Cost of Living and the Role of Markets

KENYA ECONOMIC REPORT 2023

POPULAR VERSION

KENYA VISION 2030

To create a globally competitive and prosperous nation with a high quality of life by 2030

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The KENYA INSTITUTE for PUBLIC POLICY RESEARCH and ANALYSIS

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Thinking Policy Together

KENYA ECONOMIC REPORT 2023

POPULAR VERSION

COST OF LIVING AND THE ROLE OF MARKETS

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INTRODUCTION

1

The theme for the Kenya Economic Report (KER) 2023 is ***'Cost of Living and the Role of Markets'***. This theme was considered at a time when progressive recovery from the COVID-19 economic recession in 2020 was threatened by domestic market shocks emanating from prolonged drought and the spillover effects of the Russia-Ukraine war that disrupted global food and commodity supply chains. This also came at a time when the economy was just emerging from the electioneering period of 2022. The cost of living as proxied by consumer price inflation increased substantially in 2021 through 2022, with annual inflation rates rising from 4.8 per cent in October 2020 to a peak of 9.6 per cent in October 2022, before easing to 7.3 per cent in July 2023. Thus, the inflation rate stayed outside the upper band of the medium-term target for about a year.

Figure 1: Inflationary trends; January 2016–July 2023

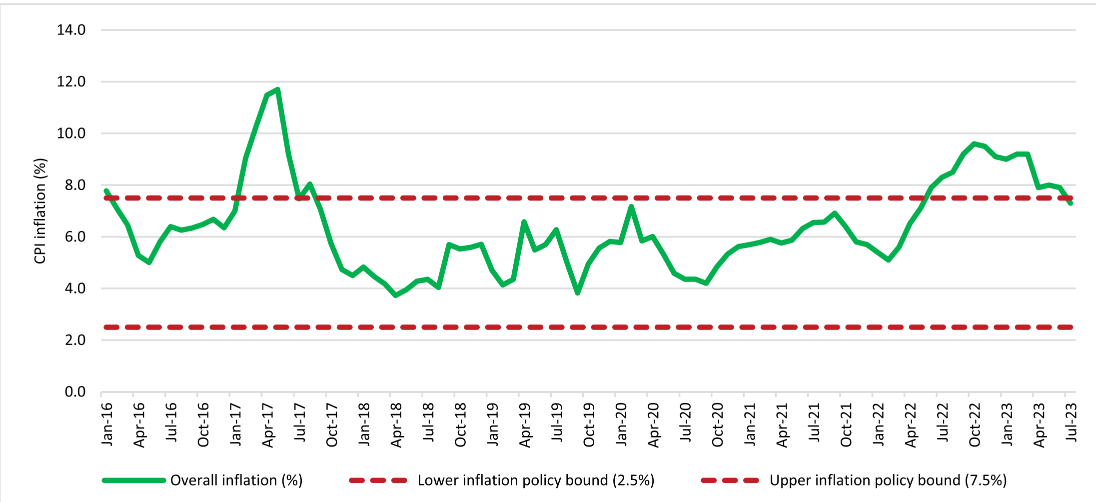
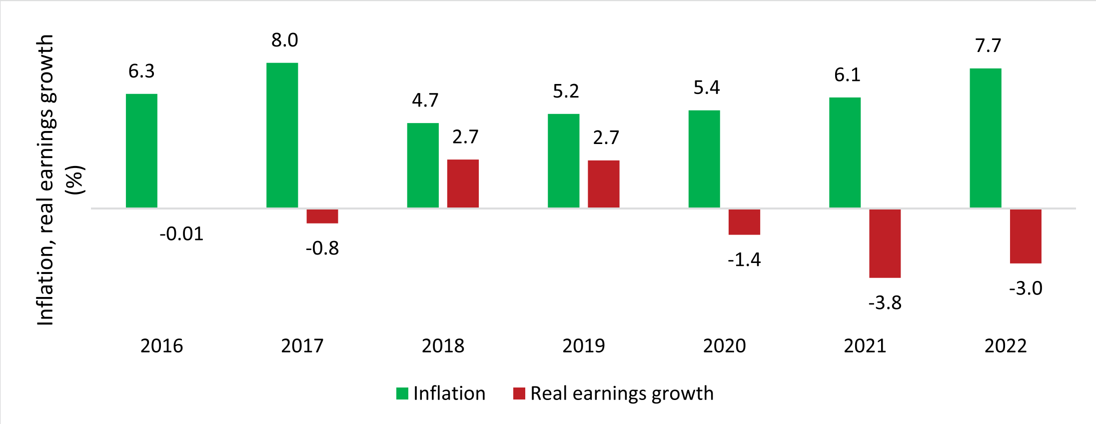


Figure 2: Real earnings growth and inflation for Kenya, 2016-2022



To contain inflation and cushion low-income households from erosion of purchasing power, the government employed various short-term interventions; for instance, minimum wage was increased by 12 per cent in 2022. From the fiscal side, electricity tariffs were lowered, maize flour, fuel and fertilizer subsidies introduced, Valued Added Tax (VAT) on essential products reduced, and waivers on import duty on maize imports introduced. Some of these measures were, however, phased out later. All these aimed to leverage on the role of markets. On the monetary policy front, monetary policy was tightened to anchor inflationary expectations.
While these interventions provided short term relief to consumers, strengthening market systems is imperative to provide long-term solutions and lower the fiscal burden on the government in form of consumption subsidies and tax waivers while mitigating distortionary effects and inefficiencies associated with direct government interventions.

The Kenya Economic Report 2023 provides macroeconomic and sectoral analysis on issues of interest in making markets work better. For the product markets, the Report covers manufacturing, trade, agriculture, food, and energy markets given their prominence as conduits to cost of living. The financial markets focus on the credit market, considering its role in supporting household consumption smoothing or investment in businesses to enhance household incomes. The Report also focuses on minimum wage as a tool to cushion households' living standards from deteriorating in the face of rising prices. The Report further considers the governance environment in terms of the role of the government through its market-enabling roles.

MACROECONOMIC PERFORMANCE

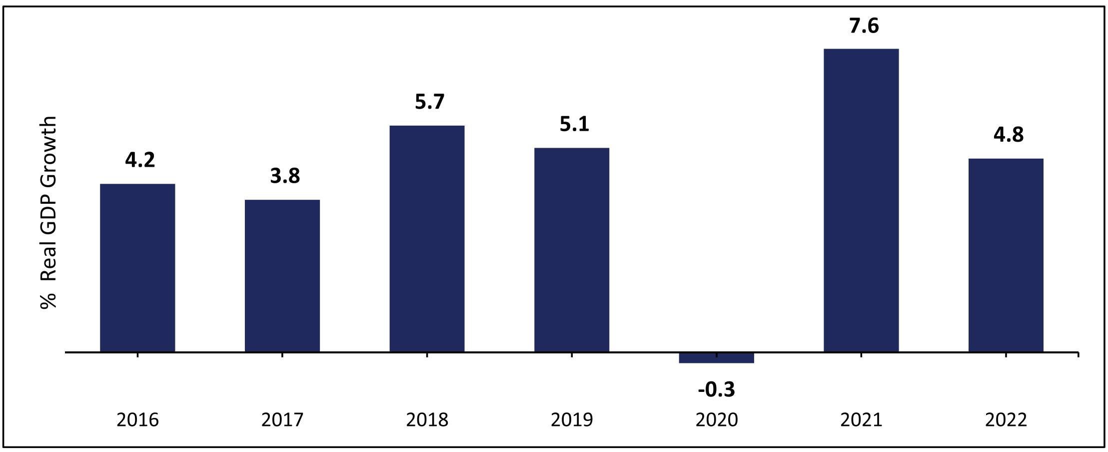
2

Macroeconomic performance covers economic output, demand management policies and external sector stability.

a) Output, employment and inflation

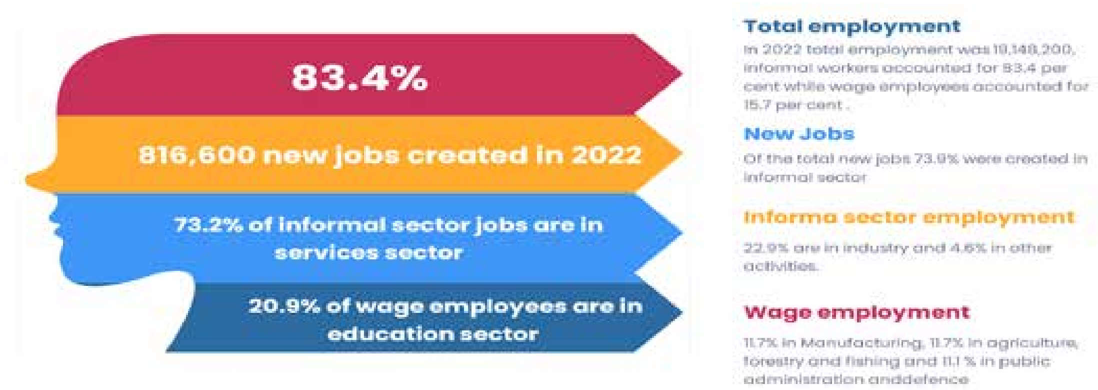
With COVID-19 pandemic, the economy shrunk by 0.3 per cent in 2020. In 2021, the economy bounced back strongly, growing by 7.6 per cent as the COVID-19 restrictions were relaxed. In 2022, the recovery pace was disrupted by severe drought and geopolitical developments in Europe that saw disruption of the global supply chain, slowing the growth rate to 4.8 per cent. The service and industry sectors performed well, while the agriculture sector contracted due to consecutive depressed rainy seasons and high input costs.

Figure 3: Real GDP growth rates; 2016-2022



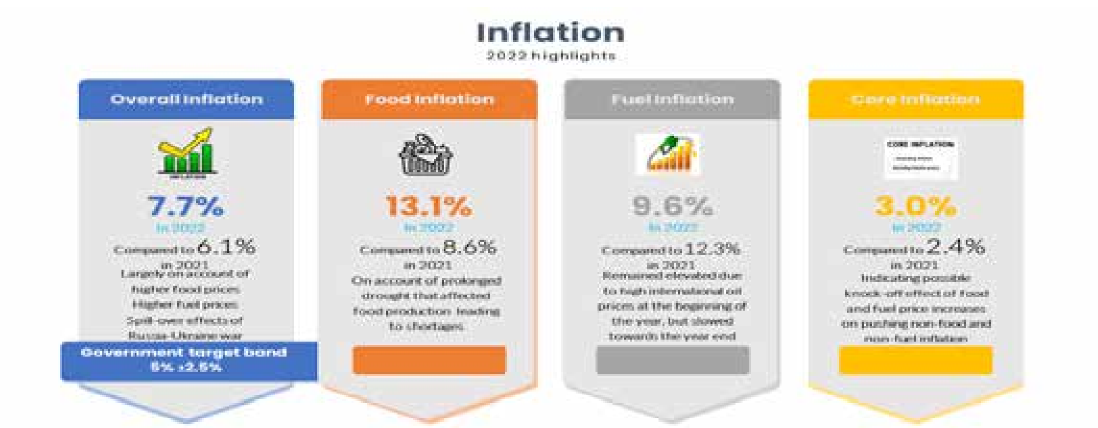
Employment levels also recovered with easing of the COVID-19 restrictions. In 2022, about 816,600 new jobs were created, with most of them in the informal sector. The services sector had the highest number of informal jobs, followed by the industrial sector. In wage employment, the education sector had the highest number of workers (20.9%), followed by manufacturing (11.7%), agriculture, forestry and fishing (11.3%), and public administration and defense; compulsory social security (11.1%). Males dominated wage employment at 61.7 per cent while women in wage employment were generally involved in activities such as household work, healthcare, agriculture, finance, and education.

Figure 4: Highlights of labour market developments



The inflation rate increased beyond the government target range for the first time in five years. Inflation was mainly driven by rising global commodity prices, high food prices, and disruptions in global supply chains due to the Russia-Ukraine war. The monetary policy was tightened to anchor inflationary expectations.

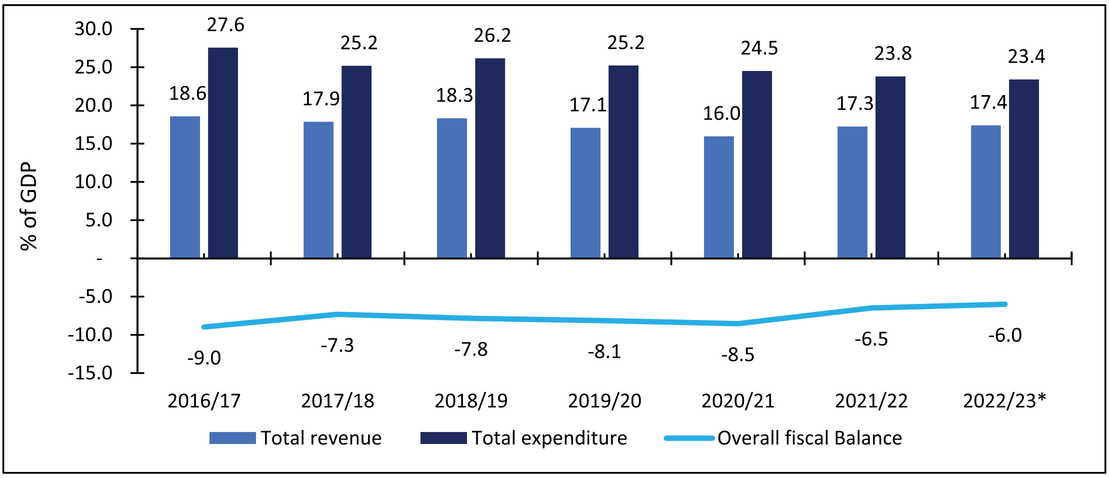
Figure 5: Inflation components



b) Fiscal developments

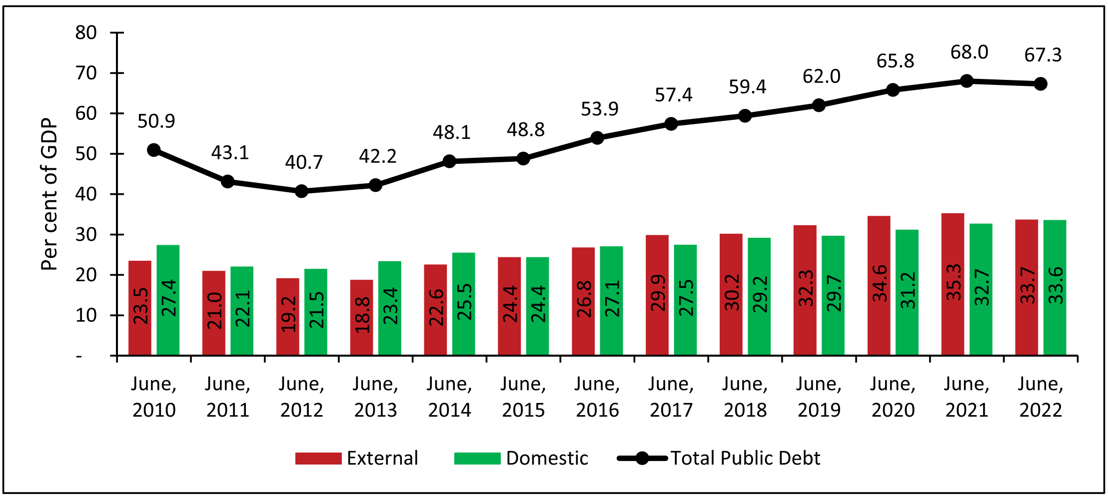
The fiscal deficit narrowed to 6.5 per cent of Gross Domestic Product (GDP) in 2021/2022 due to increased revenue and rationalization of public spending. A similar trend is projected for 2022/23 with fiscal deficit narrowing to 6.0 per cent of GDP.

Figure 6: Revenue, expenditure, and fiscal balance



During the period, public debt moderated slightly, reaching 67.3 per cent of GDP at the end of 2021/22 compared to 68.0 per cent of GDP in 2020/21, largely reflecting the impact of the debt service suspension initiative, which was implemented between January 2021 to December 2021. Despite this, the debt burden remained relatively high due to the exchange rate depreciation.

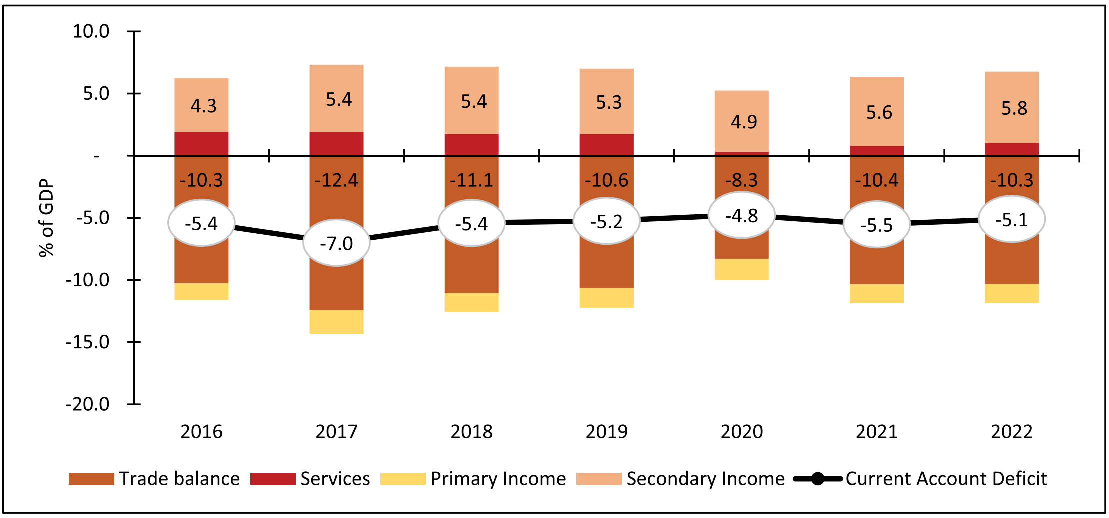
Figure 7: Total public debt by domestic and external sources



c) External balance

The external balance was affected by the global trade disruptions and strengthening of the US dollar. The current account deficit narrowed, supported by improved trade balance. Exports grew faster, while imports growth rate was slow. Services, including remittances, contributed positively to moderate the widening of the current account balance as shown in Figure 8. That said, capital inflows declined, affecting the financing of the current account and foreign exchange reserves.

Figure 8: Current account deficit and its drivers (% of GDP)



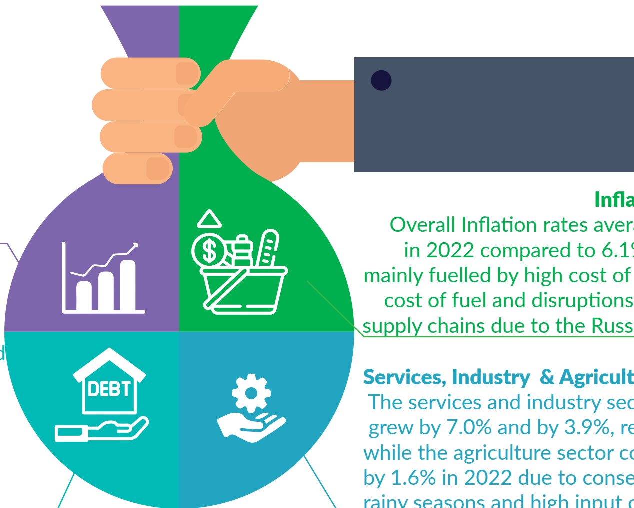
To harness the benefits of macroeconomic environment to support lowering the cost of living in Kenya, the following is recommended:

1. Accelerate investments in agriculture sector by subsidizing inputs to make them more affordable, upscaling irrigated agriculture to reduce dependency on rain-fed agriculture and adopting climate smart practices. This serves to revamp resilience to weather-related shocks and provide fresh impetus for agriculture sector growth. Further, provide adequate budget for the services and manufacturing sector to sustain their growth.
2. Keep to the fiscal consolidation path to build fiscal buffers and bring public debt to sustainable levels. This can be achieved through enhancing revenue mobilization by expanding the tax base, ensuring every eligible citizen pays their fair share of taxation, rationalizing public expenditures, and cutting back on vulnerabilities in state-owned enterprises.
3. Re-focus debt management strategy to emphasize on the acquisition of more concessional loans and prudent utilization of new loans. Considering that Kenya's growth momentum

slowed from 7.6 per cent in 2021 to 4.8 per cent in 2022, prudently utilizing newly acquired loans on concessional terms will be critical to drive the recovery process.

4. Accelerate diversification of export goods and services and expand export markets. This could involve up-scaling production of major export commodities (horticulture, tea, and coffee) and seeking new markets for exports including ACFTA. Additionally, there is need to create a favourable environment to enhance flow of remittances from the diaspora, which will strengthen the secondary income account. By strengthening external position this will help boost foreign exchange reserves and reduce the pressure on the shilling.

MACROECONOMIC PERFORMANCE



Economic Growth:
The economy grew by 4.8% in 2022 compared to 7.6% in 2021.

Public Debt:
Public debt receded slightly, reaching 67.3% of GDP at the end of 2021/22 compared to 68.0% of GDP in 2020/21.

Inflation Rate:
Overall Inflation rates averaged 7.7% in 2022 compared to 6.1% in 2021, mainly fuelled by high cost of food, high cost of fuel and disruptions in Global-supply chains due to the Russia-Ukraine war.

Services, Industry & Agricultural Sectors
The services and industry sectors grew by 7.0% and by 3.9%, respectively, while the agriculture sector contracted by 1.6% in 2022 due to consecutive failed rainy seasons and high input costs.

TO ENHANCE MACROECONOMIC STABILITY TO SUPPORT STRONG GROWTH AND REDUCE COST OF LIVING:

- Revamp productivity of agriculture sector by enhancing supply of affordable inputs, upscaling irrigated agriculture and adoption of climate smart practices.
- Contain inflationary pressures with timely and sufficient monetary policy response to anchor inflationary expectations.
- Strictly adhere to established fiscal consolidation path to build fiscal buffers and bring public debt to sustainable levels.
- Remain vigilant to global developments for timely policy action in addressing vulnerabilities that may arise therefrom.
- Accelerate the pace of economic diversification to enhance export of goods and services and expand export markets.

MEDIUM-TERM PROSPECTS FOR KENYA

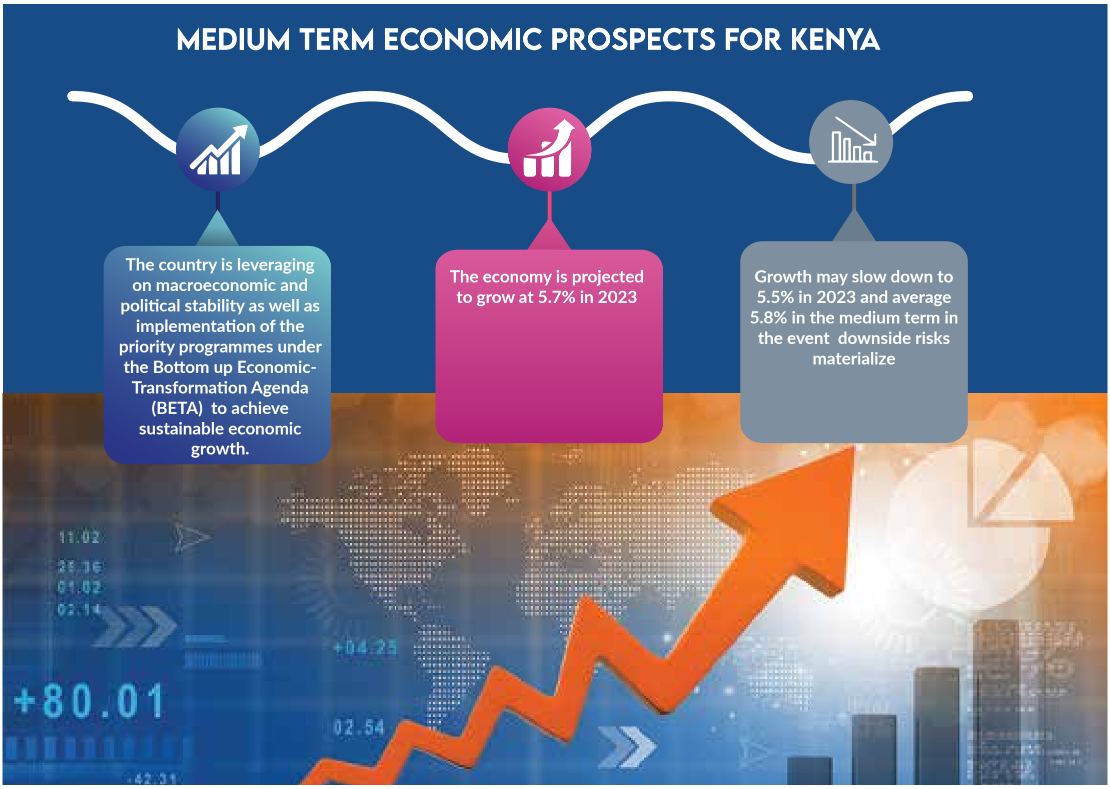
3

Economic activity globally was on a recovery path with the fading effects of the COVID-19 pandemic. However, with the onset of the Russia-Ukraine war, which started in February 2022, the recovery momentum was slowed down. Economic activity in Kenya, like many other countries, slowed down from the second quarter of 2022. Looking ahead, the country faces significant downside risks, including the uncertainty with the Russia-Ukraine war and weather conditions. The country is leveraging on macroeconomic and political stability and implementation of the priority projects and programmes under the Bottom-Up Economic Transformation Agenda to achieve sustainable economic growth. In 2023, the economy is projected to grow at 5.7 per cent and average 6.1 per cent in the medium-term, with progressive implementation of the Bottom-Up Economic Transformation Agenda. The performance will be supported by growth in all sectors, indicating a broad-based growth approach. However, growth may soften to 5.5 per cent in 2023 and average 5.8 per cent in the medium-term should risks materialize.

To cushion the agriculture sector from further contraction and sustain overall economic recovery in the medium term:

1. The Ministry of Agriculture and Livestock Development could support farmers to plant early maturing and drought-resistant varieties of crops, fodder and pasture, such as short season maize (3-4 months), sorghum, cassava, and beans to sustain adequate food supply. Further, pastoralists with support of the county governments, need to adopt appropriate measures to conserve pasture following the rain season to ensure their livestock have adequate feed beyond the season.
2. The Ministry of Agriculture and Livestock Development in collaboration with the county governments through agricultural extension officers need to intensify farmers' sensitization and capacity building on appropriate technologies, innovations and implementation of smart agriculture to support the agriculture sector transformation agenda.

3. Farmers need to diversify the types of fertilizer they use, to include organic fertilizer in order to avoid disruptions when there are shortages of imported fertilizer; also organic fertilizer may be affordable.
4. With uncertainties in the global markets, policy makers need to remain vigilant and monitor policy developments to inform appropriate policy formulation for the domestic economy.
5. Finally, there is need to fast-track implementation of priority projects and programmes under the Bottom-Up Economic Transformation Agenda to ensure a sustained growth momentum.



INFLATION DYNAMICS IN KENYA

4

There are 330 items in the Consumer Price Index (CPI) basket of which food items have a weight of 32.9 per cent. This basket is used to calculate overall inflation where prices of these items are compared at different times. This helps in understanding how changes in prices of goods and services evolve over time, and the factors at play. In an environment of rising inflation, purchasing power of consumers is eroded, adversely impacting on their welfare.

In Kenya, the government sets the inflation target range at 5 per cent plus or minus 2.5 per cent. On several occasions, inflation exceeded the upper band (7.5%) mainly because of drought episodes. This includes in 2011 when the inflation rate averaged 14.0 per cent, in 2017 when inflation rate averaged 8.1 per cent and in 2022 when the rate averaged 7.7 per cent. With 32.9 per cent of the CPI basket constituting food commodities, food shortages that drive food prices tend to exert inflationary pressures. Normally, the government uses monetary policy to contain inflationary expectations. In 2022, for example, the Central Bank of Kenya policy rate was raised from 7.00 per cent in December 2021 to 8.75 per cent in December 2022, and further to 10.50 per cent in June 2023. The government also lowered import duties for food commodities such as maize and edible oils to ensure there is adequate supply in the domestic market. Additionally, the government sought to enhance production through fertilizer subsidies.

Results from estimating the inflation model show that shortages in food production put pressure on food prices. In addition, international oil prices and exchange rate have a pass-through effect, while increase in money supply drive the demand-pull inflation. Further, inflation has an inertia effect. In case of a disequilibrium due to shocks, it takes approximately one and a half years for inflation to completely converge to its steady state long-run equilibrium.

Second-round effects or secondary inflation is a phenomenon where an initial increase in prices leads to a subsequent increase in wages and other costs, which in turn leads to a further increase in prices. This creates a spiral effect. Oil price second round effects are immediate and peak after three quarters while food price second round effects delay and begin after about 2.5 quarters and peak after six quarters. Moreover, during an inflation episode, potential wage-price spiral is detected as labour unions push for higher wages to cope with the eroding purchasing power.

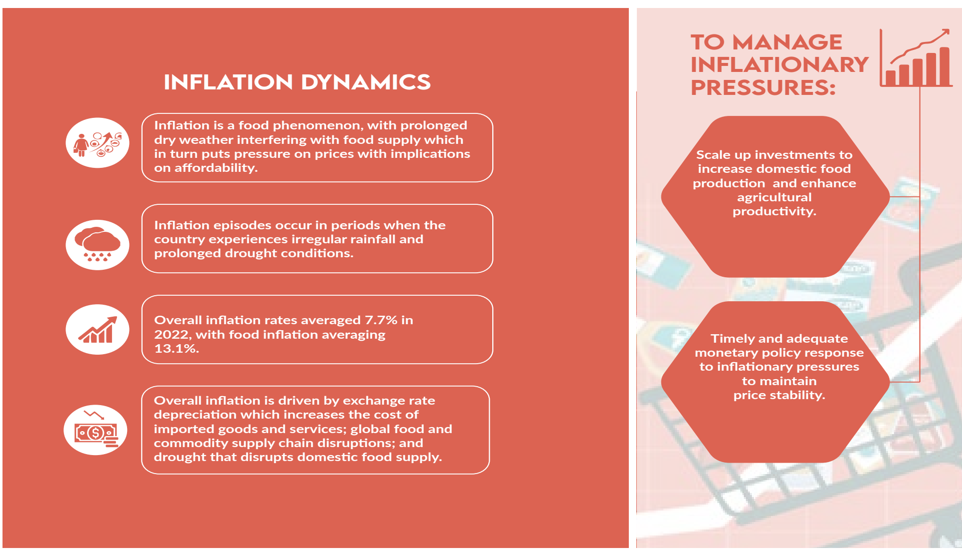
Table 1: Short- and long-term semi-elasticity of CPI inflation with respect to its drivers

Short run		Long-run	
Variable	Coefficient	Variable	Coefficient
Lagged CPI	0.444	Lagged CPI	0.791
Oil price	0.028	Oil price	0.022
Exchange rate	0.106	Exchange rate	0.180
Money supply	0.162	Money supply	0.078
Lagged agriculture output gap	0.001	Lagged agriculture output gap	0.021
Lagged error correction term	-0.166		

Note: All coefficients are statistically significant at 5%

To control inflation, the following recommendations are made:

1. Strive for available, adequate and affordable food to lower the cost of living. To achieve this, recalibrate the national policy towards scaling up investments in domestic food production and enhancing agricultural productivity.
2. The longer adjustment period to steady state inflation rate and the different timings of second round effects of food prices and oil prices on core inflation shows the importance of timely and adequate monetary policy response to ensure price stability is maintained and minimize second round effects. Furthermore, removal of price-related incentives such as subsidies needs to be phased out gradually to ensure consumers are not adversely affected.
3. Remain vigilant to global developments for timely policy action in addressing vulnerabilities that may arise from international markets.

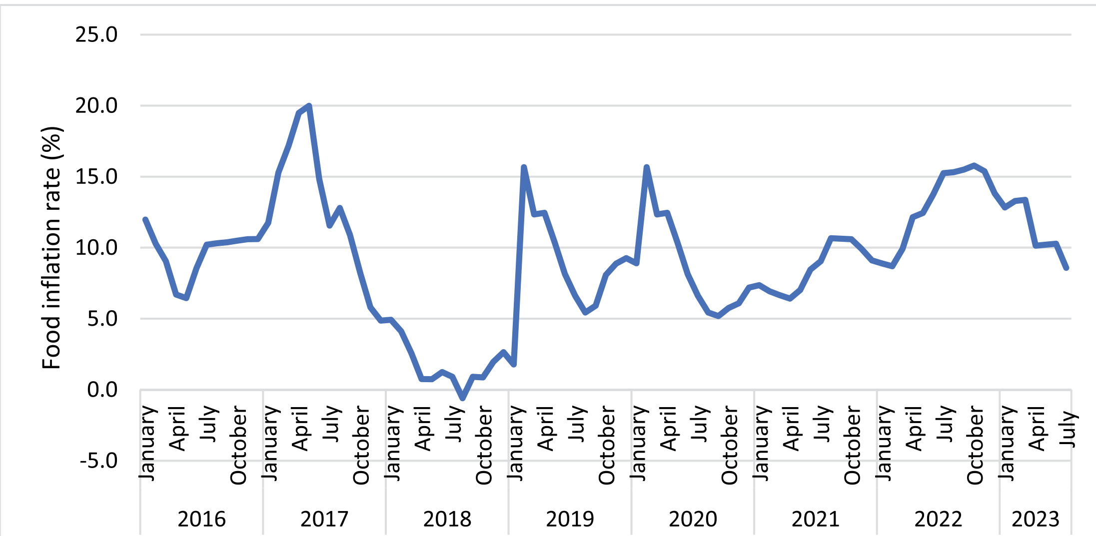


FOOD INFLATION AND COST OF LIVING

5

Food inflation and the cost of living are closely related. Food inflation rose from 8.9 per cent in January 2022, peaking at 15.8 per cent in October 2022 before declining to 8.6 per cent in July 2023. Food prices have a direct impact on the cost of living, especially for poor households who spend about 60 per cent of their income on food. This means that any increase in food price results in households spending more money to maintain their usual consumption patterns. Poor households are, in addition, forced to cut back spending on other essential items such as health, sanitation, clean water and education to meet their food demands. As a result, they are pushed into poverty and made more susceptible to poor health, malnutrition and weak human capital development.

Figure 9: Food inflation rates



As a result of high dependence on rain-fed agriculture, hikes in food prices are experienced during prolonged drought, as food supply is disrupted. In addition, global commodity inflation contributes to an increase in local food inflation due to price transmissions to domestic prices through trade channels. Kenya imports most of its fertilizer from the global market and is, therefore, susceptible to rising international fertilizer prices that lead to high cost of production.

Rising cost of energy also increases the cost of production and transport, which in turn affects food prices. Market infrastructure in the agri-food systems plays a crucial role in linking farmers to consumers. Poor market infrastructure, such as poor rural roads/feeder roads, and poor market information flows, and absence of cooling and storage systems, contribute to distribution constraints leading to food surplus and wastage in some parts of the country while other parts experience food shortages.

To stabilize food prices:

1. Promote crop diversification and improved crop variety, including for local indigenous food crops that are less affected by extreme weather conditions. Further, more research is imperative to ensure that drought-resilient crops are discovered to fit the regional climatic conditions and soil types.
2. Promote irrigation systems such as drip irrigation, utilization of underground water in the Arid and Semi-Arid Lands (ASALs) and improved water harvesting to help reduce over-reliance on rain-fed agriculture.
3. Strengthen kitchen garden technologies, including urban farming, farms in schools and other learning institutions. This will contribute to households' access to fresh food, especially vegetables and fruits for healthy diets. The produce could also add to households' income as they sell the surplus.
4. Promote post-harvest management of fresh produce to minimize post-harvest losses through agri-food processing and adequate storage facilities to help mitigate the effect of seasonal supply disturbances, thereby stabilizing prices at all seasons.
5. Fast-track the establishment of local fertilizer production plants in the country to help reduce the country's over-reliance on imported fertilizers at high prices within the global markets. In addition, support farmers to diversify fertilizer to include the use of organic fertilizer, which is cheaper and helps reduce the cost of food production.
6. Rehabilitate rural roads and feeder roads to help boost marketing activities and connect food markets. Balanced development of transport infrastructure could minimize price disparities in retail food markets and improve distribution logistics.
7. Promote the adoption of information and communications technology to improve market information flows. The

use of modern information technologies such as mobile phones, Internet, and social media can help farmers access information about market prices, weather patterns, and other critical market information. In addition, establish sustainable market information systems to support dissemination of market information to farmers and other stakeholders, thereby reducing transactional costs or market power by some actors.

8. Enhance targeted social safety net programmes to protect the poor and vulnerable groups such as orphans, elderly and people with disabilities from food inflation shocks. Early warning systems on weather shocks could be utilized to ensure that social safety nets are in place before a crisis occurs.

FOOD INFLATION AND COST OF LIVING

Food inflation rose from 8.9% in January 2022, peaking to 15.8% in October 2022 before easing to 8.6% in July 2023.

Kenyans spend 54.3% of their income on food. An increase in food prices reduces the purchasing power and therefore limits the quantity and quality of food purchased and consumed by households.

Weather conditions influence food prices. Low rainfall seasons result in low food production which translate to high food prices.

The government has increased investments to improve local food supply by supporting farmers to increase production and importation.

TO STABILIZE FOOD PRICES & LOWER COST OF LIVING

Enhance investment and create awareness of smart agricultural practices to help in building resilience against climate change risks.

Fast-track the establishment of local fertilizer plant to reduce the country's overreliance on high global fertilizer prices.

Strengthen kitchen garden technologies, including urban farming, farms in schools and other learning institutions.

Promote post-harvest management of fresh produce to minimize post-harvest losses.

MINIMUM WAGE AND COST OF LIVING

6

Kenya has a minimum wage policy in place, aligned with the International Labour Organization (ILO) conventions, and has legislated its implementation through the Labour Institutions Act, 2007. The minimum wage serves as a policy tool to safeguard workers against low wages, the burden of a high cost of living, and to elevate them out of poverty. Employers are obligated to comply with the prescribed minimum wage.

However, despite being embedded in law, the implementation of minimum wage has faced constraints in terms of its coverage and enforcement. The policy only applies to salaried workers in the formal sector, leaving many workers in the informal sector without coverage, yet they account for about 83 per cent of the total employees. The limitation of coverage and enforcement is due in part to inadequate capacity in terms of the number of enforcement officers and limited awareness and understanding of minimum wage laws among employers and employees in the informal sector.

Even though the country increased minimum wage by 12 per cent in 2022, the cost of the minimum basket increased by an average of 22 per cent over the same period. This implies that minimum-wage earners continue to struggle to make ends meet. The increase in the cost of living has, therefore, eroded the purchasing power of minimum wage earners. In addition, the minimum wage rate only covers around half of the necessary expenses for a decent living. This amount is insufficient in ensuring a worker's ability to lead a decent life. Consequently, workers face difficulties in affording the fundamental and necessary goods and services needed for their sustenance.

To ensure that the minimum wage effectively addresses the cost of living and improves the well-being of individuals with low incomes:

1. Align the minimum wage to the prevailing minimum living wage based on the cost of living trends and current economic conditions as provided for in Section 44(5) of the Labour Institutions Act, 2007. This will ensure that workers afford a decent standard of living.
2. Enhance the implementation of minimum wage in the informal sector by strengthening compliance and enforcement measures. Furthermore, raise awareness among employers

and employees through informative campaigns, using diverse platforms including print and social media to create awareness among the workers about their entitlements according to minimum wage legislation.

3. Enhance the capacity of enforcement officers to adequately monitor to ensure every worker eligible for minimum wage is paid as stipulated in the law.

4. Provide a comprehensive social protection system to complement the minimum wage so that workers and their families can maintain a reasonable level of income through decent work. This can be done through provision of reliable and affordable public transport for workers, housing, universal health care and universal education to cushion the minimum wage earners against the high cost of living.

MINIMUM WAGE

Kenya has a minimum wage policy in place and has legislated its implementation through the Labour Institutions Act of 2007; aligning with the International Labour Organization (ILO) conventions. The policy only applies to salaried workers in the formal sector, leaving many workers in the informal sector without coverage, yet they account for about 83 per cent of total employees. Kenya increased minimum wage amount by 12 per cent in 2022. However, the cost of the minimum basket increased by an average of 22%.

TO ENSURE THAT THE MINIMUM WAGE EFFECTIVELY ADDRESSES THE COST OF LIVING AND IMPROVES THE WELL-BEING OF INDIVIDUALS WITH LOW INCOMES:

1. Align the minimum wage with the prevailing minimum living wage based on the cost-of-living trends and current economic conditions. This will ensure that workers are able to afford a decent standard of living.

2. Strengthen compliance and enforcement measures by raising awareness to enhance the implementation of minimum wage in the informal sector.

3. Strengthen enforcement of the minimum wage so that every eligible worker is paid as stipulated in the law.

4. Provide a comprehensive social protection system such as provision of reliable and affordable public transport, housing and universal health care to cushion the minimum wage earners against the high cost of living.

ROLE OF CREDIT MARKETS IN MANAGING THE COST OF LIVING

7

Households experience various income shocks from time to time. In the absence of robust coping mechanisms such as credit markets, these shocks pose severe welfare-eroding implications on households in the long-term. The findings from FinAcess 2021 household survey show that approximately 6 out of 10 Kenyan households reported having experienced high cost of living as a dominant shock. Other shocks reported included health-related incidents, job losses and deaths. With health-related shocks recurring, households are exposed to underlying catastrophic health expenditures.

Most households have inadequate buffers against income shocks. The main coping strategy to the high cost of living shocks is cutting back on expenses or adjusting consumption patterns. Poor households are more likely to cut their expenditures on food when faced with a significant income shock such as the high cost of living. Since majority spend more than half of their incomes on food, to some households, adjusting prevailing consumption expenditure would imply falling back to poverty.

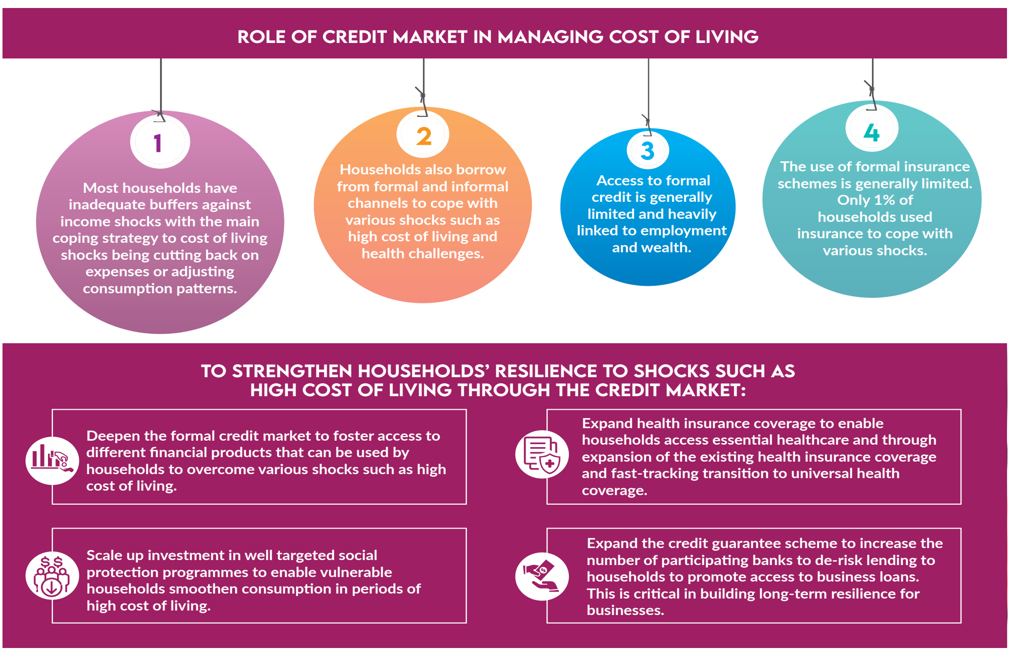
Reliance on assistance from family and friends is another popular coping strategy adopted by households, since formal social protection schemes are limited. Therefore, if high cost of living persists, in regions where majority of households are poor, getting assistance from family and friends may be unsustainable as there will be little to share as the shock affects all in the society. This may lead to many households sliding back to poverty.

Households also borrow from formal and informal channels to cope with various shocks such as high cost of living and health challenges. However, access to formal credit is generally limited and heavily linked to employment and wealth. This is because the wealthy are more likely to have assets, which can be used as collateral while the employed normally have a steady flow of income, which in most cases is required by banks to qualify for credit. In addition, financial institutions may perceive the wealthy as less risky compared to the poor households.

The use of formal insurance schemes, though critical in addressing catastrophic health spending and other income shocks, is generally limited. Only one per cent of households use insurance to cope with various shocks. Other coping strategies such as disposal of assets (selling livestock) adopted particularly by rural households may undermine their productivity, further exposing them to risks of poverty.

To strengthen households' resilience to shocks such as high cost of living through the credit market:

1. Deepen the formal credit market to foster access to different financial products that can be used by households to overcome various shocks such as high cost of living. Commercial banks and other financial institutions can redesign their loan products to be more responsive to challenges encountered by households when faced with income shocks. In addition, enhanced financial literacy could raise households' awareness and shift towards formal finance.
2. Scale up investment in social protection programmes to enable vulnerable households smoothen consumption in periods of high cost of living. The programmes need to be well targeted to ensure they benefit the eligible households. This can enhance ability of vulnerable households to increase spending on food in periods of distress.
3. Expand health insurance coverage to enable households access essential healthcare and cope with catastrophic health expenditure. This can be done by expanding the existing health insurance coverage and fast-tracking transition to universal health coverage. It is also important to expand livestock insurance schemes to transfer risks and minimize losses associated with climate shocks and build resilience of rural households who are heavily dependent on livestock.
4. Expand the credit guarantee scheme to increase the number of participating banks to de-risk lending to households to promote access to business loans. This is critical in building long-term resilience as most of the borrowed funds are used for investment and expansion of businesses. It is also important to raise awareness on the credit guarantee scheme to increase uptake.



8 LEVERAGING ON FOOD MANUFACTURING TOWARDS LOWERING COST OF LIVING

Manufacturing helps to stabilize consumer prices through processing of primary products such as fruits, vegetables and grains, which helps preserve food during glut and have adequate supply of food throughout. Manufactured food products account for 24.8 per cent of the consumer expenditures basket, presenting substantial implications on the cost of living through the price channels. Food and beverages account for 10.9 per cent of manufactured imports, with processed imported food mainly including rice, milk, cooking oil, sugar and sugar confectionary such as chocolates and candies.

Food manufacturing is prone to supply disruptions, especially those emanating from droughts that adversely affect agricultural production. In addition, manufactured food products that face relatively high input costs are those whose inputs are largely imported, with exposure to international prices. Moreover, low technology adoption, policy uncertainty, limited access to credit and inadequate skills constrains capacity utilization in food processing, especially among the Micro and Small Enterprises (MSEs), which account for 86 per cent of the food manufacturing enterprises. Given that food prices at producer (manufacturer) level are passed on to consumers through increased food prices, addressing these constraints becomes a priority.

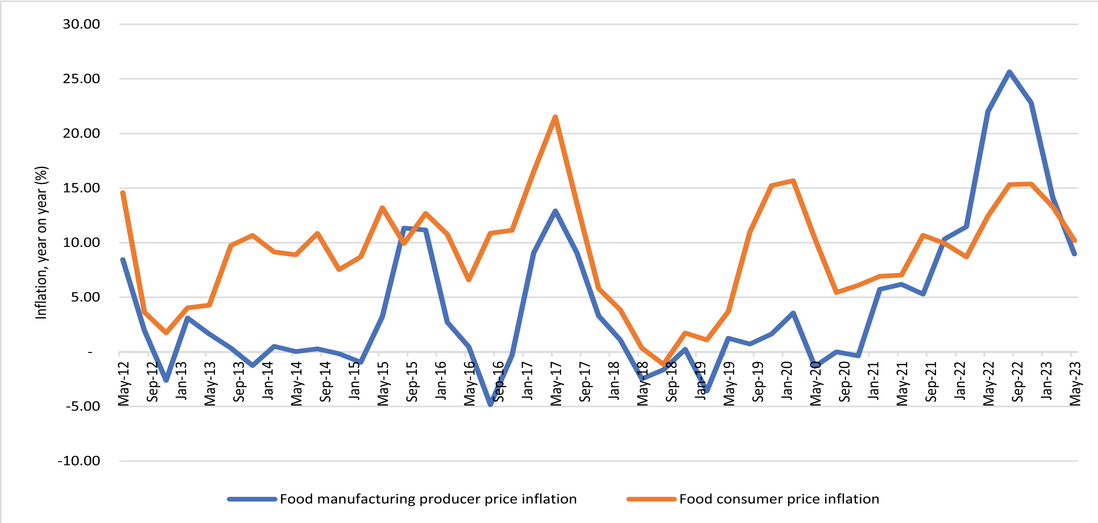
LEVERAGING ON FOOD MANUFACTURING TOWARDS LOWERING COST OF LIVING

- Manufactured food products account for 24.8% of the consumer expenditures basket in Kenya, presenting substantial implications for cost of living through price channels.
- Food and beverages account for 10.9% of manufactured imports.
- Food manufacturing in Kenya is prone to supply disruptions, especially those emanating from droughts that adversely affect agricultural production.
- GDP: 55% of the manufacturing GDP is in food and beverage processing, which is dependent on agriculture for raw material supplies.
- COST: The cost of intermediate input, especially raw materials, is a key driver of cost of food manufacturing, with potential influences on consumer food prices.

TO LOWER COST OF LIVING THROUGH MANUFACTURING:

1. Reduce the constraints related to the supply of raw materials for food processing by strengthening the value chain.
2. Support food manufacturing MSEs by strengthening technology upgrading and capacity utilization.
3. Strengthen and expand the institutional support for MSEs on a model based on one-stop shop, like the Kariobangi MSEs Centre of Excellence.

Figure 10: Relationship between food manufacturing producer price inflation and food consumer price inflation



To lower the cost of living through manufacturing:

1. Address constraints related to the supply of raw materials for food processing. The key considerations include strengthening the value chain that leverages on the cooperative model for economies of scale in supply of raw materials. It is also imperative to support raw material supply through infrastructure such as aggregation centres and storage facilities. The aggregation centres will help overcome low economies of scale in sourcing raw materials from individual farmers. Storage infrastructure, including cold storage facilities are key, considering the perishability of raw materials for food processing, such as fruits, vegetables and tubers.

2. Support MSEs in food manufacturing to upgrade technology and maximize capacity utilization. This can be achieved through enhanced access to finance, skills development, market access opportunities, access to inputs and policy predictability. This can be considered in the context of improving the business environment for MSEs.

3. Strengthen and expand the institutional support for MSEs on a one-stop shop model, such as the Kariobangi MSEs Centre of Excellence. It is imperative to fast-track completion of other planned centres of excellence in the medium-term. Strengthening institutional support also calls for fast-tracking infrastructure support, standardization and capacity building anchored on business development centres in every ward as articulated in the government priorities.

TRADE AND THE COST OF LIVING

9

The allocative and pricing function of trade is prone to distributional bottlenecks and adjustments in tax policy. Distributional bottlenecks are reflected in freight, insurance, and warehousing costs. Tax adjustments are reflected in taxes such as Value Added Tax (VAT), customs, and excise duties. The ensuing cost effects filter into commodity prices, then into consumer prices and have implications on the cost of living. The evidence reveals that information asymmetry between government and players in the consumer goods value chain creates artificial shortages, which translate to distortions in the pricing function of trade. This is compounded by distributional bottlenecks that hinder supply of food commodities from areas with surplus to areas with shortage. The evidence also reveals that marginal reductions in VAT on animal fats and vegetable oils could avail more disposable income to poorer households and help to smoothen their consumption.

To improve the allocative and pricing function of trade:

1. Finalize development of the central registry by the Warehousing Receipt System Council (WRSC) to promote real time monitoring of the country's food stocks in order to inform the government decisions on food acquisition and distribution. This would improve efficiency in allocation and distribution of food commodities from areas of plenty to areas of shortages, thus smoothening consumption and mitigating supply shortages that pull up prices. Further, access to the Warehouse Receipt System could enable MSEs to use the warehouse receipts as collateral for accessing credit.
2. Expand access to the Financial Inclusion Fund (Hustler Fund) to incentivize MSEs to tap into opportunities in the local logistics industry to enhance distribution of consumer commodities from regions with surplus to regions with shortages.
3. Diversify sources of imports for essential consumer goods to cushion consumers against rise in the cost of living emanating from distributional bottlenecks linked to the global supply chain disruptions.
4. Reduce VAT on animal fats and vegetable oils to cushion poorer households from rural areas against erosion in the cost of living. It raises the disposable incomes available to households, and this smoothens consumption.

TRADE AND COST OF LIVING

The allocative and pricing function of trade is prone to distributional bottlenecks and adjustments in tax policy.

Distributional bottlenecks are reflected in freight, insurance, and warehousing costs. Tax adjustments are reflected in taxes such as VAT, customs, and excise duties. The ensuing cost effects filter into commodity prices then into consumer prices.

Information asymmetry between government and players in the consumer goods value chain creates artificial shortages, which translate to distortions in the pricing function of trade.

The evidence also reveals that marginal reductions in VAT on animal fats and vegetable oils could avail more disposable income to poorer households and smoothens consumption.

TO IMPROVE THE ALLOCATIVE & PRICING FUNCTION OF TRADE:

1. Finalize development of central registry by the Warehousing Receipt System Council (WRSC) to enhance transparency in warehousing receipt system to improve efficiency in food distribution.
2. Incentivize local MSEs to tap into opportunities in the local logistics industry and enhance distribution of consumer commodities from regions with surplus to regions with shortages.
3. Diversify import sources for essential consumer goods, especially unmilled wheat to cushion consumers against rise in cost-of-living emanating from the global supply chain disruptions.
4. Reduce VAT on animal fats and vegetable oils to cushion poorer households from rural areas against erosion in cost of living.

ACCELERATING ADOPTION OF ELECTRIC MOBILITY FOR AFFORDABLE AND SUSTAINABLE TRANSPORT IN KENYA

10

Adoption of electric mobility, also known as vehicle electrification, is an innovative way to reduce the burden of fossil fuels and positively contribute to lowering transport costs and therefore the cost of living. Transportation accounts for an average of 34 per cent of any country's carbon pollution, making it the highest polluting sector in the economy. By promoting electric mobility, Kenya can acquire a competitive advantage in the new technologies and export the surplus to other countries. Available evidence indicates that an electric vehicle is about three to four times more efficient than a comparable fossil fuel vehicle, commonly referred to as a combustion engine vehicle. Electric vehicles are thus not only cleaner, but also much more economical than fossil fuel vehicles. Reducing mobility costs could therefore contribute to lowering the cost of living.

The electric mobility sector is in its early stages in Kenya with a potential to grow. The country has experienced increased number of innovations and startups largely targeting the 2 and 3-wheelers. Notably, Kenya is home to over 2 million motorcycles and most of the riders are showing interest to convert their motorcycles to be electric because of the ability to save on fuel and maintenance while doubling their income. Retrofitting, which entails conversion/modification of fossil fuel engines to electric engines, offers a promising complementary solution to new vehicles. Retrofitting of fossil fuel engines to electric will help cut down the shifting costs and reduce carbon emissions. Further, equipping the electric mobility sector with technical automotive skills for engine conversion will build a home-grown supply chain for 2 and 3-wheelers. Further, the sector requires technical standards to guide retrofitting necessary for successful conversion to electric mobility.

Electric mobility presents an opportunity to generate additional funds to support maintenance, rehabilitation and development of roads that largely depend on fuel levy collections. Additional funds will be key to complement the fuel levy in the development of infrastructure, including charging facilities for innovations and startups in the sector.

That said, electric mobility requires adequate charging infrastructure and network, and maintenance and after-sale service facilities in public strategic locations and routes for electric vehicles.

To leverage on electric mobility towards affordable and sustainable transport:

1. Partner with private sector players to build adequate

charging infrastructure and battery-swapping stations across the major routes in the country. Further, issue guidelines to establish charging facilities in public parking and new residential buildings; and expand and modernize power grid to enhance distribution and billing for smart charging.

2. Build retrofitting skills for second-hand fossil fuel vehicles with emphasis on 2 and 3-wheelers to cut down the shifting costs and reduce carbon emissions. Further, develop technical standards to guide successful retrofitting of fossil fuel vehicles.

3. Explore public private partnerships in assembling, distribution and selling of electric vehicles to build a home-grown supply chain for new electric vehicles. Tap into the Financial Inclusion Fund ('Hustler Fund') and the Climate Change Fund to support innovations and startups in the electric mobility sector. In addition, set targets for possessing electric vehicles by public agencies to create demand for electric mobility.

4. Introduce subsidized charging fee, offer reduced insurance and license plates fees and allow free parking in public areas to support efforts towards accelerating the adoption of electric mobility.

5. Fast-track the approval of the draft National Electric Mobility Policy Framework to enhance sector-wide coordination in supporting its growth. In addition, amend the Road Maintenance Levy Fund Act, 1993 to generate additional revenue from the electric mobility.

ACCELERATING ADOPTION OF ELECTRIC MOBILITY FOR AFFORDABLE AND SUSTAINABLE TRANSPORT IN KENYA

Electric mobility is instrumental in achieving affordable and sustainable transport in Kenya.

Adoption of electric mobility also known as vehicle electrification is an innovative way to reduce the burden of fossil fuels on the cost of living.

Transport sector is one of the main contributors of greenhouse carbon emissions in the country due to the predominant use of fossil fuel vehicles.

Electric mobility presents an opportunity to generate additional funds required to support maintenance, rehabilitation and development of roads that largely depend on the fuel levy collections.

TO LEVERAGE ON ELECTRIC MOBILITY TOWARDS AFFORDABLE AND SUSTAINABLE TRANSPORT:

Partner with private sector players to build adequate charging infrastructure and battery-swapping stations across the major routes in the country.

Introduce subsidized charging fee, offer reduced insurance and license plates fees and free parking in public areas to support efforts towards accelerating the adoption of electric mobility.

Fast-track the approval of the draft National Electric Mobility Policy Framework to enhance sector-wide coordination in supporting its growth.

Explore public private partnership in assembling, distribution and selling of electric vehicles to build a home-grown supply chain for new electric vehicles.

Tap into the Financial Inclusion Fund ('Hustler Fund') and the Climate Change Fund to support innovations and startups in the electric mobility sector.

Amend the Road Maintenance Levy Fund Act to generate additional revenue from electric mobility

Expand and modernize power grid to enhance distribution and billing for smart charging.

GOVERNMENT INTERVENTIONS TOWARDS MAKING MARKETS WORK

11

Government intervention is crucial in reducing the cost of living by fostering well-functioning markets characterized by availability, accessibility, and affordability of quality goods and services. Market failures, often caused by market power, information asymmetry, and negative market externalities, can be corrected through government interventions. The role of government to support well-functioning of the markets is anchored in the Kenya Vision 2030, which seeks to promote a more competitive and inclusive economy. Further, the Bottom-Up Economic Transformation Agenda (BETA) underscores policy interventions that promote inclusive growth and development through empowering MSEs to overcome structural barriers and participate effectively in the markets.

To make markets work, the government has established various policies, laws, and regulations to promote competition. Key to the policy and regulatory framework is the Competition Authority of Kenya (CAK), which enforces the Competition Act, 2010 by monitoring and enforcing regulations to promote fair competition and prevent anti-competitive behaviour arising out of market power imbalance, information asymmetry and market externalities. Market power imbalance is characterized by restrictive trade practices, price discrimination, and mergers and acquisitions that yield market dominance and thus reduce competition, charging higher prices and potentially disrupting other firms from entering the market. Information asymmetry entails inaccurate or incomplete information, which creates unfair advantage to the party with less information, such as false advertising, misleading claims, and deceptive marketing practices. Market externalities occur when the production or consumption of a good or service has a positive or negative impact on third parties who are not involved in the transaction. It also occurs when a common resource is overused or depleted due to the absence of clear property rights or government regulation. The incidental costs pose additional costs not reflected in the market price of goods or services. Addressing market failures is essential in tackling the cost of living as it highlights the inefficiencies and inequities within the market system that have significant implications on consumers.

Despite the government's intervention, there are challenges that hinder the enhancing market efficiency. First, technological advancements have outpaced the current regulations, leading to rise of digital giants who have had first mover advantage of technological breakthrough and have dominated the market, causing market power imbalances. Secondly, information asymmetry persists due to various factors that create barriers to consumers. Technical language on product labels, which is primarily in English and Swahili, excludes minority-language speakers from understanding product ingredients or packages. This is compounded by inadequate standardization of packaging of products. Thirdly, rapid urbanization exacerbates market externalities by increasing pressure on housing, infrastructure, and public services, resulting to traffic congestion, air pollution, inadequate waste management, and strain on water and energy resources. Moreover, the growing externality arises from escalating use of electronic devices and improper disposal of electronic waste (e-waste), which contributes to soil and water pollution and poses public health risks. The abuse of medicated drugs and the emergence of infectious diseases such as COVID-19 create significant cost implications, affecting resource allocation, and negatively impacting overall public health.

To enhance effective government interventions:

1. Develop adaptable and comprehensive competition and sector-specific regulations that keep pace with evolving market dynamics, and which accommodate emerging technologies and industries. Rigid competition laws that do not evolve to keep pace with changing market dynamics, emerging technologies, or new business models, create gaps that businesses might exploit to gain an unfair advantage over competitors, creating barriers to entry for new businesses and concentrating power in the hands of a few without facing appropriate consequences. Adaptable regulations respond to new and unforeseen dynamics that arise due to factors such as technological advancements, market shifts, or changing consumer behaviour.
2. Update the competition framework to accommodate the unique barriers of MSEs, which would ease their regulatory surveillance and enforcement mechanisms. MSEs often face significant barriers to entry in the market, such as limited access to capital, resources, and information and struggle with adopting compliance burden of traditional regulations designed for larger firms, consequently concentrating market power among the latter. An updated competition framework accommodating the unique barriers faced by MSEs is key towards creating an inclusive and competitive business environment for all the market players allowing MSEs to enter and compete in the market more effectively.
3. Implement multilingual product labeling and standardization, incorporating minority languages to cater for all consumers including the minority language speakers. By providing product information in multiple languages, firms could

ensure that their products are accessible to a broader and more diverse group of consumers, enabling them to fully understand product details, instructions, and safety information. Thus, reducing information asymmetry and empowering consumers with the ability to evaluate product quality and make more informed choices.

4. Establish and enforce standardization guidelines for consumer goods, making it easy for customers to compare and understand products. Standardization ensures that products meet specific quality and safety requirements, protecting consumers from substandard or unsafe goods and facilitates product comparison, thus reducing information asymmetry among consumers. Establishing and enforcing standardization guidelines promotes consumer welfare, fosters fair competition, and contributes to a transparent and efficient marketplace.

5. Bridge the digital divide by establishing Internet infrastructure and Internet education in rural areas. Digital divide hampers the ability of individuals and businesses in under-served areas to obtain crucial information about products, services, prices, and market trends, creating an information asymmetry between them and more connected consumers and businesses. Similarly, it exacerbates market power concentration, as businesses with better access to the Internet and online platforms expand their reach and influence more effectively, gaining a competitive advantage, making it difficult for the smaller or less-connected counterparts to compete. Bridging the gap is crucial in creating a more equitable and competitive marketplace and empowering all participants with equal access to information and opportunities.

6. Enhance the implementation of sustainable urban planning that prioritizes efficient land use, improved public transportation, and eco-friendly infrastructure. Sustainable urban planning focuses on eco-friendly infrastructure, such as green spaces, energy-efficient buildings, and renewable energy sources. This reduces greenhouse gas emissions, air pollution, and other environmental externalities, leading to improved air quality and mitigating the impact of climate change. Moreover, prioritizing efficient land use and public transportation alleviates traffic congestion in urban areas, culminating into lower fuel consumption and fewer emissions, and positive impact on the environment and public health.

7. Establish and enforce comprehensive e-waste management policies that promote recycling, safe disposal, and the use of environmentally friendly materials in the production of electronic devices. Recycling and safe disposal of e-waste prevent hazardous substances from leaching into the soil and water, reduce pollution,

and protect ecosystems while allowing for the recovery of valuable materials, such as metals, which reduces the need for raw material extraction. Similarly, safe disposal of e-waste prevents harmful substances from getting into the environment and potentially posing health risks to communities. In totality, comprehensive e-waste management policies lead to numerous positive market externalities.

8. Strengthen healthcare systems to manage the burden of infectious diseases and address the growing abuse of medicated drugs. Weak healthcare system often results to various negative externalities such as increased healthcare burden to individuals, businesses, and the government, leading to higher insurance premiums, distorted labour productivity, and reduced economic productivity. By prioritizing healthcare system improvements, it creates a healthier society, more resilient, and prosperous market environment, benefiting both businesses and the general population.

GOVERNMENT INTERVENTIONS TOWARDS MAKING MARKETS WORK

Government intervention is crucial in reducing the cost of living by fostering well-functioning markets characterized by availability, accessibility, and affordability of quality goods and services.

Market failures, often caused by market power, information asymmetry, and negative market externalities, can be corrected through government interventions.

Market power and information asymmetry are prevalent in the growing digital market, which have outpaced the traditional competition regulations framework.

Rapid urbanization exacerbates market externalities by increasing pressure on housing, infrastructure, and public services, resulting to traffic congestion, air pollution, inadequate waste management, and strain on water and energy resources.

TO ENHANCE EFFECTIVE GOVERNMENT INTERVENTIONS:

1. Develop adaptable and comprehensive competition and sector-specific regulations that keep pace with evolving market dynamics which accommodates emerging technologies and industries.
2. Update the competition framework to accommodate the unique barriers of MSEs which would ease their regulatory surveillance and enforcement mechanisms.
3. Implement multilingual product labelling and standardization incorporating minority languages to cater for all consumers including the minority.
4. Establish and enforce standardization guidelines for consumer goods to make it easy for customers to compare and understand products.
5. Bridge the digital divide by establishing internet infrastructure and internet education in rural areas.
6. Enhance implementation of sustainable urban planning that prioritize efficient land use, improved public transportation, and eco-friendly infrastructure.
7. Establish and enforce comprehensive e-waste management policies that promote recycling, safe disposal, and the use of environmentally friendly materials in the production of electronic devices.
8. Strengthen healthcare systems to manage the burden of infectious diseases and address the growing abuse of medicated drugs.

NOTES

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The Kenya Institute for Public Policy Research and Analysis (KIPPRA) is an autonomous institute whose primary mission is to conduct public policy research leading to policy advice. KIPPRA's mission is to produce consistently high-quality analysis of key issues of public policy and to contribute to the achievement of national long-term development objectives by positively influencing the decision-making process. These goals are met through effective dissemination of recommendations resulting from analysis and by training policy analysts in the public sector. KIPPRA therefore produces a body of well-researched and documented information on public policy, and in the process assists in formulating long-term strategic perspectives. KIPPRA serves as a centralized source from which the Government and the private sector may obtain information and advice on public policy issues.

Our Vision

An international centre of excellence in public policy research and analysis

Our Mission

To provide quality public policy advice to the Government of Kenya by conducting objective research and analysis and through capacity building in order to contribute to the achievement of national development goals.

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