MEMORANDUM

ON

EXPORTS AND INVESTMENTS PROMOTION LEVY

TO

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1. About KAM

- ✓ KAM was established in 1959.
- ✓ KAM is the representative organization for manufacturing value-add industries in Kenya, comprising of more than 1300 members who cut across 14 sectors; all of whom are distributed in different counties across the country.
- ✓ In pursuit of our core mandate of policy advocacy, KAM plays a key role on behalf of manufacturers in Kenya by providing an essential link for co-operation, dialogue, and understanding with the Government and its related agencies.
- ✓

About ASNET

ASNET is the umbrella body of the agriculture sector in Kenya. It was formed through a partnership of KEPSA, KNCCI, KAM, SDG Partnership Platform of the United Nations with support from BAF, Elgon Kenya Limited, like minded business associations, partners and other stakeholders. ASNET's strategic issues include;

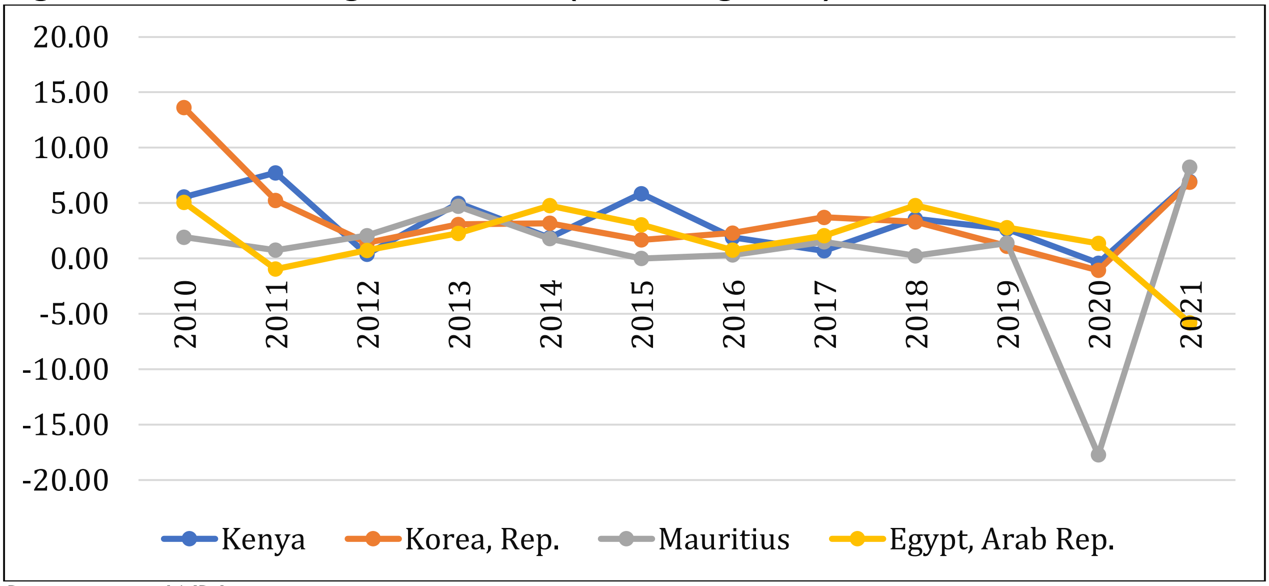
- ✓ Sector-wide coordination of the often fragmented agriculture sector
- ✓ Policy and advocacy for a competitive and enabling business environment
- ✓ Agriculture Value Chains development
- ✓ Trade and Investment facilitation

2. State of manufacturing sector in Kenya

a) Growth of the manufacturing sector

- ✓ The manufacturing sector growth for Kenya and comparator countries has been generally low and volatile for the period under review (Figure 1) and averaged 3.48% between 2010-2021.
- ✓ In 2020, Kenya, South Korea and Mauritius recorded a negative growth of 0.42%, 1.07% and 17.73%, respectively due to the impact of COVID-19 pandemic.
- ✓ Surprisingly, Egypt registered a positive rate of the manufacturing in 2020 at 1.37% but was negative in 2021 at 5.81%.

Figure 1: Manufacturing, value added (annual % growth)

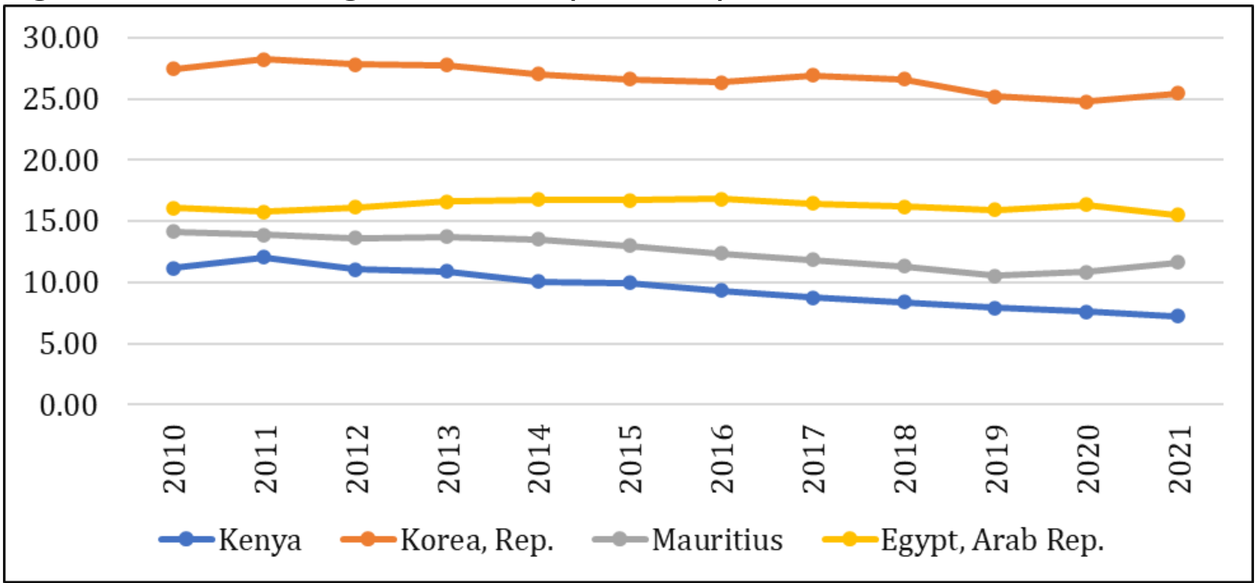


Data source: WDI

b) GDP contribution of the manufacturing sector (%)

- ✓ Manufacturing GDP contribution can give indications whether a country is making strides in industrialization.
- ✓ Kenya is performing poorly in terms of manufacturing GDP contribution compared to competitors on the African Continent such as Mauritius and Egypt (Figure 2).
- ✓ Manufacturing GDP for Kenya has been on a persistent decline from 2011 to 2021, declining from 11.16% in 2011 to 7.24% in 2021. Kenya hopes to reverse this trend through Vision 20 by 30.

Figure 2: Manufacturing, value added (% of GDP)



Data source: WDI

c) Manufacturing output

- ✓ Value of manufactured output increased from Ksh. 2.11 trillion in 2017 to Ksh. 2.69 trillion in 2021 (Table 3). This is despite the persistent decline of manufacturing GDP contribution.
- ✓ Compensation of employees also increased from Ksh. 190.34 billion in 2017 to Ksh. 231.98 billion in 2021.
- ✓ Table 1 also reveals the heavy reliance of the manufacturing sector on intermediate inputs which averaged 65% of final output for the 2017-2021 period.
- ✓ Most of the intermediate inputs are imported.

Table 3: Manufacturing output (Ksh, million), 2017-2021

	Value of output	Intermediate consumption	Intermediate consumption as % of final output	Value added	Compensation of employees
2017	2,109,602	1,368,227	65%	741,376	190,339
2018	2,216,547	1,431,178	65%	785,369	206,420
2019	2,311,586	1,502,333	65%	809,253	218,255
2020	2,373,278	1,557,612	66%	815,666	215,492
2021	2,685,545	1,809,125	67%	876,420	231,984

Average		**65%**		

Data source: World Bank's World Development Indicators (WDI)

3. Kenya's External Trade

a) Direction of Trade

- ✓ The East African Community (EAC), rest of Africa, European Union, USA are the leading Kenya's export destinations accounting for 66% of total value of exports in 2021 (Table 4). Africa accounts for 42% of total value of exports in 2021. This illustrates the importance of the African continent, through the African Continental Free Trade Area (AfCFTA) as an export market.

Table 4: Leading export destinations (% of total value of exports)

	2017	**2018**	**2019**	**2020**	**2021**
	22.42	21.16	23.54	24.60	25.87
	15.66	14.26	14.04	13.64	15.71
	24.58	24.86	25.36	26.65	25.75
	7.91	7.71	8.70	7.67	8.01
	27.17	29.45	26.14	24.49	23.07
	2.27	2.56	2.22	2.96	1.59
	100	100	100	100	100

Data source: Economic Survey, 2022

b) Export Structure

- ✓ Successful industrialization requires outward orientation. Export-led industrialization is based on the production of manufactured products for purposes of selling them in the international market. It was advanced in part because of the failure of the import substitutions industrialization strategy and as model of development due to the success of East Asian countries (Ramdoo, 2015).
- ✓ Countries that produce sophisticated products tend to grow faster. Holding other factors constant, nations that specialize in the types of goods that rich countries export are likely to grow faster than countries that specialize in other goods (Hausmann, Hwang and Rodrik, 2006). Rich countries produce "rich-country products," while countries that continue to produce "poor-country" goods remain poor. Countries become what they produce.
- ✓ Kenya is a small economy, and for firms to realize economies of scale, external market would be useful. Following the CIP methodology, for Kenya to improve its global competitiveness, the country must increase its share in the world market especially for high technology manufactured goods.

c) Import Structure

- ✓ Kenyan exports are primary in nature whereas we import intermediate products (industrial supplies) and other types of value-added products such as machinery, capital, and transport equipment (Table 5). Non-food industrial supplies are the main import category for Kenya and comprised 38.59% of total imports by value in 2021. This serves to illustrate Kenya's reliance on imported inputs for processing. This is why the value and availability of foreign exchange matter to manufacturers.

Table 5: Kenya's import structure, 2017-2021 (% of value)

Import category	2017	2018	2019	2020	2021
Food and beverages	14.4	9.98	10.34	10.73	9.89
Industrial supplies (non-food)	31.76	34.58	33.44	38.88	38.59
Fuel and lubricants	16.28	19.19	18.5	13.66	17.48
Machinery and other capital equipment	17.9	16.47	17.97	16.96	15.61
Transport equipment	11.37	10.72	10.55	9.95	9.31
Consumer goods not elsewhere specified	8.00	8.43	8.66	9.56	8.92
Goods not elsewhere specified	0.30	0.64	0.54	0.26	0.20

Data source: Economic Survey, 2022

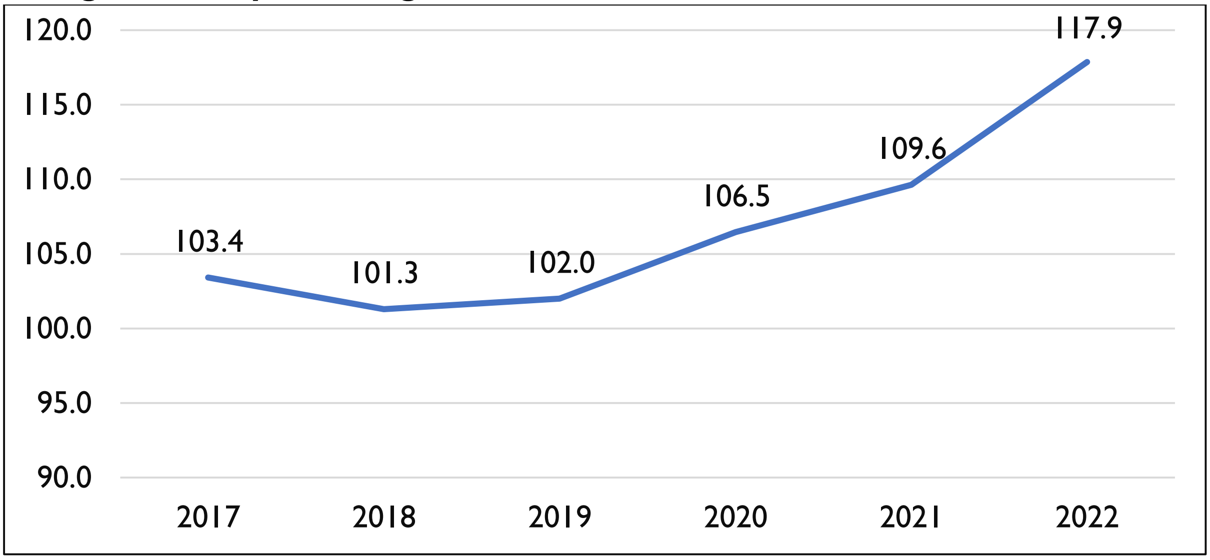
d) Exchange Rate

- ✓ The Kenyan shilling has been depreciating year on year and depreciated significantly in 2022 against the major hard currencies such as the US$ (Figure 2.6). The shilling depreciated by about 7.57% against the US$ between 2021 and 2022.

- ✓ The US$ is a key reference to which trade in other currencies are benchmarked. To this end, the US$ availability and its pricing dynamics have far-reaching implications on the manufacturing sector. Availability and pricing of US$ is a matter the requires urgent government intervention to ensure smooth operation of manufacturers.

- ✓ According to the draft 2023 Budget Statement, the Kenyan shilling has weakened in the face of tightening global financial conditions attributed to strengthening US$, uncertainties regarding the ongoing Russian-Ukraine conflict and increased import bill.

Figure 3: Kenya exchange rate versus US$



Data source: Central Bank of Kenya

Agricultural Imports

The agriculture sector is the mainstay of the Kenyan economy with a contribution of approximately 22% to the GDP. The sector employs 40% of the total population and accounts for 65% of all exports. Kenya imports food and beverages, agricultural machinery and pesticides and fertilizers among others products in the agriculture sector.

Due to to inadequate local production, the Kenyan agriculture relies heavily on imported machinery, pesticides and fertilizers. Imposition of the import levy therefore will increase the cost of production at farm level and ultimately further reduce competitiveness of Kenyan products within the African region and exports.

3.1 EXPORT COMPETITIVENESS

Kenya has market access to an over $ 43 trillion spanning around preferential market access to the EAC, COMESA, European Union, USA, United Kingdom and larger African continent under the African Continental Free Trade Area (AfCFTA). This represents preferential market access to about half of the world economy.

However, Kenya has not been able to capitalise on its huge market access opportunities due to the lack of a deliberate attempt to develop the country's export competitiveness.

As noted earlier in this memorandum, Kenya mainly exports agriculturally based products in raw form. This has been the dominant trend around exports of tea and coffee where Kenya has been exporting bulk produce, losing over 10 times value along the way.

Currently, H.E President Dr. William Ruto has given a directive and guideline that is expected to grow Kenya's value-added tea exports from the current 5% to 50% of total tea exports in the next 5 years. We expect that such, initiatives will set a background for increased value addition within the country.

Kenya lacks exports product diversity: with the bulk of manufactured goods sold in the national and regional markets.

At the regional level, Kenya's exports to the rest of the EAC have been on a decline mainly driven by 3 reasons:

- The growing industrial capacity in the EAC.
- The cost un competitiveness of Kenyan products.
- Perennial market access challenges including NTBs.

There is a need for a deliberate and long-term action to develop a competitive manufacturing sector for the domestic and export markets that will among others address:

- Reduce the cost of doing business.
- Create localised supply chains to grow industrial capacity.
- Increase the ease of doing business by lifting red tape and unnecessary bureaucracy.
- Promote and develop Kenyan products in the exports markets.

3.1.2 Exports Development Policy Scheme: -Exports Promotion Program Office (EPPO)

One of the most competitive exports-oriented programs was the exports promotion program office (EPPO) that saw Kenya rise to a regional manufacturing hub; with companies getting from 0% to 40 % of their annual turnover within the early 2000's.

The EPPO program provided manufacturers and producers with a tax policy environment that enabled them to channel their resources to trade financing, investments and reinvestments. It avoided the current challenges associated with tax refunds, high cost of inputs and raw materials due to import duties.

It is recommended that Kenya reinstates a program similar to EPPO as it works on other policy and infrastructural interventions to drive exports competitiveness.

4.0 FEEDBACK ON THE EXPORTS AND INVESTMENT PROMOTION LEVY

4.1 Situational Analysis

- ✓ The manufacturing sector currently supported through the following fiscal interventions:
- ✓ EAC common external tariff (CET).
- ✓ Specific duties that have been developed to address under invoicing.
- ✓ Differentiated IDF and RDL for raw materials and inputs for local manufacturers at 1.5% and 1.5% instead of 3.5% and 2% respectively.
- ✓ Excise duty.

The Kenyan manufacturing sector can adequately be supported by addressing the following 2 challenges:

i. Global competitiveness - The cost of doing business in Kenya is higher than in competing countries, leading to competitiveness gaps leading to influx of products from low cost / competitive economies to Kenya. Kenya needs to reduce the cost of doing business within the country to sustain and grow its manufacturing capacity, especially with expected increased competition from the Free Trade areas including AfCFTA and TFTA.

ii. Lack of a level playing field – there are imports that fail to provide a level playing field with local manufacturers translating to increased unfair competition from imported goods. Some of the sources of the unlevel playing field are:

   a) Illicit Trade: - Tax anomalies including undervaluation, misdeclaration, under declaration and tax evasion.
   -In the past, the use of specific duties and multi-agency action against illicit trade has been useful in addressing the unlevel playing field.

   b) Taxation/ duty structure anomalies that classify raw materials and finished products on the same duty rate band for instance finished furniture& boards, fabrics & garments, tanning chemicals and wire rods.

- ✓ The development of the Exports and investments development levy would not be able to deliver the expected results of enhancing exports without addressing the bottlenecks around exports competitiveness.
- ✓ Over taxation may encourage tax evasion and increase in other forms of illicit trade. There is therefore a need for a deliberate policy framework to drive exports competitiveness.

4.2 What is Required to drive exports Growth from Kenya?

Deliberate policy to support exports competitiveness: - We propose the reintroduction of the Exports Promotion Program Office (EPPO) that was being implemented in the early 2000's and was successful in transforming Kenya's exports.

The current policy environment is restrictive and at times punitive for manufacturers to export for instance in VAT refunds (currently VAT refunds stand at about 11 billion).

It would be important to administer the proposed levy simultaneously with EPPO to achieve the desired objectives of exports growth.

4.3 What products should the levy be applied on?

- ✓ Finished Goods under 25% and 35%.
- ✓ Finished goods attracting 10% and 0%. (These are essential goods that are not industrial inputs for example pharmaceuticals, textbooks, exercise books).

Key to note: *There are some industrial inputs that sit on 35%. 25% or 10% and they should be exempted from the proposed levy. Such inputs include Boards & timber used in furniture industry and fabrics used in garments industry.*

4.4 What products should not be levied?

- ✓ Raw materials, intermediates and approved industrial spare parts and machinery. Raw materials and inputs for manufactures are registered with the Ministry of Investment, Trade and Industry, National Treasury and KRA under the preferential IDF and RDL scheme. There is already a list of industrial inputs that are provided with remission from full IDF and RDL.
- ✓ Inputs under Duty remission or any form of exceptions for manufacturing for instance in the Exports Processing Zones.
- ✓ Goods originating from the EAC region to avoid creation of NTBs.

4.5 Administration/ Governance of the Levy

- ✓ The levy should be solely used in exports development work including the development of warehouses in strategic markets, trade missions, export incentivization to business entities. To support export development and promotion for the manufacturing sector.
- ✓ The fund created from the levy should be rein fenced for the sole purpose it was developed for and not be redirected to alternative use.
- ✓ A management board for this fund should be developed and should constitute of manufacturers and exporters to guide its administration.

5.0 Way forward on Exports Development

- ✓ The ministry should consider reviving the Exports Promotion Program Office (EPPO) or any other similar program to boost exports competitiveness.
- ✓ The ministry should form a committee comprising of public and private stakeholders to craft a simple to use but impactful export competitiveness policy framework to enable the country to realise its exports and manufacturing potential.
- ✓ The ministry to subject the exports and investments promotion levy to thorough stakeholder review and impact/sensitivity analysis to avert any unintended negative implications to various value chains.

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