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UNDERSTANDING KENYA'S ECONOMIC TRANSFORMATION OUTCOME (THE CETO REPORT)

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WHAT WENT WRONG

Kenya's Country Economic Transformation Outlook (CETO) report tells a troubling story of an economy that has lost its way. For two decades, we have witnessed a peculiar form of development where the country leaped from farming directly into services, bypassing the manufacturing stage that historically creates prosperity (page 6 of the CETO Report). This isn't merely an academic concern, it represents a fundamental threat to millions of livelihoods as the African Continental Free Trade Area approaches.

Imagine Kenya's economy as a three-legged stool meant to stand on agriculture, manufacturing, and services. Instead of building all three legs, we've tried to balance on just two, with manufacturing barely a stub. This imbalance becomes catastrophic when continental competition arrives. While Nigeria built factories, Egypt developed industries, and South Africa created manufacturing giants, Kenya built shopping malls to sell their products.

WHEN EXPORT LEVIES BACKFIRE

The CETO analysis reveals a particularly cruel irony in Kenya's export levy system (page 22). Policymakers designed these levies to encourage value addition by making raw material exports expensive. The theory seemed sound: if exporting raw cashews costs more due to levies, farmers would invest in roasting equipment and export processed nuts instead.

Reality tells a different story. Think of Charo, a cashew farmer in Kilifi. She harvests 1,000 kilograms annually, earning KES 15,000 profit after costs. The export levy reduces this to KES 10,000. The roasting equipment that would exempt her from levies costs KES 2 million, equivalent to 200 years of her current profits. The policy assumes Charo can simply choose to add value, ignoring that she lacks capital for equipment, electricity for processing, and knowledge of international food standards.

This same tragedy repeats across sectors. Honey producers pay levies on raw honey but cannot afford organic certification that often costs more than their annual income. Leather producers face levies on raw hides while industrial tanning equipment remains financially unreachable. The levy system, meant to promote industrialisation, instead taxes those least able to industrialise.

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STANDARDS THAT LOCK OUT SMALL PRODUCERS

Non-tariff barriers (NTBs) present another layer of exclusion masquerading as quality assurance. These standards, designed for industrial operations, become insurmountable obstacles for small enterprises. The CETO findings show how certification requirements systematically exclude MSMEs from markets they could otherwise serve competitively (page 21).

Take organic certification for agricultural products. In developed countries, this certification assumes farmers have offices for record-keeping, computers for documentation, and staff for compliance monitoring. A Kenyan smallholder farmer might produce perfectly organic products using traditional methods passed down through generations yet cannot prove this to international standards without spending multiples of their annual income on certification.

The tragedy deepens when examining specific requirements. Food safety certifications demand stainless steel processing surfaces, temperature-controlled storage, and laboratory testing capabilities. A woman making exceptional peanut butter in her kitchen, selling locally with zero food safety incidents, cannot access export markets because her kitchen lacks industrial specifications. The standards protect consumers in theory while excluding capable producers in practice.

HOW GENDER DISCRIMINATION HURTS OUR ECONOMY

The CETO report's findings on gender-based exclusions reveal how discrimination multiplies economic inefficiency (pages 7-9, 28, 30). Women entrepreneurs demonstrate higher productivity when given opportunities yet face barriers at every turn. These aren't abstract policy failures but concrete obstacles destroying economic potential.

Financial exclusion operates through both obvious and hidden mechanisms. Banks demand land titles as collateral, yet custom and law often prevent women from owning land. Even when women legally own property, loan officers demand male guarantors, treating successful businesswomen as credit risks requiring male validation. A woman running a profitable food processing business generating KES 80,000 monthly cannot access a KES 500,000 equipment loan because her husband holds their land title.

Time poverty compounds financial exclusion. Women entrepreneurs manage businesses while bearing disproportionate responsibility for childcare, elder care, and household management. When export promotion agencies schedule trade missions, women often cannot participate due to care responsibilities. When certification requires traveling to Nairobi for training, women without childcare support remain excluded. The productivity advantages of women-owned firms remain trapped by structural barriers that no amount of business acumen can overcome.

THE MANUFACTURING CRISIS DEEPENS

The data provided in the CETO report reveals that manufacturing wages consistently lag behind service sector earnings, creating a vicious cycle where talent avoids the very sector needed for structural transformation (page 19). Skilled workers naturally gravitate toward better-paying service jobs, leaving manufacturing with inadequate human capital for technological upgrading and export competitiveness.

The gender dimension in manufacturing employment proves particularly troubling. Women find themselves concentrated in lower-skilled, labour-intensive positions: textile production lines, packaging operations, basic food processing, while men dominate technical and managerial roles (page 28). This segregation reflects not capability differences but entrenched biases about who can 'handle technology.' Female employees also experience longer working hours and exposure to sexual harassment, creating hostile environments that waste human potential.

EXPORT FAILURE: A NATIONAL EMERGENCY

Perhaps most alarming, only 0.4 percent of manufacturing MSMEs undertake direct export, with 83.5 percent having no plans to export in the future. This represents not just missed opportunities but an existential threat as AfCFTA implementation approaches. The concentration in low-technology sectors: food production (37.1%), leather products (27.4%), apparel (19.9%), while potentially competitive, remains trapped in domestic markets by the very constraints CETO identifies (pages 19 and 24).

Export Processing Zones, meant to catalyse export growth, account for merely 12.3 percent of Kenya's total domestic exports (page 53). Their concentration in Mombasa, Kilifi, and Nairobi excludes most MSMEs, particularly women-owned enterprises unable to relocate or meet EPZ entry requirements. The AGOA success in apparel exports demonstrates potential but remains captured by large, often foreign-owned enterprises, with benefits barely trickling to local MSMEs.

WHAT AFCFTA MEANS FOR LOCAL BUSINESSES

As Kenya prepares for AfCFTA implementation, these structural weaknesses transform from domestic challenges to existential threats. The agreement creates a continental free trade area where Kenyan businesses compete directly with established manufacturers from more industrialised African economies. Without protective tariffs, the competition becomes a matter of survival. Consider what happens when AfCFTA eliminates duties. Nigerian companies, backed by significant infrastructure investments, can land processed foods in Nairobi cheaper than local MSMEs can produce them. Egyptian textile manufacturers, operating modern factories with economies of scale, can undercut Kenyan producers using outdated equipment. South African retailers can leverage sophisticated supply chains to dominate markets where Kenyan informal traders once thrived.

The numbers paint a stark picture. Kenya expects to lose KES 22.53 billion in annual tariff revenue (KIPPRA Discussion Paper No 306, 2023). But revenue loss pales compared to livelihood destruction. When imported products flood markets, the mama mboga selling locally-produced goods loses customers. The jua kali artisan making furniture cannot compete with mass-produced imports. The informal sector, employing 83 percent of Kenyans, faces decimation without transition pathways to competitiveness. A practical example illustrates the threat. Today, a Gikomba trader sells locally made shirts for KES 500, earning KES 100 profit. Under AfCFTA, Nigerian factories can land similar shirts for KES 300. The trader cannot reduce prices without eliminating profit. She cannot improve efficiency without capital for better equipment. She cannot access export markets without meeting standards she cannot afford. Her options narrow to closing shop or joining millions seeking non-existent formal employment.

TAX POLICY THAT HELPS RATHER THAN HURTS

The CETO analysis demands a fundamental rethinking of how tax policy can enable rather than impede transformation. Current approaches extract resources from those least able to pay while failing to generate development. Revolutionary alternatives exist that could transform tax systems from barriers into bridges. In this regard, CFS offers the following recommendations addressing some of the identified constraints in CETO:

1. Turn Export Levies into Growth Incentives

Replace punitive export levies with graduated tax credits rewarding incremental progress. Instead of taxing farmers for exporting raw cashews, provide credits for each value addition step. Basic cleaning and sorting might earn 15 percent credits on equipment purchases. Roasting and packaging could generate 25 percent credits. Branded export-ready products might receive 40 percent credits. This creates incentives aligned with capabilities, supporting businesses as they grow rather than punishing them for starting small.

2. Break the Non-Export Trap

With only 0.4 percent of MSMEs exporting, radical intervention is required. An Export Transition Credit providing 50 percent tax credits on first-year export expenses, 40 percent on second-year, and 30 percent on third-year acknowledges that export entry requires sustained support. For sectors with competitive potential: food production, leather, apparel, five-year tax holidays on export earnings would provide patient capital for quality improvements and market expansion.

3. Build Infrastructure Through Tax Innovation

An Infrastructure Tax Credit Bond specifically for shared MSME facilities would allow investors to receive tax credits rather than interest payments. A 100 million shilling investment in cold storage facilities accessible to small agricultural exporters might generate 120 million shillings in tax credits over five years, providing attractive returns whilst building critical infrastructure. For credit constraints, a revolutionary Export Finance Tax Offset would allow MSMEs to borrow against future tax obligations. A manufacturer with KES 2 million annual tax payments could access KES 6 million in export development finance, repaid through tax offsets over three years. This transforms tax obligations from extraction into working capital.

4. Create Hybrid Economic Zones

The most innovative solution involves creating hybrid economic zones where informal enterprises access formal sector benefits without abandoning operational advantages. These zones would provide shared infrastructure: processing equipment, testing facilities, cold storage, accessible through mobile booking systems requiring no formal registration. Imagine a Kibera Hybrid Zone where metalworkers book welding equipment for KES 500 daily, accessing technology they could never purchase individually. Groups of women food processors reserve certified kitchens for export production, paying only for usage time. Informal trader associations access cold storage for consolidating exports, achieving scale collectively while maintaining independence.

5. Tackle Information Asymmetry Through Tax-Incentivised Knowledge Networks

A Peer Learning Tax Credit would reward businesses that mentor others into export markets. An established exporter providing documented support helping five MSMEs achieve first exports could receive tax credits equal to 50 percent of the new exporters' first-year export values. This creates multiplier effects where success breeds success through knowledge transfer.

6. Implement Gender-Responsive Export Promotion

Companies achieving gender parity in technical roles could access preferential corporate tax rates, perhaps 20 percent instead of 30 percent, creating powerful incentives for inclusion. For women-owned enterprises, an Export Achievement Rebate could provide retroactive tax refunds based on export success. A woman entrepreneur achieving USD 50,000 in first-year exports could receive refunds of previous three years' tax payments, creating patient capital without traditional lending.

7. Enable County-Based Specialisation

CETO's recommendation of 'One County, One Product' strategy could transform through coordinated tax incentives. If Makueni County chooses mango processing, every business in the mango value chain: from farmers to processors to exporters, could access special tax rates, creating clusters of excellence that achieve global competitiveness through specialisation.

MOVING FORWARD WITH PURPOSE

Kenya stands at a crossroads where decisions made today determine whether millions prosper or face destitution under AfCFTA. The CETO report documents two decades of policy failures that created current vulnerabilities. Continuing these approaches while expecting different results represents economic malpractice that will devastate livelihoods. Success requires abandoning comfortable assumptions about development proceeding through formal channels. It demands recognising that mama mbogas and jua kali artisans represent not problems to solve but assets to leverage. It necessitates tax policies that build rather than extract, standards that include rather than exclude, and financial systems serving all Kenyans rather than privileged minorities.

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