi-year *Action Plan for Jobs* implemented in Ireland that puts employment-friendly policies at the heart of the recovery efforts. Policymakers in Kenya could learn from the strengths and weaknesses of these initiatives for the development of their own strategy. Not only will this help to improve the content and design of programmes for youth, but it will also help to ensure a more inclusive process that views youth as central to providing solutions, as opposed to being a source of problems. Several areas of initiatives could be part of such a strategy, including:

- *Re-orient the suite of existing programmes to better align them with youth employment challenges:* While the efforts to date to address youth-employment challenges have been a welcome initiative, they remain too general in their approach. This is, they target young people in general but fail to identify those in greatest need and to address the main challenges of youth in Kenya, notably; (i) lack of job opportunities available to them; and, (ii) their low employability for the few jobs that are available. Policies and programmes that target a specific challenge – e.g. having the right set of skills – are more effective and efficient than simply targeting an age group. To improve the relevance of the existing programmes for youth, the following issues need to be addressed:
- *Improve skills matching and school-to-work transitions, including elements of soft-skills development:* There is a common view among the different stakeholders in Kenya that one of the reasons for the high proportion of the youth out of employment is the prevalence of a mismatch between the skills youth have and those needed by the labour market. The Report underlines the importance of education

and training policies, but especially when adapted to the needs of the labour market. For instance, the Republic of Korea and Singapore not only addressed the issue of the quality of education (including secondary and tertiary education) but also improved vocational skills, which they rightly believed were essential factors in improving productivity and competitiveness. Both countries introduced training levies to encourage enterprises to participate in workers training. Moreover, the combination of education and training could be complemented with policies that help the youth acquire work experience to ensure their long-term integration into the labour market. The programmes *Joven* in Chile and *Juventud y Empleo* in Dominican Republic aimed to provide youth not only with technical skills, but also with necessary soft skills for the labour market.

- *Ensure equity in programme participation, especially for women and youth in rural areas:* To ensure equity in programme participation and to combat discrimination, the *Programme for the Promotion of Children and Youth* (PCY) was implemented in Uganda between 2003 and 2006. The PCY was a Ugandan–German comprehensive approach to promote the interests of disadvantaged youth living in rural areas, suffering from either unemployment or underemployment.
- *Supporting the most vulnerable:* Traditional employment policies may be ill-suited to ‘activate’ youth who are discouraged and have been out of the labour market for long periods of time. For instance, in Egypt, in an effort to promote the reintegration of youth into the labour market and society more broadly, a UNESCO-funded programme provides youth with literacy training, vocational education, life-skills, as well as computer and foreign language skills.
- *Improve the employment content of growth:* In an effort to achieve a more equitable distribution of the gains from growth, some countries have undertaken measures that provide incentives to enterprises to hire young workers, while others have promoted entrepreneurship among youth. Examples of initiatives are detailed below:

- *Targeted subsidies and other measures to encourage the hiring of youth:* Governments can support youth labour demand by providing incentives to enterprises to hire young workers, through subsidized wages or tax breaks. *The First Employment Programme* established in Brazil, Colombia, Paraguay and recently Mexico and the *Youth Wage Subsidy Programme* in Turkey, are examples of this type of programmes that provide subsidies to companies to encourage the recruitment of young people. For these programmes to be effective, it is important to make sure they are targeted enough to a particularly affected population, for example, by offering the training grant subsidy to firms that hire youth that have yet to complete secondary school or to offer subsidized wages to youth who are long-term unemployed. This is what the *First Employment Programme* has done targeting youth who have no labour market experience.
- *Promoting entrepreneurship among youth:* Another type of measure that can also help increase employment levels among youth is promoting entrepreneurship among the youth. Successful entrepreneurship programmes incorporate not only start-up assistance but also knowledge of how to maintain and develop business activities. For example, the *Northern Uganda's Youth Opportunities Programme* offers young people aged 16 to 35 cash grants to cover training programmes and the tools and materials needed to run a business.
- *Promote cohesion between adults and youth.* It is important to remember that youth and adults are not substitutes in the labour market, and the promotion (or discouragement) of one is not to the detriment (or benefit) of the other. All too often, it is wrongly assumed that early retirement will open up positions for youth – which has had the unfortunate effect of creating an adverse relationship between the two groups. Both young and adult workers are central to a productive and efficient labour market. Furthermore, through contact with more experienced workers via mentoring, young workers can better instil good practices at the workplace and help to dispel misconceptions regarding the attitudes of youth. The recent initia-

tive of the Kenya government to launch an internship programme is welcome but will need to be monitored carefully to ensure that the above policy parameters and principles are integrated and taken into consideration.

- *A coherent and tripartite strategy to leverage the above complementarities will be needed:* Engaging in social dialogue with relevant stakeholders when pursuing policy initiatives for youths is also imperative to ensure that measures are tackling the needs of the labour market. Indeed, social dialogue with relevant stakeholders can help to bridge information asymmetries between the government, employers and youth, target specific needs of workers and employers and promote strategic partnerships aimed at achieving longer-term sustainable outcomes. Some areas and examples that Kenya could draw on in the future are detailed below:
- *Building partnerships with the private sector and with international organizations:* Fostering collaboration with these structures is essential, not only to facilitate the integration of partners' needs into national employment policies but also to allow private partners to integrate into the budgeting and planning aspects of employment strategies. South Africa, for example, instituted a statutory levy in April 2000 to be invested in training and development as part of the Government's skills strategy. In addition, partnerships with international organizations could also play a crucial role. The *ILO's Youth Employment Programme* (YEP) follows an integrated approach that combines macroeconomic policies and targeted measures, addressing labour demand and supply, as well as the quantity and quality of employment.
- *Promote youth engagement in the process:* Youth are themselves, crucial stakeholders for the discussion, creation and implementation of youth employment policies and programmes. They are the future national labour force and as such represent an immense opportunity and a potential for the country's future development prospects. One example of a country that has made efforts to involve the youth

or youth organizations in its youth employment policies and programmes is Sri Lanka. The *National Action Plan for Youth Employment* in Sri Lanka involved youth throughout the country in the design and running of the consultative process. As a result of these consultations, concrete inputs were met, such as the recommendation of fifteen amendments that were taken into account in the final draft of the National Action Plan.

- *Improved monitoring and evaluation of programmes:* The ability of policy makers to improve the effectiveness of existing (and new) programmes depends very much on a proper evaluation framework. Generally, however, little is known about the effectiveness of the existing suite of efforts. First, there is a need to gather and monitor pre- and post-programme information and results. To the extent possible, a vast range of information should be gathered: cost, employment status, earnings, demographic information, education level, etc. Second, it is critical to continue to monitor participants over longer periods. Given that in many cases returns to programmes, in particular training for youth, accrue over time, monitoring participants and outcomes beyond programme exit, e.g. for 3-5 years, should be part of any monitoring and evaluation strategy. Finally, the government needs to establish at the outset, clear and measurable objectives with respect to expected outcomes in the short- and long-term.

The task is not a simple one but it is possible provided that employment goals are better integrated into current strategic growth and development plans.

The inaugural five-year Medium-Term Plan (MTP) of Vision 2030 was completed in 2012 and the next leg of the process is intended to take place from 2013 to 2017. This would provide an excellent opportunity to mainstream labour market policies into development planning. More fundamentally, the new Government could take steps to ensure a more equitable growth process.

The new Government will, however, have to work closely with social partners – that is representations from the Central Organization of Trade Unions (COTU) and Federation of Kenya Employers (FKE). Indeed, effective social dialogue can ensure the best possible design of reforms and increase the likelihood of equitable and sustainable policies being implemented. In this respect, the ILO through its technical and research capacity and as a facilitator of tripartite dialogue has an important role to play along with the Government and social partners to ensure growth with equity.

CHAPTER 1

ECONOMIC AND LABOUR MARKET PERFORMANCE

INTRODUCTION

During the past three decades, Kenya's economic stability has been affected not only by a series of droughts and the volatility of commodity prices, but also by ethnic conflict and political instability. Since 1980, there have been only two periods (1986–1988 and 2003–2007) during which economic growth exceeded 5 per cent and was sustained for at least 3 years. The most recent period of growth was abruptly ended by a wave of ethnic violence following a disputed presidential election coupled with the global economic crisis. Against the backdrop of an unstable growth pattern, progress in labour market and social developments has been slow. Employment rates in Kenya are low compared to its African counterparts due to the weak labour market participation of women and youth, combined with the fact that many of the job gains during the recent expansionary period took place in the informal sector and were therefore of insufficient quality to raise workers out of poverty.

The purpose of this chapter is to shed light on recent economic and labour market developments in order to assess the labour market and social challenges to achieving a more inclusive and employment-rich growth trajectory. In particular, section A reviews the economic developments leading up to the crisis, including a discussion of the drivers of this performance. Section B assesses in more detail the labour market impacts stemming from the high volatility of GDP. This section also highlights the heterogeneous evolution of labour market trends among different groups in society and discusses the situation facing certain groups of vulnerable workers, including youth and those workers in precarious forms of employment. Section C takes a closer look at how Kenyan households are constrained by persistent income and non-income inequalities, including the issue of poverty. The final section of this chapter discusses a number of policy considerations and introduces the remainder of the report.

A **MACROECONOMIC DEVELOPMENTS BEFORE AND DURING THE CRISIS**

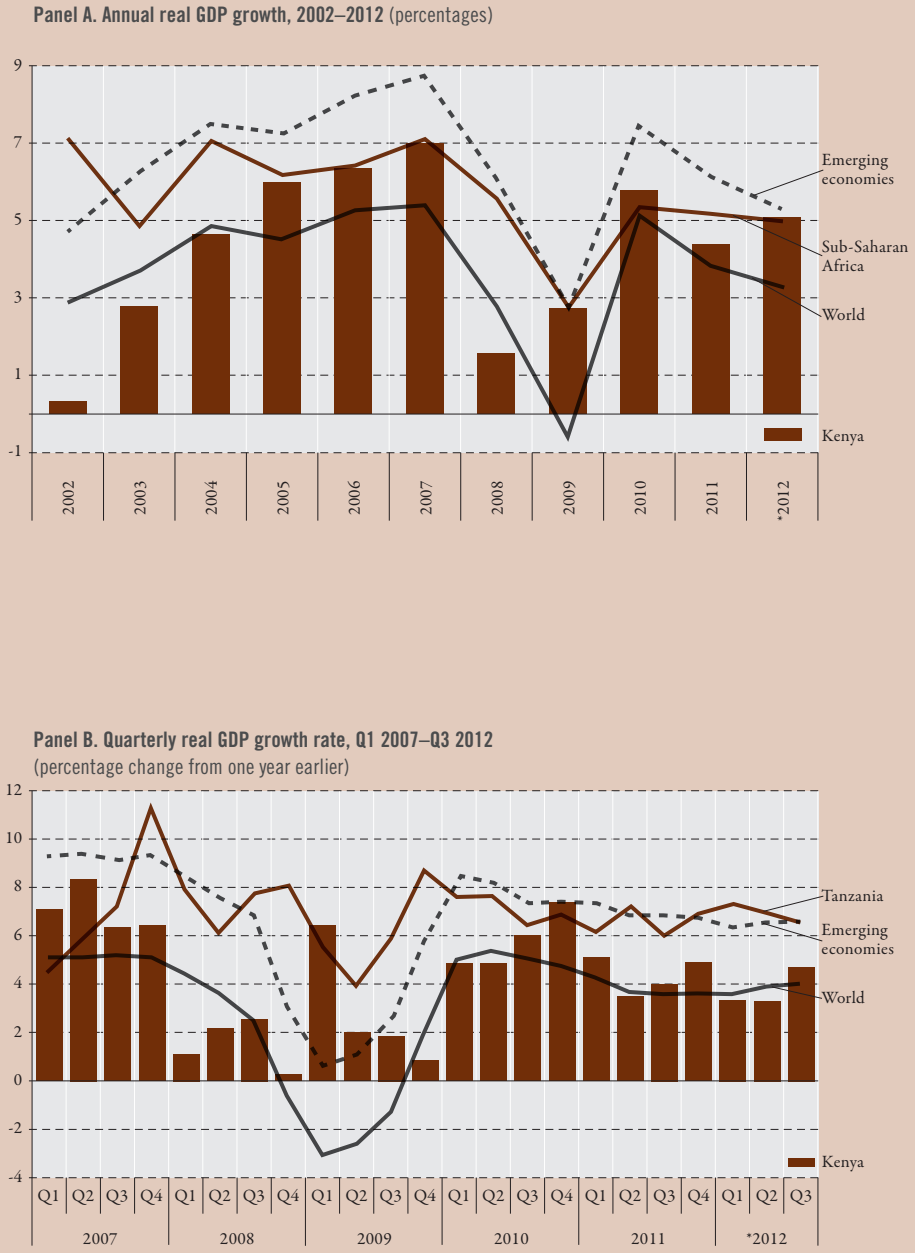
The fast pace of economic growth in Kenya that began in 2003 was interrupted by a political and economic crisis in 2008...

In 2003, Kenya's economic performance accelerated after a decade of poor economic growth. During this 5-year period of sustained growth, real GDP growth increased on an annual basis from 0.3 per cent in 2002 to almost 7 per cent in 2007 – on a par with growth in sub-Saharan Africa and slightly above the global growth rate of 5.4 per cent (figure 1.1, panel A). Importantly, economic growth during this period took place in spite of a resurgence of drought that negatively affected the agricultural sector. The expansionary phase was a result of the emergence and resurgence of other sectors, notably tourism. Manufacturing, transport and communications also showed signs of renewed growth in response to a number of incentive structures introduced by the Government (AfDB and OECD, 2006).

In 2008, however, economic recovery ended abruptly as both investment and exports collapsed. First, the post-election violence that broke out at the beginning of 2008 affected almost every sector of the economy during the first quarter. Second, the country was heavily impacted by the global increase in commodity prices at the end of 2008. Food and oil prices soared during the course of the year and were passed directly on to consumers through a significant increase in the costs of electricity and transportation, which also resulted in higher manufacturing costs. This problem was exacerbated by the drought that had been affecting production in the Horn of Africa since 2007 (see Chapter 2).

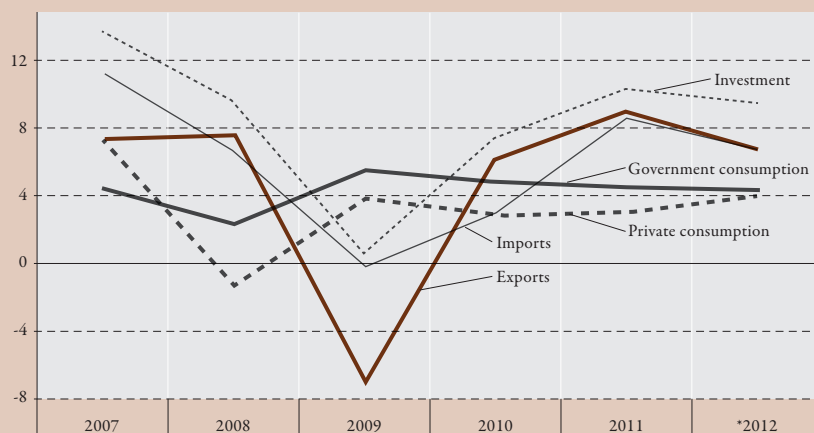
As a result, at the beginning of 2008, quarterly GDP fell to 1 per cent in the first quarter (figure 1.1, panel B and AfDB and OECD, 2009). Moreover, in comparison to neighbouring countries, such as Tanzania, quarterly GDP growth in Kenya remained suppressed throughout the year and was consistently low throughout 2008. And, while there was a brief respite at the beginning of 2009, growth slowed again to hover just above zero by the end of the year. However, by the end of 2010 the economy had achieved

Figure 1.1 Real GDP growth



*Figures for 2012 are estimated values.
Source: IMF, 2012; AfDB et al., 2012; Kenya Bureau of National Statistics.

Figure 1.2 Real GDP growth by component, 2007–2012 (percentages)



*Figures for 2012 are estimated values.
Source: Kenya National Bureau of Statistics.

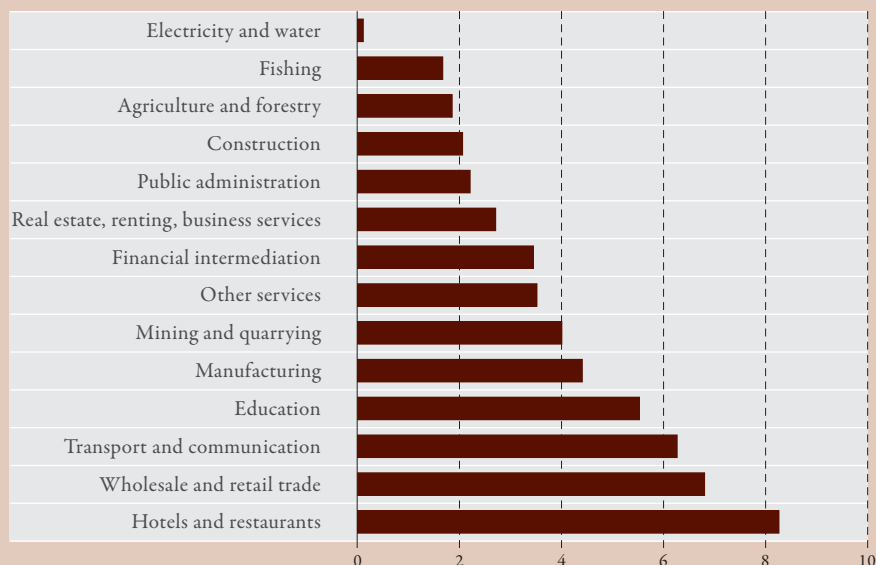
an impressive growth rate of 7.3 per cent – comparable to that of emerging economies during the same period.

... but the economy recovered in 2010 due to strong growth in exports and increases in infrastructure spending by the Government.

After a period of instability and adjustment occasioned by the various crises, a strong recovery took hold in 2010. The increase in growth can be attributed mainly to a full recovery of exports and significant gains in investment (figure 1.2). Indeed, good rainfall during 2010, coupled with higher prices for some Kenyan export products, in particular coffee,¹ resulted in an impressive recovery in the growth rate of exports – from -7.0 to 6.1 per cent between 2009 and 2010. In addition, gross fixed investment grew by 7.4 per cent in 2010, close to 7 percentage points above the growth in 2009. The Economic Stimulus Programme (ESP) put in place by the Government in 2009/2010 played an important part in boosting infrastructure and creating credit for

¹ Average annual prices for coffee sales more than doubled in 1 year; from 195.75 Kenyan Shillings (KSh) to 396.78 KSh per kilogram between 2009 and 2010 (AfDB et al., 2011).

Figure 1.3 Real GDP growth by economic activity, between Q4 2010 and Q4 2011
(percentage change)



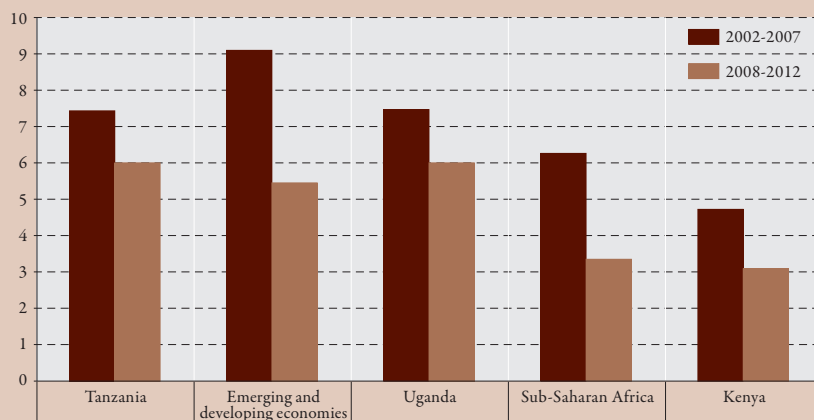
Source: Kenya Bureau of National Statistics.

small and medium-sized enterprises (SMEs) (AfDB et al., 2011), which in turn boosted investment and economic growth. Real GDP growth in the third quarter of 2012 fell moderately to 4.7 per cent, however, it is expected – in the absence of economic and social turbulence – to grow at 5.1 and 5.6 per cent in 2012 and 2013, respectively (World Bank, 2012).

Wholesale and retail trade, along with the transport and communications sectors, were the main drivers of the recovery ...

Tourism, wholesale and retail trade and communications were the fastest growing sectors in 2011 in terms of economic performance. Indeed, between the fourth quarters of 2010 and 2011, GDP in hotels and restaurants grew 8.2 per cent. Similarly, GDP in wholesale and retail trade, which accounts for over 14 per cent of total GDP, grew by 6.7 per cent and GDP in transport and communications by 6.2 per cent (figure 1.3). Due to their relative importance in the overall economy, these latter sectors – wholesale

Figure 1.4 Evolution of real GDP per capita 2002–2012
(compound annual changes, percentages)



Note: Real GDP per capita has been derived by dividing GDP in purchasing power parity (PPP) dollars by total population. Real GDP per capita is expressed in PPP dollars instead of national currencies because of the lack of available data on GDP expressed in national currencies for country groups. Figures for 2012 are estimated values.

Source: ILS estimates based on IMF, 2012.

and retail trade and transport and communications – were also the biggest drivers of economic growth during the period 2003–2011, contributing 20 and 10 per cent to total GDP growth respectively.

... but GDP per capita growth rates remain low in comparison to those attained in other sub-Saharan African and emerging and developing countries.

In spite of the improvements in certain sectors, GDP per capita in Kenya continues to be well below the levels observed in sub-Saharan Africa and in other neighbouring countries, such as Tanzania or Uganda (figure 1.4). Even during the growth period of 2002–2007, annual growth in GDP per capita in Kenya averaged just 4.7 per cent, compared to over 7 per cent in Tanzania and more than 6 per cent in Uganda and sub-Saharan Africa. Since 2008, despite a strong recovery, the gap between Kenya and other emerging and developing countries has persisted, with the pace of per capita GDP growth slowing to an average of 3 per cent per annum. As a result, in terms of the levels in 2012, GDP per capita in Kenya stood at US\$1,807

compared to US\$1,217 in 2000 in contrast to Tanzania, which had just above half the per capita GDP of Kenya (US\$771) in 2000 but, in 2012, has all but closed the gap, with per capita GDP rising to US\$1,472.

Moving forward, a number of unresolved vulnerabilities will need to be addressed.

Underlying the relatively weak growth performance are a number of persistent vulnerabilities. First, the unpredictable nature of inflation has in many instances eroded households' purchasing power and increased their risks of falling into poverty. For Kenya, this is especially worrying since the incidence of low earnings and high poverty rates are two major social barriers to progress. Inflation in Kenya increased to 18.9 per cent at the end of 2011 – driven mainly by food and transport inflation – from 4.5 per cent at the end of 2010. Second, Kenya's economy suffers from its high dependence on agriculture and overall declines in productivity.

Addressing the second issue will be crucial if the country is to attain higher and more sustainable rates of economic growth that allow for sufficient employment creation. Agriculture represents approximately one-quarter of GDP, making Kenya susceptible to nature and commodity price volatility. During the cycle of severe droughts that has affected the Horn of Africa since 2007, Kenya's food deficit had to be met through highly priced food imports, in particular maize.² Although exports benefit from higher price levels, Kenya's top exports can no longer cover the costs of oil and highly priced food imports and, as a result, the current account deficit hit close to 10 per cent of GDP in 2011. Achieving macroeconomic stability in these areas and improving investment and productivity are important elements in achieving more sustained economic growth, which will in turn increase employment opportunities. These and other related macroeconomic issues are discussed in Chapter 2.

² Global maize prices increased from an average of US\$167 per tonne in 2010 to US\$299 in 2011. Moreover, Kenyans themselves paid up to US\$530 per tonne of maize, due to additional policy distortions that disrupted the domestic food market.

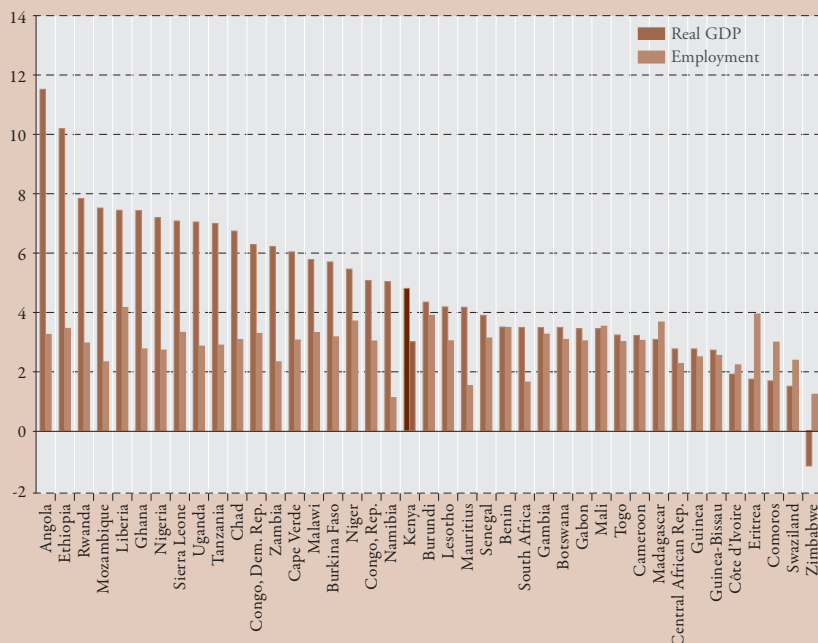
B LABOUR MARKET PERFORMANCE

Employment has grown in Kenya at a pace similar to that of other African and emerging and developing countries outside the region ...

The evolution of real GDP and employment during the past decade has varied considerably across countries in Africa (figure 1.5). Since economic growth picked up in Kenya in 2003, employment has grown at an average of 3 per cent per annum – a rate which is comparable to the average annual employment growth for sub-Saharan Africa and above the employment growth achieved in developing and emerging countries of other regions, such as Bangladesh (2.2 per cent), Brazil (2.2 per cent), Indonesia (2 per cent) and Tunisia (2.1 per cent) as well as neighbouring countries (with the exception of Ethiopia with 3.5 per cent): Tanzania (2.9 per cent) and Uganda (2.9 per cent).

Figure 1.5 Real GDP and employment growth, selected countries

(compound growth rate between 2003 and 2012, * percentages)



*Figures for 2012 are estimated values.

Source: IMF, 2012; ILO, 2012c.

... but employment rates remain lower in Kenya than in the rest of Africa, especially for youth and women ...

Since 2003, employment growth has outpaced the growth in working-age population, and has therefore been sufficient to absorb the new entrants into the labour market. Indeed, the employment rate (measured as the employment-to-population ratio) has increased – albeit marginally – from 59.7 per cent in 2003 to 60.6 in 2012. However, this increase represents only an insignificant reversal of the decline experienced in the employment rate since the beginning of the 1990s. In fact, the employment rate fell by over 7 percentage points from 67 per cent between 1991 and 2003. As a result, the employment rate in Kenya remains low in comparison to the average level in sub-Saharan Africa: in 2012 it stood at 60.6 per cent in Kenya compared to 65.1 per cent for sub-Saharan Africa as a whole. The gap between Kenya and sub-Saharan Africa in terms of gender is similar, with the employment rate among men being 5 percentage points lower in Kenya than in sub-Saharan Africa and among women almost 4 percentage points lower (figure 1.6, panel A).

The gap in employment rates is almost entirely explained by the gap among youth cohorts. In fact, the employment rate for people aged 15 to 24 is close to 14.5 percentage points lower in Kenya, with the difference being even more pronounced among female cohorts of the same age – at over 15 percentage points.³ Moreover, the total employment rate for women is among the lowest in sub-Saharan Africa (figure 1.6, panel B) and has fallen below the level attained in 2000. Only four other countries in the region – Angola, Mozambique, Uganda and Zambia – have seen a decline in the employment rate of women and, of those four, three initially had much higher levels than that of Kenya.

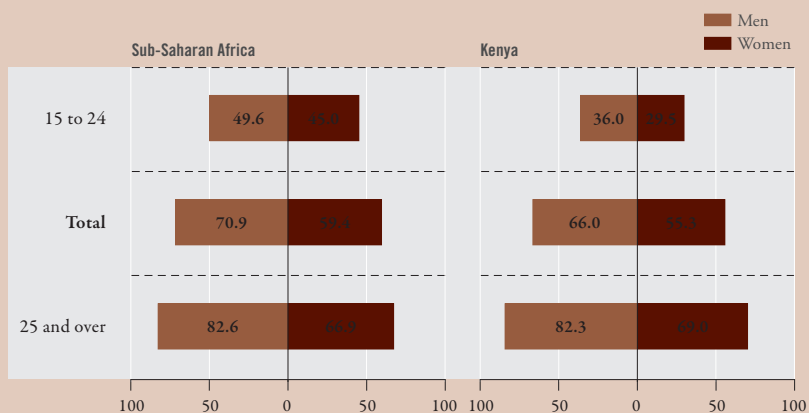
... which is partly explained by comparatively low levels of participation in the labour market.

However, the relatively low employment-to-population ratio among women and youth is driven primarily by weak labour force participation rather than higher unemployment rates. In fact, in 2012 female labour force participation, at 61.7 per cent, was over 10 percentage points below the male

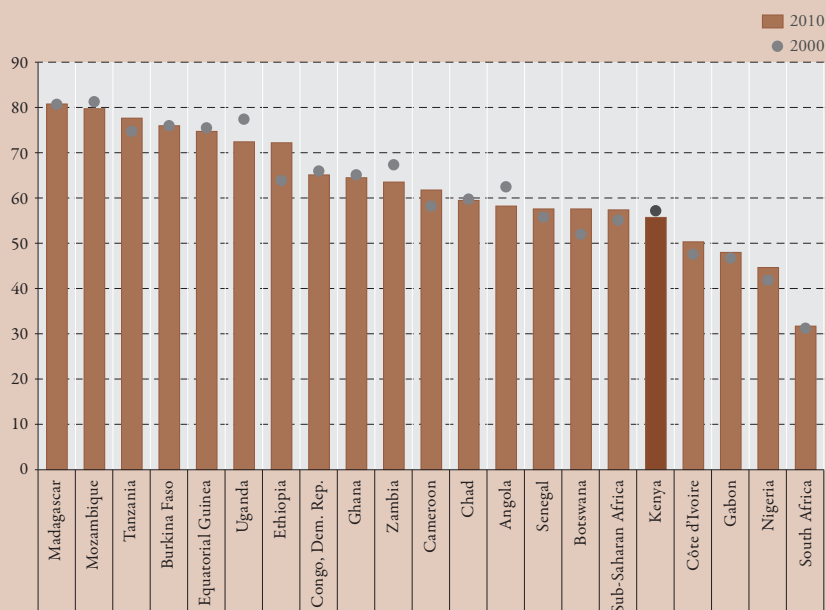
³ The Government of Kenya defines youth as the population between the ages of 15 and 30 years. To comply with this definition, the analysis in this report will take into account, whenever possible, the international definition of youth (15–24) and an enlarged sample of youth (15–34). Given that the most commonly employed categorization of the population is by decade, starting with 15 years of age, the specific Kenyan national definition of youth is not applicable.

Figure 1.6 Employment rates by age and sex
(percentages)

Panel A. Employment rates by age⁴ and sex, 2012



Panel B. Employment rates for women in sub-Saharan African countries, 2000 and 2010



Source: ILO, 2012c for panel A and World Bank Development Indicators for panel B.

⁴ Youth in this graph is defined as the population aged 15 to 24 since it is not possible to calculate employment rates by the wider category of youth.

participation rate. Moreover, during the past decade, participation rates among women have declined by nearly 1.5 percentage points. Similarly, in 2012, labour market participation among youth was 39.5 per cent, which is 5 percentage points lower than in 2000.⁵ The problem is particularly acute among young women, who appear to be one of the most vulnerable groups (see Chapter 3).

In comparison to results for the region, the female and youth participation rates in Kenya are 2.9 and 14 percentage points respectively below the average observed for sub-Saharan Africa as a whole. Even in terms of the overall population, labour market participation is comparatively low: 66.8 per cent in 2012 in comparison to neighbouring countries, such as Tanzania and Uganda, where participation rates are approximately 89 and 78 per cent respectively, and lower than the averages for low-income countries (75.1 per cent) and for sub-Saharan Africa (70.4 per cent).⁶

*Employment creation during the past decade
has been mainly concentrated in urban informal-sector enterprises ...*

As in other developing countries, informal-sector employment in Kenya – which includes employment in urban informal-sector enterprises⁷ – constitutes an important element of the labour market and has been the biggest contributor to employment creation during the past decade.⁸ In 2011, non-agricultural informal-sector employment accounted for 64 per cent of total employment in Kenya. Moreover, the share of informal-sector employment rose by more than 25 percentage points between 2000 and 2011, and the number of people in informal employment increased by approximately 5.1 million during that decade (see Chapter 3).

⁵ Participation rates among individuals aged 15 to 34 stood at 57.6 per cent in 2011, a decline of nearly 2 percentage points since 2000.

⁶ The fact that participation rates in Kenya are lower than those in sub-Saharan Africa – which has a higher GDP per capita – is somewhat surprising given that analyses of the overall labour force participation rates of countries at different stages of development find a U-shaped relationship between these two variables. That is to say, in less-developed countries, economic growth is associated with a decline in participation rates (ILO, 2012c).

⁷ Defined by the Kenya National Bureau of Statistics as small-scale activities (with fewer than ten employees) that are semi-organized, unregulated and use simple technologies.

⁸ The 17th International Conference of Labour Statisticians defined informal employment as encompassing both employment in the informal sector and informal workers in the formal sector (whether employees or contributing family workers) as well as persons working in households, such as domestic employees and those who produce goods for their own end use (see ILO, 2002). In Kenya, however, only data on employment in informal-sector enterprises are gathered and therefore available figures are underestimations.

Unfortunately, in Kenya the publically available data on categorization of jobs by employment status do not include own-account workers in the agriculture sector and employees engaged in small-scale agricultural activities. However, by combining existing national statistics and estimates on total employment produced by the ILO (2012c), it is possible to extrapolate the missing category. It can therefore be estimated that, in 2011, close to 21 per cent of total employment was comprised of agricultural self-employed and employees engaged in small-scale agricultural activities.⁹ This constitutes an important reversal from the figure of almost 45 per cent at the beginning of the decade. Thus, it appears that at least part of the decrease in employment in agricultural activities has been absorbed by the increase in employment in urban informal-sector enterprises.

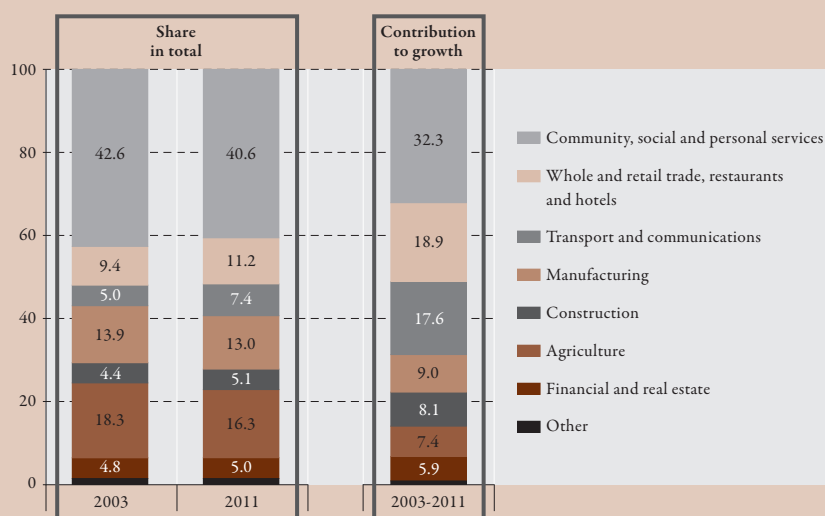
In terms of sectoral distribution, employment in the sector of wholesale and retail trade, restaurants and hotels has been the main driver of employment growth in the urban informal sector. Indeed, in 2011, 96 per cent of employment in this sector corresponded to employees working in informal-sector enterprises. Moreover, with an annual average growth rate of 6.6 per cent between 2003 and 2011, the sector accounted for almost two-thirds of total employment growth in informal-sector enterprises. The second main contributor to the growth in informal-sector employment is the manufacturing sector: in 2011, 87 per cent of employees in that sector were working in informal-sector enterprises and accounted for more than 16 per cent of the informal-sector employment created between 2003 and 2011.

The creation of salaried jobs in formal-sector enterprises has been driven by growth in transport and communications and wholesale and retail trade ...

As highlighted in section A, growth since 2003 has been mainly driven by the progress of the transport and communications and wholesale and retail trade sectors. Not surprisingly, employment growth in these sectors was the highest of all the sectors. In fact, during the period 2003–2011, employment in the transport and communications sector increased at an average annual rate of 7.7 per cent, followed by the sector of wholesale and retail

⁹ Small-scale agricultural activities are not categorized in Kenya as part of the informal sector but, since 96 per cent of the agriculture sector consists of agricultural self-employed and workers engaged in small-scale agricultural activities, it seems pertinent to include them here.

Figure 1.7 Share of employment by economic activity in total salaried employment in 2003 and 2011 and in the change between 2003–2011 (percentages)



Source: Kenya Economic Surveys.

trade, restaurants and hotels (4.9 per cent). Meanwhile, employment in the services sector grew by 2 per cent per year, in the agriculture sector by 1.1 per cent and in the manufacturing sector by 1.8 per cent.

Yet, in terms of overall composition, the community, social and personal services sector¹⁰ – taking into account its relative size – was the main driver of salaried job creation accounting for close to one-third of the jobs created between 2003 and 2011 (figure 1.7). Moreover, 56 per cent of the total number of female salaried jobs are concentrated in this sector. The wholesale and retail trade, restaurants and hotels, and transport and communications sectors were also important sources of job creation during the period, accounting for close to 19 and 18 per cent of total employment growth, respectively. Importantly, the concentration of female salaried jobs in the services sector is higher than that of men. Conversely, both the manufacturing and financial and real estate sectors experienced a fall in their share of employment but together still account for close to 30 per cent of salaried employment.¹¹

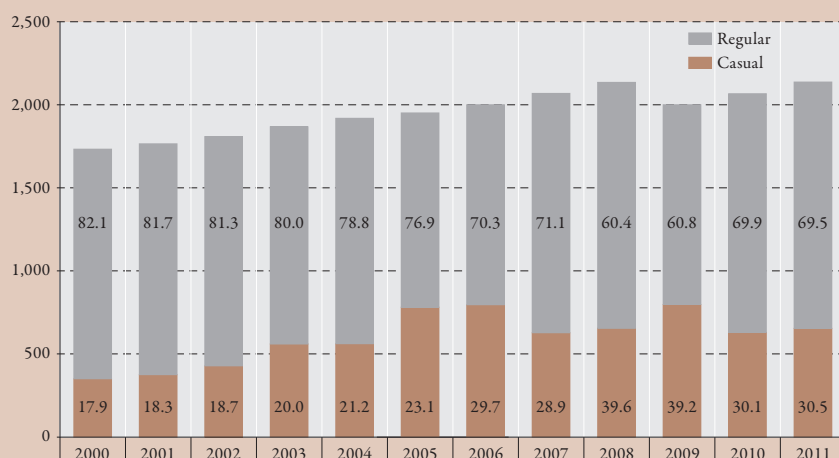
¹⁰ This sector includes: professional, scientific and technical activities; administrative and support service activities; public administration and defence; compulsory social security; education; human health and social work activities; arts, entertainment and recreation and other service activities.

¹¹ Some have argued that Kenya's manufacturing industry has lagged due to the lack of investment, given the perception of the environment for investors as risky and also the rather high costs (relative to productivity) of doing business in Kenya (Bigsten et al., 2010).

... but an increasing number of the jobs created in the formal sector are casual in nature.

Between 2003 and 2011, employment in formal sector enterprises in Kenya grew by just over 23 per cent (compared to over 120 per cent in informal-sector enterprises). However, the vast majority of formal jobs in this period were casual in nature: regular employment grew by 7 per cent over this period compared to 87 per cent growth in casual employment.¹² As a result, the proportion of casual employment in total formal-sector employment increased from 20 per cent in 2003 to over 30 per cent in 2011 (figure 1.8).¹³

Figure 1.8 Waged formal-sector employment by type, 2000–2011 (in thousands)



Note: Figures contained within the bars represent the contribution of each segment to total employment in that year and are in percentages. For the definition of casual workers, see footnote 12.

Source: Kenya Economic Surveys.

¹² 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, 2007). This category of workers enjoys the same rights as other employees to a large extent, but may be excluded from certain crucial benefits, such as leave entitlement, medical cover or provision of accommodation.

¹³ Some studies indicate that this increase in the incidence of casual employment is due to a preference on the part of employers for these types of contracts. Indeed, most employers in Kenya have tended to increase the use of casual contracts to reduce labour costs, achieve more flexibility in management and exert greater levels of control over labour. The trend is mainly observed within textile and garment manufacturing, especially in the export processing zones, and the plantation sector. The situation is fuelled by weak enforcement of labour legislation (Omolo, 2012).

C SOCIAL CONSIDERATIONS

Kenyan workers' livelihoods are constrained by a variety of persistent income disparities ...

Overall, income inequalities are relatively high in Kenya: in 2005, the Gini coefficient stood at 47.7 – the sixth highest among the 24 African countries with available information. This overall level of income disparities is rooted in a number of different, although interconnected, forms of wage inequalities. For example, data from the 2005–2006 Kenya Integrated Household Budget Survey (KIHBS) show that the median monthly income of formal workers is higher than that of informal-sector workers by a factor of at least 2 (private sector), rising to 4.4 and 5.3 among semi-public and public workers, respectively (see table 1.1). Even own-account workers in the formal sector earned a median salary (6,000 KSh per month) which was 2.3 times that of their informal counterparts (2,600 KSh per month). Given the trend increase in informal-sector employment discussed above, it is not surprising that overall wage developments have been adversely affected by this specific type of employment creation.

There are also important disparities within the formal sector. Indeed, in 2010 monthly public sector wages were, on average, more than 25 per cent higher than those in the private sector. Moreover, in only 3 out of 10 sectors

Table 1.1 Median real monthly incomes (wages or business revenues) by category of employment, 2006 (in KSh)

		Informal	Formal	Formal to informal wage rate
Salaried employees	Private		6,160	2.1
	Public	2,880	15,375	5.3
	Semi-public		12,800	4.4
Own-account workers		2,600	6,000	2.3

Source: Pollin, 2009.

are the wages of private sector workers higher, with the disparity reaching a peak among manufacturing workers where public sector workers earn, on average, twice the salary of their private sector counterparts per month (figure 1.9).¹⁴ Yet, Kenyan employees in formal sector enterprises continue to earn less than their counterparts in other countries in the region. In 2009, for example, Kenyans earned, on average, US\$835.6 per month, while the average wage in all African countries with available information was US\$1,167.9 per month.¹⁵ In addition, in Kenya, between 2006 and 2011, average real earnings decreased by 27.8 per cent, putting additional pressure on household incomes and increasing the risk of a rise in poverty levels.

There are also important wage disparities across economic sectors, with financial and real estate activities paying the highest wages, both in the public and private sectors, followed closely by transport and communications activities and public-sector activities related to trade, restaurants and hotels. Indeed, compared to the lowest earning activities (i.e. agriculture and forestry, and mining and quarrying) workers engaged in the financial and real estate sector earn, on average, around four to five times more per month. Importantly, one of the lowest paid sectors is the community, social and personal services sector, which accounted for one-third of jobs created in the past decade and represents more than 40 per cent of total salaried employment.

... and by high levels of poverty ...

Poverty still affects a significant percentage of the population in Kenya. According to the International Human Development Indicators of the UNDP (2011), 47.8 per cent of the population lives in poverty in Kenya – as measured by the percentage of the population having a weighted deprivation score of at least 33 per cent.¹⁶ In comparison, 27.2 per cent of the population lives in poverty in Bhutan, 34.5 per cent in São Tomé and

¹⁴ Large disparities also exist between urban and rural areas in all sectors of economy activity. When all employment categories are taken into account, urban workers earn about twice as much as rural workers in the same job category (Pollin, 2009).

¹⁵ Information on gross average nominal monthly wages comes from the ILO Global Wages Database and is available for the following African countries: Algeria, Botswana, Burundi, Republic of Congo, Egypt, Kenya, Lesotho, Malawi, Mauritius, Senegal, South Africa, Tanzania and Uganda.

¹⁶ Calculated based on data on household deprivations in education, health and living standards (UNDP, 2011).

Príncipe, 49.4 per cent in Pakistan and 41.4 per cent in Swaziland; all of these countries have around the same level of development as Kenya (as measured by the Human Development Index). Moreover, 19.7 per cent of the population still lives in extreme poverty, which is below the international poverty line of 1.25 dollars per day (in PPP terms). Yet, this is still below international poverty levels in most of Kenya's African counterparts (with the exception of Cameroon and South Africa) and other developing countries at similar levels of development, such as Bangladesh (49.6 per cent), Cambodia (28.3 per cent) and Pakistan (22.6 per cent).

Importantly, although poverty is often associated with joblessness, the earnings of a significant proportion of workers do not allow them to rise above a given poverty line. According to ILO estimates (ILO, 2012a), in 2011, 67.1 per cent of workers in sub-Saharan Africa were classified as "working poor" (i.e. those who are working but live still in poverty),¹⁷ which is more than 35 percentage points higher than the global figure. In Kenya, in 2006 (the latest year for which information on working poor exists) the proportion of working poor in total employment was 33.6 per cent. This is 38 percentage points lower than in sub-Saharan Africa as a whole but still higher than in a number of African countries, such as Gabon (14.2 per cent), Egypt (21.5 per cent) or South Africa (23.2 per cent), and much higher than in other countries at similar levels of development in other regions, such as Paraguay (11 per cent) and the Republic of Moldova (11 per cent).¹⁸

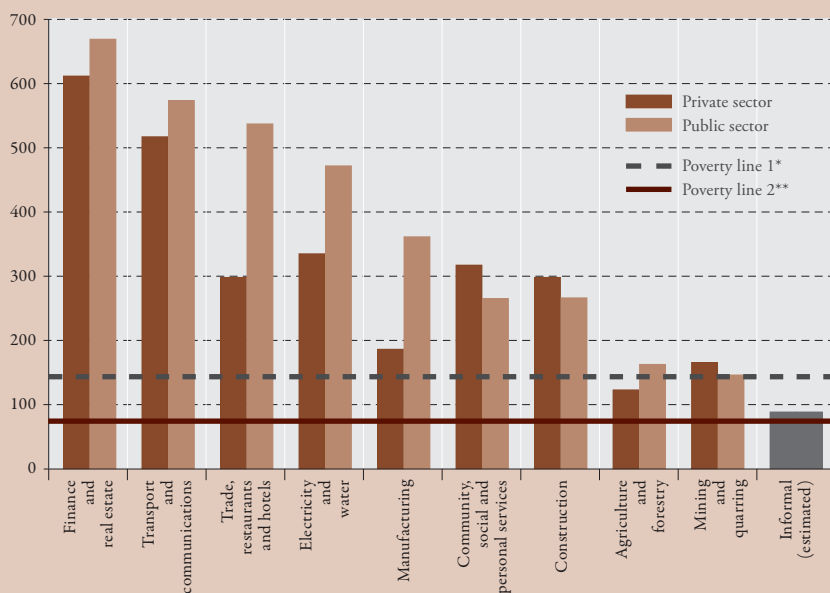
Low levels of income, either because workers cannot work enough hours or because wages are low, are one of the major factors determining the persistence of working poverty (ILO, 2003). In Kenya, in 2010, all workers engaged by formal sector enterprises earned a salary that was, on average, above both the national and international poverty lines. Yet, when salaries are adjusted for the fact that the average worker in Kenya supports themselves and 1.9 other people,¹⁹ the earnings for workers in

¹⁷ According to the ILO, "working poor" is defined as the proportion of employed persons in a household whose members are living below the international poverty line, in this case US\$2 per day (in PPP terms).

¹⁸ Data refer to the year 2005 (Egypt and Gabon), 2006 (South Africa), and 2008 (Paraguay and the Republic of Moldova).

¹⁹ Average number of individuals supported by each wage earner based on Kenya Household Survey.

Figure 1.9 Real monthly wages per person supported by wage earner²¹ by economic sector and poverty lines, 2010 (based on PPP current international dollars)



Note: Private- and public-sector information by economic activity refers to the formal sector.

*National poverty line (overall poverty line): Cost of purchasing a minimally adequate level of food and a minimal level of consumable goods other than food in the urban sector. Adjusted for inflation and converted to PPP international dollars, the Kenyan overall poverty line is equivalent to \$139 per month.

**International poverty line: An international monetary threshold under which an individual is considered to be living in poverty. The World Bank defines the population below the poverty line as that proportion of the population living on less than US\$2.00 per day at 2005 international prices.

Source: Kenya Economic Survey.

agriculture and forestry and in the public mining and quarrying sector fall below the national poverty line (figure 1.9). Informal-sector workers²⁰ – who account for 85 per cent of total employment – also earn, on average, less per month than the established international and national poverty lines when the number of individuals supported by the wage earner is taken into consideration.

²⁰ Including informal agricultural workers.

²¹ The average number of people supported by one wage earner equalled 2.9 in 2010. See also footnote 19.

Table 1.2 Education indicators by sex, 2000–2009/10 (percentages)

		Kenya		Sub-Saharan Africa		Middle East and North Africa	
		2000	2009	2000	2010	2000	2010
Literacy rate (% of population aged 15 and above)	Total	73.6	87.0	–	62.5	–	75.2
	Male	77.7	90.5	–	71.6	–	83.0
	Female	70.2	83.5	–	53.7	–	66.8
Gross primary school enrolment (%)	Total	95.2	113.3	81.3	99.6	97.7	104.4
	Male	95.9	114.6	87.7	103.2	103.1	107.4
	Female	94.5	112.0	74.8	95.8	92.1	101.2
Gross secondary school enrolment (%)	Total	39.2	60.2	25.1	39.6	69.5	77.0
	Male	40.2	63.2	27.7	43.5	73.1	79.9
	Female	38.2	57.1	22.6	35.6	65.9	73.9
Gross tertiary school enrolment (%)	Total	2.7	4.0	4.3	6.8	21.4	30.6
	Male	3.6	4.7	5.2	8.3	23.4	30.2
	Female	1.9	3.3	3.5	5.2	19.3	31.1

Note: Gross enrolment ratio is the total enrolment in each level of education, regardless of age, expressed as a percentage of the population of official age corresponding to that level.

Literacy rates for sub-Saharan Africa and the Middle East and North Africa correspond to 2008.

Source: World Bank Statistics, Kenya Economic Survey and United Nations Development Programme (UNDP).

... and by a number of inequalities that are not income related.

Inequalities in access to health and education can exacerbate poverty and lead to greater marginalization within society, reinforcing a vicious circle than dampens development prospects (ILO, 2012b). In Kenya, there has been significant progress in a number of areas, notably for initial and basic education, but tertiary enrolment remains low (table 1.2). Indeed, in terms of literacy rates and access to primary education, both men and women have seen dramatic improvements over the past decade. In 2009, only 13 per cent of the Kenyan population aged 15 years and above were illiterate. This figure is 13 percentage points lower than in 2000 and 24 percentage points lower than in sub-Saharan Africa as a whole. This improvement in literacy rates is largely due to the population's increased access to education. In fact, the gross primary school enrolment ratio has increased by 8 percentage points from 95.2 per cent in 2000 to 113.3 per cent in 2009. Likewise, the gross secondary school enrolment ratio, at 60.2 per cent in 2009, has increased by more than 20 percentage points relative to the rate

at 2000. In comparison, 99.6 per cent and 39.6 per cent of the population in sub-Saharan Africa had access to primary and secondary education, respectively, in 2010.

However, improvements have been slow – in fact, almost non-existent – with regard to tertiary education where the enrolment rates are far below international standards. Indeed, in 2009 only 4 per cent of the Kenyan population were enrolled in tertiary education – an increase of only 1.3 percentage points since 2000. This is almost 3 percentage points lower than in sub-Saharan Africa as a whole and more than 25 points below the average for North Africa. Moreover, inequalities in access to education are particularly acute between men and women – while 63.2 per cent of men had access to secondary education in 2009, only 57 per cent of women could benefit from this opportunity. As a result, the literacy rate is 7 percentage points lower among women than among men.

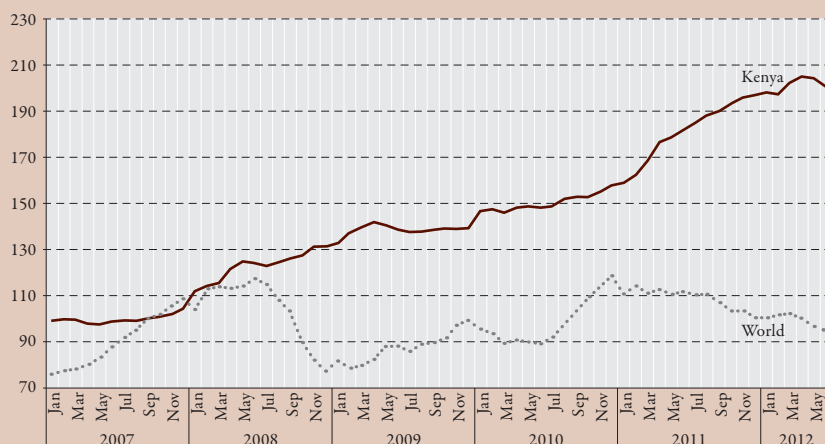
Inequality with respect to food access and affordability in Kenya is also somewhat alarming. So-called food poverty (i.e. the inability to afford or have reasonable access to food which provides a healthy diet) can impact health and human capital development. In Kenya, the percentage of the population who continuously have an insufficient food intake to meet dietary energy requirements (i.e. the prevalence of undernourished individuals) is 33 per cent. This is more than 10 percentage points higher than the share observed in sub-Saharan Africa as a whole (22 per cent). The severe effect of rising food prices over recent years has only aggravated this situation in Kenya. Indeed, since 2007, consumer food prices have increased continuously in Kenya at a significantly higher rate than that observed in the world as a whole (box 1.1).

Box 1.1 Evolution of food prices and their impact on inequality and poverty

Between January 2007 and June 2012, the consumer food price index in Kenya increased by more than 100 percentage points, compared to a 26 percentage point global average (figure 1.10). Changes in food prices can have detrimental effects in terms of poverty and inequality through consumption and income channels. It is true that the rise in food prices could potentially lead to an increase in the incomes of those whose earnings arise from the agricultural sector (such as self-employed farmers, salaried workers in the agricultural sector and rural landowners). However, an increase in food prices also raises the cost for households of acquiring a fixed basket of consumables, hence reducing consumers' welfare and aggravating poverty and income inequalities (Deaton, 1989; Ravallion, 1990; De Hoyos and Medvedev, 2008).

The global rise in commodity prices at the end of 2008 was passed directly on to consumers through a significant increase in the costs of electricity and transportation. This also resulted in higher manufacturing costs, adding to inflationary pressures, which still constitute an important challenge for the country. In addition, the *World of Work Report 2011* found that the positive agricultural income effect of the rise in food prices has been limited. On the contrary, there is significant evidence of the negative poverty effect associated with higher food prices. Indeed, in around 50 per cent of the countries with available information, the share of food expenditure in household incomes among the poorest population quintile is over 60 per cent, reaching 78 per cent in Africa. Moreover, the report finds that a further 30 per cent rise in food prices may increase poverty rates by 3 percentage points in countries with chronic food shortages. This rise in food prices would mean that low-paid workers would need more than a week's additional work per month in order to maintain their living standards (ILO, 2011).

Figure 1.10 Trends in consumer food price indices, Kenya and the world, January 2007 to June 2012



Source: Laborsta and FAO.

D CONCLUDING REMARKS

Kenya has fared relatively well during the crisis and its output in the fourth quarter of 2010 rebounded to more than 7 per cent. This comes on the heels of a fairly robust growth period between 2003 and 2007. The challenges, however, are twofold. First, the most recent expansionary period was rather short and, taking a longer view, it is apparent that growth spells have been uneven and over the past several decades growth has lagged in comparison to other least developed countries. Of particular concern are the high and volatile inflationary pressures, arising in part due to international food and fuel prices. Moreover, dependence on agriculture – with consequent susceptibility to nature and recent droughts – coupled with declining productivity elsewhere, has negatively impacted the overall macroeconomic environment. With this in mind, Chapter 2 of this report studies the drivers of macroeconomic instability in Kenya in greater detail to shed light on the constraints to accelerating and sustaining economic growth.

Second, the growth that has taken place has not sufficiently translated into labour market and social improvements. Employment rates in Kenya remain lower than in other sub-Saharan Africa countries, due to the lower participation rate of women and youth in the labour market. Chapter 3 will therefore examine the labour market challenges confronting young women and men and suggest measures designed to improve the employment and income situation of this important group. Moreover, employment creation during the past decade has been concentrated mainly in informal-sector enterprises, a fact that has fuelled a number of significant disparities in earnings, increasing the risk of families falling into poverty. Against this background, Chapter 4 will analyse the issue of informal-sector workers and the policies required to promote quality job creation.

Finally, in light of the new government in place as of March 2013, the final chapter (Chapter 5) will discuss the policy planks necessary to enhance overall employment and social content of growth measures. In particular, the new government will have to work closely with both workers and employers to increase the likelihood that the policies implemented are both equitable and sustainable.

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CHAPTER 2

MACROECONOMIC PERFORMANCE: DECLINING AND VOLATILE GDP GROWTH²²

INTRODUCTION

As seen in the previous chapter, achieving macroeconomic stability and tackling its deep-rooted vulnerabilities and structural impediments are key to addressing employment and social inequity in Kenya. In general, the low rates of economic growth over the years have been insufficient to absorb the new labour market entrants. As a result, employment rates have been declining during the decade and inactivity rates have increased. Furthermore, the unpredictable nature of inflation has in many instances eroded households' purchasing power and increased their risk of falling into poverty. In addition, Kenya's economy is threatened by its high dependence on agriculture and overall declines in productivity. Addressing the latter will be vital if the country is to attain higher and more sustainable rates of economic growth, which in turn will allow for sufficient employment creation.

Against this backdrop, the purpose of this chapter is to study, in greater detail, the drivers of macroeconomic instability in Kenya in order to identify appropriate policies to accelerate and sustain employment-centric economic growth. In particular, section A reviews the macroeconomic developments during the past three decades, comparing the evolution of the Kenyan economic growth to that of least developed countries (LDCs). Section B documents the decline in competitiveness and productivity, including an analysis of the causes and consequences. The final section discusses a number of policy considerations necessary to achieving equitable, inclusive and sustainable growth in Kenya.

²² This chapter is authored by Dr Hamid Rashid, Senior Adviser for Macroeconomic Policy in the United Nations Department of Economic and Social Affairs (UN-DESA) in New York. The views and opinions expressed herein are those of the author and do not necessarily reflect those of the United Nations Secretariat or the International Labour Organization (ILO). The designations and terminology employed may not conform to United Nations practice and do not imply the expression of any opinion whatsoever on the part of the ILO. For questions or comments, please write to rashid12@un.org.

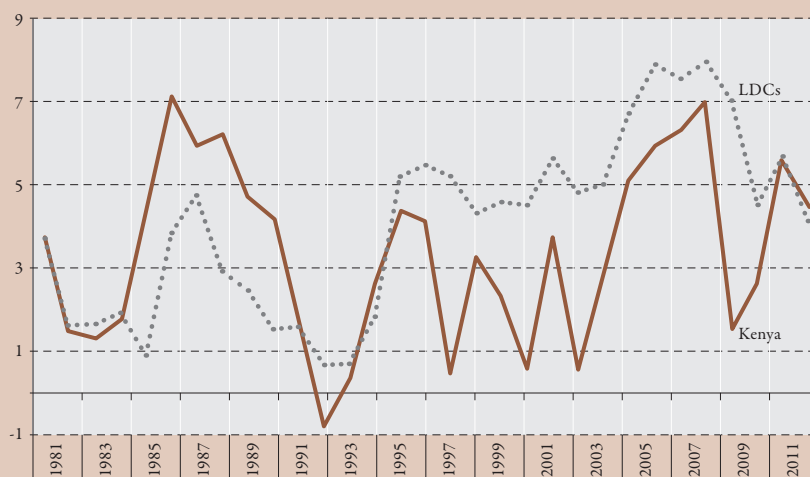
A **MACROECONOMIC DEVELOPMENTS DURING THE LAST THREE DECADES**

The gap between Kenya and LDCs has widened in recent years due to the country's lacklustre economic performance...

It was only natural that Kenya was not among the LDCs when the United Nations first prepared the list of these countries in 1971. Kenya's per capita income in 1971 – one of the key criteria for inclusion in the LDC group – was 29 per cent higher than the threshold income set for LDCs. Forty years later, the Kenyan per capita income is now 11 per cent below the threshold for graduation from the LDC group. As a non-LDC developing economy, Kenya grew at an average of 3.4 per cent per year during the period 1981–2011, while LDCs as a group grew by an average of 4.0 per cent per year during the same period. The Kenyan GDP growth was particularly slow during the decade of structural adjustment programmes in the 1990s, averaging only 1.9 per cent, compared to a 3.4 per cent growth rate in LDCs. The growth gap between Kenya and LDCs further widened during the period from 2001 to 2010 as GDP in LDCs grew by 6.3 per cent per year while Kenya's GDP grew by 4.1 per cent annually (figure 2.1).

Kenya's per capita growth rate has averaged about 0.32 per cent a year during the past 30 years, with GDP growth barely keeping pace with the growth rate of the population, suggesting that there has been little improvement in the living standards of the average Kenyan since the early 1980s. During the same period, the per capita income of LDCs grew by 1.5 per cent a year. A number of factors explain the low growth performance of Kenya during the past 30 years. A combination of falling domestic savings, lack of productive investments, inadequate structural transformation, declining labour force participation rate, insufficient numbers of new jobs and stagnant productivity growth depressed the growth of the Kenyan economy.

Figure 2.1 GDP growth rates of Kenya and LDCs, 1981–2011 (percentages)



Source: World Bank, 2012.

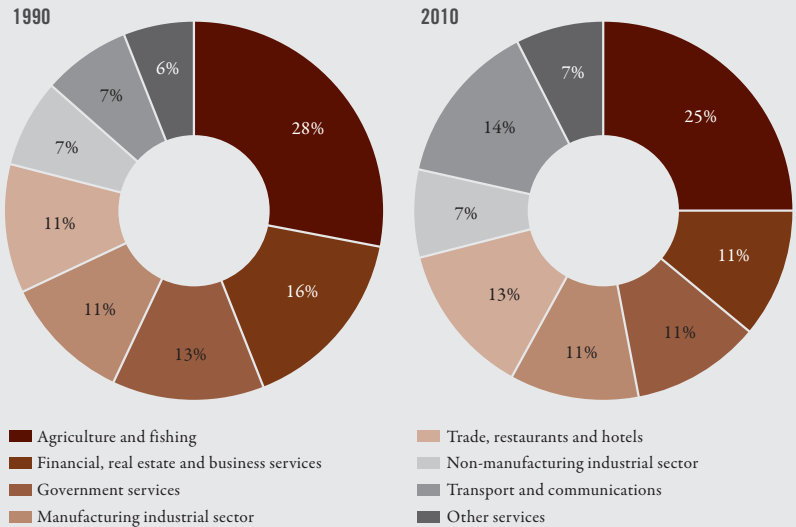
*... and structural transformation of the economy
has been slow relative to its counterparts.*

The size of the industrial sector – including manufacturing and non-manufacturing activities – in the total economy has remained unchanged during the past 20 years, at 18 per cent of GDP. In comparison, in Tanzania and Uganda the relative importance of the industrial sector in GDP has increased by 7.8 and 14.4 percentage points respectively during the same period, to reach 25.5 per cent of GDP in each country in 2010. Likewise, on average, LDCs have seen the relative size of the industrial sector increase by 7.6 percentage points, to 28.3 per cent in 2010. The relative growth in the industrial sector in these countries, however, is often driven by non-manufacturing activities (i.e. construction). Indeed, during the past two decades, the share of manufacturing activities in GDP in Tanzania increased by a mere 0.3 percentage points. Likewise, in the LDCs, the manufacturing sector accounted for close to 12 per cent of GDP in 2010 and increased

slightly – by around 1 percentage point – between 1990 and 2010. Uganda is the exception to this trend, as the increase in the share of the overall industrial sector in Uganda was mainly driven by the growth of manufacturing activities, which increased by 2.6 percentage points between 1990 and 2010.

Agriculture remains the main sector of the Kenyan economy. By 2010, it accounted for 25 per cent of GDP, despite a slight decrease of 3 percentage points during the previous 20 years (figure 2.2). Only the transport and communications sector experienced sustained growth during the past two decades. Indeed, thanks to an impressive growth rate of 8.3 per cent per year, the transport and communications sector has gone from representing the seventh largest sector in 1990 (with a 7 per cent share of GDP), to becoming the second largest component of GDP (at 14 per cent) in 2010. Likewise, the trade, restaurants and hotels sector, which today is another

Figure 2.2 GDP by economic activity, 1990 and 2010



Note: “Non-manufacturing” includes mining, quarrying, electricity, water and construction.
Source: Kenya Economic Surveys.

important component of GDP, has increased its share by 2 percentage points over the past two decades – from 11 per cent in 1990 to 13 per cent in 2010. This increase in the relative importance of the transport and communication sector occurred at the expense of both financial, real estate and business services and government services, both of which experienced a decrease in their share of GDP. These two sectors – which in 2010 each accounted for 11 per cent of GDP – have seen their shares reduced by 5 and 2 percentage points, respectively.

B DECLINES IN COMPETITIVENESS AND PRODUCTIVITY: CAUSES AND CONSEQUENCES

Macroeconomic policy reforms and liberalization made the export sector vulnerable...

As Kenya liberalized its trade regime during the 1990s, the share of goods and services imports in GDP increased from about 30 per cent in 1990 to approximately 45 per cent in 2011, while the share of exports remained steady at around 26 per cent, contributing to rising trade and current account deficits. The rise in imports can be partly explained by surges in food imports. The share of food imports, as a percentage of total merchandise imports, increased from 7.7 per cent in 1980 to 12 per cent in 2010. However, the share of fuel imports actually dropped from 33.9 per cent to 22.1 per cent during the same period. Growing dependence on imports, facilitated by a liberalized trade regime, adversely affected the growth in import-competing sectors (e.g. light manufacturing) of the economy and employment in those sectors. Weighted average applied tariffs on imports fell from 20.6 per cent in 1994 to 6.1 per cent in 2006. The applied weighted tariff on manufacturing imports registered an even sharper decline – from 32 per cent to about 12 per cent during the same period. Low tariff structures prompted a steady rise in imports of consumer goods. Imports of passenger vehicles, for example, grew by an average of 28.8 per cent a year during 2002–2007²³ while imports of television sets grew by an average of 44.0 per cent per year during the same period, far outpacing the import growth rates of capital goods and machinery.

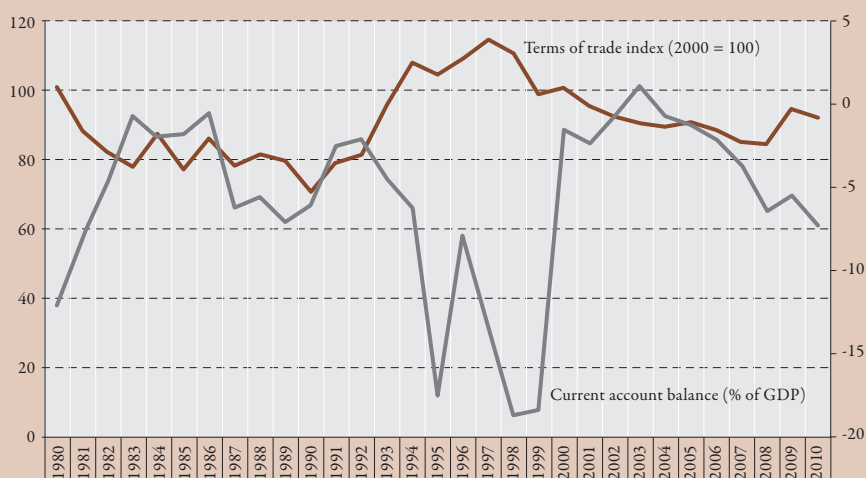
The current account balance has been increasingly volatile during this period, showing considerable swings in the demand for Kenyan exports, which are largely concentrated in primary products such as tea, coffee and cut flowers. In 2011, these three products alone accounted for nearly one-third of the total value of Kenya's exports. Kenya's coffee exports experienced a major decline during the past decade, due to a plunge in international prices and increases in the global market shares of Brazil and Viet Nam. Falling coffee prices and other compounding factors, including a falling nominal

²³ International Trade Centre Database: http://www.trademap.org/countrymap/Product_SelCountry_TS.aspx [accessed 8 Feb. 2013].

exchange rate, were largely responsible for the fall in its terms of trade index (2000 = 100) from 114 in 1997 to 84 in 2007 (figure 2.3). The fall in the terms of trade index partly explains the very slow growth in Kenya's per capita income. Although the global demand for, and price of, tea remained relatively stable, Kenya also experienced a decline in tea exports due to increases in market share by countries such as China, Malawi, South Africa and Viet Nam.

Despite the fact that Kenyan coffee exports remained robust during the recent economic crisis, its total exports of goods and services fell by more than 9 per cent in 2009. While global exports also fell by 10 per cent, exports from neighbouring Tanzania and Uganda grew by 15.5 per cent and 16.1 per cent respectively in 2009 (figure 2.4, panel A). Exports from low-income countries, in general, declined in the aftermath of the global crisis but Kenyan exports were particularly hard hit by the crisis, which exposed the vulnerability of the Kenyan economy.

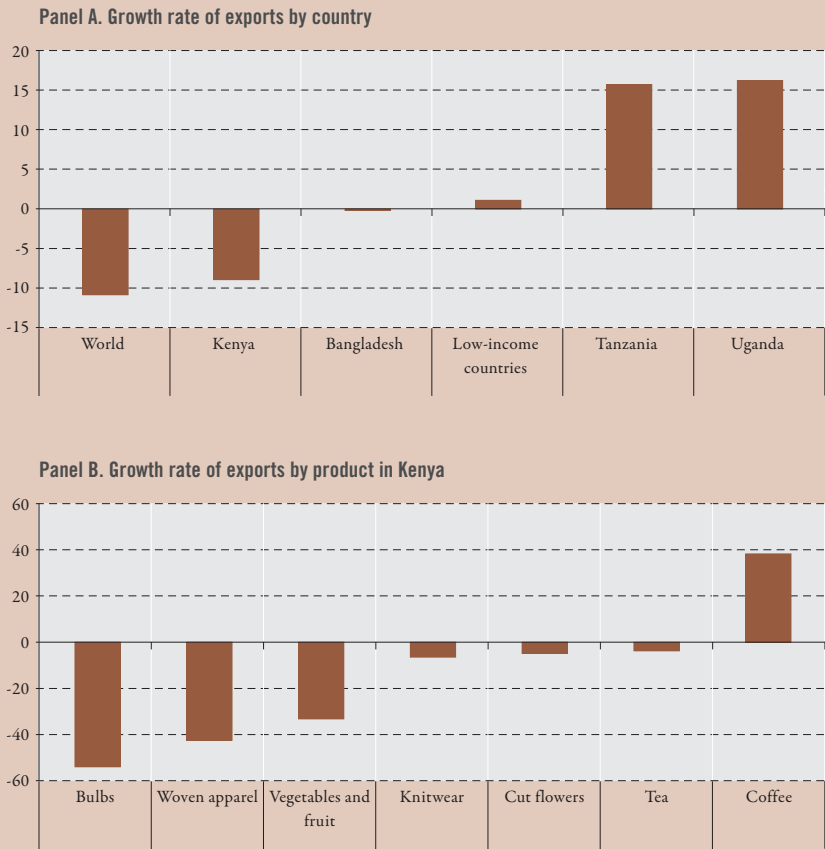
Figure 2.3 Kenya: Terms of trade index (2000 = 100) and current account balance, 1980–2010
(percentages of GDP)



Source: Author's estimates based on the World Development Indicators (WDI) database of the World Bank, 2012.

Tourism revenue – another important source of foreign exchange, employment and economic growth – declined by 19.6 per cent in 2009. A narrow export base that is sensitive to global demand shocks, droughts and crop failures, political instability and uncertainty, external economic shocks, including the oil and food price shocks and the recent financial crisis, largely explain the high degree of volatility in Kenya’s current account balance and GDP growth.

Figure 2.4 Export developments by country and product, 2009
(percentages)

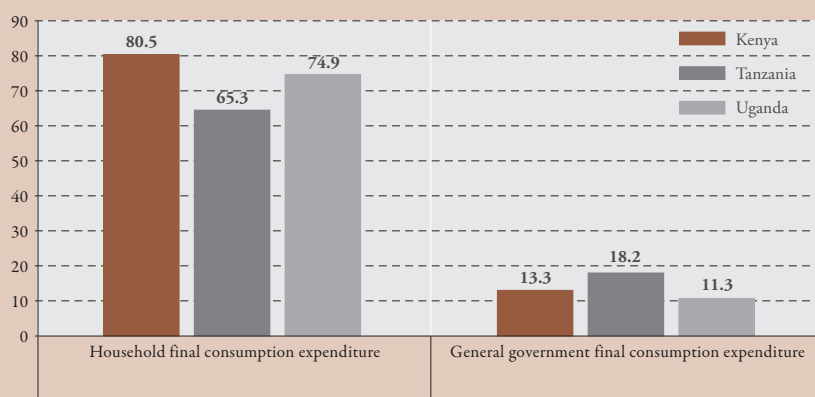


Source: Author’s estimates based on the World Development Indicators (WDI) database of the World Bank and the International Trade Centre database.

... and consumption-led growth depressed domestic savings and investment rates ...

Kenya's economic growth during the past three decades was largely driven by household consumption, which outpaced GDP growth and depressed domestic savings and investment rates. The share of household final consumption expenditure increased from 62 per cent of GDP in 1981 to about 81 per cent in 2011 (figure 2.5). In neighbouring Tanzania and Uganda, the shares of household final consumption expenditure were 65 per cent and 75 per cent, respectively. The LDCs average for household final consumption expenditure was 75 per cent. Lack of employment opportunities and persistently low levels of household income largely explain why the household share of national expenditure is so high in Kenya. Correspondingly, the share of government final expenditure declined from 18.6 per cent in 1990 to 13.3 per cent in 2011. In Tanzania, government final consumption expenditure accounted for 18.2 per cent in 2011. Primary government deficit fell from -2.8 per cent of GDP in 1991 to +2.0 per cent of GDP in 2001. Structural adjustment and economic reform programmes implemented during the 1990s eliminated fiscal deficits and contained inflation but did not deliver growth or generate employment during the 1990s, which represent a lost decade for Kenya.

Figure 2.5 Share of Household and Government Final Expenditures in GDP, 2011 (percentage of GDP)

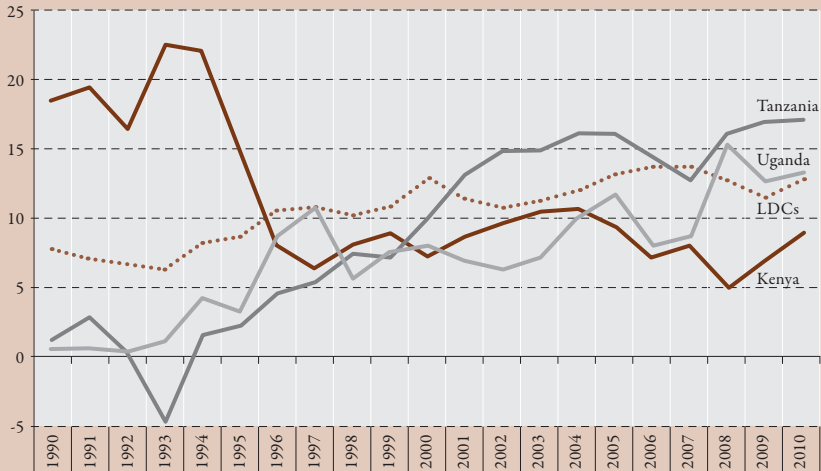


Source: Author's estimates based on the World Development Indicators (WDI) database of the World Bank.

Kenya experienced one of the sharpest declines in gross domestic savings rate in the developing world. While the majority of the emerging, developing and least developed economies managed steadily to increase their savings rates and reduce their reliance on more unpredictable sources of external finance, such as foreign direct investment (FDI) and foreign borrowings, Kenya's domestic savings rate fell from 18.6 per cent in 1990 to 8.9 per cent in 2010 (figure 2.6). Both Tanzania and Uganda substantially increased their savings rate during this period. Tanzania's domestic savings rate was 1.3 per cent in 1990 and rose to 17.2 per cent in 2010. The gross domestic savings rates of the LDCs increased, on average, from 7.8 per cent to 12.8 per cent during the same period, acting as key drivers of domestic investment, growth and employment.

During the 1990s, growing consumption and falling savings rates impeded vital growth in fixed capital formation and investment in productive capacities, which, in turn, inhibited growth and employment potential for Kenya. Although external debt stock fell from its highest level of 132

Figure 2.6 Gross domestic savings, 1990–2010
(percentages of GDP)



Source: Author's estimates based on the World Development Indicators (WDI) database of the World Bank.

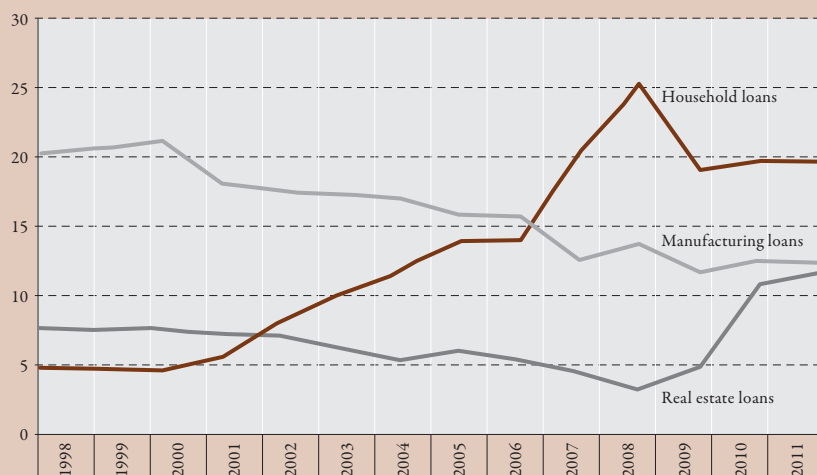
per cent of gross national income (GNI) in 1993 to about 48 per cent of GNI in 2000 and inflation dropped from 46 per cent to 10 per cent during the same period, there was no improvement in the domestic savings rate. Despite achieving macroeconomic stability with a low government deficit and relatively low inflation (growth rate stalled at around 1.9 per cent a year), unemployment remained steady at around 10 per cent during the 1990s. Kenya's lost decade was essentially a period of low inflation, no growth and no employment.

... with high and volatile inflation adding pressure to the already depressed domestic savings.

Consumer price inflation averaged over 10.3 per cent during the period from 2001 to 2010, falling from the previous decade average inflation of 15.6 per cent, which peaked at 46 per cent in 1993. Relatively high-level inflation and nominal wage rigidity among middle-income households that depend on salaries meant that both the purchasing power of households and their savings eroded during the past two decades. During this time, households increased their borrowing from the banking sector, which crowded out credit to manufacturing and other productive sectors of the economy. According to data available from the Central Bank of Kenya,²⁴ the share of household loans, as a percentage of total private sector credit, increased from 5 per cent in 1998 to 19.7 per cent in 2011 (figure 2.7). During the same period, the share of credit to the manufacturing sectors of the economy fell from 20.5 per cent to 12.5 per cent. The declining share of manufacturing sector credit also explains the weak economic growth and weaker employment generation in Kenya.

²⁴ Central Bank of Kenya Statistical Bulletin (2011), Table 1.7: Distribution of credit facilities from the banking system.

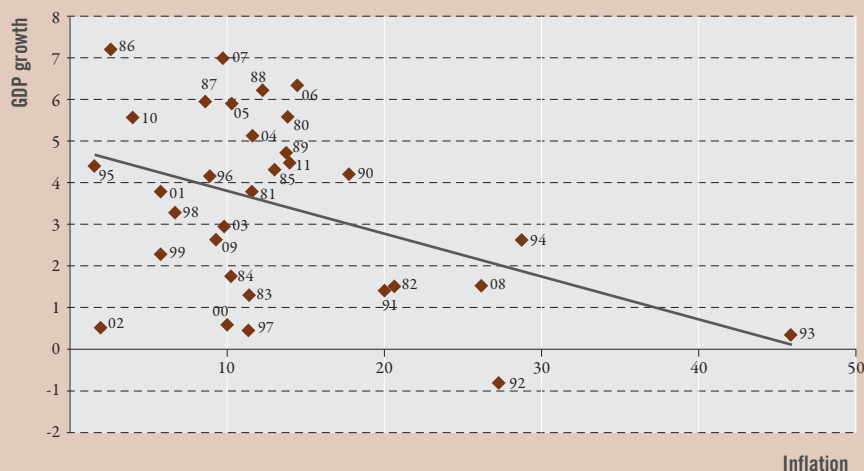
Figure 2.7 Sectoral distribution of private credit from the banking sector, 1998–2011
(percentages of GDP)



Source: Author's calculation based on data from the Central Bank of Kenya.

The relationship between inflation and growth is both complex and ambiguous. Cross-country evidence on the relationship shows all four possible combinations – low inflation and high growth, low inflation and low growth, high inflation and high growth and high inflation and low growth. In the case of Kenya, the data suggest a strong correlation of high inflation and low growth although the direction of causality is unclear. The observed correlation is as high as -0.42 (figure 2.8). Even when the four outlier inflation rates during 1991 to 1994 are excluded, the correlation is still significant and negative (-0.14). Persistently high inflationary expectation is manifested in the nominal lending rate, which averaged 15.7 per cent between 2000 and 2010. With such a high interest rate, it is difficult for businesses, especially small and medium-sized enterprises (SMEs), to borrow and make economically feasible investments that generate employment and growth.

Figure 2.8 Inflation and GDP growth in Kenya, 1980–2011
(percentages)



Source: Author's estimates based on the World Development Indicators (WDI) database of the World Bank.

The economic reforms did little to stimulate employment generation...

As economic growth plummeted from 6.2 per cent in 1988 to -0.8 per cent in 1991, Kenya began the first generation of structural reforms. In 1991, Kenya liberalized its interest rates, long before other low-income countries or LDCs did so. Credit ceilings and credit targets were eased in 1992 while barriers to entry to the banking sector were eliminated – for both domestic and foreign banks – in 1996, along with privatization of a number of state-owned banks. The restrictions on banks borrowing internationally and engaging in securities market activities were also relaxed during this period, making the Kenyan financial sector one of the most liberalized in the developing world.²⁵ The financial sector liberalization was reinforced by commensurate liberalization in capital account transactions. In 1996, Kenya was one of the very few low-income countries to eliminate the multiple exchange rates, which were proving detrimental to the interests of its export sector. In the same year Kenya withdrew all restrictions on current account transactions and abolished the requirement to surrender export proceeds (Chinn and Ito, 2008).

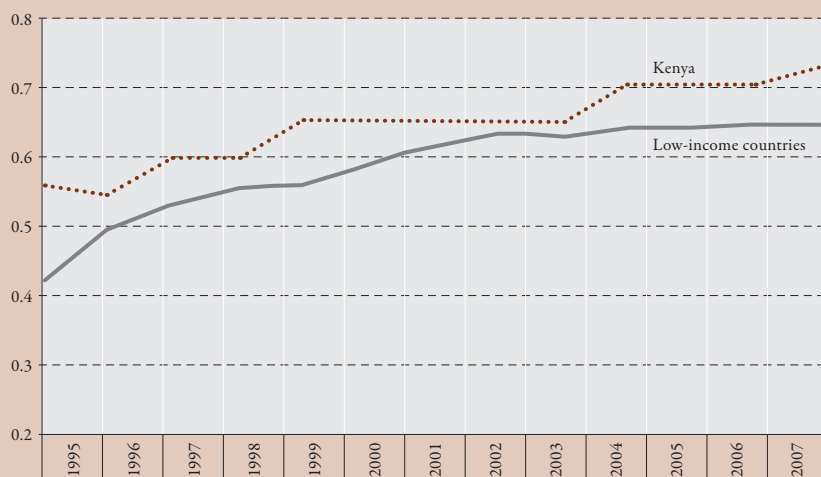
²⁵ Please see the financial reform database developed by Abiad, et al. (2010).

Complementing these reforms, Kenya has since pursued a tight macroeconomic policy, which brought down inflation, albeit briefly, from 46 per cent in 1993 to 5.7 per cent in 1999. However, as the first wave of reforms during the 1990s did not deliver growth but instead plunged Kenya into a period of macroeconomic instability, the Government of Kenya began a second generation of reforms in 2000, outlined in its Poverty Reduction Strategy Paper (PRSP), which focused on governance and public sector reforms, further liberalization of imports and privatization of state-owned banks and utilities. An International Monetary Fund (IMF) assessment (IMF, 2000) of the Kenyan reform package highlighted the following:

The three year policy-matrix correctly recognizes that the shift to the higher growth path will require not only the envisaged reduction in domestic real interest rates but also the implementation of the supply-side measures that address existing constraints on economic activity. These include measures that address pervasive governance problems, correct regulatory distortions in various markets, especially in agriculture, redirect public resources toward the rehabilitation of infrastructure, and improve the efficiency and governance of state-owned banks and utilities through privatization. While the measures to improve governance (and their timetable) are well articulated in the interim PRSP, the remaining supply side measures will need to be developed and prioritized more fully, and implemented more decisively if the growth targets envisaged for the medium term are to be attained.

Under the first phase of the privatization programme, which was initiated in 1992, the Government privatized a large number of SMEs. During the second wave of reforms, the Government privatized the Kenya Commercial Bank (KCB) and the National Bank of Kenya (NBK) during 2000-2003. TELKOM – the telecommunication utility – was among a number of companies privatized in 2006. Energy utilities – notably Kengen and KPLC – were partly privatized and contracts awarded to foreign management in mid-2000.

Figure 2.9 Pace of financial market liberalization*, Kenya and low-income countries, 1995–2007 (percentages)



* Based on a liberalization index built considering a number of dimensions of financial regulation and financial sector policies.

Source: Constructed from Abiad *et al.* (2010).

As part of the Poverty Reduction Growth Facility (PRGF) credit arrangements with the IMF and Economic and Public Sector Reform credit arrangements with the World Bank – both approved in 2000 – the Government of Kenya adopted a Medium-Term Expenditure Framework (MTEF) that helped to eliminate government deficits by increasing VAT and implementing a major retrenchment in the civil service. VAT was raised from 15 per cent to 18 per cent in 2000, with the aim of offsetting the loss of revenue arising from cuts in import duties. Under the 2000–2001 fiscal programme, the Government replaced existing suspended duties with constant tariffs and, at the same time, reduced the number of resultant tariff bands, excluding sugar, from 13 to nine. The Government of Kenya made a commitment to improve governance and reduce public sector inefficiencies by cutting 32,348 civil service jobs, which accounted for 15.5 per cent of public sector employment. There was a further commitment to remove 25,783 civil servants from the payroll by September 2000 and another 8,800 employees during 2001–2002 through natural attrition. Under the same retrenchment programme, about 7,000 employees of the public universities, the Kenya Revenue Authority, an agricultural research institute and the Catering and Training Levy Trust were also removed from their jobs (Republic of Kenya, 2000).

*... and when growth returned,
there was little improvement in the labour market.*

As illustrated in Chapter 1, between 1991 and 2003, the employment rate in Kenya fell by over 7 percentage points from 67 per cent to 59 per cent. Even during the most recent period of strong and persistent growth, starting in 2003, total employment grew by an average of 3 per cent, a rate that has barely kept pace with the growth in the working-age population, and the unemployment rate has remained high and sticky. In particular, against the backdrop of a favourable global economy, the GDP growth rate accelerated from 0.54 per cent in 2002 to 2.9 per cent in 2003 and 5.1 per cent in 2004 and yet the unemployment rate only fell from 9.6 per cent to 9.5 per cent.²⁶ The growth momentum of the period 2003 to 2007 came to a halt in 2008 after the country was hit by the post-election violence that broke out on 27 December 2007, coupled with drought and the effects of the global financial crisis. GDP growth plummeted from 7 per cent in 2007 to 1.5 per cent in 2008 but, surprisingly, the unemployment rate – according to official statistics – fell from 9.5 per cent to 9.3 per cent. During the 2008–2009 economic crisis, the labour force participation rate remained resilient, suggesting the possibility that the sectoral composition of employment changed, which helped to prevent a rise in unemployment rate. The observed correlation between GDP growth and employment rate is -0.08, underscoring the fact that growth in Kenya does not necessarily translate into job creation.

After recovering in 2010, the Kenyan economy faced a number of challenges in 2011, including the severe drought in the Horn of Africa and high international commodity prices that affected both the urban and the rural poor. The external price shocks, strong domestic demand and a rapid expansion of bank credit to the private sector – which grew by over 30 per cent in 2011 – increased the inflationary pressure, widened the current account deficit and depreciated the KSh. The nominal value of the KSh fell by more than 12 per cent between 2010 and 2011. However, once again the economic recovery did not translate into job growth as the unemployment rate remained stalled at 9.4 per cent.

²⁶ The unemployment rate is estimated from the data available in the World Development Indicators database of the World Bank.

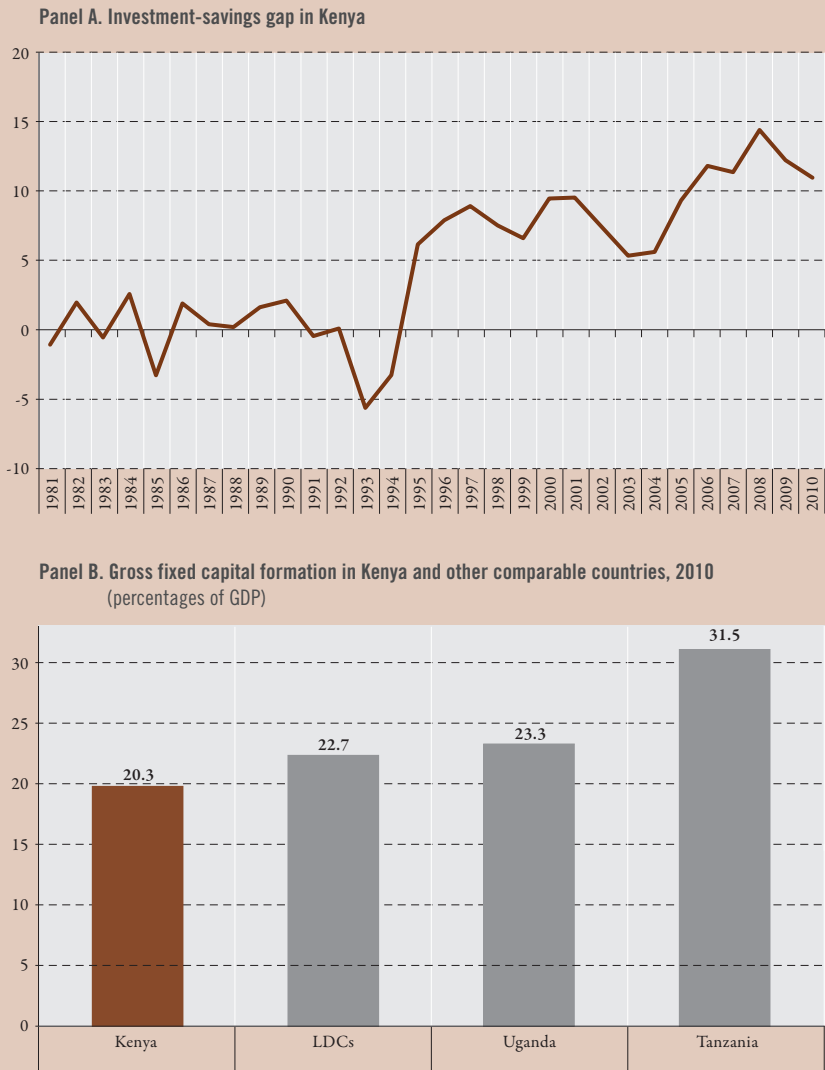
Between 1991 and 2010, employment in Kenya grew at an average rate of 2.8 per cent a year, while GDP grew by an average of 3.1 per cent, suggesting an implied employment elasticity of growth of 0.9.²⁷ While implied employment elasticity provides some idea of the employment response to growth, it cannot account for the quality of jobs created in the economy – it cannot distinguish between formal and informal-sector jobs or between part-time and full-time employment. In the case of Kenya, the relatively high employment elasticity of growth can be largely explained by the increases in informal employment, as discussed in Chapter 4.

A growing savings–investment gap and falling investment are behind the lacklustre economic performance...

Kenya has one of the highest levels of savings–investment gaps among the developing countries. The gap increased from almost 0 in 1980 to 14.3 per cent in 2008 (figure 2.10, panel A). As a consequence of the falling domestic savings rate, gross fixed capital formation did not keep pace with the rates in other developing countries and LDCs. Gross fixed capital formation has remained stagnant at around 20 per cent of GDP during the past decade: too low to trigger a structural transformation of the economy and increase employment. It is also likely that most of the fixed capital formation took place in private construction – mainly housing – which has had little or no long-term impact on employment generation and productivity growth. Large-scale investments in productive capital, production processes and technology upgrades are the key determinants of employment generation and economic growth.

²⁷ This analysis of the employment elasticity of economic growth during the past 20 years is also carried out in Chapter 3 with similar results. In that chapter, a number of scenarios are presented showing the annual rate of economic growth that would be required to absorb the growing working-age population.

Figure 2.10 Investment trends in Kenya and selected countries, 1981–2010



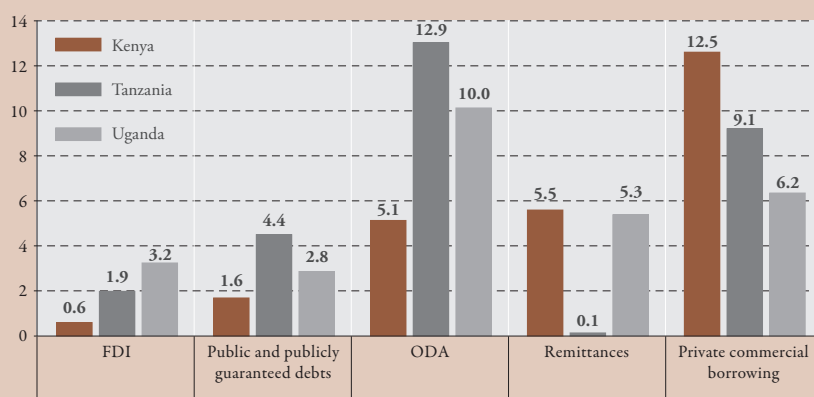
Source: Author's estimates based on the World Development Indicators (WDI) database of the World Bank.

... which was only partly offset by an increase in remittances...

Kenya has had few offsetting long-term inflows to make up for the falling domestic savings rate. FDI has been particularly low, largely because of weak business and institutional frameworks and the relatively unstable and

uncertain political environment. Both Tanzania and Uganda have been far more successful in attracting FDI in recent years, although this has largely been confined to their mineral sectors. Even if foreign investments in mineral sectors are excluded, FDI in both neighbouring countries far exceeded that in Kenya and the gap continues to widen (figure 2.11). During the past 20 years, FDI in Kenya averaged 0.6 per cent of GDP, compared to 2.4 per cent in Tanzania and 3 per cent in Uganda. Kenya also experienced a declining flow in public and publicly guaranteed (PPG) external debt, which can be a major source of investment in the economy. In 1990, external debt disbursement was 6.8 per cent of GDP but has fallen sharply to about 1.6 per cent since 2010, which suggests that it is increasingly difficult for Kenya to borrow on a long-term basis from external sources – a prerequisite for long-term investments. Similarly, Official Development Assistance (ODA) flows are also trending downwards, which adversely impacted investment in the social sector, particularly in the health and education infrastructures of the economy – one of the key determinants of labour productivity and long-term economic growth. The share of ODA in GDP fell from 13.7 per cent of GDP in 1990 to 5.1 per cent in 2010.

Figure 2.11 Financial inflows into Kenya and other comparable countries, 2010
(percentages of GDP)



Source: Author's estimates based on the World Development Indicators (WDI) database and the Bank of International Settlement's (2012).

Remittance flows from Kenyans living and working overseas, however, have risen considerably in recent years. In 1990, remittances accounted for only 1.6 per cent of GDP but steadily increased to 5.5 per cent by 2010. Unlike FDI, ODA or PPG debt flows, inflows of remittances remained robust and resilient during the current financial crisis. Remittances, which reached US\$1.7 billion in 2010, are now Kenya's single largest source of foreign exchange and a key social safety net. While remittances represent a dependable source of external financial flows, they primarily go into household consumption. It is likely that only a small fraction of remittances, if any at all, goes to productive investments that can create employment and contribute to long-term growth.

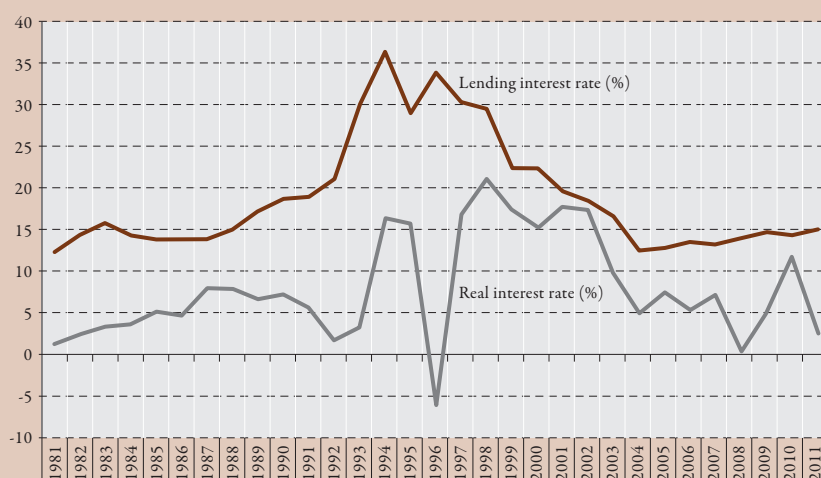
In recent years, Kenya witnessed a significant increase in private commercial borrowing from abroad. Claims of foreign banks and financial institutions vis-à-vis Kenya increased by nearly 300 per cent between 2001 and 2011. As a percentage of GDP, private commercial borrowing is now the largest source of external flows into the Kenyan economy, reaching as high as 12.5 per cent of GDP in 2010. Private commercial borrowings are mostly short term and highly pro-cyclical. For example, immediately before the current financial crisis, between December 2007 and March 2008, private commercial borrowing increased from US\$2.3 billion to US\$4.3 billion – an increase of 86 per cent in a mere three months (Bank of International Settlement, 2012). These short-term inflows are largely “hot money” that enters the Kenyan economy to exploit arbitrage opportunities offered by large interest rate differentials between KSh loans and US dollar or euro denominated debt. While these inflows help Kenya to meet its current account obligations, they do not translate into long-term investments, jobs and economic growth. Moreover, these inflows keep the KSh relatively overvalued despite depreciation of the nominal exchange rate, which adversely affects Kenya's export competitiveness. In spite of the inflows of short-term capital, interest rates in Kenya remain very high, constraining access to credit for productive investment and employment generation. In fact, excessive dependence on short-term borrowing from abroad can make credit to the private sector more volatile and costly. The real interest rate averaged over 8 per cent during 1981–2010 – one

of the highest real interest rates in the world (figure 2.12). The high real interest rate kept the real exchange rate overvalued and uncompetitive, discouraging foreign investment, and also kept the lending rate very high, thus discouraging borrowing for productive investments. A lending rate for investment of 15 per cent or more makes it difficult for businesses to borrow for productive investment. Given that Kenya has a well-developed financial sector compared to LDCs, its lending rate could be significantly lower in order to promote productive investment.

... which led to weak productivity growth in Kenya.

In 1980, labour productivity in Kenya – measured in terms of GDP per person employed – was double the labour productivity in Tanzania and Uganda (figure 2.13, panel A). In the absence of data on GDP per hour worked and relevant firm-level data, GDP per person employed provides a reasonable estimate of labour productivity. Thirty years later, Uganda's GDP per person employed is 10 per cent higher than that of Kenya. During this period, labour productivity in Uganda increased by 3.6 per cent annually while Kenya's annual productivity declined by 0.24 per cent. In 1990,

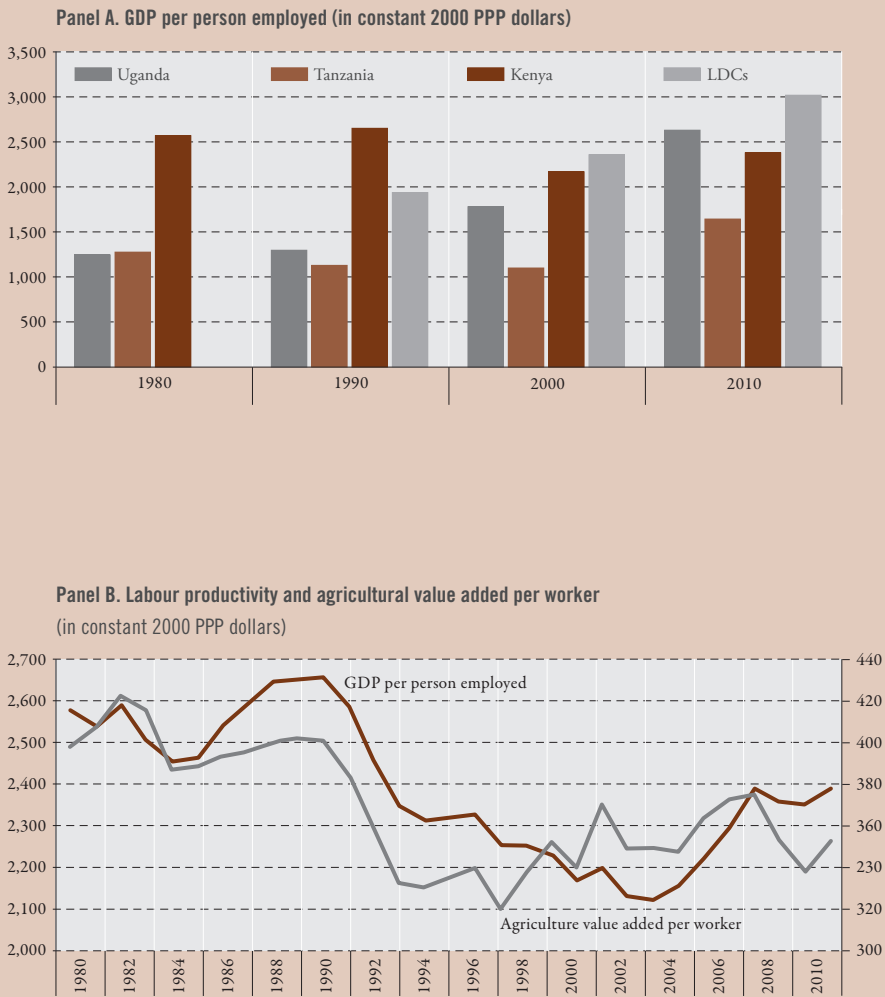
Figure 2.12 Real and lending interest rates in Kenya, 1981–2011 (percentages)



Source: Author's estimates based on the World Development Indicators (WDI) database of the World Bank.

when comparable data became available for LDCs, average labour productivity in Kenya was 37 per cent higher than the average productivity levels in LDCs. In 2010, Kenya's labour productivity was 11 per cent lower than average labour productivity in LDCs.

Figure 2.13 Trends in productivity, 1980–2010 (in constant 2000 PPP dollars)



Source: Author's estimates based on the World Development Indicators (WDI) database of the World Bank.

Consistent with overall labour productivity estimates, agricultural value added per worker also showed a decline during the period 1980 to 2010. In 1980, agricultural value added per worker was about US\$400 in constant 2000 purchasing power parity (PPP) dollar terms. By 2010, it had fallen to US\$350 (in constant 2000 PPP dollars), marking a 12 per cent decline (figure 2.13, panel B).

During the same period, LDCs, on average, managed to improve their agricultural productivity by about 30 per cent. A number of complementary factors – an increase in arable land and crop intensity, improved irrigation, investment in and mechanization of agriculture, favourable price support for agricultural inputs, access to credit, tariff and non-tariff protection against cheap agricultural imports, commercial farming and improved market access – helped many LDCs to improve their agricultural productivity and increase the real income of the rural population. Additionally, higher levels of income boosted aggregate demand for goods and services, which paved the way for structural transformation of their economies. Many of the enabling factors that boosted agricultural productivity in a number of LDCs were missing in Kenya.

At the macroeconomic level, the fall in labour productivity in both absolute and relative terms can be largely explained by inadequate investment and fixed capital formation in Kenya. The stalled productivity growth also explains why Kenya's growth rate lagged behind the growth rates of neighbouring Tanzania or Uganda or that of other least developed economies. A preliminary analysis of the sources of GDP growth between 2001 and 2010 suggests that nearly 92.2 per cent of the growth came from increases in employment, which increased from 6.0 million in 2001 to 7.9 million in 2010 and only 7.8 per cent of growth came from improvements in labour productivity. In other comparable countries, improvement in labour productivity, including total factor productivity, accounted for as much 30 per cent of GDP growth.

C POLICY OPTIONS GOING FORWARD

For Kenya, increasing the labour force participation rate and boosting employment generation must be the primary macroeconomic policy priorities. The past two decades of policy reforms managed to contain inflation and improve macroeconomic stability and growth, but have done little to increase employment. The overall unemployment rate – though modest by the standards of unemployment rates in Spain or Greece – masks the real problems of informal employment, underemployment, vulnerable employment and the working poor. Although the recently concluded IMF Article IV consultation commended Kenya for steering a robust recovery and achieving macroeconomic stability, the report makes no mention of unemployment, informal-sector employment or low labour force participation rates (IMF, 2012a). The Article IV report focuses on the imperatives of reining in inflation, observing:

Kenya's economy has continued to expand, but high inflation and exchange rate pressures are threatening the growth outlook. Economic activity has remained strong, with GDP growth above 5 per cent in 2010/11 and little sign of a slowdown so far. The drought in the Horn of Africa, higher international prices and strong domestic demand have boosted inflation – 18.9 per cent in October – and swelled the external current account deficit. Because monetary authorities hesitated to respond to these developments, inflationary expectations heightened, leading to a rapid depreciation of the KSh that if not addressed could destabilize macroeconomic conditions and bring growth to a halt. The authorities have already started to adjust their policies to stem inflationary expectations and stabilize the exchange rate to preserve the basis for continued growth.

1 EMPLOYMENT-ORIENTED MONETARY POLICY

While a high rate of economic growth is necessary for generating savings, investment and employment, it is clearly not sufficient to overcome the structural constraints of the Kenyan economy, which include the daunting challenges of raising the domestic savings rate, reducing reliance on

short-term borrowing and increasing the labour force participation rate and productivity to make economic growth broad based, inclusive and sustainable. A singular policy focus on inflation may rejuvenate growth but it is unlikely that such a policy orientation will create employment or make economic growth more inclusive and equitable. As the experience during the 1990s suggests, Kenya managed to reduce inflation significantly and growth resumed without necessarily expanding employment, particularly formal sector employment. The macroeconomic policy framework needs to avoid an excessively narrow and singular focus on inflation and instead implement specific interventions to boost savings, investments and gross fixed capital formation. Krugman (2012) has argued that a moderate but stable and predictable level of inflation – possibly at the high single digit level – can incentivize private investments by making money-holding costly. In Kenya, inflation is associated with a higher share of household consumption in GDP. To achieve a moderate level of inflation to stimulate investment, the Kenyan economy must also create a more enabling environment for investments. While macroeconomic policies to reduce the cost of borrowing and increase the availability of credit will be necessary, they will be insufficient to stimulate productive investments. Investment-friendly macroeconomic policies – while keeping interest rates low – must be complemented by appropriate sectoral policies that will increase demand for productive investments. Sectoral policies may include adequate protection and support – including support for higher value addition and market access – for specific productive sectors of the economy that are likely to demand more labour with higher levels of productivity.

2 ENCOURAGE DOMESTIC SAVINGS

The Government of Kenya needs to adopt appropriate policies to promote domestic savings. It will be critical for the Government to reduce the consumption bias of the economy. Household final consumption rates would need to stabilize to increase the gross domestic savings rate. A stable and predictable inflation rate can help households to smooth their expenditures over time and increase savings. Appropriate tax incentives and matching

government contributions for additional contributions to public and private pension funds can help to increase the domestic savings rate. This will require pension fund operations to be more professional, transparent and accountable. As is the case with Singapore and many emerging economies, pension funds, when managed properly, can be an important source of domestic investments to generate employment and growth.

Innovative savings instruments can be introduced to reduce household consumption and encourage domestic savings. The Government of Kenya may issue inflation-indexed bonds to encourage savings among salaried people and pensioners who are adversely affected by inflation. Such a step can help to reduce inflationary fears and commensurate risk and liquidity premium. If the return on private savings is inflation adjusted, then there will be no rush to spend today, propelled by fear that the same amount will buy less tomorrow due to the effects of inflation. This will, in turn, reduce the current inflationary pressures and expectations about future inflation.

The Government may also issue GDP-linked bonds – public debt instruments that allow a country to pay a return that varies with the GDP growth performance. These bonds typically pay more when the performance of the country is better than expected and less in the case of poor performance. GDP-linked bonds contain an inherent countercyclical feature, allowing a government to adjust its debt service according to its revenue earning, which can rise or fall depending on the growth performance of the economy. A number of countries – Argentina, Mexico, Nigeria and the Bolivarian Republic of Venezuela – have issued different versions of GDP-indexed bonds during the past three decades, which helped to reduce their borrowing costs and increase access to domestic and international capital. GDP-linked bonds can also reduce the probability of default as they allow the Government to reduce its debt service during an economic crisis. GDP-linked bonds have the capacity to act as automatic stabilizers, reducing the temptation to spend too much during periods of high growth. In this sense, this type of bond may be especially useful for developing countries where the presence of weaker institutions makes it easier for governments to implement more pro-cyclical economic policies. They can also allow

governments to implement more stable and predictable tax policies, since they remove the need to increase taxes during times of poor economic performance. Furthermore, these types of bonds can benefit especially the poor since governments are not required to cut social benefits during an economic crisis. Though these bonds allow governments to raise resources and make public sector investments, they can also be an important source of private investment, either through public–private partnerships or through government refinancing of private projects through a development bank. The success of these bonds in boosting savings and investments will, however, largely depend on the credibility of macroeconomic policy management, which has improved in Kenya in recent years.

The Government of Kenya may also pursue a set of monetary and financial sector policies to direct credit to the productive sectors of the economy. Moving away from liability-based reserve requirements and capital adequacy ratios, monetary authorities may adopt asset-based reserve requirements to encourage bank lending to priority sectors of the economy. Asset-based reserve requirements can allow banks to adjust their cash reserve ratios based on the sectors to which they lend. For example, reserve requirements may be lower for loans to SMEs, which can create employment, but higher for personal loans or for the import of vehicles. There can also be differential reserve requirements for unbanked or underserved areas of the country where unemployment is high and labour force participation is low. More explicitly, and following the example of the Reserve Bank of India, monetary policy may introduce priority sector lending (PSL) programmes to target sectors that are likely to create more formal jobs in the short and medium term. Commercial banks may be mandated to meet specific PSL targets and penalties may be imposed, including loss of excess reserves or overnight borrowing facilities, should a bank fail to meet the PSL target. Following the Community Reinvestment Act (CRA) in the United States, the Government of Kenya may also require banks to extend credit to underprivileged communities for productive investments. Selective interest rate caps can also be introduced to reduce the cost of lending to productive sectors of the economy. Although these are blunt instruments, they may help to reduce the borrowing costs of sectors of the economy that face financing

constraints and are excluded from the credit market. Specialized development banks can be established to support productive investments.

3 EFFECTIVE FINANCIAL REGULATIONS AND TAX POLICY

Appropriate and selective capital account regulations can be effective in preventing excessive private commercial borrowing, especially if the borrowings are for short-term consumption finance and speculative investments. A fractional financial transaction tax and higher reserve requirement on short-term inflows into the banking system can help to prevent the inflow and outflow of hot money, which often has an adverse impact on employment and economic growth as it can lead to overvaluation of the real exchange rate and loss of export competitiveness. Alongside these measures, the Government may adopt appropriate policies to attract new FDI and also to encourage reinvestment of profits earned by existing FDI. Given that the figure for repatriation of profits is almost as high as net inflows of FDI, the Government of Kenya may introduce specific tax incentives for reinvestment of profits by foreign firms. Policies must also be introduced to ensure that remittances – although private flows – are not fully used up in consumption and that they are invested in the economy to increase the labour force participation rate and create employment.

The linkages between tax policy and formal employment in Kenya need to be re-examined. Taxes on labour – including personal income taxes and social security contributions by both employer and employee – can reduce labour demand by driving up labour costs and reduce labour supply by lowering after-tax wages. Although the effects are indirect, final consumption taxes – such as VAT or excise duties – can also influence the labour demand and supply by reducing real wages. It is also argued that corporate taxes can affect employment by reducing investment and production. Higher corporate taxes may also adversely affect the labour supply as firms can pass on the effect of these taxes to employees in the form of lower wages. Given that the total tax rate – as a percentage of commercial profit – is high at almost 50 per cent in Kenya, the Government may consider tax breaks and tax

credits for both existing firms and new entrants to generate employment. Effective use can be made of fiscal incentives for investments in productive capital and penalties for investments in non-productive capital, such as real estate investments and financial assets held for speculative gain.

4 INCREASE COMPETITIVENESS VIS-À-VIS PRODUCTIVITY-ENHANCING POLICIES

A strong focus on stimulating labour and total factor productivity is vital to ensure that Kenyan labour is globally competitive. Improving labour productivity is essential to attract FDI and increase the overall employment rate. It is important for the Government to recognize that improvement in labour productivity does not necessarily reduce labour demand. In fact, the experiences of the East Asian economies show that employment and growth in labour productivity need not be a zero-sum game. Tax incentives can be offered to firms that will make essential investments in skills and productivity enhancement. The Government may consider creating a Productivity Fund to make grants and loans to firms for worker training with the aim of raising productivity levels.

To improve labour and total factor productivity, the Government may also implement a broad-based industrial policy to reduce excessive sectoral concentration and promote sectors that are incrementally more capital intensive and productive, without necessarily reducing labour demand. The industrial policy would have to ensure coherence and coordination between fiscal and monetary and exchange rate policies on the one hand, and employment and education policies on the other hand to reduce the mismatch between labour supply and labour demand. A coordinated and forward-looking industrial policy will help to ensure that educational institutions are imparting the knowledge, training and skills demanded by the employers and that the employers have the right fiscal and monetary incentives to invest and create jobs that can utilize those skills. A well-coordinated macroeconomic policy framework, within the ambit of a broader industrial policy, will be a *sine qua non* for Kenya to stimulate employment and promote inclusive, equitable and sustainable growth.

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CHAPTER 3

YOUTH EMPLOYMENT: REALITIES, CHALLENGES AND THE ROLE OF LABOUR MARKET POLICIES

INTRODUCTION

These are complex and challenging times for young people in the global economy. Kenya, where young women and men represent more than 37 per cent of the working-age population, is no exception. Youth are confronted by considerable challenges in finding meaningful employment and are often discouraged from seeking work. In addition, the few jobs available to them are mainly low-paid, of low quality and located in the informal sector.

Not only are youth in Kenya increasingly discouraged by the labour market situation in their country and future economic prospects, they are also dissatisfied with their living conditions and their role in society more broadly. Importantly, discouragement and dissatisfaction, especially among youth, have the potential to increase the risk of social unrest – as evidenced by the violence that erupted in Kenya during the post-election crisis of early 2008.

Youth employment, however, should be viewed as an opportunity rather than as a problematic challenge. Young people represent a valuable resource to the economy, businesses and society in general. With this in mind, this chapter will seek to shed light on the current labour market and social context of youth in Kenya (section A). The chapter then assesses the perceptions of young women and men regarding their situation and analyses the different reasons underlying the dissatisfaction with their prospects and their role in society (section B). The different measures and special programmes that have been implemented to support youth employment, with a focus on whether these measures have gone in the right direction, are examined in section C. This section examines the different macroeconomic and individual elements affecting youth employment with a view to discussing the elements that are at the heart of the youth labour market challenges. In addition the key policy issues for improving the situation of youth are discussed in this section, including a review of a number of successful country examples that could be leveraged in the context of Kenya.

A TRENDS AND COMPOSITION OF YOUTH EMPLOYMENT

Youth in Kenya account for a larger proportion of the population than in other African countries ...

A significant portion of the population of sub-Saharan Africa and, in particular, of Kenya is below the age of 25. In 2011, there were more than 8.5 million people between the ages of 15 and 24 in Kenya, comprising 37.4 per cent of the working-age population and rising to over two-thirds when the population under the age of 34 is included (figure 3.1).²⁸ This is close to 2 percentage points higher than the share of youth observed in Africa as a whole (35.5 per cent) and around 11 percentage points higher than the global figure (26.5 per cent). In comparison, Kenya has a rather expansive population pyramid, with a high proportion of younger people and a low proportion of older people.

In addition, Kenya's population continues to grow rapidly; according to UN World Population Prospects (UNDESA, 2011a), by 2050 the youth population in Kenya will reach 17.9 million, which is more than double the figure of 2011 and will represent 18.4 per cent of the estimated overall population and 30 per cent of the estimated working-age population.²⁹ This means that between 2011 and 2050, the working-age population will increase, on average, by more than 950,000 people per year. This fact highlights the urgent need to create employment opportunities, especially for new labour market entrants.

... however, the youth employment rate is lower in Kenya than in other countries in the region ...

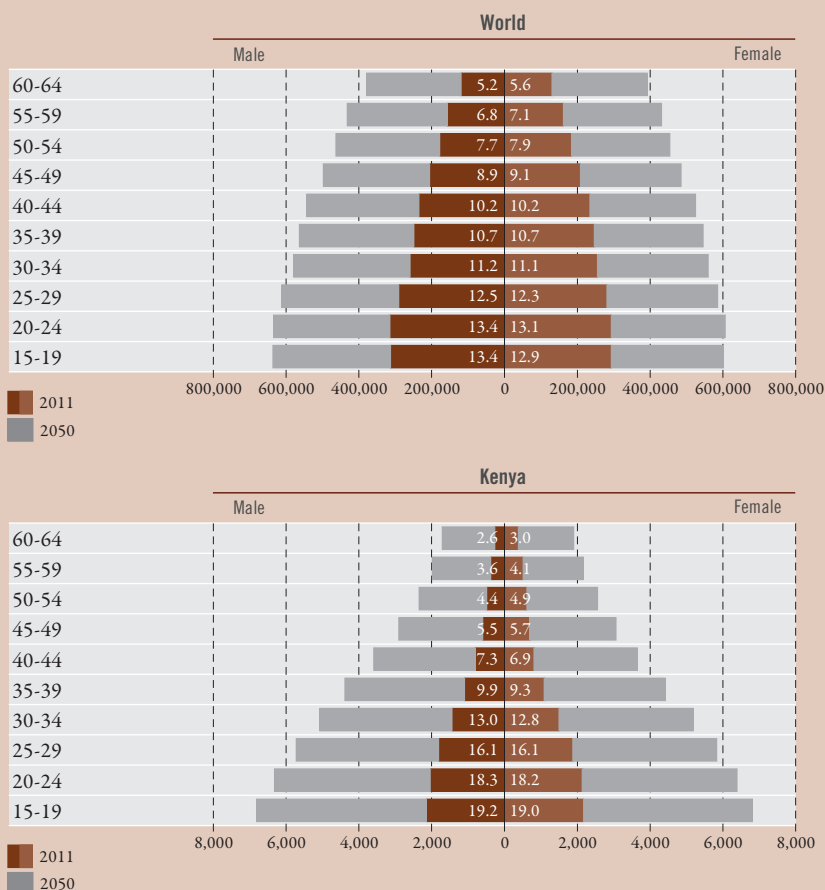
In Kenya, youth are considerably under-represented among the employed population. In fact, persons aged 15 to 24 accounted for less than 19 per cent of total employment in 2012,³⁰ whereas they made up over 35 per

²⁸ The Government of Kenya defines youth as the population between the ages of 15 and 30. To comply with this definition, the analysis in this report will take into account, whenever possible, the international definition of youth (15 to 24) and an enlarged sample of young persons (15 to 34). Given that the most commonly employed categorization of the population is by decade, starting at 15 years of age, the specific Kenyan national definition of youth is not applicable. Also, when referring to persons aged 15 to 34, the text will refer to young persons as opposed to youth, which is traditionally the age group 15 to 24.

²⁹ When considering the wider definition (persons aged 15 to 34), by 2050 Kenya is estimated to have 33.1 million young people. This is 34 per cent of the total population and 55 per cent of the working-age population.

³⁰ Latest available information. Due to the unavailability of information by age group, it is not possible to include figures on employment and employment-to-population for the group of people aged 15 to 34.

Figure 3.1 Working-age population by sex and age group, 2011* and 2050
(thousands)



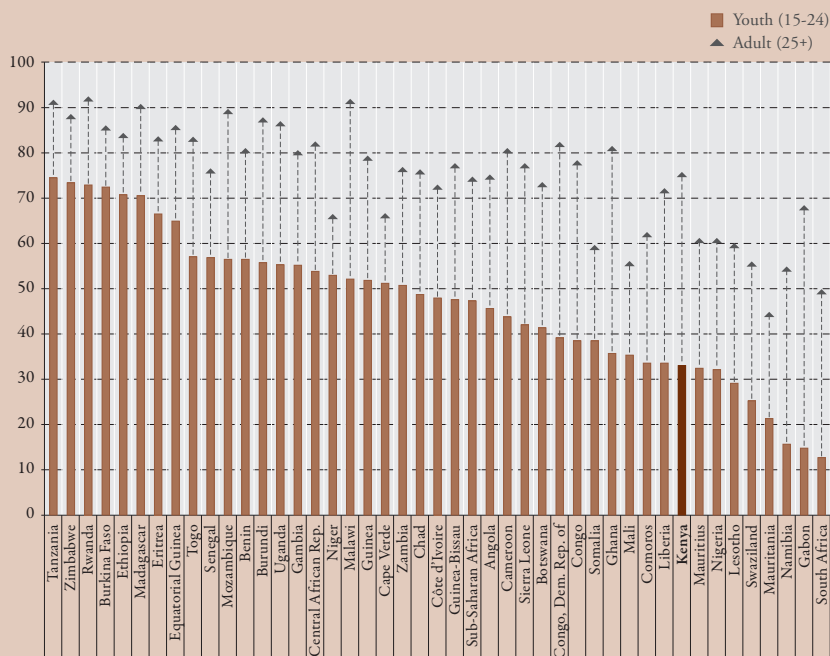
* As of July 2011.

Note: Values in bars show the share of each age group in the total working-age population (15 to 64).

Source: IILS calculations based on United Nations Population Division, Department of Economic and Social Affairs (UNDESA, 2011a).

cent of the working-age population. The youth employment rate in the country, i.e. the employment-to-population ratio, is less than half the adult employment rate (figure 3.2) and is one of the lowest youth employment rates in the region. In fact, the gap between youth and adult employment rates reached 43 percentage points in 2012, placing Kenya among those countries with the highest disparities between youth and adults in the

Figure 3.2 Employment-to-population ratio by age group, 2012
(percentages)



Source: IILS calculations based on KILM (ILO, 2012b).

region – the gap being close to twice that observed in sub-Saharan Africa as a whole. And, at 32.8 per cent in 2012, the employment rate among youth in Kenya was 14.5 percentage points below the average observed for sub-Saharan Africa as a whole. Kenya is also one of the few countries in the region to have witnessed a decline (close to 4 percentage points) in the past decade.³¹

... due principally to sluggish job growth among youth in recent years, leading in many instances to an exit from the labour market ...

The persistently low employment rates among youth in Kenya are driven primarily by a slowdown in job creation, as opposed to growth in the working-age population. For instance, employment growth among people aged 15 to 24 fell from 1.7 per cent in 2006 to 0.3 per cent per in 2012,

³¹ Between 2000 and 2005, the youth employment rate fell by close to 4 percentage points and stabilized at around 32 per cent thereafter.

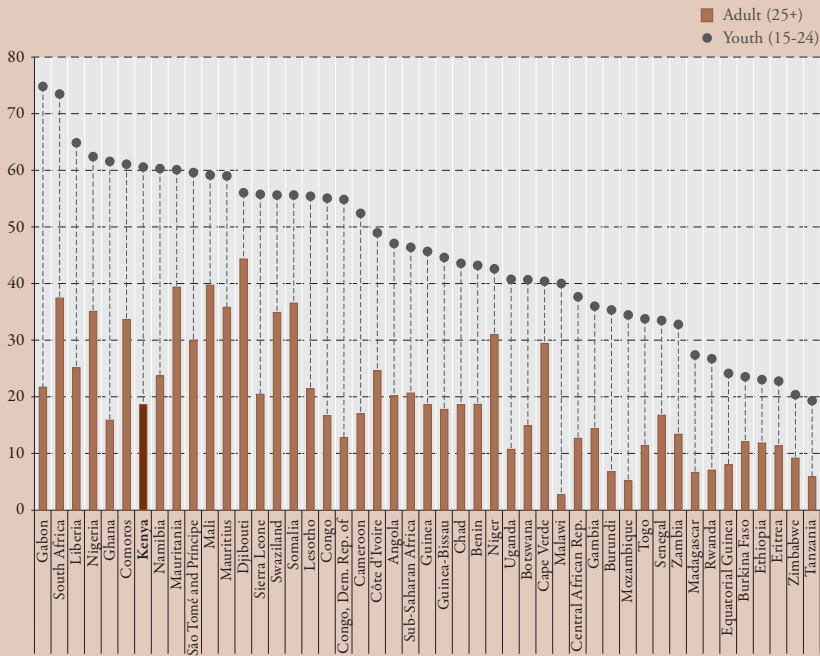
whereas the slowdown in the growth of the youth working-age population was less prominent – from 1.6 per cent to 1 per cent. In comparison, in 2012 job creation among adults (3.9 per cent) continued to slightly exceed working-age population growth (3.8 per cent).

As a result, some youth have become discouraged and are leaving the labour market entirely. Indeed, in 2012 the inactivity rate for people aged 15 to 24 in Kenya reached 60.5 per cent – an increase of 5 percentage points from 2000 (figure 3.3) – the seventh largest increase in sub-Saharan Africa.³² The problem was especially acute among women under the age of 25, who appear to be in a vulnerable employment situation (box 3.1). Moreover, Kenya's youth inactivity rate in 2012 was 42 percentage points above that of people aged 25 or more (18.5 per cent) – which, as seen in Chapter 1, is high by international standards – and 14.1 percentage points above the youth inactivity rate in sub-Saharan Africa as a whole (46.4 per cent).

One possible explanation for the comparable low employment-to-population ratios and low participation rates among youth is the increase in high school enrolment. Indeed, Kenya's primary and secondary school enrolment rates have been increasing and are now higher than those for sub-Saharan Africa as a whole (14 and 21 percentage points higher, respectively). However, this would only help to explain the situation of the group aged 15 to 19 since, for youth above this age, tertiary enrolment (as discussed in Chapter 1) remains relatively low (even below the average in sub-Saharan Africa). As a result, the inactivity rate among young people aged 15 to 34 remains elevated in Kenya at 42.2 per cent in 2012, over 7 percentage points higher than in sub-Saharan Africa.

³² The inactivity rate for young people aged 15 to 34 reached 42.2 per cent in 2012, which is 1.6 percentage points above the figure in 2000 (40.6 per cent). Although this figure is significantly lower than that for youth, aged 15 to 24, it is still 24.2 percentage points above the adult (people aged 35 or more) inactivity rate.

Figure 3.3 Inactivity (out of the labour force) rate by age group, 2012
(percentages)



Source: IILS calculations based on KILM (ILO, 2012b).

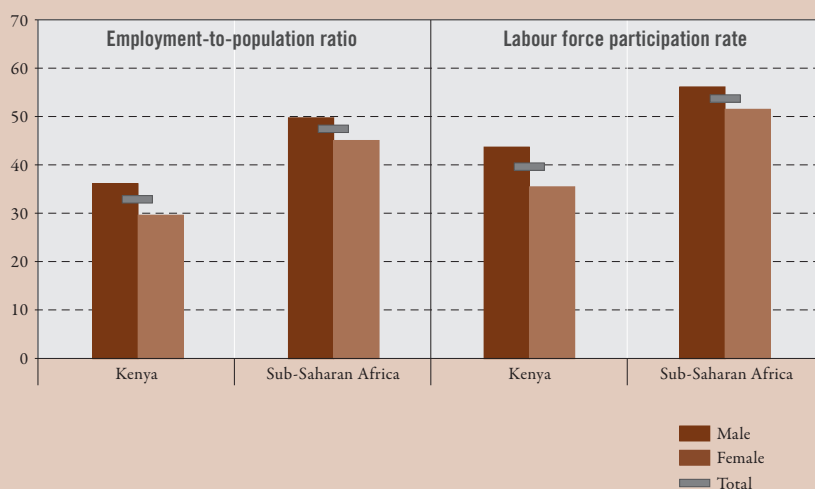
Box 3.1 Gender disparities in the access to jobs

In 2012, the proportion of young women aged 15 to 24 in employment in Kenya (29.5 per cent) was lower than that of young men (36 per cent) (figure 3.4). In addition, in 2012, the female youth participation rate in Kenya was 35.5 per cent compared to 43.5 per cent among men. These figures are, respectively, 15.5 and 16 percentage points lower than in sub-Saharan Africa as a whole. Gender disparities in access to jobs are not a new phenomenon but have worsened during the past decade. Weaker employment opportunities not only place young women as the most vulnerable group in Kenya, but are a major economic factor in the feminization of poverty in Africa (Haji, 2007).

Box 3.1 Gender disparities in the access to jobs

A number of cultural and political factors (such as discriminatory policies, structural barriers³³ and cultural prejudices) explain the additional difficulties that young women face on entering and remaining in the job market (Okojie, 2003). Moreover, differences in literacy and access to education between female and male children play a key role in explaining gender gaps among youth in both employment and labour force participation rates (World Bank, 2009; ECA, 2011). In fact, in 2009, the literacy rate among women was 7 percentage points lower than among men. Moreover, only 57 per cent of women had access to secondary education compared to 63.2 per cent of men. Likewise, only 3.3 per cent of women are in tertiary education compared to 4.7 per cent of men.

Figure 3.4 Youth employment-to-population ratio and youth labour force participation rate by sex, Kenya and sub-Saharan Africa, 2012 (percentages)



Source: ILS calculations based on KILM (ILO, 2012b).

³³ Such as customary laws and norms that prevent women from obtaining land, credit, education, information and health care.

B YOUNG PEOPLE IN KENYA: PERCEPTIONS OF DISSATISFACTION WITH THEIR PROSPECTS AND THEIR ROLE IN SOCIETY

Young women and men are pessimistic about their economic and labour market prospects...

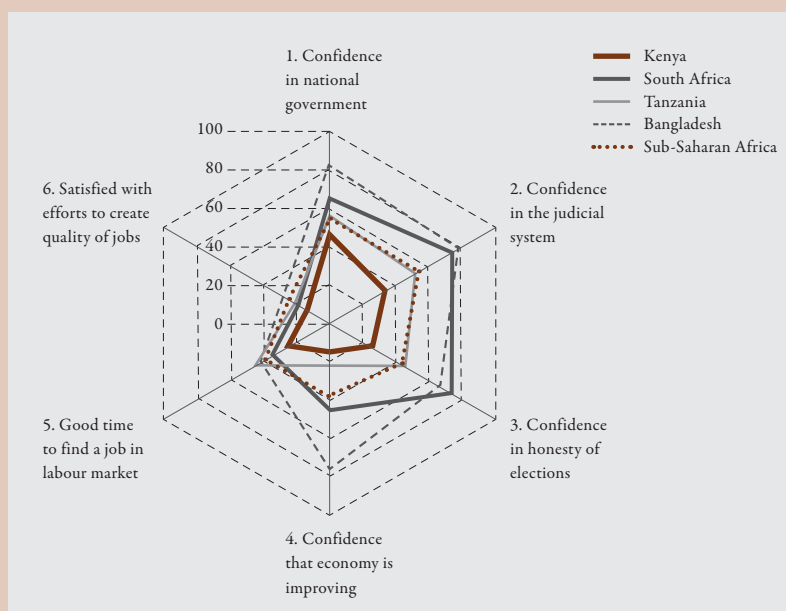
In light of the challenges confronting young people, it is perhaps not surprising that their perception of the country's economic and labour market prospects has deteriorated dramatically. According to the Gallup survey database,³⁴ in 2011, only 15.8 per cent of the population aged 15 to 34 believed that economic conditions were improving. This is 30 percentage points below the figure found in 2007, when over 46 per cent of the youth stated that they felt positive about the economic prospects. This is interesting, given that these figures correspond to a relatively strong period of growth. Moreover, Kenya's perception of future economic prospects is the most pessimistic of the developing countries analysed (figure 3.5) and the third most pessimistic of the 37 sub-Saharan African countries with available information. In comparison, in 2011, 38.5 per cent of young people in sub-Saharan Africa reported that they were confident that economic conditions were improving – although this too constitutes a deterioration of young people's perceptions compared to 2007 (by almost 7 percentage points). Importantly, adults in Kenya are as pessimistic as youth in relation to economic prospects – in 2011 only 17 per cent of people aged 35 to 49 and 12 per cent of those aged 50 and over believed that the economic conditions of the area in which they lived were improving.

Furthermore, in 2011, only 25 per cent of young women and men believed that it was a good time to find a job in the local labour market – a fall of almost 7 percentage points since 2007. In 2011, perceptions of the health of local labour markets were higher in sub-Saharan Africa (39.5 per cent) and other African countries, such as South Africa (33.9 per cent) and Tanzania (44.6 per cent), and other developing countries such as Bangladesh (40.9

³⁴ Section B is based on the analysis of Gallup World Poll Data, which gathers survey data for 160 countries as of 2011 and is representative of 98 per cent of the world's adult population. The area coverage of the surveys is national (including rural areas) and the samples are representative of the entire non-institutional civilian population aged 15 or older. In 2011, 37 sub-Saharan African countries were covered, including Kenya. The survey sample size in Kenya is comprised of 1,000 respondents and is probability-based and nationally representative of the resident population aged 15 and above.

per cent). The unavailability of jobs is not the only labour market challenge perceived by young people; they are also dissatisfied with the lack of Government effort to increase the availability of quality jobs. Indeed, in 2010 (the latest year with available information), 86.4 per cent of young people reported that they were dissatisfied with efforts made to increase the number of quality jobs – a figure which is 11 percentage points higher than in 2007. Dissatisfaction with the lack of availability of quality jobs is again higher in Kenya than in sub-Saharan Africa (75.5 per cent) and the other countries analysed.

Figure 3.5 Young people's levels of satisfaction concerning their prospects and confidence in their national institutions, 2011*
(percentage of people aged 15 to 34 that trust their country's institutions and the prospects of the economy and the labour market)



* Data relative to the question "Do you think it is a good time to find a job in the local labour market?" correspond to 2010.

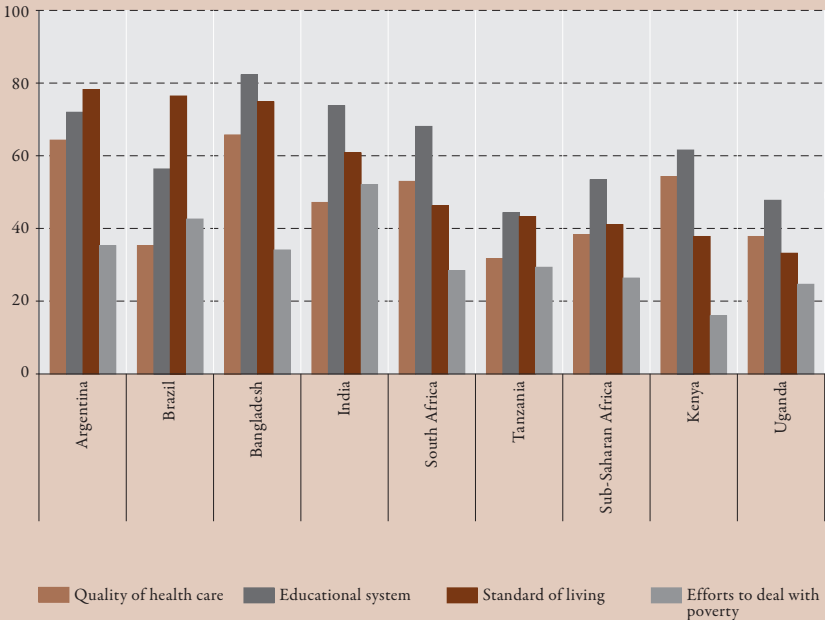
Note: Figures for sub-Saharan Africa have been calculated based on a sample of 37 countries for which available information exists.

Source: ILS calculations based on Gallup World Poll, 2012.

... and are less satisfied with their quality of life than young people in other countries ...

Relative to other countries, young Kenyans are less satisfied with their quality of life. Kenya ranks lower than the average of sub-Saharan Africa and most other developing countries analysed, with the exception of Uganda, in terms of the satisfaction of youth with their standard of living (figure 3.6). In 2011, only 38 per cent of young people aged 15 to 34 were satisfied with their standard of living – although this represents a 6 percentage point increase from 2007. Satisfaction among adults is even lower, at only 28 per cent. Young people in Kenya are most dissatisfied about efforts to counter poverty and the degree to which society focuses on the welfare of its young people. Only 16.3 per cent of young people said they were satisfied

Figure 3.6 How young people perceive their quality of life, selected countries, 2011*
(percentage of people aged 15–34 that are satisfied with various aspects of their life)



* Data relative to the question of “Satisfaction with efforts made to deal with poverty” correspond to 2010.
Note: Figures for sub-Saharan Africa have been calculated based on a sample of 37 countries for which available information exists. The variable Satisfaction with the efforts made to deal with poverty is based on a reduced sample of 24 countries.
Source: IILS calculations based on Gallup World Poll, 2012.

with current efforts to deal with the issue of poverty in 2010. Importantly, adults share this concern and have a similar percentage of dissatisfaction. The discontent among young people has increased since 2007 by close to 14 percentage points and, as a result, Kenya ranks sixth among the 24 sub-Saharan African countries with available information on dissatisfaction among young people regarding efforts made to aid the most disadvantaged. On a positive note, the majority of young women and men were satisfied with the educational system (61.6 per cent) and, to a lesser extent, the quality of health care (54.4 per cent) in 2011.

... leading to a sense of alienation, less confidence in national democratic institutions and relatively high rates of young out-migrants.

Confidence among young Kenyans in the Government and its democratic institutions has deteriorated considerably in recent years. For example, between 2007 and 2011, young people's confidence in national Government fell by 18 percentage points, in the judicial system by 20.4 percentage points and in the honesty of elections by 28.9 percentage points. As a result, in 2011, confidence in national institutions in Kenya was the lowest among the countries analysed (figure 3.5) and among the eight lowest of all African countries with available information.

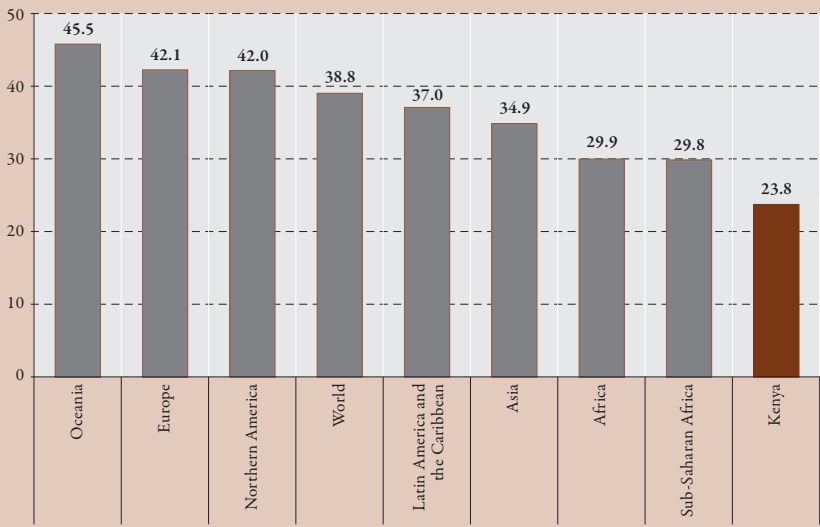
Kenyans also feel dissatisfied with policies and institutions responsible for facilitating a suitable business environment. According to the Gallup database, 24.5 per cent of young Kenyans reported that the area in which they lived was not a good place for entrepreneurs to start up new businesses in 2010.³⁵ This percentage is similar to that observed in sub-Saharan Africa as a whole (24.7 per cent) but considerably higher than in other countries in the region, such as Ghana (9.2 per cent) and Liberia (13 per cent).

In the face of the increasing discontent and the poor employment prospects, out-migration of young people has remained an important issue in Kenya. As a share of the total stock of migrants, in 2010 the stock of young migrants accounted for 22.4 per cent when considering people aged 15 to 24 and 42.3 per cent when taking into account migrants aged 15 to

³⁵ These figures result from the analysis of the question "Is the city or area where you live a good place or not a good place to live for entrepreneurs forming new businesses?", Gallup World Poll (2012).

34 – the seventh highest in Africa. As a result, the median age of Kenyan migrants in 2010 was 23.8 years. This is 6 years younger than migrants from sub-Saharan Africa as a whole (29.8 years), 15 years younger than the world median (38.8 years) and more than 18 years younger than European migrants (figure 3.7).

Figure 3.7 Median age of international migrants, selected countries, 2010
(years)



Source: IILS calculations based on UNDESA, 2011a.

C NATIONAL POLICIES AND PRIORITIES FOR THE YOUTH: THE WAY FORWARD

The Government has expended considerable effort to support youth ...

In response to these challenges, the Kenyan Government has introduced a range of programmes in recent years in an effort to provide youth with better education and training opportunities (table 3.1 and Appendix A). Most notably, in 2008, the Ministry of Youth Affairs and Sports (MOYAS) launched the Youth Employment Marshall Plan, with a view to addressing the long-term challenges of youth employment. In 2010, the Kenya Youth Empowerment Programme was established, which absorbed many of the activities of the Marshall Plan, but included a larger spectrum of activities (e.g. training and policy development). Recently, new initiatives have been put in place, including the Yes Youth Can programme, created by the youth themselves, and the Youth Employment for Sustainable Development Project, a joint initiative developed by the ILO, the Government of Kenya (through the MOYAS) and the Government of Japan.

... but in order to improve labour market outcomes for youth, first, programmes could be better aligned to the specific challenges facing them ...

Youth in Kenya continue to be confronted by a number of labour market and social challenges which have had a dampening effect on their outlook and confidence, despite considerable efforts on the part of policy-makers to address the situation. Part of the problem may be that efforts made by the Government have failed – both in terms of design and magnitude of resources allocated – to adequately address the challenges confronting youth. For instance, an analysis of the Kenyan budget for the period 2012/13, set at KSh 1,459 billion, shows that 24 per cent of the total budget was allocated to social services, of which only 3.1 per cent – or 11.1 billion – is targeted specifically at youth programmes and activities (figure 3.8). In other words, less than 1 per cent of the total budget is allocated to the activities of MOYAS, of which only 10 per cent is dedicated to the two key youth employment-oriented programmes.

Table 3.1 Government programmes, institutions and policy frameworks directed at youth in Kenya

Name of intervention	Year	Objective/description of the programme	Evaluation
Economic Recovery Strategy (ERS) for Wealth and Employment Creation (Strategic Plan 2003–2007)	2003–2007	<p>The strategy's overall objective was to improve growth and development. In terms of youth, the plan aimed to:</p> <ul style="list-style-type: none"> • ensure universal primary education through the Free Primary Education programme • support students in the transition from primary to secondary education through the Free Day Secondary Education programme. 	<p>Net primary school enrolment rate increased from 84.8 per cent in 2000 to 95.7 per cent in 2011.</p> <p>The transition rate from primary to secondary education rose from 42 to 72 per cent between 2003 and 2011.</p> <p>However, there was a fall in the primary teacher/student ratio, from 1:40 in 2003 to 1:57 in 2011.</p>
Ministry of Youth Affairs and Sports (MOYAS) (New institution)	2005	<p>To coordinate, represent and address youth concerns in Kenya.</p> <p>Responsible for the National Youth Policy and the main Government programmes directed towards youth.</p>	<p>Successfully coordinated youth concerns.</p> <p>Main criticisms: non-inclusion of demographic issues as a policy priority and the lack of collaboration with other institutions (UNICEF and IEA-Kenya, 2012).</p>
Kenya National Youth Policy	2007	<p>Legislative framework put in place to enhance youth participation in national development.</p> <p>It includes a strategy for employment creation.</p> <p>It was accompanied by the creation of a National Youth Council to facilitate, coordinate, manage and promote youth issues and youth-led initiatives.</p>	<p>The cost of the full implementation amounted to KSh 91 million for the period 2007–2011, which was mainly allocated to education and training, but also to employment creation.</p> <p>The initiative was welcomed but experts suggest that a greater effort is needed to address the lack of coordination between government agencies (UNICEF and IEA-Kenya, 2012).</p>
Youth Employment Marshall Plan (substituted in 2010 by the Kenya Youth Empowerment Programme)	2008	<p>Launched by the MOYAS to address the long-term challenge of youth unemployment through three main initiatives:</p> <ul style="list-style-type: none"> • KaziKwaVijana to generate short-term employment opportunities (now part of the Kenya Youth Empowerment Programme). Initiatives include the Tree for Jobs programme that aims to provide employment while addressing environmental problems. • Youth Enterprise Development Fund to enhance youth participation through the provision of credit to youth entrepreneurs (still active and managed by the MOYAS). • Technical Vocational Education and Training (TVET) component to provide youth with quality training in technical, vocational, industrial and entrepreneurial skills at Youth Polytechnic facilities (still active and managed by the MOYAS). 	<p>The KaziKwaVijana initiative enabled a large number of young Kenyans to have their first job experience. However, it did not include a training and capacity building component.</p> <p>The Youth Enterprise Development Fund had disbursed over KSh 2.9 million by 2010 to finance 86,000 youth-led enterprises. Challenges include insufficient support or funding, inaccessibility to certain groups and strict requirements for participation.</p> <p>Under the TVET component, 2,000 additional instructors were recruited and 3,500 young people were trained in entrepreneurial activities at Youth Polytechnic facilities. The challenges include lack of resources for training, low level of wages paid to staff and lack of collaboration with other institutions as well as a negative attitude towards graduates of such non-traditional facilities.</p>
Kenya Youth Empowerment Programme	2010	<p>To provide disadvantaged unemployed youth with opportunities to obtain training, apprenticeships and short-term jobs to improve their future employability.</p>	<p>In June 2011, the programme had approved 406 public works and had provided life skills training for 1,057 interns, of which 916 were subsequently selected for work placements.</p> <p>Due to irregularities in management, the funds were cut by the World Bank and reallocated to other activities of the Kenyan portfolio of the World Bank.</p>

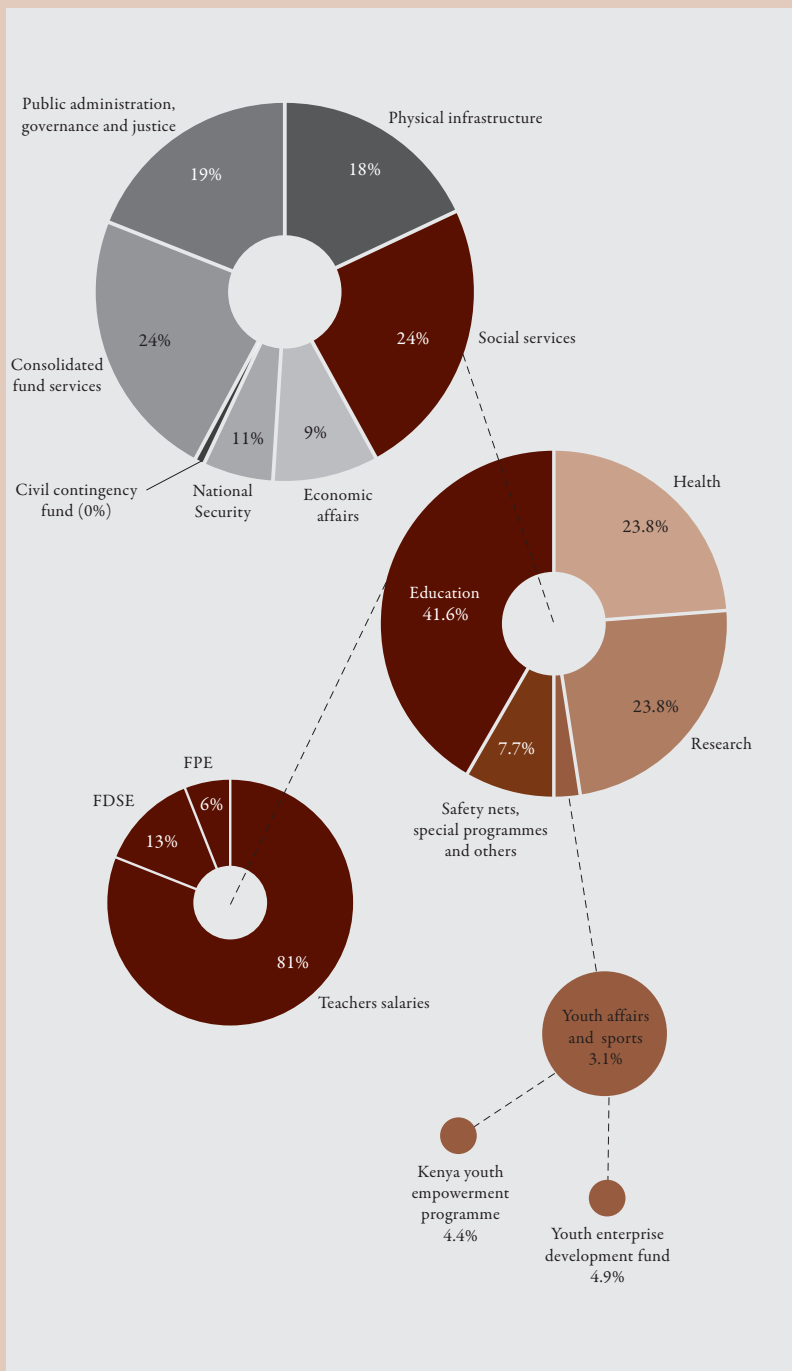
Table 3.1 Government programmes, institutions and policy frameworks directed at youth in Kenya

Name of intervention	Year	Objective/description of the programme	Evaluation
Kenya Vision 2030 (Strategic Plan 2008–2030)	2008–2030	The long-term development blueprint for the period 2008–2030 which aims to improve the quality of life of Kenyan citizens. In terms of youth, this programme highlights the need for young people to be prosperous and globally competitive, so plans for youth are proposed in several areas.	
Youth Employment for Sustainable Development (YESD) Project	2012	Joint initiative developed by the ILO, the Government of Kenya (through the MOYAS) and the Government of Japan. The project seeks to create employment for at least 2,500 youths by running road rehabilitation and maintenance projects and to educate the youth about infrastructure building. Local implementation is carried out by the Youth Polytechnics under the direction of the MOYAS.	

While lack of resources is a key consideration, there appears to be a mismatch between the problems that this group faces – as described in sections A and B – and the specific programmes that have been implemented. Evidence has shown that well-targeted policies increase efficiency and that the effects of such policies on employment can be significant relative to their budgetary costs (Jackman et al., 1990). In fact, a microeconometric assessment of the latest Kenya Integrated Household Budget Survey (KIHBS) revealed that the key individual characteristics that influence youth's probability of finding employment related principally to: (i) education and training, notably tertiary education and vocational training; (ii) gender of the individual; (iii) family responsibilities; and (iv) geographical location (see box 3.2 and Appendix B).³⁶

³⁶ See Escudero and López (forthcoming) for a more detailed analysis of the interpretations of these results.

Figure 3.8 Kenyan Government expenditures, 2012/13 budget



Note: FPE refers to Free Primary Education programme and FDSE to Free Day Secondary Education programme.

Source: Kenyan Ministry of Finances.

Box 3.2 Factors affecting labour market outcomes of youth: A micro-assessment

A microeconometric analysis of the latest KIHBS was carried out to shed light on the individual characteristics that influence youth's probability of finding employment and the factors that explain the gap between adults and youth (Appendix B). Overall, the model pinpoints the age of individuals as the principal factor determining their status in employment, even after controlling for variables such as school attendance, educational attainment and vocational training. Indeed, people aged 15 to 24 have a 22.4 per cent greater chance of being inactive than adults (people aged 35 or more). This difference holds, although it is dramatically reduced, when the wider youth group (25 to 34) is considered – for this wider group the probability of being inactive is still 2.9 per cent higher than for adults. The model also shows that being in the 15- to 24-year-old group (in comparison to the adult group) increases the probability of being unemployed by 8.1 per cent, but the same does not hold (probability being only 0.1 per cent higher) when the wider group aged 24 to 35 is considered. More importantly, the likelihood of being employed and self-employed is lower for young people – the probability of being employed and self-employed is 12 per cent and 11.2 per cent lower, respectively, for youth aged 15 to 24 and 1.8 and 2.4 per cent lower, respectively, for young people aged 25 to 34.

The most important factors that explain the differences between the employment status of youth and adults, include:

Sex of the individual: The results suggest that some gender discrimination³⁷ might be limiting the access of young people to the labour market. Indeed, young females have a 21.1 per cent greater chance of being inactive than young males when they are aged 15 to 24, rising to 25.7 per cent when aged 25 to 34, while this difference is 15.4 per cent in the case of adults (people aged 35 or more). Similarly, the sex of young people also plays an important role in explaining the gap in finding employment. Indeed, in the case of young persons aged 25 to 34, being a woman reduces the likelihood of being employed by 26 per cent compared to 17.1 per cent for the adult population as a whole.³⁸ The gender effect is radically lower when explaining the gap in self-employment. In fact, being a man only increases the probability of being self-employed by almost 2 per cent among youth (15 to 24), and slightly decreases the odds of being self-employed for young people up to the age of 34.

Family responsibilities: Surprisingly, the presence of children in the household does not play a role in explaining the level of inactivity of young people (in either age group), but it does increase the probability of being inactive among adults. However, in terms of access to employment, family responsibilities are an important driver for the older youth group. Indeed, while having children barely has any impact on the younger youth group (15 to 24), it reduces the likelihood of being employed by 8.6 per cent in the case of young people aged 25 to 34 (compared to 1.2 per cent for adults).

Geographical location: While geographical location plays a crucial role in explaining the gap in accessing labour markets between rural and urban youth, it is a factor explaining

³⁷“Gender discrimination” is captured by the differences in employment status between men and women that are not explained by educational attainment, family responsibilities and the effect of having access to a network. However, it is important to bear in mind the fact that, discrimination aside, the residual effect could also be linked to factors such as health conditions, for which the model did not control due to lack of information.

³⁸ The impact of this factor is lower in the younger age group (15 to 24). Being a woman has the same impact on employability as in the case of adults.

the differences between youth and adults. Living in urban areas increases the probability of being inactive by 8 and 4.5 per cent among youth aged 15 to 24 and young people aged 25 to 34, respectively, compared to 8.2 per cent in the case of adults. More importantly, the model shows that youth (15 to 24) living in urban areas have a 7.8 per cent lower chance of being employed than those living in rural areas, which is not surprising given the difference in youth unemployment rates between the two areas – 38.4 and 19 per cent, respectively. This effect holds, although it is radically reduced, for the young people aged 25 to 34 that live in urban areas – who have a 2.2 per cent lower chance of being employed than their rural counterparts. Likewise, living in urban areas has a lesser effect on the odds of being self-employed. Indeed, it decreases the probability of being self-employed among youth, but by a mere 0.6 and 3.4 per cent for youth and young people, respectively. Meanwhile, for adults the probability of being self-employed is greatly reduced (by close to 10 per cent) when they live in urban areas.

Education and training – notably tertiary education and vocational training: Human capital endowment plays an important role in explaining the gap between youth and adults in accessing the labour market. Yet, it is tertiary education and vocational training that play a crucial role in explaining these differences. Indeed, primary and secondary education reduce the probability of being inactive by about 18 and 19 per cent, respectively, in the two youth groups (compared to 16 and 19 per cent in the case of adults). Tertiary education, on the other hand, reduces the probability of being inactive by 31 per cent among youth aged 15 to 24 compared to 17 per cent in the case of adults; and vocational training by 8.5 per cent and has no impact on adult inactivity.³⁹ Likewise, education variables strongly influence the probability of youth being employed (while they barely have any impact on the adult group). Indeed, tertiary education and vocational training increase the likelihood of having a job by 24 and 7.7 per cent, respectively, in the case of youth aged 15 to 24 and by 36.4 and 9.4 per cent, respectively, in the case of young people aged 25 to 34. The difference in the effect of university education and vocational training between youth and adults could be attributed to the fact that, after adults have acquired professional experience and soft skills, their level of educational attainment becomes less important and therefore explains a lower part of the probability of being employed.

The availability of a network in the household: Finally, having a network (a member of the household already in employment who can facilitate entry into the labour market) in the household greatly increases the probability of youth being employed. Indeed, the presence of another employed or self-employed individual raises the likelihood of being employed by 10.1 and 11.5 per cent, respectively, among youth aged 15 to 24 and by 14.5 and 13.5 per cent, respectively, in the case of young people aged 25 to 34. Interestingly, this insider-outsider concept of job recruitment (Wittenberg and Pearce, 1996) only affects young Kenyans and not their adult counterparts. The opposite is true when analysing the probability of being self-employed. The availability of a network increases the odds of being self-employed by 2 and 7 per cent among youth aged 15 to 24 and young people aged 25 to 34, respectively (compared to 11 per cent in the case of adults).

Source: IILS calculations based on KIHBS.

³⁹ However, these two factors had a much lesser impact on the probability of young people aged 25 to 34 of being inactive. Indeed, tertiary education reduces the probability of being inactive by 15.6 per cent for this age group and vocational training by 5 per cent.

Whereas many of the policies implemented are aimed at young people in general, without identifying those in greatest need. Moving forward, greater emphasis could be placed on targeting the disadvantages that youth face, rather than focusing on youth per se:

- *Improve the technical skills match:* The combination of an education that is adapted to the needs of the country with technical training that could be used directly on the job can dramatically improve the employability of youth. For instance, the Republic of Korea and Singapore not only addressed the issue of the quality of education (including secondary and tertiary education) but also improved vocational skills, which they rightly believed were essential factors in improving productivity and competitiveness. Both countries introduced training levies to encourage enterprises to participate in workers training. The objective of both countries was to harness the potential of enterprises to function as learning organizations in order to develop worker skills (Asian Development Bank, 2004). Although, over the past decade, the key driver of growth in Kenya has continued to be domestic demand, the export sector remains a potential source of growth for the country – Kenya has moved towards higher value added products and there is also potential to develop new products (World Bank, 2011b). Thus, emphasizing the quality of education and improving vocational skills could be essential factors in consolidating this export-led growth process.
- *Facilitate school-to-work transitions:* A significant problem in Kenya remains the difficulty that youth face in moving from school to work. In recent years, several Latin American countries implemented job training programmes designed especially for disadvantaged youth. The pioneering initiative in this field was the programme Chile Joven, created in 1991 and still active today. The programme moved from an in-classroom initiative towards a more comprehensive training model that included supplementary services, such as counselling and mentoring, monitoring, job search and placement assistance, and soft- and life-skills training. It is estimated that over 50 per cent of participants in this programme have achieved employment as a direct result of this intervention – although most of these success stories (young males, with complete secondary

education and previous job experience) had advantages over the average non-participant. Moreover, about 10,000 companies (most of them small) have been involved and the vast majority were favourably disposed to repeating the experience (Sepúlveda, 2009). Other countries in the region faced with similar challenges replicated the model, on many occasions with the support of the Inter-American Development Bank and the International Labour Organization (ILO). The success of such programmes lies in the inclusion of a labour demand perspective.

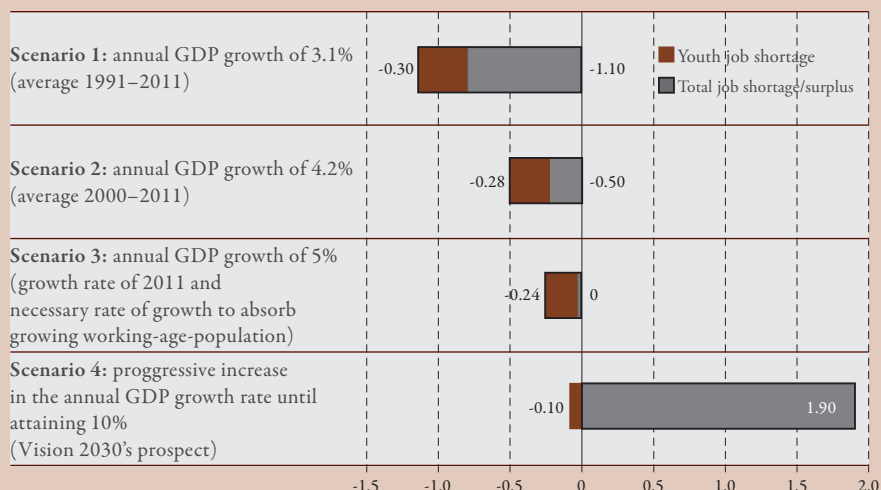
- *Include elements of soft-skills development:* While measures aimed at enhancing the employability of youth should focus on providing young people with technical skills applicable in the workplace, efforts must also be made to encourage soft skills. In 2001, the Dominican Republic created the Juventud y Empleo Programme aimed at providing youth with both technical and soft skills for the labour market. The programme integrates education in life skills to help young people to be more effective workers, through training provided mainly by private local training institutions – the so-called System Operations Centres (Centros Operativos del Sistema). The topics taught include self-esteem, teamwork, communication skills, work organization and service skills, job-search skills and knowledge related to risky behaviours (reproductive health, drug use, violence, etc.). Data from the Dominican Republic Ministry of Labour indicate that, between 2003 and 2010, 55,003 young people benefited from this programme, of which 90 per cent were from the poorest areas in the country. Furthermore, 65 per cent of people that completed the training were employed or self-employed within 6 months of completing the programme and earned, on average, 10 per cent more than those who did not participate.
- *Ensure equity in programme participation, especially for women and youth in rural areas:* A number of programmes, including KaziKwaVijana and the Youth Enterprise Development Fund (YEDF), have been criticized for the lack of access to a majority of the individuals' target group. Experts believe that there is a need for enhanced equity, accessibility, capacity building and participation of youth in these programmes (UNICEF and IEA-Kenya, 2012). This is particularly the case for young women and youth in rural or remote areas – key determinants of employment

outcomes. To ensure equity in programme participation and to combat discrimination, the Programme for the Promotion of Children and Youth (PCY) was implemented in Uganda between 2003 and 2006. The PCY was a Ugandan–German comprehensive approach to promote the interests of disadvantaged youth living in rural areas, suffering from either unemployment or underemployment. The programme facilitated the development of the National Action Plan on Youth Employment, in which PCY played an important part (GTZ, 2006).

- *Supporting the most vulnerable:* A high percentage of young people in Kenya remain outside the labour force. Measures such as the KaziKwaVijana Programme have attempted to address this problem but traditional employment policies aimed at “activating” individuals may be ill-suited to assisting youths specifically since, in contrast to their older counterparts, youths usually have only limited work experience. Some countries have responded to this new challenge by introducing specific policy measures to support and reintegrate unemployed and inactive youth into the labour market. One such example is a non-formal education project for youth in Egypt. This UNESCO-funded project, implemented under the auspices of three non-governmental organizations (NGOs), seeks to target those individuals that have fallen out of the formal educational system and provide them not only with literacy skills, but also with vocational training, life skills, computer and foreign language skills. Given the specific characteristics of the targeted youth group, the project is based on an alternative approach, using a non-formal model of education revolving around learning and working conditions rooted in local economies and local knowledge. The project leads to lifelong learning and earning skills and eventually creates networks of learning communities, acting as a vehicle for the provision of practical skills in the hope of improving productivity and successfully tackling the problem of youth unemployment.

... and, second, complemented by demand-side initiatives.

Figure 3.9 Simulations: Number of jobs that would be required by 2015 to absorb the estimated working-age population* given different growth scenarios and the existing employment elasticity, calculations for total and youth (millions of jobs)



* Existing and projected (2012–15) data on working-age population comes from UNDESA, 2011a.
Source: ILS calculations based on KILM (ILO, 2012b), UNDESA, 2011a and IMF, 2012.

Although the size of the youth cohort has significant implications for the status of youth in the labour market, aggregate demand has a greater influence in the case of Kenya (see Appendix C).⁴⁰ Moreover, the employment elasticity of economic growth during the past 20 years has been around 0.9 in Kenya, whereas the youth employment elasticity was only about 0.4 during the same period. It is, therefore, not surprising that several growth scenarios reveal that only an average annual growth rate that rises progressively to reach 10 per cent in 2015 – the objective of Vision 2030 Strategic Plan – would close both the youth and total job shortage gap (figure 3.9). Growth scenarios of 3.1 and 4.2 per cent per annum would yield job deficits for both youth and adults totalling 1.1 million and 500,000, respectively. An average growth rate of 5 per cent per annum would close the overall gap but a youth job shortage of approximately 240,000 would persist.

⁴⁰ With a view to assessing the relative importance of these factors, an econometric analysis has been carried out to estimate the impact of aggregate demand and cohort size on the rates of unemployed and inactive youth during the past 20 years. See Appendix C for the exact specification of the different equations and Escudero and López (forthcoming) for a detailed analysis of the theoretical framework from which the equations were derived and the interpretations of the results.

Fostering economic growth and ensuring economic sustainability are thus important factors, yet in isolation they will not be sufficient to address youth challenges. Additional efforts tailored to improving the employment content of growth and encouraging the demand for youth labour are needed. Indeed, in an effort to achieve a more equitable distribution of the gains from growth, some countries have undertaken measures that provide incentives to enterprises to hire youth workers, while others have promoted entrepreneurship among youth. Examples of initiatives are detailed below:

- *Targeted subsidies and other measures to encourage the hiring of youth:* A number of initiatives exist to encourage job creation among youth, including subsidized wages or tax breaks. For instance, the First Employment Programme, established in Brazil, Colombia, Paraguay and, recently, Mexico, seeks to create permanent, well-paid jobs in the formal economy through subsidies for the recruitment of young people. In Mexico, the Government returns to the company all social security contributions made for each young person employed, starting from the tenth month after the person was hired.⁴¹ The amount of the subsidy depends on the salary of the new employee. An additional advantage of this programme is that it provides incentives to enable workers and their families to receive social security benefits, such as access to health services, pensions and maternity allowances. According to the Mexican Institute of Social Security, by August 2012, some 26,178 companies had been enrolled in the programme, registering 94,200 workers. A similar programme existed in Turkey between July 2008 and June 2009, which introduced reductions of 100 per cent of employers' social security contributions in the first year, with a 20 percentage point decline per year in the subsidy over the following 4 years. Betcherman et al. (2010) found that, during the year that it was active, this programme led to significant increases in net registered jobs, estimated to be between 5 and 15 per cent.
- *Promoting entrepreneurship among youth:* Promoting entrepreneurship can help to foster employment opportunities for young people, while also reducing precarious and informal forms of employment among them. In addition, entrepreneurship has the potential to unlock the innovative

⁴¹ More specifically, after the tenth month of work, the social security contributions paid by the company during the first month are reimbursed; after completion of the eleventh month of work, the social security contributions paid by the company during the second month are reimbursed, and so on.

capacities of youth through the promotion of new and entrepreneurial types of work that achieve a better fit with such a diverse group of individuals. However, to establish and run successful businesses, young people require assistance with training, access to credit and office facilities, as well as support and advice. For instance, Uganda's Youth Opportunities Programme was introduced in 2006 to raise incomes and employment among vulnerable young people aged 16 to 35 in the country's northern region.⁴² To qualify, young adults had to organize themselves into groups of 10 to 30 people in order to receive the training and then submit a proposal (either in groups or individually) for a grant to cover training programmes and the tools and materials they required to run a business. An evaluation carried out between mid-2010 and mid-2011 (approximately 12 to 18 months after most groups had finalized their training programmes) showed that young adults who applied for the programme were more likely to be undertaking some kind of skilled activity (68 per cent) than those who did not qualify for the grant (34 per cent). Moreover, on average, grant recipients had 50 per cent higher net incomes than those who did not receive the grant and had also amassed more savings (World Bank, 2011a).

- *Promote cohesion between adults and youth:* It is important to remember that youth and adults are not mutual substitutes in the labour market, and the promotion (or discouragement) of one is not to the detriment (or benefit) of the other. All too often, it is wrongly assumed that early retirement will open up positions for youth – which has had the unfortunate effect of creating an adversarial relationship between the two groups. Both young and adult workers are central to a productive and efficient labour market. Moreover, mentoring can be a powerful resource for nourishing the entrepreneurial spirit of young people. One example of this kind of mentorship programme is the Shell LiveWIRE initiative in Nigeria. Shell LiveWIRE is a social investment programme created in 2003 that aims to empower young Nigerians in enterprise development and management. The project provides skills training as well as grants and mentoring assistance to enable beneficiaries to set up micro-enterprises. By 2008, over 2,000 young people had received training, while 260 had gone on to start their own business (ILO, 2007). Of course, mentoring of this kind

⁴² More than one-quarter had not completed primary education, more than two-fifths did not have an income or employment and more than half reported having weekly revenues of around US\$4, which is below the international poverty line of US\$1.25 per day.

can be envisioned elsewhere and greater contact and interaction between younger and more experienced workers can help to instil good workplace practices.

Finally, success will be possible only if a coherent and tripartite strategy to leverage the above complementarities is undertaken.

An integrated employment policy plan is needed to create opportunities for young people while at the same time reducing poverty and allowing youth to be part of the economic and social development of the country. Engaging in social dialogue with relevant stakeholders when pursuing policy initiatives for youth is also imperative to ensure that the complementarities between demand- and supply-side initiatives are leveraged. Indeed, social dialogue with relevant stakeholders can help to bridge information asymmetries between the Government, employers and youth and promote strategic partnerships aimed at achieving longer term sustainable outcomes. Some areas and examples that Kenya could draw on in the future are detailed below:

- *Building public–private partnerships.* Employers’ organizations and the private sector in general are key partners of institutions in charge of employment. Fostering collaboration is essential, not only to facilitate the integration of partners’ needs into national employment policies but also to allow private partners to integrate into the budgeting and planning aspects of employment strategies. Moreover, these kinds of public–private partnerships play a crucial role in the planning of training policies. Indeed, thanks to communication and dialogue with the private sector, public training providers are able to improve the relevance and quality of training, match the skills needed by employers with existing skills of workers, etc. With this in mind, some countries have created a system of sector bodies.⁴³ South Africa, for example, instituted a statutory levy in April 2000 to be invested in training and development as part of the Government’s skills strategy. The levy was set at 1 per cent of the wage bill and collected monthly through taxation by the South Africa Revenue Service. The money has been used to establish a nation-

⁴³ The term “sector body” refers to an organization whose mandate is to promote skills development in a specific economic sector, and to ensure that training in that sector meets the needs of employers as well as any Government objectives (City & Guilds Centre for Skills Development, 2008).

al network of Sector Education and Training Authorities (SETAs) and encourage employers to develop workplace skills plans and to invest in skills (Raddon and Sung, 2006). Currently, there are 23 SETAs and their funding depends on the size of the sector and the levy paid.

- *Partnerships with international organizations:* The ILO's Youth Employment Programme (YEP) follows an integrated approach that combines macroeconomic policies and targeted measures, addressing labour demand and supply, as well as the quantity and quality of employment. The ILO YEP provides assistance to countries in developing consistent and coordinated policies and programmes on youth employment. The specific functions of the ILO YEP include the establishment of strategic partnerships on youth employment through the promotion of cross-country and global peer networks, inter-agency cooperation across the United Nations and other international agencies, and collaboration between the private and public sectors at the international, regional and national levels. The YEP's work informs and shapes the ILO's contribution to the Youth Employment Network (YEN) – a global partnership forged by the ILO, the United Nations and the World Bank to find new, durable policy and programme solutions to the youth employment challenge. The YEN provides a global platform for prioritizing youth employment on development agendas and exchanging information on policies and programmes to improve employment opportunities for youth. The Network includes development agencies, governments, the private sector, youth groups and other NGOs. The Kenyan Government and the ILO YEN have been working together to create youth programmes. In 2010, for example, the ILO YEN launched the Youth-to-Youth Fund in Kenya. The Youth-to-Youth Fund is a competitive grant scheme targeting youth-led organizations, providing them with both funding and capacity building. The first call for proposals was launched in July 2010 and resulted in 156 applications, out of which ten organizations were selected to receive the Fund grant package to implement their entrepreneurship development projects.
- *Promote youth engagement in the process:* Youths themselves are crucial stakeholders in the discussion, creation and implementation of youth employment policies and programmes. Youths have a different perspec-

tive on the realities of the youth labour market and, therefore, have significant insights to offer to policy-makers. In Kenya, an effort was made to accommodate these contributions via the Yes Youth Can programme, but with limited success (see Appendix A). To build on Kenya's own experience, a number of international examples exist from which further lessons could be drawn. For example, the National Action Plan for Youth Employment in Sri Lanka involved youth throughout the country by including the Sri Lanka Youth Parliament (SLYP) in the design and running of the consultative process. The SLYP comprised 225 delegates between the ages of 16 and 25 from all districts and ethnic and religious backgrounds. The SLYP was responsible for creating a platform for young leaders in Sri Lanka to voice their concerns and documenting discussions and, in this specific case, to obtain feedback from young people across the country on the National Action Plan. As a result of these consultations, concrete inputs were achieved, such as the recommendation of 15 amendments that were taken into account in the final draft of the National Action Plan (UNDESA, 2011b and ILO, 2008).

- *Improved coordination:* There is a need to promote better coordination among the various youth-centred programmes and policies, both public and private, in order to avoid duplication of efforts and to reach more youth. This is one of the main criticisms of the MOYAS, which is believed to lack a strategy on how to collaborate successfully with other institutions on the implementation of youth-related programmes and projects housed in other ministries (UNICEF and IEA-Kenya, 2012).
- *Introduce effective programme evaluation:* The ability of policy-makers to improve the effectiveness of existing (and new) programmes is highly dependent on an accurate evaluation framework. Generally, however, little is known about the effectiveness of the existing package of measures. First, there is a need to gather and monitor pre- and post-programme information and results. As far as possible, a vast range of information should be gathered: cost, employment status, earnings, demographic information, education level, etc. Second, it is critical to continue to monitor participants over longer periods. Given that, in many cases, the benefits of programmes, in particular training for youth, accrue over

time, monitoring participants and outcomes beyond programme exit (for between 3 and 5 years) should be part of any monitoring and evaluation strategy. Finally, the Government needs to establish at the outset, clear and measurable objectives with respect to expected outcomes for both the short and long term.

APPENDIX A

REVIEW OF EXISTING PROGRAMMES FOR YOUTH

Economic recovery strategy for wealth and employment creation

In 2003, Kenya developed the Economic Recovery Strategy for Wealth and Employment Creation (ERS). This Strategy set forth the country's vision for human development for the period 2003 to 2007 through the action of different ministries and government departments working in unison. It aimed to stimulate economic growth, reduce poverty and promote human development, as well as setting targets consistent with the Millennium Development Goals (MDGs) (Republic of Kenya, 2003). To address these objectives, the programme focused on ensuring universal primary education, improving access to basic health care, expanding productive capacity in agriculture – through the development of the country's arid and semi-arid lands – and upgrading the living conditions of the urban poor.

One of the most popular measures included in the ERS – due to its large impact – was the Free Primary Education programme (FPE) put forth in January 2003. The programme was created specifically to achieve 100 per cent net primary school enrolment by 2005, and was relatively successful. Indeed, following the implementation of FPE in Kenya, enrolment in government primary schools increased dramatically – the net primary school enrolment rate increased by more than 10 percentage points over the past decade, from 84.8 per cent in 2000 to 95.7 per cent in 2011. In addition to the FPE programme, the Kenyan Government introduced the Free Day Secondary Education (FDSE) programme in 2008 to support students in the transition from primary to secondary education. As a result, the transition rate from primary to secondary education rose in Kenya from 42 to 72 per cent between 2003 and 2011.

Although the FPE and FDS programmes opened up opportunities for children and youth who had never previously enrolled in school or had

dropped out because their families could not afford the costs, the significant challenges that emerged from the elimination of school fees were not always adequately addressed. For example, the sharp increase in the number of children at school, combined with inadequate basic facilities, such as classrooms, books and equipment, produced overcrowding and reduced the quality of education by adversely affecting teacher–pupil ratios – the primary teacher–student ratio fell from 1:40 in 2003 to 1:57 in 2011. Moreover, with primary education becoming universal, school-to-work transition became a crucial, but unaddressed, challenge.

Programmes directly under the Ministry of Youth Affairs and Sports (MOYAS)

MOYAS was established in December 2005⁴⁴ to address youth concerns in Kenya. The core functions of this ministry include: (i) formulating, implementing, coordinating, reviewing and monitoring youth development policies; (ii) facilitating youth participation in the development processes; (iii) coordinating and monitoring youth-led initiatives; (iv) advocating and promoting youth-led initiatives; (v) developing youth resource centres; and (vi) facilitating leadership, entrepreneurship and life skills training. The ministry's functions are executed through five departments: General Administration and Planning, Youth Development, National Youth Service, Youth Training, and Sports.

The ministry is responsible for the National Youth Policy, as well as the National Youth Council – created to manage the youth-led initiatives included in the National Youth Policy. The ministry also oversees Youth Development Programmes (such as the Youth Employment Marshall Plan and the Kenya Youth Empowerment Programme), the Youth Enterprise Development Fund and the Technical, Industrial, Vocational, Education and Training component of the different development programmes (in particular, Youth Polytechnics).⁴⁵ In addition, the ministry is also responsible for the National Youth Service and Youth Resource Centres.

⁴⁴ Initially, MOYAS was established purely as a ministry for youth affairs. In May 2008, the Department of Sports, which was then included in the Ministry of Gender, Sports, Culture and Social Services, was transferred to the Ministry of State for Youth Affairs, creating the Ministry of Youth Affairs and Sports.

⁴⁵ Youth Polytechnics are alternative Kenyan colleges (tertiary education institutions), which provide both academic education and accredited vocational training courses.

In 2010, a programme created in 2008 – the Youth Employment Marshall Plan – was replaced by the Kenya Youth Empowerment Programme (KYEP). Of the three components of the Marshall Plan – KaziKwaVijana, Youth Enterprise Development Fund (YEDF) and Technical Vocational Education and Training (TVET) – the KYEP absorbed only the first. The other two were transferred to the MOYAS and remain active today.

- *Youth Enterprise Development Fund (YEDF)*: The fund was created to enhance youth participation in socio-economic development through the provision of credit to young entrepreneurs. YEDF was launched as a revolving fund – based on public–private partnerships. Loans are offered with annual interest rates ranging from 5 to 8 per cent, with a repayment period ranging from 6 months to 6 years. The loan sizes range from KSh 50,000 (US\$530) to KSh 2 million (US\$21,276). The fund disburses loans through: (i) the Constituency Youth Enterprise Scheme (C-YES); (ii) the Enhanced Youth Enterprise Scheme; and (iii) private financial intermediaries working as partners with the Fund to ensure continued financing.⁴⁶ As at June 2012, YEDF had disbursed KSh 6.5 billion (US\$77,380) to over 171,000 youth enterprises.
- *Technical Vocational Education and Training (TVET)*: This TVET component (partly funded by the African Development Bank) aims to empower youth through the provision of accessible, appropriate and high-quality training in technical, vocational and entrepreneurial skills. The TVET can claim a number of achievements: (i) KSh 890 million were spent in the financial year 2010–11 to subsidize tuition for trainees registered in public Youth Polytechnics and to recruit 2,000 additional instructors; (ii) the curriculum for Youth Polytechnics was reviewed to ensure that it matched labour market needs; (iii) there was a clear improvement of the physical facilities and an increase in the provision of equipment and tools to Youth Polytechnics; (iv) 3,500 young people were trained in entrepreneurial activities in 150 different districts countrywide.

⁴⁶ The fund provides both short- and long-term loans to these intermediaries at a 1 per cent interest rate. The intermediaries in turn lend to the youth at an 8 per cent interest rate. The 7 per cent difference is used to cover administrative costs and to mitigate losses that might arise from lending to a clientele perceived as risky.

Kenya National Youth Policy

The Kenya National Youth Policy (KNYP) was adopted by Parliament in 2007 as a legislative framework to enhance youth participation in national development. This was carried out through the selection of a number of priority target groups, such as youth with disability, street youth, youth infected with HIV/AIDS, female youth, unemployed youth and out-of-school youth (Republic of Kenya, 2007). Moreover, strategic areas for action (education and training, employment creation, empowerment and participation, health, the environment, art and culture, ICT and the media and, finally, sports and recreation) are defined through this policy. At present, the employment creation strategy includes the following objectives: (i) identifying those public and private youth programmes which are efficiently addressing the youth employment crisis; (ii) facilitating the establishment of high-level resource centres where youth can access information, training and technical support on income-generating activities; (iii) promoting programmes from the private sector, Community Service Organizations and the Government to provide youth with necessary skills and financial assistance (through microfinance credit facilities) and allocating funds specifically for young entrepreneurs; and (iv) encouraging companies to offer mentorship, apprenticeship and internship programmes to young people in order to provide them with labour experience.

The establishment of the KNYP was accompanied by the creation of a National Youth Council, launched within the Ministry of Youth and Sports. The Council was created to facilitate, coordinate, manage and promote youth issues and youth-led initiatives. The full implementation of this policy required KSh 91 million for the period 2007–2011 (KSh 18 million per year). The largest share of the total budget was allocated to education and training, with 61.4 per cent of the total policy budget, while employment creation accounted for 21.9 per cent. Empowerment and participation accounted for 11 per cent; health for 4.4 per cent and the rest of the strategic areas taken together (namely, environment, art and culture, ICT and the media, and sports and recreation) for 1.3 per cent.

Kenya Youth Empowerment Programme

In 2010, the Government of Kenya joined forces with the World Bank to create the Kenya Youth Empowerment Programme (KYEP). The KYEP is a World Bank funded project, which supports efforts made by the Government of Kenya to increase access to youth-targeted temporary employment programmes and to improve youth employability (World Bank, 2010). The KYEP aims to provide disadvantaged unemployed youth with opportunities to obtain training, apprenticeships and short-term jobs with a view to increasing their employability in the medium and long term. The KYEP replaced the Youth Employment Marshall Plan that was created in 2008. Of the three components of the Marshall Plan (see above) the KYEP absorbed only the first (KaziKwaVijana). The other two of its original components, the YEDF and the TVET are still active and managed by the MOYAS.

The KYEP has three main components:

- *Labour-intensive works and social services:* This component enhances and improves the performance of the KaziKwaVijana (KKV) by providing technical assistance and additional funds to the programme. The KKV programme was launched in 2009 under the Youth Employment Marshall Plan with the objective of generating between 200,000 and 300,000 short-term employment opportunities for unskilled youth through labour-intensive public works projects. The young people employed in the KKV programmes are engaged in manual-based small projects in their own communities. Moreover, under the KKV programme, the Ministry of Youth Affairs and Sports developed the Trees-for-Jobs Initiative which aimed to address the deforestation of the country by planting 90 million seedlings per year to increase Kenya's forest coverage to a total of 4 per cent by 2012. This initiative has created many employment opportunities for unemployed youth, with over 19,000 youths hired in its first 2 years and has enabled a large number of young Kenyans from both urban and rural areas to gain their first job experience. However, the programme did not include a training and capacity-building component to facilitate the transition from short-term to longer term employment for participants.

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- *Private sector internships and training:* This element is carried out by the Kenya Private Sector Alliance (KEPSA), a business membership institution created in 2003. KEPSA's main role is to interface with the Government on behalf of the private sector on cross-cutting issues such as youth employment. KEPSA serves as a platform that aims to benefit 11,000 youths over the next 4 years through internship placement in the private sector. The project plans to provide approximately 900 internships in Nairobi, 400 in Mombasa, and 135 in Kisumu per cycle, with eight cycles in total. Youth aged 15 to 29 who have been out of school for at least a year, are not currently working and who have a minimum of 8 years of schooling are eligible to participate. Formal sector internships will be limited to those over 18 years of age, since this is the minimum working age in Kenya, while youths between the ages of 15 and 18 are eligible for work in the informal sector. The share of interns with some level of tertiary education is capped at 40 per cent. KEPSA pays the participants a monthly stipend of KSh 6,000 and focuses on placements within industries that are considered to be the main growth sectors according to Kenya Vision 2030 (namely energy, finance, tourism, manufacturing and micro- and small enterprises).
 - *Capacity building and policy development:* The main objective is to enhance the capacity of the MOYAS to implement the National Youth Policy and increase the institutional capacity for youth policy planning. To achieve this, a training programme was implemented for MOYAS staff and other government workers, while a number of social audits were put in place to improve transparency and accountability in the implementation of the other two components of the project.

In June 2011, the World Bank carried out a financial management review of the KYEP. The review illustrated, in terms of objectives met, that the KYEP had approved 406 public works and had provided life skills training for a total of 1,057 interns, of which 916 were subsequently selected for work placements. However, it also identified a number of irregularities in the financial management of the labour-intensive works and social services component. As a result, the overall programme was restructured and the labour-intensive works and social services component was removed. The funds were reallocated to other activities of the World Bank Kenya portfolio (Wiseman, 2011).

Kenya Vision 2030

Kenya Vision 2030 is the new development plan covering the period 2008–2030. It replaced the ERS and aims to improve the quality of life of all Kenyan citizens (from an economic, social and political perspective). The initiative seeks to achieve its goal through economic, social and political projects and is divided into 5-year medium-term plans with the first one finishing in 2012. The next leg of the process is expected to take place between 2013 and 2017. Youth objectives within the overall plan are addressed through the implementation of public programmes: (i) to improve practical skills training and identify specific barriers to youth employment; (ii) to implement policy reforms that help to widen opportunities for youth employment; (iii) to rehabilitate or build one youth empowerment centre in each constituency; (iv) to increase allocations to the Youth Enterprise Development Fund (YEDF) and ensure the efficient and productive use of funds allocated to youth groups (Republic of Kenya, 2011).

Youth Employment for Sustainable Development (YESD) Project

In 2012, the International Labour Organization, the Government of Kenya and the Government of Japan jointly launched the YESD Project as an initiative to create job opportunities for youth through the rehabilitation and maintenance of roads (ILO, 2012). The project aims to target at least 2,500 youths in the first 9 months and is funded by Japan with a budget of KSh 136 million. The implementation of the project is carried out by the Ministry of Youth Affairs and Sports via the platform of Youth Polytechnics. The partnership has identified four main areas of interest: (i) development of youth-owned small and medium-sized enterprises (SMEs) – the project intends to provide incentives for business creation, by agreeing to contract their businesses to pave and maintain certain roads; (ii) mainstreaming cobblestone⁴⁷ and “Do-nou”⁴⁸ technologies to strengthen training capacity; (iii) development of green jobs by employing youths in the clean technology sector and investing in research relating to environmental sustainability; and (iv) strengthening programme monitoring and evaluation.

⁴⁷ Refers to cobblestone paving technology, which is a new technology in Kenya that has vast potential in improving urban and rural infrastructure.

⁴⁸ The Japanese term “Do-nou” refers to sealed sacks that are filled with soil, sand or gravel. These sacks can then be used to fill pot holes in roads, raise embankments to prevent floods, reinforce structures, etc.

Yes Youth Can

Yes Youth Can is a nationwide project that aims to empower youths through direct engagement in civic and social efforts in over 15,000 communities (USAID, 2011). Organized and led by youths themselves, the programme gained financial support from the United States Agency for International Development (USAID) in 2011. Specific initiatives seek to: (i) support quick-impact projects to promote youth voices on national issues, particularly the reform process, through independent grass-roots organizations and activities; (ii) build new skills in youth leadership and entrepreneurship; (iii) establish a youth-led fund that promotes economic opportunities in their own communities and fosters an environment conducive to youth enterprises, and; (iv) expand youth networks to encourage collaboration and leverage resources. To achieve these goals, USAID has commissioned the local organization Inunya Kenya Trust⁴⁹ to facilitate the funding and implementation of programme activities. Despite its ambitious goal, heavy criticism and public accusations of corruption have surfaced amid the lack of transparency in the practices of the Trust's management. As a result, significant benefits have yet to be realized. Intense discontent with the programme has led to violence, including an assault on the fund controller during an organizational event.

⁴⁹ Inunya Kenya Trust is a grass-roots advocacy group dedicated to inspiring youths to improve their own lives by promoting Heshima (dignity and respect for others), Diversity (inclusiveness and equality) and Self-Belief. It connects local businesses and youths with external support agents to help execute the strategic goals of both parties. Ironically, widespread suspicion of Inunya CEO John Githongo's involvement in donation embezzlement has marred the reputation of the group.

APPENDIX B

ANALYSIS OF THE DETERMINANTS OF EMPLOYMENT STATUS OF YOUTH

Section C of this chapter, discussed the implications of the different determinants of youth's status in employment. This discussion is the result of a microeconomic analysis carried out to shed light on the individual characteristics that influence youth's probability of finding employment and the factors that explain the gap in employment status between adults and youth. The aim of this appendix is to describe how the model was constructed and present the detailed results of the exercise.

In order to shed light on the individual causes of youth unemployment in Kenya, this analysis investigates the microeconomic determinants of the employment status of young individuals. The aim of the exercise is to explore the main variables that influence the probability of youth of being unemployed, employed, self-employed or in inactivity. Establishing the individual characteristics that could increase the probability of young Kenyans finding a job is a decisive step towards identifying potential policies to address youth labour market challenges.

The analysis draws on a microeconomic model based on the Kenya Integrated Household Budget Survey (KIHBS) 2005/06 conducted by the Kenya National Bureau of Statistics. Data collection for the KIHBS 2005/06 was undertaken during a period of 12 months starting on 16 May 2005. The survey was conducted in 1,343 randomly selected clusters across all districts in Kenya, comprising 861 rural and 482 urban clusters. The database contains information for 13,430 households and 66,709 household members (Kenya National Bureau of Statistics, 2007). For the purpose of this report, the analysis focuses on individuals aged 15 or more for which information on employment status is available. Thus, the selected sample consists of 36,047 individuals, of which 13,996 (38.8 per cent) are youths aged 15 to 24; 8,272 (22.9 per cent) are young people aged 25 to 34 and 13,780 (38.2 per cent) are adults aged 35 or more.

The model estimated

To analyse the determinants of youth status in employment, a multinomial probit model has been estimated, with a four-level dependent variable adopting the values of: 1, if the individual declares that they have been in inactivity during the reference period; 2, if the individual declares that they have been unemployed; 3, if the individual was an employee; and 4, if they were self-employed. The probit model makes it possible to estimate how the characteristics of individuals influence the probability of belonging to any of these four categories.

The equation estimated can be described as follows:

$$Y_i^* = X_i \beta' + \mathcal{E}_i$$

where, Y_i^* is the unobserved latent variable, X_i is a vector of the individuals' characteristics, β is the vector of coefficients to be estimated and \mathcal{E}_i is a random error. Following this equation, if the status in employment is indexed by $k(k=1,2,3,4)$, the probability that an individual i with a vector of characteristics X_i is assigned to employment status j is:

$$P(y_i = j) = \frac{\exp(X_{ij} \beta_j)}{\sum_k \exp(X_{ik} \beta_{jk})}$$

where β_k is a vector of coefficients corresponding to the k_{th} employment status.

Although, the estimated coefficients of β already indicate whether an explanatory variable has a positive or negative impact on the dependent variable, it is much easier to interpret the model using the marginal effects. The marginal effect of each of the independent variables on each of the categories can be computed as follows (Cameron and Trivedi, 2009):

$$\frac{(\partial P_{ij})}{(\partial X_{ik})} = P_{ij} \left(\beta_{jk} - \sum_{m=1}^{J-1} P_{im} \beta_{mk} \right), j = 1, \dots, m-1$$

The estimation of the model included the following explanatory variables organized by categories:

- Personal characteristics of individuals included information on the sex of the individual, age (divided into three groups as explained above) and location (rural or urban). A more detailed description of the variables included in the estimation is presented in table B3.1.
- Variables linked to the individuals' family background are introduced to control for the fact that family responsibilities can influence the decision to enter the labour force. This category included, as independent variables, marital status, the presence of the spouse or partner in the household and the presence of children under 15 years of age.
- Variables related to human capital endowment are also included, as follows: four dummies for the level of education attained (no education, primary schooling, secondary schooling and university degree); a dummy variable indicating whether or not the individual has completed vocational training; a dummy variable indicating if the individual is still attending school; and a variable to show whether the individual can read or write in another language.
- Finally, three dummy variables linked to employment status of the other members in the household are introduced: (i) the presence in the household of unemployed family members other than the individual, since additional economic responsibilities can influence the individual's decision to enter the labour force; (ii) presence of waged employees, since they could act as informants about labour opportunities; (ii) the presence of self-employed members of the household, since this can increase the probability of self-employment when setting up a family business (Mlatsheni and Rospabé, 2002).

Table B3.1 Definitions of variables used in the regression analysis

Variable	Definition
Dependent:	
Employment status	= 1 if inactive; = 2 if unemployed; = 3 if waged employee; = 4 if self-employed
Independent:	
Sex	= dummy variable: male, female
Age	= dummy variable: 15–24, 25–34, 35 or more
Location	= dummy variable: urban, rural
Marital status	= 1 if married
Living with a partner	= 1 if the spouse/partner currently lives in the household
Children	= 1 if there are children aged 15 or under in the household
No education	= 1 if the individual has not completed any level of schooling
Primary education	= 1 if the highest educational attainment of the individual is primary school
Secondary education	= 1 if the highest educational attainment of the individual is secondary school
University education	= 1 if the highest educational attainment of the individual is university
Vocational training	= 1 if the individual has completed vocational training
School attending	= 1 if the individual is currently attending school
Language	= 1 if the individual can read or write in another language
Other unemployed in the household	= 1 if members of the household are unemployed
Other employee in the household	= 1 if members of the household are employees
Other self-employed in the household	= 1 if members of the household are self-employed

The results

In order to estimate the impact of the individuals' age on their employment status, the variable age is included as an independent variable in the regression for the whole sample. However, with the aim of capturing the difference between youths and adults in terms of individual characteristics, the model is estimated separately for youths aged 15 to 24, young people aged 25 to 34 and for adults aged 35 or more. The results of the estimation of the probit model for the complete sample are summarized in table B3.2 and the outcomes of the regression by age group in table B3.3 and table B3.4. The estimation is statistically significant, with an acceptable goodness of fit, and most coefficients are highly significant. Moreover, the signs of the variables and the values of the marginal effects follow expected patterns. For a more detailed explanation of the microeconomic interpretations of these results, please refer to the body of section C.⁵⁰

⁵⁰ See also Escudero and López (2013, forthcoming).

Table B3.2 Regression results for the whole sample

		Inactive	Unemployed	Employed	Self-employed
Sex (ref. woman)	Man	-0.280 (39.9)**	0.024 (13.3)**	0.250 (38.9)**	0.006 (1.5)
Age (ref. adult)	Youth 15–24	0.224 (23.4)**	0.081 (4.1)**	-0.121 (13.3)**	-0.112 (19.5)**
	Young person 25–34	0.029 (3.2)**	0.001 (5.7)**	-0.018 (2.2)*	-0.024 (6.3)**
Location (ref. rural)	Urban	0.088 (11.4)**	0.007 (4.5)**	-0.054 (7.9)**	-0.041 (10.7)**
Married		-0.063 (4.2)**	-0.021 (5.7)**	0.063 (4.9)**	0.021 (2.9)**
Living with a partner		0.116 (8.1)**	-0.001 (0.4)	-0.135 (11.3)**	0.021 (3.1)**
Children		0.064 (5.1)**	0.003 (1.9)*	0.013 (1.1)	-0.074 (11.6)**
Educational attainment (ref. no education)	Primary education	-0.279 (17.7)**	0.004 (1.4)	0.250 (16.8)**	0.025 (3.2)**
	Secondary education	-0.297 (20.6)**	0.009 (2.3)*	0.298 (19.2)**	-0.010 (1.3)
	University education	-0.338 (23.2)**	0.003 (0.5)	0.439 (25.7)**	-0.104 (15.0)**
Vocational training		-0.094 (8.5)**	-0.000 (0.0)	0.118 (12.3)**	-0.024 (4.8)**
School attendance		0.634 (121.0)**	-0.031 (24.7)**	-0.407 (78.9)**	-0.196 (54.1)**
Foreign language		-0.106 (7.8)**	0.005 (2.2)*	0.082 (6.5)**	0.019 (3.2)**
Other unemployed in the household		0.148 (8.5)**	0.101 (10.4)**	-0.157 (10.6)**	-0.092 (12.5)**
Other employees in the household		-0.016 (1.9)*	-0.003 (2.2)*	0.153 (19.7)**	-0.134 (27.1)**
Other self-employed in the household		-0.014 (1.7)*	0.001 (0.8)	-0.042 (5.5)**	0.055 (10.4)**

Notes: Absolute value of z-statistics in parentheses.

Significance levels:

* significant at 5 per cent;

** significant at 1 per cent.

Table B3.3 Regression results for youth (15–24) and young persons (25–34)

		Youth (15–24)				Young persons (25–34)			
		Inactive	Unemployed	Employed	Self-employed	Inactive	Unemployed	Employed	Self-employed
Sex (ref. woman)	Man	-0.211 (22.9)**	0.016 (7.0)**	0.179 (20.4)**	0.016 (7.6)**	-0.257 (24.2)**	0.033 (7.8)**	0.260 (20.7)**	-0.036 (3.3)**
Location (ref. rural)	Urban	0.080 (9.4)**	0.003 (2.1)*	-0.078 (9.8)**	-0.006 (3.5)**	0.045 (3.9)**	0.011 (2.7)**	-0.022 (1.7)*	-0.034 (3.1)**
Married		-0.003 (0.1)	-0.008 (2.9)**	-0.014 (0.6)	0.025 (3.3)**	-0.040 (1.8)*	-0.038 (3.6)**	0.015 (0.6)	0.063 (3.2)**
Living with a partner		0.086 (3.8)**	-0.001 (0.2)	-0.081 (3.9)**	-0.004 (1.2)	0.071 (3.6)**	-0.015 (1.9)*	-0.119 (5.5)**	0.062 (3.5)**
Children		-0.019 (1.6)	0.001 (0.4)	0.029 (2.6)*	-0.010 (5.3)**	0.018 (0.8)	-0.009 (1.8)*	-0.086 (3.0)**	-0.095 (4.2)**
Educational attainment (ref. no education)	Primary education	-0.177 (7.9)**	0.006 (1.8)*	0.162 (7.6)**	0.009 (2.7)**	-0.175 (7.0)**	0.001 (0.1)	0.166 (4.8)**	0.008 (0.3)
	Secondary education	-0.191 (6.0)**	0.015 (2.4)*	0.174 (5.6)**	0.002 (0.5)	-0.192 (9.2)**	0.003 (0.3)	0.217 (6.3)**	-0.028 (1.0)
	University education	-0.312 (4.3)**	0.076 (1.6)	0.240 (3.1)**	-0.003 (0.2)	-0.156 (9.2)**	0.012 (0.7)	0.364 (12.2)**	-0.221 (13.1)**
Vocational training		-0.085 (4.7)**	0.003 (1.6)	0.077 (4.5)**	0.005 (1.6)	-0.050 (3.7)**	0.005 (1.3)	0.094 (6.1)**	-0.050 (3.8)**
School attendance		0.583 (76.9)**	-0.060 (17.9)**	-0.445 (58.7)**	-0.078 (19.6)**	0.601 (20.2)**	-0.029 (11.3)**	-0.371 (16.1)**	-0.201 (10.5)**
Foreign language		-0.038 (2.1)*	0.006 (3.2)**	0.032 (1.9)*	-0.000 (0.1)	-0.128 (5.1)**	0.009 (1.4)	0.099 (3.4)**	0.020 (0.9)
Other unemployed in the household		0.069 (4.8)**	0.044 (5.9)**	-0.099 (8.8)**	-0.014 (6.2)**	0.087 (2.7)**	0.213 (6.7)**	-0.135 (3.7)**	-0.164 (7.5)**
Other employees in the household		-0.072 (7.8)**	-0.003 (2.2)*	0.101 (12.3)**	-0.027 (8.2)**	0.064 (5.2)**	-0.001 (0.3)	0.145 (10.0)**	-0.208 (19.4)**
Other self-employed in the household		-0.033 (3.6)**	0.001 (0.5)	0.115 (1.8)*	0.018 (7.3)**	0.054 (4.1)**	0.009 (2.0)*	0.135 (9.0)**	0.073 (5.3)**

Notes: Absolute value of z-statistics in parentheses.

Significance levels:

* significant at 5 per cent;

** significant at 1 per cent.

Table B3.4 Regression results for adults

		Adult (35 or more)			
		Inactive	Unemployed	Employed	Self-employed
Sex (ref. woman)	Man	-0.154 (15.0)**	0.014 (6.7)**	0.171 (15.2)**	-0.031 (2.9)**
Location (ref. rural)	Urban	0.082 (7.8)**	0.007 (3.3)**	0.009 (0.8)	-0.098 (9.8)**
Married		-0.055 (3.4)**	-0.009 (2.1)*	0.091 (5.7)**	-0.026 (1.6)
Living with a partner		0.069 (5.0)**	0.003 (1.3)	-0.129 (8.5)**	0.058 (4.0)**
Children		0.296 (10.3)**	-0.006 (2.9)**	-0.012 (4.3)**	-0.177 (8.2)**
Educational attainment (ref. no education)	Primary education	-0.164 (10.7)**	-0.001 (0.3)	0.085 (9.3)**	-0.020 (1.1)
	Secondary education	-0.186 (15.3)**	-0.004 (2.1)*	0.069 (13.5)**	-0.079 (4.5)**
	University education	-0.169 (11.3)**	-0.014 (12.1)**	0.023 (17.0)**	0.240 (12.1)**
Vocational training		-0.015 (1.1)	-0.005 (2.1)*	0.109 (8.6)**	-0.089 (6.8)**
School attendance		0.155 (2.5)*	-0.002 (0.2)	0.119 (2.0)*	-0.272 (8.6)**
Foreign language		-0.084 (6.0)**	-0.003 (1.2)	0.049 (3.1)**	0.037 (2.6)**
Other unemployed in the household		0.258 (5.2)**	0.097 (3.5)**	-0.178 (4.2)**	-0.176 (5.0)**
Other employees in the household		-0.025 (2.1)*	-0.001 (0.4)	0.008 (17.3)**	-0.232 (22.7)**
Other self-employed in the household		-0.035 (2.9)**	-0.003 (1.0)	-0.074 (4.9)**	0.111 (7.5)**

Notes: Absolute value of z-statistics in parentheses.

Significance levels:

* significant at 5 per cent;

** significant at 1 per cent.

APPENDIX C

DETERMINANTS OF YOUTH LABOUR MARKET PERFORMANCE

Section C of this chapter analysed, among other things, the drivers of youth unemployment and inactivity (i.e. the proportion of youth that have fallen outside employment) from a macroeconomic point of view. The aim of this appendix is to explain how the model was constructed and present the detailed results of the exercise.

The objective of the analysis is to examine the determinants of youth labour market performance in Kenya during the past 20 years. From a macroeconomic point of view, the main determinants of the youth unemployment and inactivity rates are the aggregate demand and the size of the young labour force (i.e. the share of young people in their respective working-age population).⁵¹ Aggregate demand affects youth unemployment in the same way that it affects overall unemployment. A fall in aggregate demand will lead to a fall in the demand for labour in general and therefore for youth labour as well. Adult unemployment and employment rates are therefore commonly used as proxies of aggregate demand factors since they capture the overall effect. Likewise, the size of the youth cohort has a clear intuitive relationship with the youth status in employment: the higher the number of youth entering the labour market, the higher the number of jobs that will be needed to accommodate them.

In this context, the question for analysis is related to the size of the elasticity of youth not in employment – i.e. unemployed and inactive youth – with respect to changes in their cohort size and in aggregate demand. In other words, what is the relative importance of each of the factors specifically for Kenya? With a view to assessing this relative importance, an econometric

⁵¹ Relative cohort size and aggregate demand are not the only variables affecting youth non-employment rates. Institutional features of labour markets affecting their flexibility (in particular, wage setting) and the level of wages are likely to be important. In terms of labour market flexibility, centralized wage setting and other institutions and policies that make labour markets less flexible may make absorption of large youth cohorts more difficult and, therefore, the response of youth non-employment rates to changes in relative youth cohort sizes should be greater (Korenman and Neumark, 1997). In terms of wages, assuming that young and adult workers are close substitutes, the higher the wages of young workers, the higher the incentives of firms to hire their adult counterparts. Nevertheless, if young and adult workers are complementary – a more realistic assumption given that they respond to different skill requirements – then young workers' wages will have no effect on adult wages or on the number of young labourers hired (O'Higgins, 2001). The level of wages has not been included in this analysis as the relationship is not clear-cut in the literature.

analysis has been carried out to estimate the impact of aggregate demand and cohort size on the rate of Kenyan unemployed and inactive youth during the past 20 years.

The analysis draws on a time-series econometric model based on annual data for Kenya during the period 1990–2011. Labour market variables were gathered from ILO databases, demographic variables from UN Population Division databases and information on GDP from the World Economic Outlook database. A more detailed description of the variables and sources is presented in table C3.1.

Table C3.1 Definitions and sources of variables used in the regression analysis

Variable	Definition	Source
Rate of youth not in employment	Population aged 15 to 24 that is either unemployed or in inactivity, as a percentage of the total population aged 15 to 24	KILM database (ILO, 2012b)
Relative cohort size	Ratio of the population aged 15 to 24 over the population aged 25 or more	UN Population Division (UNDESA, 2011a)
Adult employment rate	Population aged 25 or more that is employed as a percentage of the total population aged 25 or more	KILM database (ILO, 2012b)
Adult unemployment rate	Population aged 25 or more that is unemployed as a percentage of the total labour force aged 25 or more	KILM database (ILO, 2012b)

The model estimated

Following Korenman and Neumark (1997), a model was estimated to assess the effects of labour demand and supply variables on the rate of youth not in employment. In its reduced form, the rate of youth not in employment depends on the adult unemployment and employment rates (which capture aggregate demand factors) and on the relative cohort size (which captures the demographic factor). In particular, the model is formulated as follows:

$$YNE_t = \beta_0 + \beta_1 RCS_t + \beta_2 AU_t + \beta_3 AE_t + \varepsilon_t$$

where YNE corresponds to the rate of youth not in employment (measured by the share of youth that are either unemployed or in inactivity in the total youth population); RCS corresponds to the relative cohort size (calculated as the ratio of the youth population over the adult population), AU corresponds to the adult unemployment rate and AE to the adult employment rate.⁵²

All the variables are included in natural logarithms and have been tested for non-stationarity through the augmented Dickey-Fuller and Phillips-Perron tests. In all cases, the tests rejected the null hypotheses of non-stationarity at 1, 5 and 10 per cent levels.

⁵² The impact of the relative cohort size on youth non-employment rate could also be affected by changes in school enrolment rates, since low employment-to-population ratio and low participation rate could be explained by high school enrolment. To take into account this possible effect, the model was estimated controlling for secondary and tertiary school enrolment; however, both variables yield non-significant results. Previous studies have found similar results, showing that the relative cohort size variable is largely unaffected by adding the youth enrolment rate as a control (Korenman and Neumark, 1997). Moreover, these results seem intuitively correct for the Kenyan case. Indeed, the statistical analysis carried out in this chapter shows that low employment-to-population ratios in the country do not seem to be explained by education since the tertiary school enrolment rate (which is the most direct substitute for youth employment) has remained persistently low, at 4 per cent in 2009.

The results

The model was estimated using ordinary least squares (OLS). The results of the exercise (estimated coefficients and levels of significance of variables) are presented in table C3.2. The first column reports OLS estimates controlling for possible heteroskedasticity using the robust option available. The second column reports OLS estimates adjusted for correlation of the error terms using the Newey-West procedure. A number of interesting results arise from the analysis.

The model shows that an increase in the youth working-age population relative to the adult one (relative youth cohort) is associated with an increase, albeit small, in the rate of youth not in employment. Indeed, the elasticity of the rate of youth not in employment with respect to its cohort size is around 0.12, which means that a 10 per cent increase in the relative size of the youth population will translate into a 1.2 per cent increase in the number of youth who are either unemployed or inactive. These results are consistent with those predicted by the cohort crowding hypothesis (Easterlin, 1961), although the estimated coefficient in this analysis is small in comparison with international standards – analyses carried out for the EU 15 and the OECD have found elasticities of the order of 0.5 (Korenman and Neumark, 1997) and 0.6 (O’Higgins, 2003), respectively. However, as already pointed out in the main document, the growth rate of young people of working age has fallen during the past 10 years in Kenya, putting less and less pressure on employment creation. Therefore, intuitively, it seems correct for other factors to have a higher relative importance in determining the share of youth out of employment than the relative cohort size. Indeed, the same analysis carried out for the purposes of this study illustrates that the elasticity of the rate of youth out of employment with respect to the adult employment rate – representing aggregate demand factors – is considerably higher – of the order of 2. In other words, although the size of the youth cohort does have significant implications for the status of youth in the labour market, aggregate labour market conditions have greater influence. Consistent with the above, the model shows that both variables capturing the influence of aggregate demand factors – the adult unemployment and employment rates – have a large and significant impact

on the rate of youth out of employment. The model illustrates that a 1 per cent increase in the adult unemployment rate would produce a 3.5 per cent increase in the rate of youth out of employment. On the other hand, a 1 per cent decrease in the adult employment rate would produce an increase in the rate of youth out of employment of the order of 2.8 per cent. In other words, it is not so much the number of young people entering the labour market as the insufficiency of job creation measures which is keeping young people out of employment in Kenya.

Table c3.2 Regression results

	Rate of youth not in employment (<i>lnYNE</i>)	
	OLS regression with robust standard errors	OLS regression with Newey-West standard errors
Relative cohort size (<i>lnRCS</i>)	0.115 (2.11)**	0.115 (1.78)*
Adult unemployment rate (<i>lnAU</i>)	3.523 (2.97)***	3.523 (2.95)***
Adult employment rate (<i>lnAE</i>)	-2.810 (-16.48)***	-2.810 (-14.86)***
Constant	9.134 (3.26)***	9.134 (3.15)***

Notes: All variables are controlled for non-stationarity. Absolute value of t-statistics in parentheses. R-squared: 98.1 per cent.

Significance levels:
* significant at 10 per cent;
** significant at 5 per cent;
*** significant at 1 per cent.

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CHAPTER 4

INFORMAL-SECTOR EMPLOYMENT: TRENDS AND POLICY IMPLICATIONS

INTRODUCTION⁵³

Despite some improvements achieved in the overall performance of the labour market, informal-sector employment remains a key labour market challenge in Kenya. In 2011, employment among informal-sector enterprises constituted 64 per cent of total employment with agricultural self-employed and workers engaged in small-scale agricultural activities (many of which are informal) accounting for an additional 21 per cent of total employment. Moreover, employment in informal-sector enterprises has continued to rise over the past two decades – increasing by approximately 5.1 million in the past 10 years alone – and outstripping the growth in formal sector employment over this period.

Although informal employment provides an important source of income for many individuals, the trend increase in informal-sector employment has had severe repercussions on workers and their families and has become a central determinant of poverty and income inequalities in Kenya. Section A of this chapter discusses the trends in informal-sector employment in Kenya, including sectoral composition and relevant international comparisons. Section B assesses the determinants of informal-sector employment based on a database comprised of 22 developing countries in order to better understand the persistent nature of informality in Kenya. Finally, the key policy challenges of informal-sector employment are discussed in section C. This last section also presents a number of country examples that could serve as a basis for action to improve outcomes related to informal employment in Kenya.

⁵³ The authors would like to thank Carolina Lennon for valuable guidance on section B of this chapter. Research assistance provided by Marcus Cheng is also gratefully acknowledged.

A INFORMAL-SECTOR EMPLOYMENT: TRENDS, COMPOSITION AND INTERNATIONAL COMPARISONS

Informal-sector employment in Kenya has increased dramatically over the past two decades ...

According to its international definition, informal employment comprises all informal jobs, regardless of whether they are located in formal- or informal-sector enterprises or in households (box 4.1). However, in this chapter, due to the limited availability of recent data, unless otherwise stated, informal employment refers only to employment in informal-sector enterprises⁵⁴ (or informal-sector employment) as defined by the Kenya Economic Survey's definition. It should be borne in mind that employment in the informal sector is only one subset of all informal employment and, as such, figures in this chapter are likely to underestimate total informal employment. For instance, some workers are employed in formal sector units, but without social security coverage or health benefits and should therefore technically be included in the informal employment group but are excluded in the case of Kenya.

Over the past two decades, the growth of informal-sector employment in Kenya has significantly outpaced that of formal-sector employment. In particular, the share of informal-sector employment has grown from approximately 13 per cent of total employment in 1991 to 64 per cent in 2011 (figure 4.1). In the past 10 years alone, informal-sector employment has grown by 5.1 million, while formal-sector employment has grown by 432,000. Moreover, if the agricultural self-employed and workers engaged in small-scale agricultural activities – the bulk of which could be considered informal⁵⁵ – are taken into account, total informal-sector employment would reach 85 per cent of total employment. The remaining 15 per cent comprises salaried employment in modern establishments⁵⁶ (i.e. in formal-sector enterprises).

⁵⁴ Defined by the Kenya National Bureau of Statistics as small-scale activities (with fewer than ten employees) that are semi-organized, unregulated and use basic technologies.

⁵⁵ Although they are not categorized as part of the informal sector in Kenya.

⁵⁶ The "modern sector" is defined by the Kenya National Bureau of Statistics as the entire public sector and private enterprises and institutions that are formal in terms of registration, taxation and official recording (incorporated enterprises).

According to the 15th International Conference of Labour Statisticians (ICLS), the informal sector is an enterprise-based concept. It includes all workers in economic units who work in informal-sector enterprises, either in unincorporated informal own-account enterprises, which are owned and operated by own-account workers and which may employ contributing family workers and employees on an occasional basis, or in unincorporated enterprises of informal employers which employ one or more employees on a continuous basis and which may be defined as having fewer than a specified number of workers and/or non-registration of the enterprise or its employees. Under the 1993 ICLS definition, individual countries can decide what size of unregistered units should be included in the informal sector and whether the agriculture sector and domestic workers should be included (Becker, 2004).

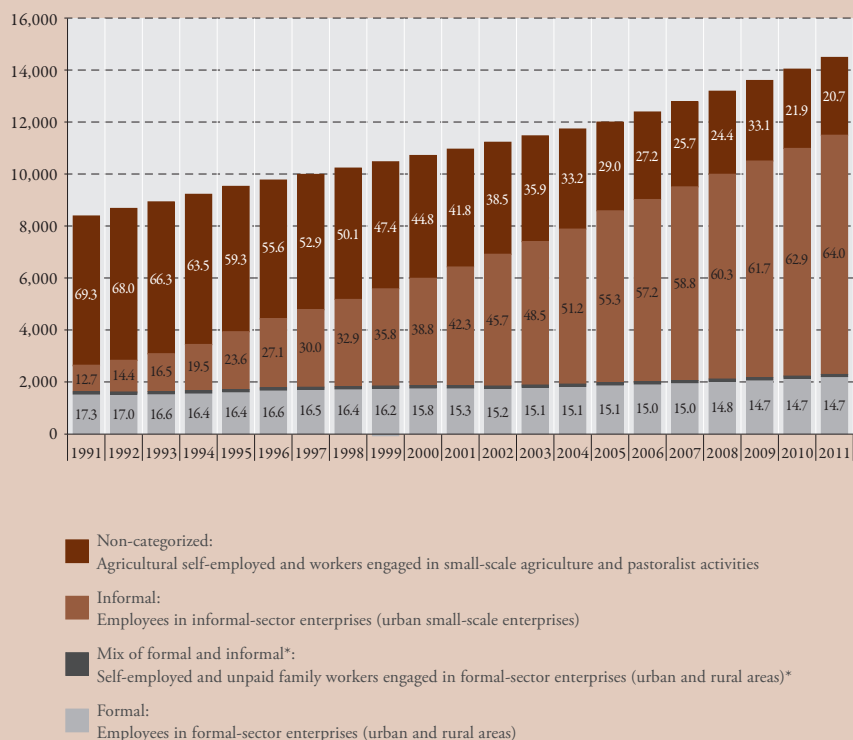
In addition to employment in the informal sector, there may be persons employed outside the informal sector who are not subject to national labour legislation, income taxation, social protection or entitlement to certain benefits. These are workers in situations of informality and it is important to identify them. The 17th International Conference of Labour Statisticians provided a definition of informal employment, which includes both employment in the informal sector and informal workers in the formal sector (whether employees or contributing family workers) as well as persons working in households, such as domestic employees and persons who produce goods for their own final use.

Source: ILO, 1993; ILO, 2004.

... driven mainly by the services sector and employment in rural areas ...

Regarding the sectoral distribution, important differences exist in terms of the weight of informal-sector employment. For instance, in the dominant sector – trade, restaurants and hotels – informal-sector employment accounts for 96 per cent (figure 4.2, panel A). In 2011, this sector accounted for just over 60 per cent of all informal-sector employment with a corresponding share of the growth in informal-sector employment (figure 4.2, panel B). In fact, with an annual average growth rate of 6.6 per cent between 2003 and 2011, the sector contributed 63 per cent of the total growth of employment in informal-sector enterprises. Similarly, only 10 per cent of agriculture and forestry employment corresponds to employees working in formal-sector enterprises with the remainder either self-employed or engaged in small-scale farming and pastoralist activities, most of which remain unregistered.

Figure 4.1 Employment by status, 1991–2011
(in thousands)



* Own-account workers employed by formal-sector enterprises are categorized as being in formal employment and unpaid family workers (contributing family workers) in informal employment, irrespective of whether they work in formal- or informal-sector enterprises.⁵⁷

Note: Non-categorized workers are estimated by deducting the combined total of formal, informal and mixed formal and informal employment (Kenya Economic Surveys) from total employment (KILM). Total employment is not reported annually by the Kenya National Bureau of Statistics and therefore these figures are estimated values. Figures in the bar chart represent the contribution of each segment to total employment in that year and are in percentages.

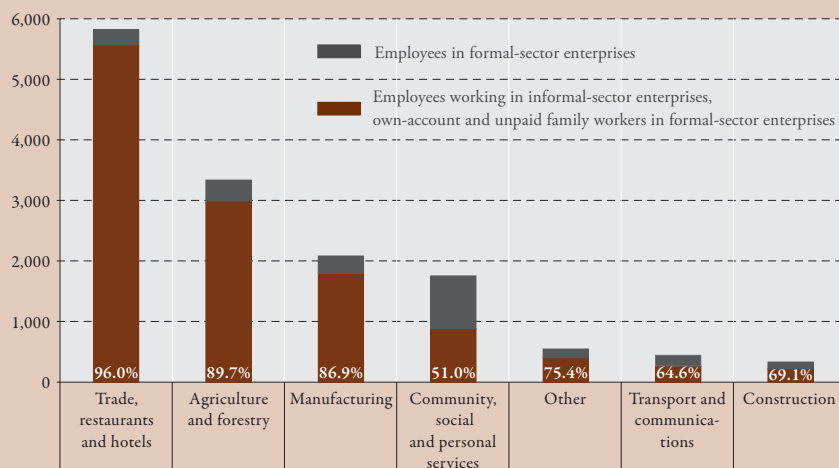
Source: Kenya Economic Surveys; ILO, 2011a.

While manufacturing's share in informal-sector employment declined moderately between 2003 and 2011 (from 21.6 to 19.7 per cent), it was the second largest contributor to informal-sector employment growth. In fact, the manufacturing sector, which is comprised of 87 per cent informal-sector workers, contributed almost 17 per cent of the rise in informal-sector employment over the period. Meanwhile, community, social and personal services – in which just over half of all employees are informal-sector workers – grew modestly and accounted for a little over 10 per cent of total informal-sector employment growth.

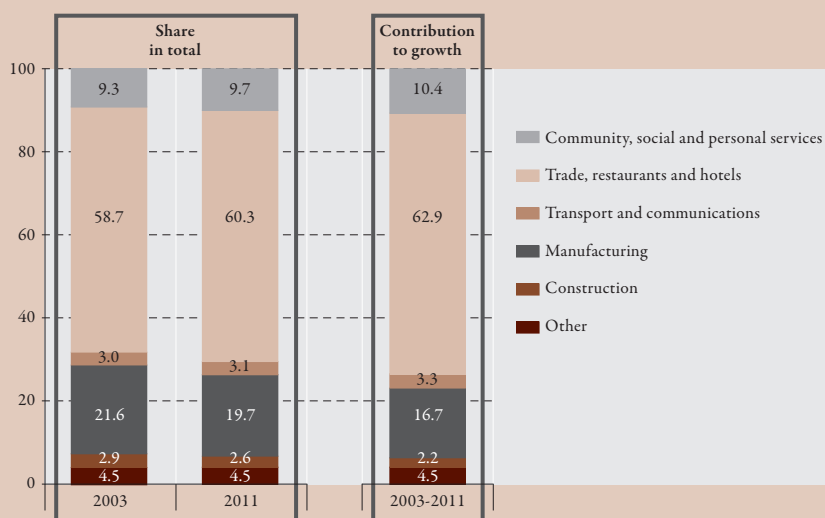
⁵⁷ According to the definitions provided by the 17th International Conference of Labour Statisticians (ICLS) (Hussmanns, 2004).

Figure 4.2 Employment in informal-sector enterprises by economic activity

Panel A. Employment by status and by economic activity, 2011 (in thousands)



Panel B. Share of employment in informal-sector enterprises by economic activity in 2003 and 2011 and in the change between 2003 and 2011 (percentages)



Source: IILS estimates based on Kenya Economic Surveys, various years.

Another important aspect of the trends in informal-sector employment in Kenya is their regional distribution. Most of the informal-sector activities are located in rural areas, which are estimated to have absorbed 61 per cent of informal-sector employment in 2011. Despite this, over the past decade, informal-sector employment has moved from being purely rural to being increasingly concentrated in urban areas. Indeed, informal-sector employment in urban areas has doubled in the past 10 years, increasing by almost 5 percentage points – from 34.2 per cent of total employment in informal-sector enterprises in 2000 to 39 per cent in 2011.

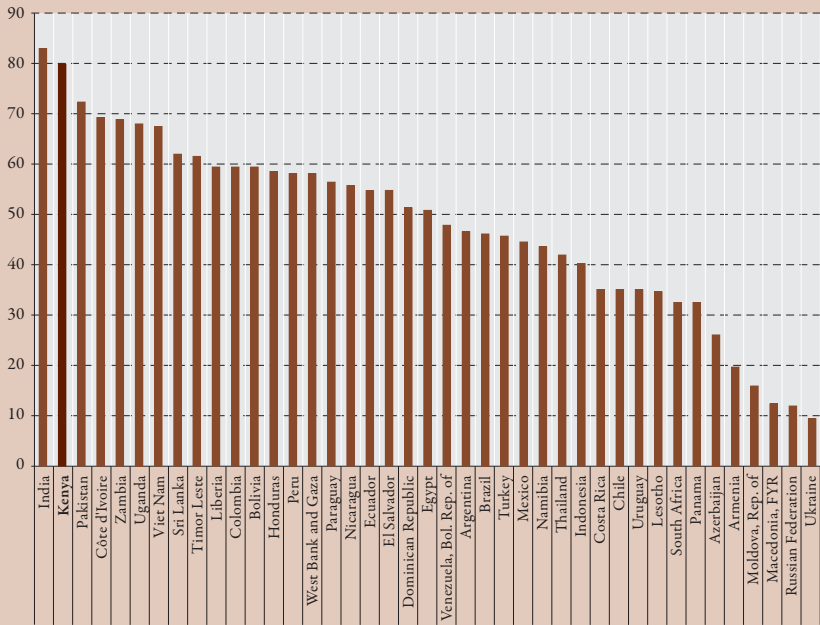
... *keeping informal-sector employment high in Kenya by international standards.*

Informal employment has become an important feature of many labour markets across the globe with recent studies showing that it accounts for over 40 per cent of total employment in two-thirds of emerging and developing countries (ILO, 2009; ILO, 2012a). Moreover, estimates of informal employment in different regions of the world show that informal employment in developing countries often accounts for between half and three-quarters of non-agricultural employment. Even in advanced economies, the proportion of informal employment often reaches well over one-quarter of workers outside the agricultural sector (Huitfeldt and Jütting, 2009).

The prominence of informal-sector employment in terms of its share in non-agricultural employment in Kenya, at 80 per cent in 2010, is relatively high by international standards (figure 4.3). Indeed, despite the fact that the figure excludes informal workers in the formal sector, it still ranks as one of the highest incidences of informal employment among 41 countries with available data.⁵⁸ The figure is considerably higher than in other African countries, such as Uganda (68.5 per cent) and South Africa (32.7 per cent), as well as other developing and emerging countries, such as Bolivia (59.6 per cent), Brazil (46.5 per cent) and Indonesia (40.8 per cent) where informal workers in the formal sector are also taken into account. Only India, at 83.6 per cent, has a higher incidence of informal employment as a share of non-agricultural employment.

⁵⁸ For Côte d'Ivoire, Kenya, Pakistan, Russian Federation, Turkey and Ukraine, figures correspond to employment in informal-sector enterprises (informal workers in the formal sector are excluded). For the other countries analysed, figures are estimates of overall informal employment.

Figure 4.3 Share of informal employment in non-agricultural employment in selected countries, 2010 (percentages)



Notes: For Côte d'Ivoire, Kenya, Pakistan, Russian Federation, Turkey and Ukraine, figures correspond to employment in informal-sector enterprises (informal workers in the formal sector are excluded). For the other countries analysed, figures are estimates of overall informal employment. Data for Bolivia, Brazil, Republic of Moldova, Sri Lanka, Turkey and the Ukraine correspond to 2009 and data for Zambia and Nicaragua correspond to 2008.

Source: Kenya Economic Surveys; ILO, 2012b.

B FACTORS INFLUENCING INFORMAL-SECTOR EMPLOYMENT IN KENYA

Informality is a multidimensional phenomenon that can only be fully understood through a comprehensive approach that analyses its drivers and different forms. Cross-country studies of the determinants of informal employment reveal that the causes of informality are heterogeneous and therefore a variety of factors underlie the developments in informal employment. Indeed, these studies provide useful insight into the different factors that can affect the relative levels of informality in any economy. They include, but are not restricted to, (a) macroeconomic factors, (b) institutional settings and (c) individual characteristics (box 4.2).

Against this background, this section attempts to shed light on the factors that influence informal-sector employment (as a share of non-agricultural employment) in the specific case of Kenya. The purpose of this exercise is to gain a better understanding of the trend increase in informal-sector employment in the country and to present potential policy options that could allow this looming labour market challenge to be effectively addressed. To achieve this end, a principal component analysis (PCA) has been carried out for a panel of 22 developing and emerging countries with available information, considering a number of pertinent macroeconomic, social and institutional characteristics and drawing heavily on the existing body of literature.⁵⁹

The analysis shows that nine of the principal components cumulatively explain roughly 90 per cent of the variation in country responses. However, only two of them are sufficiently correlated with the share of informal employment⁶⁰ in non-agricultural employment to be retained for the analysis (see Appendix A). The two retained components cumulatively account for almost half (48.7 per cent) of the variation in country responses.⁶¹ Component 1 is explained principally by the sectoral distribution of a country's economic activity, the

⁵⁹ This method allows the numerous variables in the data set to be rationalized into their principal components, where each component is a linear weighted combination of the original variables included in the data set (Appendix A).

⁶⁰ In this section, data for all countries except Kenya have been gathered from ILO (2012b) and correspond to informal employment. For Kenya, however, information corresponds to informal-sector employment and has been gathered from the Kenya Economic Surveys, as in the rest of this report.

⁶¹ Component 1 explains 36.3 per cent of the variation in the original data and component 2 an additional 12.4 per cent of the variance. The subsequent components do not yield useful insights for this analysis.

Macroeconomic: The sectoral composition of the economy is a relevant determinant of informal employment. Some sectors are more prone than others to experience high levels of informality – as shown by the case of the trade, restaurants and hotels sector in Kenya – and an increase or decrease in the relative importance of these sectors within the economy will lead to a corresponding increase or decrease in the overall level of informality. Some studies report a negative correlation between the size of the informal economy and certain forms of economic modernization, in particular, trade openness and trade liberalization, which reduce informality both directly and indirectly by promoting a shift to export-oriented sectors (Frankel and Romer, 1996; Rodrik et al., 2002; Dreher and Schneider, 2006; Rei and Bhattacharya, 2008). In contrast, empirical evidence from Latin America suggests that overall increases in the share of informality are mainly related to increases within sectors rather than sectoral shifts. Indeed, Bosch and Maloney (2006) find that 90 per cent of fluctuations in informality in Mexico during the 1990s can be attributed to changes in the extent of informality within sectors.

Institutional: Existing theories argue that the size of the informal economy is the result of a trade-off between the costs and the benefits of informality. In particular, specific institutional factors might discourage employers from starting up formal enterprises, such as explained by the legalist theory of informality championed by Hernando de Soto (De Soto, 1989). Indeed, a number of costs are associated with accessing the formal economy, such as:

- the cost of bureaucratic procedures and permits necessary to enter an industry;
- the cost of housing (such as allocation of state land, building permits, etc.);
- costs associated with trade (such as the permits required to open a shop or build a market stall); and
- the cost of transport access.

It is not only the process of entering the formal sector that has associated costs, remaining in the formal sector also entails charges, in particular costs relating to tax, non-tax legal matters and public utility charges. However, firms in the formal sector may enjoy benefits, such as better access to productive public goods in the form of an enabling legal framework and public infrastructures, etc. According to this theory of informality, this trade-off determines the size of the informal economy (Azuma and Grossman, 2002; Loayza, 1996). A number of empirical studies support this thesis and find a positive correlation between the size of the informal economy and the burden imposed by regulations, the level of corruption and the stringency of employment protection legislation (Johnson et al., 1998; Dreher and Schneider, 2006; Botero et al., 2004). Other studies, however, maintain that the size of the informal economy is negatively correlated with the rule of law and the quality of the legal system, the efficiency of the public administration, and the presence of an efficient banking and financial system that guarantees access to credit (Friedman et al., 2000; Krakowski, 2005; Straub, 2005).

Determinants of informal employment: Brief review of the literature

Individual characteristics: A significant number of studies have explored the microeconomic determinants of informality, finding that the probability of being in informal employment varies widely between categories of workers. Women are generally more likely than men to be in informal employment, as both salaried and self-employed workers. This can be explained not only by the more restricted employment opportunities for women in the formal sector, but also by the fact that informal employment offers the possibility of greater flexibility, which women prefer as it allows them to reconcile their work commitments with family duties (Geldstein, 2000; Chant, 1991). Indeed, being married and having children increases the likelihood of women being in informal employment (Maloney, 2004; Perry et al., 2007). Other relevant individual determinants of informal employment appear to be educational attainment and age. Young workers with no or little educational attainment generally begin their careers as waged workers in informal-sector enterprises. When they accumulate the necessary experience, they often become self-employed, still within the informal sector. By contrast, young workers with higher levels of educational attainment have a greater probability of securing a formal sector job at the beginning of their careers and if they do move into the informal sector it is by choice and not due to the absence of employment opportunities in the formal sector (Maloney, 2004; Saavedra and Chong, 1999; Packard, 2007).

income level of the country and the educational attainment of its population. A country with a higher score for component 1 can be identified as a lower income, agriculture-based economy in which most of the population lives in rural areas and has low literacy rates and low levels of educational attainment. The results of component 1 also suggest that the level of corruption and challenges facing those attempting to carry on businesses are important considerations. Component 2 is derived from the variation in country figures relative to total and youth employment rates, notice period for redundancy dismissal and paid annual leave. The time required to start a business is also an important element of component 2. The purpose of the following section is to assess in greater detail the direction and intensity of the relationship between the variables within each principal component and the incidence of informal employment in Kenya.

Institutional settings play a key role in explaining the importance of informal-sector employment in Kenya ...

The above analysis suggests that informal employment is related to the state of institutional settings, such as the incidence of corruption and the conduciveness of regulatory environments to favourable business operations.⁶² Indeed, for the countries with available data, the incidence of corruption and the ease of doing business index show strong and positive correlations with component 1 and the number of days required to start a business is positively and closely correlated with component 2, which in turn are highly correlated with the share of informal employment in non-agricultural employment.⁶³ For example, in countries where at least 50 per cent of firms have reported that they have made informal payments to public officials⁶⁴, informal employment accounts, on average, for more than 75 per cent of non-agricultural employment. Likewise, countries that require more than 40 days to start a business and/or are placed above 100 in the ranking on the ease of doing business index have, on average, a share of informal employment of more than 53 and 66 per cent, respectively (figure 4.4).

In the case of Kenya, the incidence of corruption is notably high. In fact, close to 80 per cent of firms reported having made informal payments to public officials in Kenya between 2005 and 2010 – almost 30 percentage points above the figures observed in some of Kenya's sub-Saharan African neighbours, such as Tanzania (49.5 per cent) or Uganda (52 per cent). Moreover, Kenya faces a number of challenges in the process of starting and operating a business, which can deter formal-sector enterprise creation – especially for micro- and small-scale enterprises. Indeed, the World Bank report *Doing Business 2013* estimates that starting a business in Kenya takes, on average, 32 days and involves approximately ten different administrative procedures – placing Kenya 126th out of 185 economies ranked according to ease of starting up a business. This is considerably lower in the ranking than other countries in the region (World Bank, 2013).

Despite the existing challenges and barriers to formalization and enterprise creation in Kenya, considerable improvements have been made in

⁶² See Appendix A for exact specifications, detailed results and levels of significance of the different variables.

⁶³ See Appendix A for component loading for these variables.

⁶⁴ Figures used for the PCA analysis (and indicated hereafter) correspond to the averages of the variables for the period 2005–2010. This was done to exclude missing values and avoid measurement errors.

Figure 4.4 Link between institutional settings and the share of informal employment in total employment (percentages)

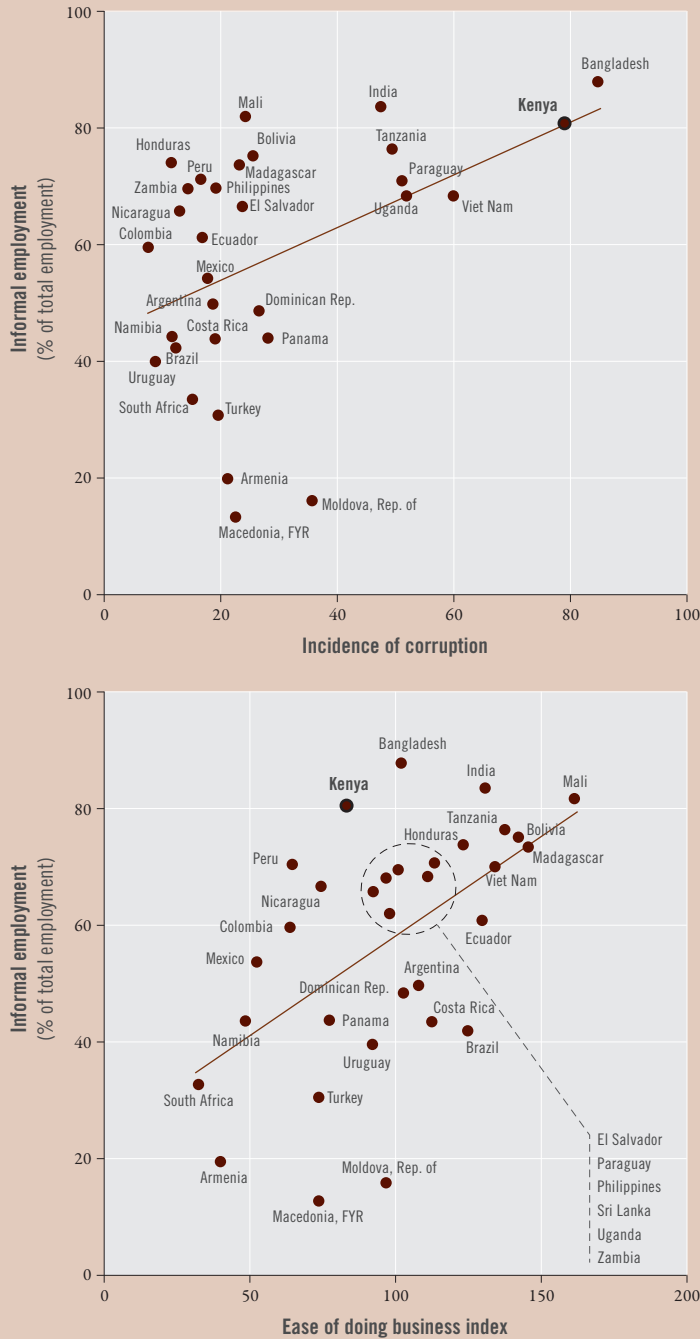
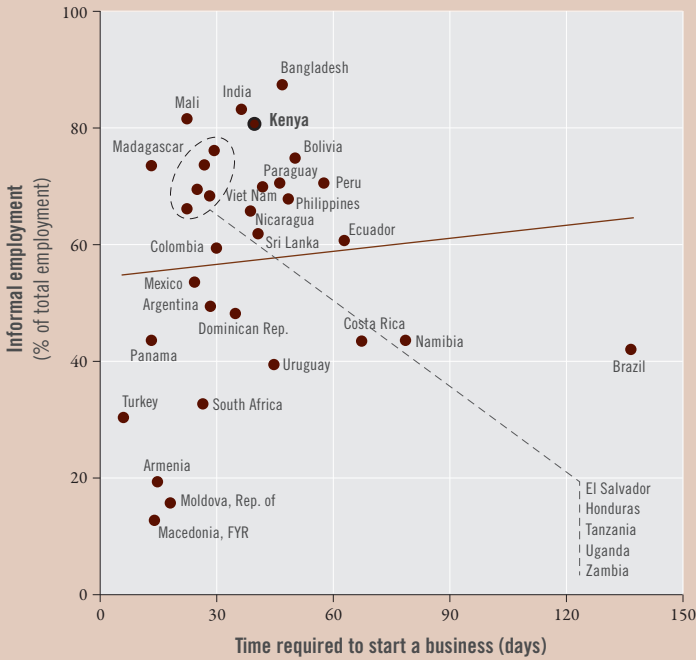


Figure 4.4 Link between institutional settings and the share of informal employment in total employment (percentages)



Note: Incidence of corruption is measured as the percentage of firms expected to make informal payments to public officials to "get things done" with regard to customs, taxes, licenses, regulations, services, and the like. Source: ILS estimates based on ILO, 2012b; IMF, 2012; Kenya Economic Surveys; World Bank, 2011.

recent years – starting a business is, on average, 35 days faster and more than 5 per cent cheaper than in 2009 (World Bank, 2013). This has been accomplished mainly due to Government efforts to reduce the time needed to approve and stamp the memorandum and articles of association required to create a business. Moreover, in 2010, all Registry of Companies records were digitized, which reduced – by more than six days on average – the time needed to complete the company deed and details.

In 2010, the Kenya Revenue Authority also merged the income tax and value added tax registration procedures thanks to the adoption of a Personal Identification Number (PIN), which facilitated the process of operating a business with the Kenyan Revenue Authority. Applying for income tax and value added tax registration can now be done simultaneously on the tax

authority website. The introduction of the PIN also eliminated the need for entrepreneurs to travel to cities with tax authority offices.

... yet, the size of the informal-sector employment sector is also associated with the fact that Kenya remains predominately an agriculture-based economy.

In the group of countries analysed, the share of the rural population and the weight of agriculture in terms of both GDP and total employment are highly correlated with component 1, which in turn is highly and positively correlated with the share of informal employment in total non-agricultural employment (figure 4.5). In particular, the analysis shows that countries where informal employment accounts for over 60 per cent of non-agricultural employment, as in the case of Kenya, are characterized by (on average): (a) a high concentration of their population living in rural areas (65.5 per cent); (b) the strong weight of the agricultural sector in terms of GDP (17.5 per cent); and (c) a high concentration of employment in primary sector related activities (50 per cent). In Kenya, where 80 per cent of non-agricultural employment is informal, more than 78 per cent of the population lives in rural areas and the agricultural sector accounts for 23 per cent of GDP. Moreover, despite the fall in employment in the agricultural sector during the past few years (by 7 percentage points between 2005 and 2010), the sector still accounts for a higher share in total employment than the industrial sector – 25 per cent of jobs are located in the agricultural sector compared to only 15 per cent in the industrial sector.

High levels of informal employment are also intrinsically linked to poverty and low income.

The incidence of informal-sector employment is also related to income-related variables, including GDP per capita, minimum wages and poverty headcount ratios, which are highly correlated with component 1. The analysis shows that in countries where informal employment accounts for over 60 per cent of non-agricultural employment, GDP per capita and monthly minimum wages are, on average, 3.5 and 5.5 times lower, respectively, than in other countries. Moreover, in countries with a high incidence of informal employment, more than 65 per cent of the population lives in

poverty (below the international poverty line of US\$2 per day) and more than 35 per cent in extreme poverty (below the international poverty line of US\$1.25 per day). The relationship holds for Kenya, where 40 per cent of the population lives below the international poverty line of US\$2 per day and more than 18 per cent live on less than US\$1.25 per day (figure 4.6).

Of course, the relationship between poverty and informality is a complex one. As evidenced in Chapter 1, informal-sector workers earn, on average, less per month than the established international and national poverty lines. Thus, informal-sector employment in Kenya produces low-income workers, reinforcing the persistence of poverty. However, poverty is also one of the main causes of informality. Indeed, in general, poor households have specific characteristics that increase their vulnerability to poverty and that limit employment opportunities (Rakowsky, 1994). In this sense, poverty actively contributes to the expansion of informality by preventing individuals from gaining access to better opportunities (Maloney, 2004; Gulyani and Talukdar, 2010). In other words, while informal-sector employment reinforces the persistence of poverty, poverty drives individuals into informal-sector employment. The conjuncture of the two creates a vicious circle where poverty and informality are mutually reinforced.

Figure 4.5 Link between agriculture-based economic variables and the share of informal employment in total employment (percentages)

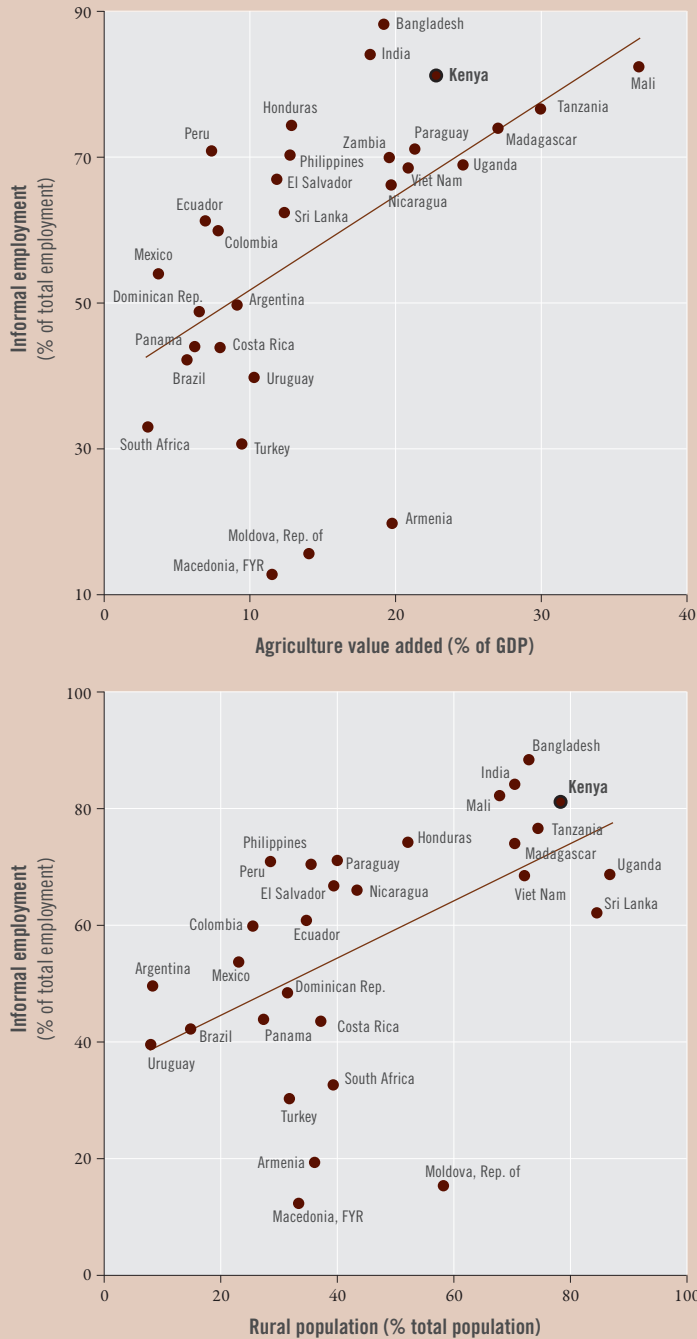


Figure 4.5 Link between agriculture-based economic variables and the share of informal employment in total employment (percentages)



Source: IILS estimates based on ILO, 2012b; IMF, 2012; Kenya Economic Surveys; World Bank, 2011.

Figure 4.6 Link between income-related variables and the share of informal employment in total employment (percentages)

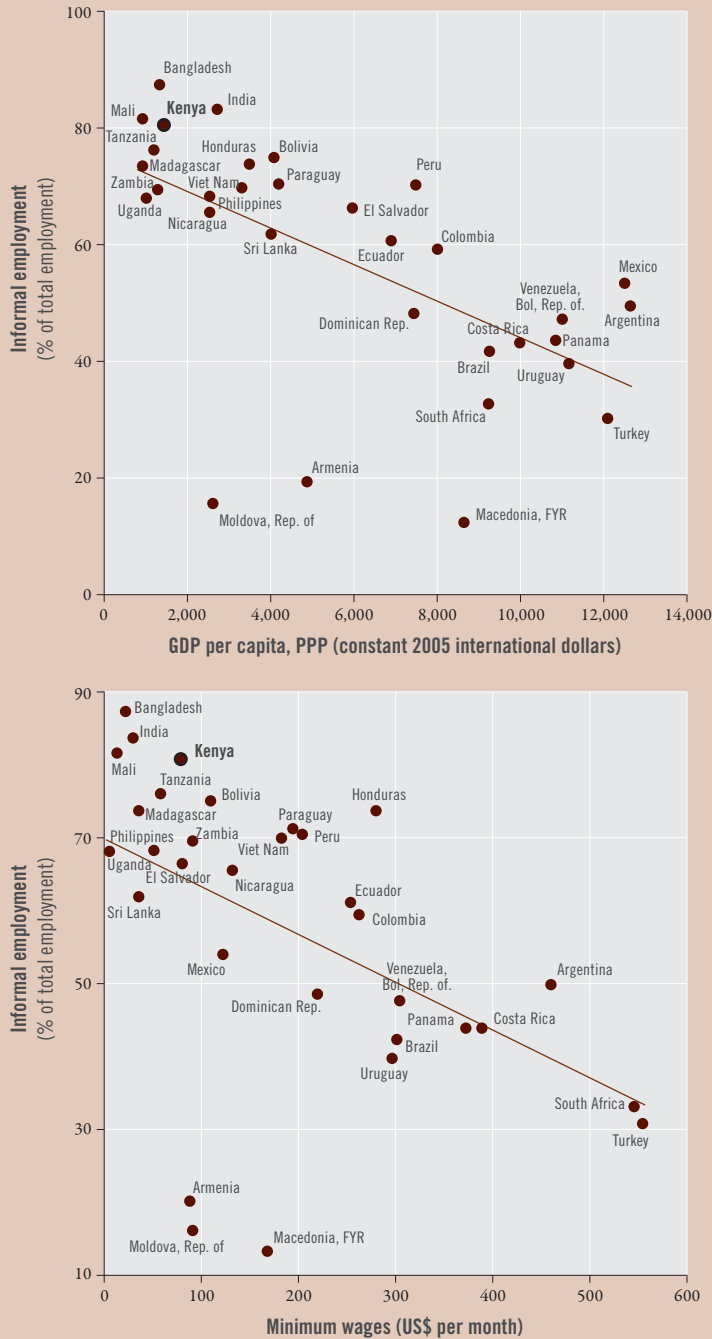
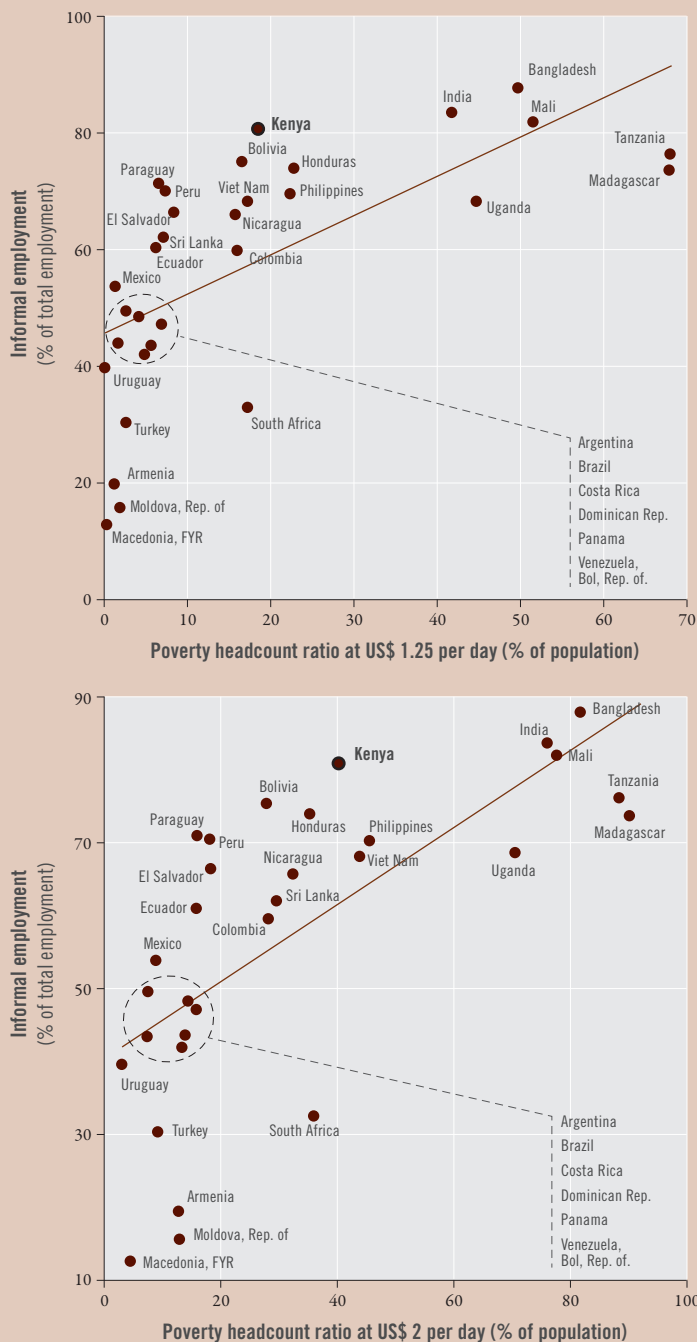


Figure 4.6 Link between income-related variables and the share of informal employment in total employment (percentages)



Source: IILS estimates based on ILO, 2012b; IMF, 2012; Kenya Economic Surveys; World Bank, 2011.

C POLICY OPTIONS GOING FORWARD

Informal employment in Kenya has continued to grow steadily since the 1990s and currently accounts for a significant proportion of total employment. And, while it provides an important means by which many individuals derive their livelihoods, it is often associated with poverty, with informal workers earning, on average, less than the international and national poverty lines. The increasing trend in informal employment has several repercussions for workers and their families and has become a central determinant of poverty and income inequalities in Kenya. Kenya's Vision 2030 acknowledges the fact that the informal sector must be supported in ways that will raise its productivity, improve its distribution and increase both jobs and incomes. It advocates the strengthening of informal trade (wholesale and retail) through investment in infrastructure, training and linkages to local and global markets (Republic of Kenya, 2007). However, additional efforts are needed to effectively shape a more inclusive labour market and improve the incomes of those in informal employment.

Promoting sustainable economic growth will be an important step in this direction. Indeed, much of the economic instability that the country has experienced during the past three decades has been due to the relatively high concentration of agricultural production. However, in addition to the necessary macroeconomic and structural measures discussed in Chapter 2, the Kenyan Government could build on recent progress and consider focusing on two strategic objectives: first, promoting private sector development and the formalization of informal-sector enterprises and jobs; and, second, improving working conditions and the livelihoods of those in informal employment (by promoting labour rights and social protection floors). The rest of this section details steps that could be taken to facilitate these objectives.

1 PROMOTING PRIVATE SECTOR DEVELOPMENT AND THE FORMALIZATION OF INFORMAL-SECTOR ENTERPRISES AND JOBS

Removing or even just lowering the barriers to formalization can facilitate a progressive movement into the formal sector (World Bank, 2004). Although Kenya has made significant progress in recent years, notably regarding a number of administrative procedures and the time required to start a business, further measures based on a number of international examples could be considered, including:

- *Continuing to simplify the process of formalization:* The introduction of the Personal Identification Number (PIN) in Kenya has been an important step forward but starting a formal business in Kenya remains relatively difficult by international standards. In Tanzania, the Government has taken steps to reduce barriers to formalization through a three-pronged approach based on reforms to business registration, business regulation (i.e. licensing) and revenue generation (i.e. taxation, fee collection, etc.) With this in mind, a multi-donor funded programme was created – Business Environment Strengthening for Tanzania (BEST) – to implement the reforms. Thanks to this programme, business registration is now automatic following payment of a predetermined fee based on nationally adopted guidelines and enshrined in legislation to ensure absolute clarity. Similarly, the Government of Brazil passed the Individual Entrepreneur Law (Lei do Empreendedor Individual) in 2009 to reduce the administrative and tax burdens on small businesses. The initiative facilitates the registration of micro-enterprises with up to one employee and allows entrepreneurs to collect a tax identification number (known as CNPJ), which exempts them from federal taxes – something that could be considered in Kenya as a complement to the PIN.

- *Overcoming financial barriers to formalization:* In the past decade, Brazil has successfully taken steps to make formalization possible by overcoming the financial barrier that it previously presented. In 1994, the Government established the Programme for the Creation of Employment and Income (*Programa de Geração de Emprego e Renda Rural*). This programme aims to extend credit to micro-enterprises, small enterprises, cooperatives and production initiatives in the informal sector. The main goal of the programme is to promote employment and income in enterprises that otherwise would have had little or no access to credit. The programme started by targeting informal enterprises in metropolitan areas – where unemployment rates were highest – but was later extended to rural areas as well.
- *Strengthening property rights:* Enforceable property rights serve as a legal framework to protect citizens and businesses which are officially registered with the state, thus encouraging entry into the formal sector. Moreover, officially recognized titles and deeds facilitate access to formalized services, such as bank lending (i.e. official owners can leverage their properties), which in turn opens up new opportunities to increase the size of businesses. Peru has taken significant steps to strengthen property rights by setting up the Praedial Registration System, which offers a quick and inexpensive way to convert informal property in the hands of a large proportion of the population into legally recognized private property, as a source of capital for the grassroots development of these countries.
- *Bringing service delivery closer to business:* Well-designed government decentralization processes could benefit formalization if they bring service delivery closer to businesses and enable policies to quickly and more effectively react to local concerns. One way to achieve this is through the development of one-stop shops that unite government officials from different departments in one location to provide citizens with all the information, assistance and forms required for business registration start-up procedures. This method of simplifying the administration of regulation has been used successfully in a number of countries, such as Liberia and Uruguay. Liberia eliminated one procedure, which reduced business start-up time by 14 days, introducing a one-stop shop in 2011 that brings all the agencies involved in the registration process together under a single roof. Uruguay cut the number of procedures by six, reduced

the time required to start a business by 58 days and the cost by 33 per cent through the use of a one-stop shop created in 2010 (World Bank, 2013).

- *Promote formal sector job creation through industrial policy:* Making agriculture a viable sector through coherent rural development policies, which include increased investment in transport, infrastructure and distribution networks, would enhance the scope for formal employment in the sector. Indeed, the development of rural productive non-farming activities reinforces the linkages between the agricultural sector and the broader economy, creating opportunities for formal employment. In addition, this could prevent displaced workers moving from the rural sector into urban informal-sector employment, which is a key problem in Kenya. An example of this is the dynamic rural non-farming sector in China. It has been a major contributor to the country's growth, increasing rural household income and contributing to rural development (Lanjouw and Lanjouw, 2001).

2 DEVELOPING SOCIAL PROTECTION FLOORS AS A TOOL TO IMPROVE WORKING CONDITIONS OF WORKERS IN INFORMAL-SECTOR EMPLOYMENT

In addition to having to cope with lower earnings, informal-sector workers in Kenya often have limited social protection coverage. For instance, the percentage of the population not covered by medical insurance due to financial resources deficit remains high, at 82 per cent, with households financing 41 per cent of all health-care expenditures through out-of-pocket payments (ILO, 2011b). Medical care coverage is an important consideration for informal-sector workers as accidents and work-related diseases are often more widespread than in the formal sector. Importantly, this lack of protection also means that these workers are disempowered and are therefore unable to actively change their precarious situations. Good social provisions can strengthen individual health and well-being of informal-sector workers, as well as providing the capacity to organize themselves and make demands for better overall conditions of work (ILO, 2011b). Some examples and areas for potential action are detailed below:

- *Access to health care for informal workers:* Some developing countries have implemented schemes that provide access to health care for workers in the informal sector. For example, a mutual health scheme called UMASIDA was established in Tanzania as early as 1995 to minimize the problem of restricted access to health-care services by workers in the informal economy. UMASIDA is a mutual association that manages a health insurance scheme in workers' cooperatives in the informal sector in Dar es Salaam and, therefore, is a community-based insurance model, where the policyholders themselves are the owners and managers of the insurance programme. For a small premium (covering the member, a spouse and four children below the age of 18 years), members receive all necessary outpatient care. Care is provided at dispensaries or health centres owned by UMASIDA (see also McCord and Mutesasira, 2000).
- *Health provision and empowerment of working women:* The Self Employed Women's Association (SEWA) has specifically addressed the welfare of Indian women who work informally by establishing initiatives to ensure health, income security and empowerment. The approach of SEWA is founded on the recognition that lack of protection in the workplace is both a cause and a consequence of job and income insecurity (Lund, 2009). The organization provides members with health education and preventive health care, such as immunization of children. It also provides curative care from their homes or health centres, where low-cost generic drugs are dispensed at cost price to members (Raval et al., 2000). SEWA's efforts to supply working women's health-care needs depend on linkages with other institutions of SEWA, including the SEWA Bank, childcare services and institutions for disaster management.
- *Mixed national- and community-based health-care provision:* One of the problems faced by developing countries in the attempt to extend social protection provisions to informal-sector workers is the financing aspect. In this respect, combining national and community-based social provisions could be a better option for developing countries. In Ghana, for example, a mixed system combining elements of a compulsory national insurance scheme and community-based health insurance was introduced. It is financed by individual contributions based on income and

a 2.5 per cent value added tax (VAT). Although the system has been beset by a number of problems, it has seen a significant increase in the number of informal-sector workers benefitting from the system. Indeed, the coverage rate of the population increased from 15 per cent to 38 per cent between 2005 and 2007, 24 per cent of which consisted of informal workers (ILO, 2011c).

- *Non-contributory pensions in South Africa:* Informal-sector workers are often not eligible for any kind of pension scheme, thus exacerbating poverty concerns. To address this issue, South Africa created a non-contributory pension programme – now among the largest of this type of programmes, along with that of Brazil. Non-contributory pension programmes reduce poverty among the elderly and their households and enable investment in human and physical capital. Empirical evidence in South Africa shows that the state non-contributory pension scheme for elderly people not only reduces poverty and inequality, but is also used for income-generating purposes by the elderly themselves as well as other household members.

APPENDIX A

ANALYSIS OF THE FACTORS INFLUENCING INFORMAL-SECTOR EMPLOYMENT IN KENYA

Section B of this Chapter discussed the different factors that influence informal-sector employment in Kenya in order to understand the phenomenon and present potential policy options that could allow this looming labour market challenge to be effectively addressed. This discussion is the result of a principal component analysis (PCA) carried out for a group of 22 countries, including Kenya. PCA is a multivariate statistical technique that allows the grouping of numerous economic, social and institutional variables in the database into predetermined categories (principal components), where each component is a linear weighted combination of the original variables included in the dataset. The variables used in this section are drawn from the literature on the determinants of informality. See Table A4.1 for a description of the variables and sources used.

The PCA's procedure starts by seeking the linear combination of variables that produces the maximum possible variance. Finding this linear combination allows the first (principal) component to be established. The second component is the linear combination of the same variables having a maximum variance, subject to it being uncorrelated with the first component. In general, one can have as many components as variables, but the aim is to have a few components (usually the first ones) that explain a large proportion of the total variance. Therefore, those components with an eigenvalue of less than 1 have been omitted. In the exercise carried out for the purposes of this chapter, nine principal components were retained. Table A4.2 shows the scores of each component, which are a measure of the degree of association between each variable and the component. Large positive numbers (maximum of 1) indicate a strong positive correlation with the underlying component while large negative numbers (minimum of -1) signify a strong negative correlation.

Table A4.1 Definitions and sources of variables used in the PCA analysis

Variable	Source
Informal employment	ILO, 2012b
Real GDP growth	IMF, 2012
Foreign direct investment, net inflows (% of GDP)	World Bank, 2011
Value added in agriculture (% of GDP)	World Bank, 2011
Value added in manufacturing (% of GDP)	World Bank, 2011
High-technology exports (% of manufactured exports)	World Bank, 2011
Exports of goods and services (% of GDP)	World Bank, 2011
GINI index	World Bank, 2011
Prevalence of HIV (% of population aged 15–49)	World Bank, 2011
GDP per capita, PPP (constant 2005 international dollars)	World Bank, 2011
Rural population (% of total population)	World Bank, 2011
Life expectancy at birth (years)	World Bank, 2011
Poverty headcount ratio at US\$1.25 a day (PPP) (% of population)	World Bank, 2011
Poverty headcount ratio at US\$2 a day (PPP) (% of population)	World Bank, 2011
Adult literacy rate (% of people aged 15 and above)	World Bank, 2011
Tertiary school enrolment (% gross)	World Bank, 2011
Secondary school enrolment (% gross)	World Bank, 2011
Age dependency ratio (% of working-age population)	World Bank, 2011
Informal payments to public officials (% of firms)	World Bank, 2011
Domestic credit to private sector (% of GDP)	World Bank, 2011
Ease of doing business (global ranking out of 185)	World Bank, 2011
Internet users (per 100 people)	World Bank, 2011
Time required to enforce a contract (days)	World Bank, 2011
Time required to start a business (days)	World Bank, 2011
Employment in agriculture (% of total employment)	World Bank, 2011
Employment in industry (% of total employment)	World Bank, 2011
Female labour participation rate (%)	World Bank, 2011
Female employment-to-population ratio (%)	World Bank, 2011
Total employment-to-population ratio (%)	World Bank, 2011
Youth employment-to-population ratio, aged 15–24 (%)	World Bank, 2011
Firing cost (weeks of wages)	World Bank, 2011
Notice period for redundancy dismissal for a worker with 5 years of tenure (in salary weeks)	World Bank, 2011
Notice period for redundancy dismissal for a worker with 20 years of tenure (in salary weeks)	World Bank, 2011
Paid annual leave for a worker with 5 years of tenure (in working days)	World Bank, 2011
Paid annual leave for a worker with 20 years of tenure (in working days)	World Bank, 2011
Minimum wage for a 19-year-old worker or an apprentice (US\$/month)	World Bank, 2011

Table A4.2 Principal components' scores

	Component 1	Component 2	Component 3	Component 4	Component 5	Component 6	Component 7	Component 8	Component 9
Real GDP growth	0.19	0.21	0.28	-0.07	0.01	0.32	0.39	0.34	0.60
Foreign direct investment	0.01	-0.05	0.69	-0.36	-0.27	0.17	-0.46	-0.03	0.16
Value added in agriculture	0.88	-0.21	0.01	-0.09	0.04	0.12	-0.04	-0.04	0.01
Value added in manufacturing	-0.48	0.44	-0.30	0.12	0.11	0.13	-0.19	-0.38	-0.05
High-technology exports	-0.15	0.37	-0.40	0.11	0.31	0.04	-0.55	0.37	0.16
Exports of goods and services	-0.17	0.32	0.47	-0.15	-0.06	0.57	-0.18	0.32	-0.33
GINI index	-0.35	0.16	0.22	0.52	-0.27	-0.27	-0.05	0.38	-0.33
Prevalence of HIV	0.49	-0.15	0.29	0.11	0.47	-0.32	0.22	0.40	-0.07
GDP per capita, PPP	-0.86	-0.10	0.11	0.17	-0.22	-0.16	0.10	0.05	0.09
Rural population	0.88	0.08	0.01	-0.22	0.20	0.17	0.06	0.01	-0.14
Life expectancy at birth	-0.81	0.30	0.14	0.05	-0.17	0.21	-0.06	-0.29	0.01
Poverty headcount ratio at US\$1.25 a day	0.90	0.14	-0.14	0.01	-0.31	0.00	-0.04	-0.08	0.12
Poverty headcount ratio at US\$2 a day	0.91	0.19	-0.19	-0.08	-0.20	0.05	0.02	-0.06	0.12
Adult literacy rate	-0.76	0.07	0.33	0.06	0.41	0.04	-0.20	-0.05	-0.03
Tertiary school enrolment	-0.83	-0.22	0.15	0.15	-0.05	0.10	0.02	-0.06	0.28
Secondary school enrolment	-0.93	0.03	-0.02	-0.16	0.17	0.04	-0.10	-0.06	0.13
Age dependency ratio	0.79	-0.11	0.04	0.34	-0.09	-0.33	-0.06	0.27	-0.09
Informal payments to public officials	0.56	0.16	0.08	-0.15	0.45	0.28	0.50	-0.09	-0.07
Domestic credit to private sector	-0.19	0.45	0.25	-0.48	-0.16	0.47	0.18	0.25	-0.30
Ease of doing business	0.56	0.11	-0.26	0.37	-0.26	0.37	-0.22	0.26	0.10
Internet users	-0.83	-0.07	0.39	-0.04	0.01	0.00	0.06	0.08	0.17
Time required to enforce a contract	0.20	0.34	-0.49	-0.02	-0.45	0.03	0.19	0.02	0.25
Time required to start a business	-0.11	0.63	-0.09	0.25	0.31	0.05	0.18	0.17	0.29
Employment in agriculture	0.89	-0.04	-0.02	-0.14	-0.09	0.17	-0.24	-0.15	0.03
Employment in industry	-0.82	0.19	-0.03	-0.02	0.08	-0.07	0.26	-0.09	-0.02
Female labour participation rate	0.53	0.24	0.59	0.13	0.36	-0.17	-0.10	-0.23	0.10
Female employment-to-population ratio	0.49	0.52	0.55	0.24	0.13	-0.15	-0.09	-0.19	0.06
Total employment-to-population ratio	0.43	0.69	0.41	0.37	-0.08	-0.07	0.00	-0.12	0.04
Youth employment-to-population ratio	0.41	0.64	0.32	0.40	-0.25	-0.01	0.00	-0.19	-0.03
Firing cost	-0.27	0.25	-0.35	0.49	0.00	0.39	0.34	-0.18	-0.30
Notice period for redundancy dismissal for a worker with 5 years of tenure	0.25	-0.57	-0.14	0.40	0.27	0.47	-0.18	-0.05	0.05
Notice period for redundancy dismissal for a worker with 20 years of tenure	0.29	-0.52	-0.01	0.45	0.35	0.43	-0.14	-0.05	0.06
Paid annual leave for a worker with 5 years of tenure	0.36	-0.65	0.51	-0.02	-0.28	0.04	0.13	-0.08	0.03
Paid annual leave for a worker with 20 years of tenure	0.09	-0.64	0.40	0.40	-0.23	0.18	0.25	-0.14	-0.02
Minimum wage for a 19-year-old worker or an apprentice	-0.74	-0.18	0.07	0.36	-0.22	0.19	0.02	0.20	0.06

The analysis shows that the nine principal components retained cumulatively explain almost the totality (89.6 per cent) of the variation in country responses; however, only the first two are significantly correlated with the share of informal employment in non-agricultural employment and therefore only these two have been retained for the analysis. The two components retained, cumulatively account for almost half (48.7 per cent) of the variation in country responses,⁶⁵ which is sufficiently high for the purposes of this study given that the subsequent components do not yield useful insights for the analysis.^{66, 67}

To shed light on the effect that each component has on the share of informal employment in the different countries – and most specifically in Kenya – figure A4.1 plots the scores of the components for the different countries⁶⁸ with the shares of informal employment as a percentage of non-agricultural employment in these countries.

The analysis illustrates that agriculture-based economies with low socio-economic development (i.e. scoring highly for component 1) are economies where the share of informal employment in non-agricultural employment is high (figure A4.1, panel A). Moreover, the results indicate that those countries with unfavourable institutional settings (i.e. scoring highly for component 2), are also countries where informal employment accounts for a higher share of non-agricultural employment (figure A4.1, panel B). For a more detailed explanation of the economic interpretations of these results, please refer to section B above.

⁶⁵ Component 1 accounts for 36.3 per cent of the variation in the original data and component 2 an additional 12.4 per cent of the variance.

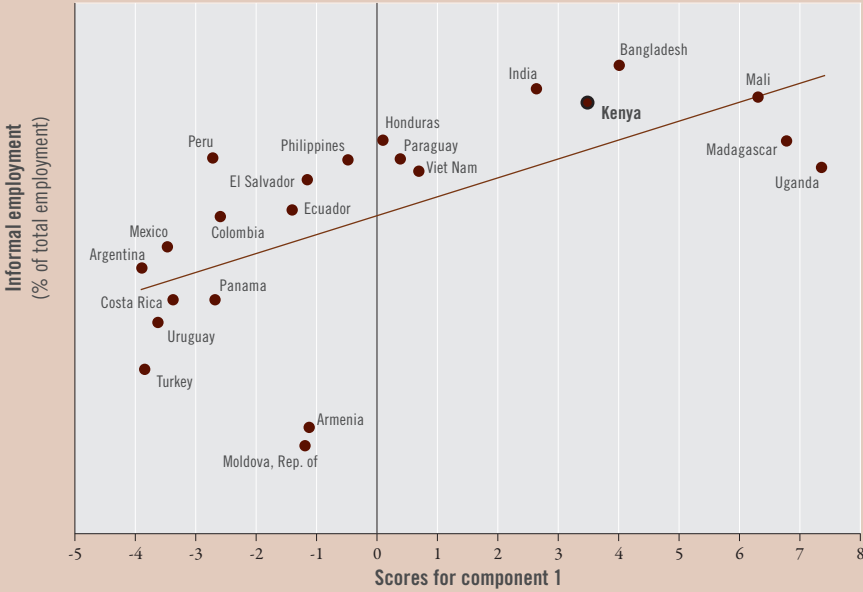
⁶⁶ Weighted component loadings for the 15 variables related to component 1 are: 0.88 for value added in agriculture as a percentage of GDP; 0.89 for employment in agriculture as a percentage of total employment; -0.82 for employment in industry as a percentage of total employment; 0.56 for the level of corruption; 0.56 for ease of doing business ranking (1 indicating the best possible place for doing business); 0.88 for the share of rural population in total population; 0.78 for the age-dependency ratio; -0.81 for life expectancy at birth; -0.86 for GDP per capita; -0.74 for the level of minimum wages; 0.90 for poverty head-count ratio at US\$1.25 per day and another 0.90 for poverty head-count ratio at US\$2 per day; -0.76 for the adult literacy rate; -0.93 for secondary school enrolment; and -0.83 for tertiary school enrolment.

⁶⁷ Weighted component loadings for the seven variables related to the second component are: 0.68 for total employment-to-population ratio; 0.64 for the youth employment rate; -0.57 for notice period for redundancy dismissal of a worker with 5 years of tenure; -0.52 for notice period for redundancy dismissal of a worker with 20 years of tenure; -0.65 for paid annual leave in working days for a worker with 5 years of tenure; -0.64 for paid annual leave in working days for a worker with 20 years of tenure; and 0.63 for the number of days required to start a business.

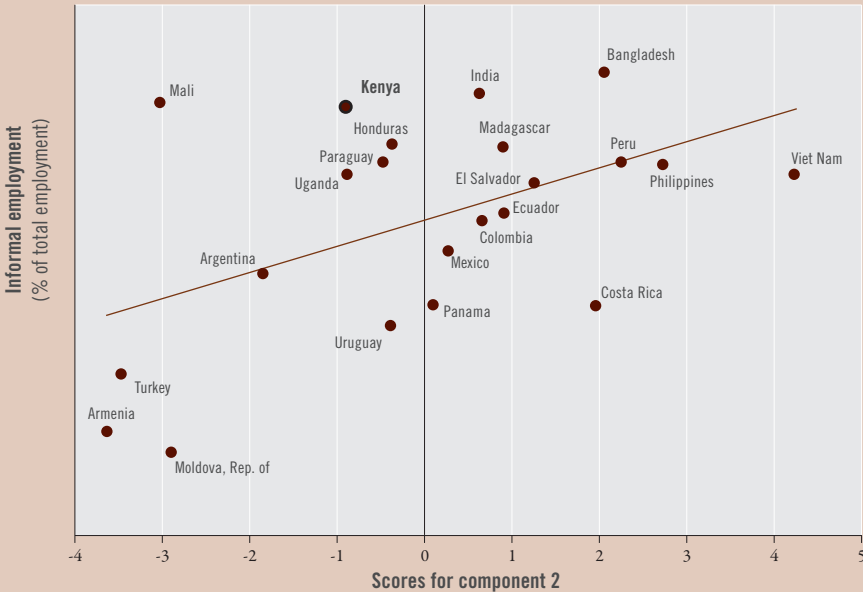
⁶⁸ Component scores are calculated as the weighted average of all the explicative variables of each component.

Figure A4.1 Principal component analysis scores and share of informal employment in total employment (percentages)

Panel A. Share of informal employment in total employment (percentages) and scores for component 1



Panel B. Share of informal employment in total employment (percentages) and scores for component 2



Note: Component scores are calculated as the weighted average of all the explanatory variables of each component.
Source: IILS estimates based on ILO, 2012b; IMF, 2012; Kenya Economic Surveys; World Bank, 2011.

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CHAPTER 5

ENSURING POLICY COHERENCE AND COMPREHENSIVENESS

INTRODUCTION

The previous chapters highlighted a number of areas in which measures to improve labour market and social outcomes could be implemented. Attaining a more inclusive growth model is possible, provided that effective policies are put in place in a coherent and comprehensive manner. Against that background, this chapter will discuss the importance of developing a national employment strategy that is integrated into the country's growth and development plans. Importantly, the report has shown that there are a number of disadvantaged groups in Kenya who have not benefited from recent job growth. In this context, section A highlights the need for an employment strategy to be centred on concerted efforts to address the labour market and social challenges confronting youth and informal-sector workers. Section B discusses the importance of a complementary stable and conducive macroeconomic framework in achieving employment and social goals. Finally, section C reviews the benefits of policy coherence and considers how the interaction among different policies can be improved in order to maximize the benefits of full and productive employment.

A NATIONAL EMPLOYMENT STRATEGY: ALIGNING LABOUR AND ECONOMIC GOALS

There is renewed recognition of the important role played by employment as a key driver of economic growth. Indeed, a number of studies now show that job-friendly policies have a positive effect on the economy because they are able to encourage income generation, thereby stimulating aggregate demand and improving overall economic growth (ILO, 2003; 2012). The case of Kenya shows that too narrow a focus on economic growth in isolation, important though this aspect is, will not be sufficient to achieve quality job creation, continuous poverty reduction and sustainable development. Improving employment opportunities – both by increasing the number of jobs available and by extending labour market access to the most vulnerable – is a vital step towards attaining these goals.

A national employment strategy is, therefore, needed; a strategy that integrates employment goals with strategic growth plans. This will allow for a more coherent and comprehensive framework that combines economic and labour market efforts with a view to enhancing the employment content of economic growth. Many countries have adopted national employment strategies in recent years (box 5.1). Policy-makers in Kenya could learn from the strengths and weaknesses of these initiatives for the development of their own strategy. The overall impact and success of such a strategy will depend on the degree to which it is embedded within national legislative and development frameworks.

The Irish Action Plan for Jobs: In February 2012, the Irish Government implemented a multi-year Action Plan for Jobs 2012, which puts employment-friendly policies at the heart of the recovery efforts. The objective of the plan is to increase the number of people in work from 1.8 to 1.9 million by 2016, reaching 2 million people by 2020. Key measures delivered in 2012 include:

- the establishment of a Micro Finance Loan Fund in the first quarter of 2012. The fund generated €90 million in additional micro-enterprise lending, benefitting 5,000 businesses and creating 7,700 jobs over a 10-year period;
- the establishment of a Temporary Partial Credit Guarantee Scheme endowed with €450 million to benefit 5,600 businesses and create 4,000 jobs;
- a second call for expressions of interest in the remaining €125 million of the Innovation Fund Ireland;
- a cross-Government Statement on the Green Economy with the potential to create 10,000 jobs;
- implementation of a series of “pro-job” tax measures.

By the end of 2012, 249 actions had been implemented under the Action Plan 2012. The Plan helped to support net growth of almost 12,000 private sector jobs during 2012. In February 2013, the Action Plan for Jobs 2013 was launched. It contains 333 actions to be implemented in 2013 by 16 government departments and 46 agencies. This new phase builds on the progress made in 2012 in order to continue improving support for job-creating businesses and remove the barriers to employment creation across the economy.

The Saudi Employment Strategy: In July 2009, Saudi Arabia’s Council of Ministers adopted the Saudi Employment Strategy. Although the launch of the strategy coincided with the slowdown of economic growth induced by the global economic and financial crisis, the preparation of the strategy started well before the crisis set in. The strategy, developed and implemented by the Ministry of Labour, presents a detailed and comprehensive set of measures aimed at redressing imbalances in the Saudi labour market – namely, a severe gender gap in the supply of labour as well as significant wage disparities between similarly educated Saudis and non-Saudis and the high unemployment rate of Saudis, especially youth – in the context of the Ninth Development Plan (2010–2014).

The strategy sets out the following overall objectives: (i) to provide an adequate number of opportunities with appropriate terms of pay and conditions in an attempt to increase labour market participation and reach full employment; (ii) to increase the country’s competitive advantage based on the development of its national human resources; and (iii) to increase labour productivity to a level comparable with advanced OECD countries.

The strategy covers a period of 25 years, but objectives have been carefully categorized depending on the time frame needed to implement specific policies necessary to achieve the overall goals. In the short term (2 years), the objective is to limit unemployment by offering incentives to private enterprises, enhancing skills and capacities and improving the employment information system of the country. In the medium term (3 to 5 years), the Government aims to promote employment-creation policies by encouraging participation and fostering greater productivity. In the long term, the goal is to achieve the overall objective – increasing competitive advantage for the economy through the enhancement of national capacities – through the reorganization and reconstruction of Saudi Arabia’s labour market.

Additional efforts are required to transform the current approach into a comprehensive national employment strategy ...

The Kenyan Government has made considerable progress in its efforts to tackle labour market challenges through appropriate programmes, policies and labour market institutions. However, if a coherent strategy were adopted, in which these measures and other employment issues were fully integrated in strategic development and growth plans, it would yield additional benefits. To date, while employment has been part of development plans, it has not played a central role. For example, in 2003, the Government implemented the Economic Recovery Strategy for Wealth and Employment Creation (ERS). This strategy set the vision of the country in terms of human development for the period 2003 to 2007. However, employment creation was neither one of the strategy's pillars nor one of its five cross-cutting themes (Republic of Kenya, 2003).

The new development plan, articulated in Kenya's *Vision 2030*, covering the period 2008–2030 supersedes the abovementioned ERS and aims to improve the quality of life for all Kenyan citizens (from an economic, social and political perspective). It is anchored on ten main foundations: macroeconomic stability; continuity in governance reforms; enhanced equity and wealth creation opportunities for the poor; infrastructure; energy; science, technology and innovation (STI); land reform; human resources development; security; and public sector reforms. As with the ERS, the employment challenge was not identified as one of the foundations of this strategic plan. It was, however, included as one of the priorities under “human resources development”, which intends to tackle the existing mismatch between skills and job opportunities through lifelong training and education and to make additional efforts to raise productivity to international levels (Republic of Kenya, 2011).

Although the ERS and *Vision 2030* are important steps towards improving growth and development in the country, they do not specifically target the structural problems of the labour market. *Vision 2030* sees labour market improvements as a by-product of the action taken to strengthen economic growth – with the aim of attaining a 10 per cent growth in

GDP – rather than through the implementation of labour market policies as a specific and mutually reinforcing measure. In general, the focus of the sectoral actions is on efficiency improvements that will, in turn, stimulate growth and employment. However, there are two concerns: first, that economic growth will not necessarily create the number of jobs needed to substantially decrease the existing high rates of inactivity and unemployment (SID, 2010) and, second, that the jobs created will not necessarily be either of higher quality or target those who are most in need. Moreover, few efforts have been made to develop further the universal social security floor, which has important implications for health, quality of life and the means of empowering the poor to actively improve their precarious situations.

... including measures that effectively tackle the challenges faced by youth and informal workers.

The report has shown that a number of groups are being disproportionately affected by the lack of employment creation and job precariousness. A comprehensive national employment strategy would therefore have to include measures to tackle the challenges facing disadvantaged groups. Specifically, youth unemployment and inactivity rates are particularly high compared both to international standards and to their adult counterparts. Moreover, informal-sector employment has continued to rise over the past two decades and currently constitutes a sizeable share of total employment in the country. Within the national employment strategy it would therefore be advisable to introduce additional measures both to increase the employability of youth, thereby fostering greater labour force attachment among this key cohort, and to promote the formalization of firms and jobs while improving the living and working conditions of those engaged in informal-sector employment.

Importantly, the ability of policy-makers to improve the effectiveness of existing (and new) programmes depends very much on a proper evaluation framework. Generally, however, little is known about the effectiveness of existing measures. First, there is a need to gather and monitor pre- and

post-programme information and outcomes, including such aspects as cost, employment status, earnings, demographic information and educational level. Second, it is critical to continue to monitor participants over longer periods. Given that in many cases the benefits (and financial returns) of programmes, in particular training for youth, accrue over time, monitoring participants and outcomes beyond programme exit (say for 3–5 years) should be part of any monitoring and evaluation strategy. Finally, the Government should also establish at the outset clear and measurable objectives in terms of expected outcomes, in both the short and long term.

1 YOUTH AND THEIR STRIVE TO FIND JOBS

As Chapter 3 has shown, young people have not shared equally in the benefits of recent economic and employment rate growth. In fact, youth accounted for less than 19 per cent of total employment in 2012 although they made up over 35 per cent of the working-age population. Moreover, the gap between youth and adult employment rates reached 43 percentage points in 2012, placing Kenya among the countries with the highest disparities between youth and adult rates in the region and among the lowest in terms of employment rates for youth.

Due to the sluggish rate of youth employment creation, the struggle to find jobs and dissatisfaction with their living conditions and their role in society more broadly, some young people have become discouraged and have started to leave the labour market entirely. Keeping young people out of the labour market clearly has significant detrimental consequences for individuals, but it also has negative effects on social, economic and development prospects for the country as a whole. An integrated employment policy plan is needed to create opportunities for young people while reducing poverty and allowing youth to be part of the economic and social development of the country.

The analysis has shown that the two biggest challenges faced by working-age youth are lack of job opportunities and their low eligibility for the few jobs that are available. Efforts to date have focused on the latter issue, particularly in terms of general training and primary and secondary education. Moving forward, however, more attention must be given to job creation measures and the effect of labour market policies in attaining this goal. In fact, while overall employment has been growing – albeit at a slow pace – the gains have been made mainly by adults rather than by youth. This is reflected in the lower youth employment elasticity (0.4) relative to the overall employment elasticity observed in the country (0.9). Measures to support demand for youth labour need to be better aligned with labour market realities; that is, they should focus on tertiary education and vocational training – key factors explaining the difference between the likelihood of adults and young people finding a job (see Chapter 3).

2 INFORMAL-SECTOR EMPLOYMENT: AN IMPORTANT SOURCE OF LIVELIHOOD FOR THE MAJORITY OF THE COUNTRY'S POPULATION

Employment creation during the past decade has been mainly concentrated in urban informal-sector enterprises at the expense of agricultural self-employed and workers employed in small-scale agricultural activities (see Chapter 4). Moreover, the informal economy has tended to accommodate most of the growing labour force in urban areas. The increasing trend in informal-sector employment has significant repercussions for workers and their families and has become a central determinant of poverty and income inequalities in Kenya. Among the factors that have contributed to the growth of informal-sector employment, the most important include: (i) the presence of unfavourable institutional settings, which constitute entry barriers into the formal economy; (ii) unstable economic performance and the high concentration of production in agriculture; and (iii) the prevalence of low income levels and poverty.

Despite the current challenges that Kenya faces in reaching a more inclusive labour market, some improvements have already been made (such as the time and cost of starting up a business being reduced by 35 days and 5 per cent, respectively, since 2009). Moreover, the new Constitution established in 2010 (box 5.2) could bring about the political stability necessary for attaining sustainable growth and enabling the creation of formal sector employment. Likewise, the fact that this new Constitution establishes mechanisms to ensure fair access to land titles is a key factor in eliminating one of the main entry barriers into the formal economy.

On 4 August 2010, 67 per cent of Kenyan voters confirmed the transition to a new Constitution in a national referendum. This Constitution was ratified on 27 August 2010, replacing the first Constitution of Kenya, which was established in 1963. With a turnout rate of more than 72 per cent of all registered voters, the result proved a significant step towards rebuilding trust in the Government amid the controversies and the wave of violence that ensued after the disputed 2007 presidential election. The new Constitution aims to enhance equality and inclusive citizenship, thereby addressing one of the main drivers of the persistent high levels of social unrest, which is a manifestation of the perception of exclusion and unfair distribution of national resources, such as land. The main objectives of the new Constitution include the following themes:

- *Establishing national values and principles of governance:* These values and principles include enhanced participation of people, equity, social justice, inclusiveness, non-discrimination and protection of the marginalized. Thus, the new Constitution seeks to ensure that all citizens are treated equally and fairly, thereby addressing the strong sense of exclusion among certain groups of citizens.
- *Reforming the electoral system:* The new Constitution also introduces changes to the electoral system with a view to ensuring that the voices of all segments of society are fairly represented in the government.
- *Creating devolution mechanisms to enhance fairness in the sharing of national resources:* The new Constitution establishes a system of devolution of governance so that all citizens – many of whom feel marginalized, neglected and discriminated against on the basis of their ethnicity – can participate meaningfully in governmental decision-making at the local level.
- *Establishing mechanisms to ensure fairness in land administration:* The land law regime in Kenya is poorly coordinated and gives excessive power to administrators without establishing mechanisms to ensure fairness between potential beneficiaries, since being a beneficiary is usually dependent on personal access to political power. Corruption is therefore rife in government agencies that administer land. To address these issues, the new Constitution establishes a National Land Commission (NLC) to conduct investigations into historical land injustices and recommend appropriate compensation. Moreover, the law enables a review of all grants and dispositions of public land to establish their legality. However, the new Constitution only extends constitutional protection to legally acquired land rights.

B FOSTERING A MORE STABLE MACROECONOMIC ENVIRONMENT

Job-friendly policies have an enormous potential to generate economic growth and, as such, should be at the centre of development and growth strategies. However, in Kenya this potential is constrained by the macroeconomic instability arising from the persistence of long-standing structural weaknesses and the recurrence of short-term shocks. Indeed, a stable macroeconomic framework is an essential prerequisite for sustained economic growth, a dynamic labour market and continued development. During the past three decades, Kenya's economic stability has been affected by a series of crises arising from droughts, the volatility of commodity prices and a climate of political instability.

Current vulnerabilities will have to be tackled before the country can achieve higher and more sustainable rates of economic growth that will allow adequate employment creation to take place. Indeed, the average annual economic growth experienced during the past two decades has been insufficient to generate improvements in employment. In fact, if growth continues at 3.1 per cent over the next 4 years (the average annual growth during the past two decades) there will be a shortage of 1.1 million jobs by 2015. Indeed, Kenya will require an annual rate of economic growth of about 5 per cent to absorb the growing working-age population; however, even this growth rate would not guarantee adequate youth job creation, given the lower youth employment elasticity. The youth job gap would only be closed – assuming that the actual youth employment elasticity remains constant – if the average GDP growth rate increased progressively to reach 10 per cent in 2015 (which is the objective of Kenya's Vision 2030 strategic plan) to produce a total surplus of around 1.9 million jobs by 2015. However, given Kenya's average GDP growth, attaining such a sustainable rate of growth seems a daunting task without special attention being given to addressing the prevailing structural vulnerabilities.

A perception of high political risk continues to hinder investment and the development of new businesses. This arises because economic uncertainty increases in the face of political risk due to an upsurge of expectations

regarding rising inflation and interest rates, which slow down private investment and growth. Addressing the persistently high inflation rate in Kenya is also a prerequisite to achieving macroeconomic stability. However, while an inflation-centric macroeconomic policy could rejuvenate growth, it is unlikely to create employment and make economic growth more inclusive and equitable.

Strengthening export competitiveness will allow Kenya to gain access to new markets, such as Asia, and to reduce climate condition vulnerabilities. A strong focus on stimulating labour and total factor productivity will be essential to ensure that the Kenyan labour market is competitive in global terms. This will require a renewed emphasis on investment targeted towards improving labour productivity which will also attract foreign direct investment. It is important for the Government to recognize that improvements to labour productivity will not necessarily reduce labour demand. In fact, the experiences of the East Asian economies show that employment and growth in labour productivity need not be a zero-sum game.

C ENSURING COHERENCE AMONG POLICIES

Mutually reinforcing economic, employment and social policies have the potential to ensure effective growth prospects and sustainable development. Yet, policies are often conceived and implemented by a variety of different institutions and ministries in response to diverse imperatives. The importance of improving the interaction between different policies is increasingly vital if full and productive employment is to be achieved. In this respect, Kenya could benefit from better aligning macroeconomic and social goals and placing employment issues at the heart of the overall strategic growth and development plans. The current economic paradigm has proceeded without enough attention being paid to the social dimension and to the potential economic gains of effective labour market policies and related institutions.

The election that took place at the beginning of March 2013 opened a window of opportunity in terms of demonstrating to the world that political stability can be achieved during an election year – in contrast to the violence that broke out during the last election in 2007/08. Moreover, the devolution of responsibility to 47 new counties could, if properly implemented by the new Government, pave the way for a more equitable model of development. The new Government will, however, have to work closely with both workers* and employers**. Indeed, effective social dialogue can ensure the best possible design of reforms and increase the likelihood of equitable and sustainable policies being implemented.

*Through COTU.

**Through the FKE.

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KENYA:

MAKING QUALITY EMPLOYMENT THE DRIVER OF DEVELOPMENT

This report on Kenya, published under the series *Studies on Growth with Equity*, examines how employment and social policies can contribute to a more stable and equitable growth pattern. Indeed, growth in Kenya has been characterized by considerable volatility due in part to a narrow growth base and weak investment patterns. This has adversely affected formal job creation and hampered improvements in living standards. The disconnect between growth and job creation has been particularly acute for young Kenyans, despite considerable efforts by the government to support youth employment.

Moving forward, the challenge for Kenya is to establish a more job-centred macroeconomic framework that addresses the current vulnerabilities. Yet, as evidenced by the experience of the most recent expansionary period, GDP growth in and of itself is not enough to ensure labour market and social improvements. One alternative is for policy-makers to develop a national employment strategy that integrates employment goals with strategic growth plans. Particular emphasis is merited on stimulating job creation for youth, facilitating the creation of

formal-sector enterprises and improving the working conditions of workers in informal-sector employment. To that end, this report highlights a number of policy areas and recommendations intended to help guide the government and social partners in achieving growth with equity.

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