

This work is licensed under a
Creative Commons Attribution-NonCommercial-
NoDerivs 3.0 Licence.

To view a copy of the licence please see:
<http://creativecommons.org/licenses/by-nc-nd/3.0/>

OUTWARD LOOKING INDUSTRIALIZATION:
The Promotion of Manufactured Exports
from Kenya.

By

Peter N. Hopcraft.

DISCUSSION PAPER NO. 141

INSTITUTE FOR DEVELOPMENT STUDIES
UNIVERSITY OF NAIROBI

SEPTEMBER 1972

An earlier version of this paper was presented as a memorandum to the I.L.O. Employment Mission in Kenya.

Any views expressed in this paper are those of the author. They should not be interpreted as reflecting the views of the Institute for Development Studies or of the University of Nairobi.

OUTWARD LOOKING INDUSTRIALIZATION:
The Promotion of Manufactured Exports from Kenya.

by

Peter N. Hopcraft.

Abstract.

Neither traditional primary exports nor capital inflows from rich countries will adequately meet the foreign exchange requirements for sustained industrialization in countries such as Kenya. The constraints of the local market, the elasticity of foreign markets, and the import requirements for industrial growth make the expansion of manufactured exports imperative. Inhibitions on this expansion are a serious aberration in industrialization and development policy. The consequences of export suppression are curtailed investment and growth, inefficient use of the country's resources, chronic balance of payments problems and, eventually, an unsuccessful industrialization effort.

The necessarily increasing reliance on the country's own resources to maintain a balance in external payments makes a serious re-examination of export policies and problems very timely. "Escalating" tariffs in some of the countries to which we might export are often a problem and should be the subject for intensive international negotiation. The most serious inhibitions on the growth of non-traditional exports, nevertheless, are coming not from overseas but from the exchange rate and fiscal implications of the country's own import substitution policies. Protectionist policies, whether they are motivated by balance of payments considerations or industrial promotion, inevitably result in the anti-protection of non-protected industries by unilaterally raising the prices of protected imports and depressing the prices of all other tradeable goods. The result is the promotion and subsidization of industries that look exclusively to the protected local market, and the counter-promotion and taxation of non-protected industries and, particularly, exports. The effect on foreign firms is singularly unfortunate; they are motivated to seek and repatriate the profits of import substitution (despite the frequently artificial nature of those profits) rather than use their international connections to expand exports.

There is a good deal of scope for industrial harmonization and trade in the East African community and nearby countries but special arrangements between countries cannot be relied upon to sell products that are not competitive in terms of price and quality.

The country does have considerable capacity to expand exports, and a number of industries, many of which have strong linkages into the agricultural sector and very attractive employment implications, would undoubtedly experience rapid export expansion in a non-distorted situation. Nevertheless export promotion, without a thorough-going correction of the distortions in the price and incentive system is an exercise in futility. A complete review of trade, tariff and exchange rate policies is necessary if exports are to play their appropriate role in the growth process and if an outward-looking industrial sector is to develop.

Despite (and occasionally because of) international agreements designed to maintain the prices of traditional primary exports from countries such as Kenya,¹ the chance of earning the necessary foreign exchange from these exports to meet the import requirements for rapid and sustained industrial growth can be readily discounted. A fortiori, "development assistance" and capital inflows from rich countries, while useful, are increasingly recognized as unreliable and totally inadequate to fill the foreign exchange gap that opens up if acceptable growth and investment rates are to be maintained. An inward looking industrialization strategy,² oriented largely toward the protected local market and away from exports will, therefore, rapidly run the economy into growth constraints imposed by the requirement that foreign payments be balanced. Inward looking industrialization is thus constrained, not only by the limits of the local market, but by its increasing reliance on the foreign exchange earning capacity of other sectors, particularly the traditional exports sector. This increasing dependence is ironic in view of the fact that stimulus for this kind of industrialization is often precisely to diversify the economy away from reliance on traditional primary exports.

Contrary to popular myth on the subject, there is now considerable evidence from the 1960s that Less Developed Countries (LDCs) cannot be assumed to have a continuing natural comparative advantage exclusively in primary and agricultural products.³ Cohen and Sisler examine the imports of five industrialized areas (EEC., JAPAN, U.K., U.S., & U.S.S.R.) in the years 1959-60 and 1967-68. Over this period they find that the share of primary and particularly agricultural imports to these countries that originate in the LDCs declined sharply, while the share of these rich countries' manufactured imports originating in the LDCs recorded a substantial rise.

1. See D.M. Etherington, "An International Tea Trade Policy from East Africa - An Exercise in Oligopolistic Reasoning". F.R.I. Studies in Agriculture, Trade and Development (forthcoming) and G.D.Gwyer, "East African and Three International Commodity Agreements: The Lessons of Experience." IDS Discussion Paper No. 129, February 1972.

2. For an earlier sounding of the alarm on this topic, see my Notes on the Industrial Development Aspects of the Plan" East Africa Journal March 1970 pp.39-45. For a recent, somewhat pamphleteering approach, my "Toward a Protectionist Economy? Some Reaction to the Import Bans and controls Recently Imposed by the Kenya Government," I.D.S. Working Paper No. 29, March 1972 is out of print, but a few copies are available from author.

3. As Stephen Lewis has pointed out to me, historical data, when price distortions in the LDCs have been as they have, are not an adequate basis for assessing comparative advantage. Nevertheless, while there are

The annual percentage change in these rich countries' (individual) agricultural imports over the period was 3.5; the annual growth of their agricultural imports originating in LDCs was 1.7%. Meanwhile, for a list of six manufactured item categories (clothing, cotton fabrics, footwear, jute fabrics and jute, pearls and precious stones, and veneer), the annual percentage increase of all imports for the period was 12.0, while the increase in this manufacturing group originating from LDCs was a remarkable 15% per year.⁴ Figures of this sort clearly suggest that labour abundant countries such as Kenya do themselves a considerable disservice to assume that manufacturing is not an area that offers much potential for export, to confine themselves to inward looking industrialization, and to rely on traditional agricultural exports to earn foreign exchange.

The fact that an overwhelming percentage of the dramatically increased LDC manufactured exports have come from a mere handful of LDCs is illuminating. These few countries, unlike the vast majority of LDCs, have succeeded in removing or avoiding the biases against manufactured exports within their own borders, and have thereby concentrated the benefits of the rich country markets on themselves. The experience of these aggressive exporting countries suggests that policies in this area for any one country should not be treated as if they were policies for the whole less developed world taken as one country. To fantasize the existence of such a country is no more realistic than fantasizing the existence of one single, unified, industrial country, instead of the disparate and far flung industrial world that actually exists. Appropriate advice to all less developed countries simultaneously would not be very different, i.e. remove biases against exports, from appropriate advice to any individual country (though if all countries acted on the advice simultaneously the results would be somewhat different, presumably resulting in more specialization and a more equitable distribution of the resultant gains). The only difference in the nature of the appropriate advice might be in circumstances where all LDCs were treated as one country, under these

3. cont./ a number of countries that have distorted prices against agricultural exports they have generally distorted their prices against manufactured exports to a similar degree, and when corrections are made, they generally (though perhaps not always) made with respect to both manufacturing and agricultural sectors. Given the fact, furthermore, that factor price distortions tend to particularly penalize LDC industrial sectors (i.e. wages paid in the "modern" industrial sector to exceed by a substantial margin agricultural sector wage), it may not be illicit to draw some comparative advantage inferences from what follows.

4. Benjamin I. Cohen and Daniel G. Sisler, "Exports of the Developing Countries in the 1960's" Review of Economics and Statistics, vol LIII No.4, Nov. 1971.

circumstances "optimal tariff" arguments and policies designed to exploit a monopoly position become relevant. (The basic difference is, of course in the shape of the demand curve facing any individual country on the one hand, and all countries on the other. By analogy with micro theory, however, one does not advise a firm in an atomistic market structure to behave like a monopolist merely because of the inelasticity of the demand curve facing the entire industry.)

In the context of an increasing reliance of countries such as Kenya on export markets, international trade liberalization efforts assume particular importance. Escalating tariffs by stage of processing and the prospects of "backlash" protectionism in the industrialized countries if LDC exports expand, clearly deserves attention.

It is often precisely those industries in which comparative advantage is shifting to the LDCs that are experiencing the worst adjustment problems in the rich countries. The consequent pressure in those countries for protection against imports from LDCs is hard to resist, despite the fact that everyone, including the protecting country is made worse off. These issues should be the subject of vigorous negotiating efforts at multilateral and bilateral forms.⁵

While some rich countries will undoubtedly continue to use import restrictions to stave off adjustments that should be made and to protect inefficient employment at home, there will be some limit to the price they are prepared to pay in this regard. Gunnar Floystad calculates that with manufactured LDC exports representing only about 0.2% of the total volume of manufactured goods produced in the industrialized countries, and with an annual growth rate of 4.2% in these rich countries, imported manufactures from LDCs to rich country markets would not have to increase to more than about 1% over the next 20 years even if LDC manufactured exports increased cumulatively by as much as 20% per annum.⁶

For each individual commodity or project that looks at the export market, existing or potential trade and commercial policies of consuming

5. For a discussion of the issues and some of the recent historical experience with the negotiations on these issues, see H.G. Johnson (editor), Trade Strategy for Rich and Poor Countries George Allen and Unwin (1971), especially parts I & II.

6. Floystad, Gunnar, Foreign Trade, Aid and Economic Growth, Universitetsforlaget, 1968.

country governments must obviously form a part of any market analysis. Nevertheless, it would be a very serious mistake to think that the discrimination of certain other countries against some of Kenya's existing or potential exports justifies compounding the problem by local policies that discriminate even further against our own exports. Undue export pessimism has a habit of resulting in a number of import substitution policies whose anti-export biases make the initial pessimism self-fulfilling. Export markets, especially for manufactured and semi-manufactured commodities, are often fairly concentrated and highly competitive. Doubts about whether Kenya should be exporting, inefficiency, excessive red tape and delay in getting a particular project off the ground, or any one of a number of price discriminations that reduce the competitiveness of the export, simply mean that the market is supplied by someone else.

The cases of two excellent export lines that were forgone recently might be illustrative. One was a large contract that was terminated for price reasons. The exporter in this case was unable to get the export rebate to which he was entitled on a reliable enough basis to incorporate it into his price quotation. Furthermore the monopoly-creating transport licencing system resulted in transport costs that were far in the excess of those that would have been incurred if competitive transporters had been permitted. In this case the market was lost to a New Zealand supplier.

The second case involved an agricultural production and processing project designed to supply a large food processor in Europe. The capital, know-how, etc. for the project was all there, and it offered good returns all the way down the line. After more than a year of negotiating and efforts, the agricultural part of project still could not be finalized, so the same company moved to Greece. The production, processing and export is now being done from there, and a major marketing outlet is now closed.

At the more aggregative level, the statistical association between export growth and the growth of investment is now familiar. Fanny Ginor, for example, in a study of 55 countries over 18 years finds the correlation coefficient between the two to be 0.636 and that the growth rate of exports "explains" 40 percent of the growth rate of investment⁷

7. Her regression equation is the following: $GI = 0.504GX \times 3.122$ where GI and GX are the average annual growth rates of investment and exports respectively. $R^2 = 0.404$. F. Ginor, "Exports and Economic Growth" Israel Quarterly of Economics vol.1 no.1 Winter 1971/72 pp.50-65

She attributes the contribution of export growth to investment firstly to the increased capacity to import investment goods with the export earnings, secondly to the increased demand for investment when the market is not limited to within the national borders, and third to the increased local savings that are generated by export industries.

Kenya is currently plagued by what growth theorists must regard as a series of paradoxes in the area of investment and capital use. Each of the paradoxes I shall briefly refer to can be seen, at least in part, as a direct consequence of a market limitation which, in turn, is the consequence of the overwhelmingly domestic orientation of the industrial sector.

First of all industrial capital utilization in Kenya is low and most industries run with considerable excess capacity; hardly an appropriate situation in a capital scarce country. There is little doubt that the protectionist syndrome of the proliferation of lines of production, all geared toward the local market which is simply not large enough to keep the necessary indivisible capital equipment fully occupied, is among the prime explanations for this paradox.

A second paradox is the low interest rate for industrial lending that prevails in Kenya, paradoxical again because it could be regarded as the prime signal of capital abundance. The resultant pressure from foreign firms to borrow locally rather than being in foreign capital has been met with regulations to put a ceiling on such borrowing⁹ In part this interest rate phenomenon can be simply attributed to inadequately functioning capital markets. In general Kenya, in common with a number of similar countries, is characterized by a highly compartmentalized capital market with little intermediation between compartments. The result is a low industrial lending interest rate in the presence of what amounts to chronic capital scarcity in other sectors.

Nevertheless the low industrial lending interest rate still calls for an explanation. High profits and rates of financial return are commonplace in Kenya industry, but a low interest rate in theory suggests

8. For a detailed study of capacity utilization in Kenya's industrial sector, see the forthcoming work of Mary Anne Bailey, a research associate of this Institute.

9. Risk aversion and the fear of expropriation could provide an additional incentive for borrowing locally but that would explain a higher than expected local interest rate, not the opposite.

that at the margin, rates of return are low (otherwise why would entrepreneurs not step in and take up the slack until rates of return and borrowing rates were more nearly equated).¹⁰ The "absence of entrepreneurs" argument lends some explanation, but there does not seem to be any shortage of entrepreneurs to step into the easy profits of import substitution, and entrepreneurs, like other skilled categories of manpower can always be imported.

At least part of the explanation for the interest rate paradox would seem to be a shortage of good industrial investment opportunities, again, as a direct consequence of the limitations of the local market and the artificial unattractiveness of exports. High profits are being made in import substitution but with a readily satiable market and existing overcapacity the incentive for reinvestment is simply not there. Various government subsidies and inducements to investors in these circumstances don't get to the root of the problem; insofar as they are successful, in fact, they tend to result in a wastage of capital, i.e. investment where the real economic payoff is low.

The result of the system is the final paradox (again, not uncommon in less developed countries where the policies under attack in this paper prevail) of capital export. As we shall discuss, the ultimate source of the artificial profits made available by protection is those sectors of the economy that are not protected (are anti-protected).¹¹ The protectionist syndrome therefore becomes a means whereby industrial entrepreneurs (if they are also successful bureaucratic entrepreneurs) extract capital from the most capital starved and discriminated against sectors and, for lack of industrial investment opportunities, export it.

The response of exchange controls under these circumstances is a common one, but a poor one indeed. Again, it is not dealing with the cause of the problem. It is an effort, in the social interest, to prevent people from doing what the system motivates them to do, rather than an effort to motivate them to do what is in the social interest, the latter

10. Capital market imperfections, which result in investments with high rates of return being ignored if they do not occur among those customers with which the financial institutions choose to deal, would imply that marginal rates of return are low among the favoured customers but would say nothing about the rest. I am grateful to K. Burke Dillon, a research associate of this institute who is currently completing a study of capital markets in Kenya for a useful discussion on this topic.

11. For a full discussion of witting and unwitting intersectoral resource flows, see: S.R. Lewis, Jr. "Agricultural Taxation and Intersectoral Resource Transfers." I.D.S. Discussion Paper No. 134.

being the essence of good economic policy-making. If the various other trade, protection and currency overvaluation policies are maintained intact, it is virtually certain that exchange control with its inevitable attendant, the currency black-market, will have to be part of the package. Nevertheless, it must be recognized that it is virtually impossible for exchange control to plug the leaks successfully. Furthermore, it introduces extreme arbitrariness and rigidity, and therefore inefficiency, into the allocation and use of foreign exchange. Finally, the prospect of exchange control is hardly conducive to investment and the inflow of foreign funds. On a net basis, it is perfectly possible for exchange controls to worsen the foreign holdings of a country.

The purpose of this first section of this paper has been to argue that Kenya must think in terms of exports, and that these must include manufactured exports. Inhibitions on the exporting ability of the country should be seen as serious aberrations in development and industrialization policy. The result of these aberrations is a series of unfortunate and paradoxical economic ailments that are not amenable to the curative policies they frequently engender. Chronic foreign exchange difficulties and an unsuccessful industrialization effort are the sure consequences of the protectionist, inward-looking option in industrialization and trade policy. It has also been inferred, and will now be argued, that while Kenya should do everything possible to reduce the discrimination of other countries against Kenya exports, the most serious anti-export discrimination might well be coming, unwittingly, from within. Kenya's own trade and commercial policies, often designed, ironically to promote industrialization, are increasingly imposing the major barriers to the development of exports, particularly in the non-traditional and manufacturing category. In view of the fact that Kenya's policies are more amenable to decision-making within Kenya than the policies of the countries to which we hope to export, the tenor of this paper is one of optimism.

Before going into specific policies and prospects for Kenya's manufactures exports, let us briefly review the export consequences of the protectionist policies that have come to be regarded as normal in countries such as Kenya. I shall not attempt to cover the ground that has been so fully covered in the IDS series of papers on Trade, Protection and Industrialization; nevertheless, export promotion must be seen in the context of the complete package of the trade and commercial policies that exist. The reason is simply that the notion that some industries can be protected without other industries being antiprotected and discriminated against is what McKinnon and Shaw call "the fundamental policy illusion".¹²

12. R.I. McKinnon and E.S. Shaw, "Policies in Restraint of Development," mimeo, Stanford University.

(I use the word "anti-protected," since "unprotected" fails to convey the idea that, in the presence of protected industries, unprotected industries are made less able to compete than they would be in a free trade situation).

The arguments for the promotion of industrialization in countries such as Kenya are examined in detail in the papers of John Power and Stephen Lewis in the IDS series mentioned.¹³ In essence, the problem is that the promotional tools chosen, by which the rest of the economy could subsidize the industrial sector, viz. tariffs and import restrictions, have the effect of promoting and subsidizing only those industries that cater to the local market where protection is applied. The unwitting effect of these policies is the anti-protection of those industries, be they exporting or import substituting, that are not operating behind protective barriers. The result is, as reference to the Phelps - Wasow data on effective protection and international viability will show,¹⁴ enormous differences in real efficiency are tolerated and encouraged in Kenya's industrial sector. In some industrial categories, only the most super-efficient subset of lines can survive; in other categories, highly inefficient industries and lines are made to appear profitable, and are therefore stimulated into production. The picture that emerges is an incredible hodge-podge that no planner in his right mind could possibly have intended. In general, in fact, it is those industries in which Kenya probably has the greatest comparative advantage, those in which Kenya can compete successfully with the rest of the world and should therefore be encouraged, that end up being the most anti-protected and, therefore, discouraged.

The ways in which protectionist policies do, in fact, discriminate against exports and non-protected import substitutes are now familiar. First of all, import restrictions put up the scarcity price¹⁵ of the products protected¹⁶ and (depending on the supply elasticities) the resources and

13. John H. Power "The Role of Protection in Industrialization Policy" IDS Discussion Paper No. 136 April 1972
Stephen R. Lewis "The Effects of Protection on the Growth Rate of the Economy and the Need for External Assistance" IDS Discussion Paper No. 140.

14. M.G. Phelps and B. Wasow, "Measuring Protection and its Effects in Kenya," IDS Discussion Paper No. 147 April 1972.

15. I use the words "scarcity price" since it is unaffected by price control. Price controls do not alter the price at which an item can be sold they merely alter the price at which legal transactions take place with the effect that the gains of a price increase are diverted into "informal" channels.

16. Even in the large and competitive U.S. market, Louis and Frances Esposito find that "less restrictive trade policies encourage more

inputs that they use. In effect one has a kind of a partial inflation, with the export parity price being the only one that does not rise. (General deflationary measures are obviously no solution to this problem as they apply across the board, and the anti-export bias remains). Duty rebates for the imported components of exported commodities can go a certain distance in redressing the anti-export bias involved here, but short of an extremely detailed input-output table, complete with all the elasticity coefficients, it is simply not possible to estimate the duty rebate necessary to remove the price disadvantage on any particular item.¹⁷ (Given a uniform tariff on all imports, of course, the appropriate "duty rebate" for exports would be a subsidy equivalent to the tariff). Suffice it to say that it is not merely the dutiable or banned imports that go up in price or down in quality, or both, relative to external goods; the price effects pervade a large section of the economy, eventually putting up the costs, and undermining the competitiveness of the range of non-protected tradeable goods industries.

The resource allocation consequences of these price distortions are obvious. Resources are drawn into protected industries and, since we are not in the happy world where all resources are abundant, they are drawn out of the industries that are not protected. The discrimination, therefore is once again against non-protected industries and, as long as we are not

16. cont./ competitive pricing behaviour in domestic industries." Review of Economics and Statistics vol LIII, No.4, November 1971). There can be little doubt that the operative price ceiling for most of Kenya's tradeable products is set by the external price, and, in the case of import substitutes, by the c.i.f. price plus tariff where a tariff is operative. Where quantitative controls or import bans are operative, of course, no such price ceiling exists, the result being more unmitigated monopoly.

17. The duty rebate system in Kenya must be regarded as virtually non-functional except for a few influential firms. In the case where the exporter is also the importer he may apply, through an incredibly long drawn out and complicated procedure, to become gazetted as a "concessionaire". Long and hard bargaining ensues with East African Community customs officials as to exactly the percentage of dutiable material incorporated in the export and even then it appears to be a matter of luck whether or not the duty is refunded. If the importer of the material is not the same firm as the processor and exporter, let alone more involved linkages, there is no mechanism whatever to so much as claim a duty rebate.

The Kenya Export Promotion Council recently completed a survey of Kenya exporters; their final question was: "Have you any comments regarding your exporting position and why you feel it is being limited?" The following sections of two of the replies represent the recurring theme that inflated costs for inputs and packaging materials are undermining the ability to compete:

cont....pg. 10

(shillings earned per dollar's worth of exports are less than they would be), and the importation of non-tariffed goods are being subsidized (fewer shillings are paid per dollar's worth of imports than would otherwise have to be paid).

Since the non-tariffed imports are generally capital goods, intermediate goods and other "essential items", their subsidy will tend to make them a) overused, and b) underproduced locally. The result is, of course, discrimination against the production and use of local intermediate and capital goods. In the case of the overuse of foreign capital goods, there are obvious implications for both capital intensity and appropriate technology; highly profitable small domestic shops producing producer goods and components are made to appear uncompetitive at the exchange rate affecting them, and so are commercially unprofitable and many never get started. The favouring of foreign over local intermediate goods has implications for the backward linkages from industry into other domestic sectors. Some of the most predictable exports for Kenya would be in the agricultural and forestry product processing categories. The employment implications for these kinds of industries are appealing. The protected currency overvaluation, however, makes linkages to overseas suppliers, whose materials appear cheap, seem more profitable than linkages to domestic suppliers, whose goods appear more expensive at the official exchange rate.

A way of estimating the extent of the local currency overvaluation engendered by protection (and thus the extent of the non-tariffed import subsidy and export tax) is to consider the complete removal of all import controls and tariffs. Imports would undoubtedly increase and the ensuing balance of payments problems would require a substantial devaluation. The extent of the devaluation that would be required to preserve balance of payments equilibrium in a totally free trade situation is the extent of the overvaluation that existing commercial policies are protecting. It would seem unlikely that the extent of the overvaluation currently being protected in Kenya is less than about 20%. The implications are, of course, that in the absence of trade and exchange rate liberalization an export subsidy of that order should be given merely to remove the anti-export bias that exists.¹⁹

19. It is important to see that a protective tariff on import control is a subsidy from the rest of the economy to the producer of the protected item who is, hopefully, saving foreign exchange. That subsidy is only available, however, when the producer sells in the local market. (I say the subsidy is from the rest of the economy rather than specifying the consumers of the protected item because there revenue resulting from a price increase could equally be taxed into general coffers). An export subsidy is thus a complete equivalent to an import tariff or control except that the
cont.....pg. 12

It should be noted, incidentally, that while external aid and credits may usefully augment local capital and lead to higher rates of GNP growth and exports, and inflow on the capital account may also have the effect of showing up an inappropriate exchange rate in exactly the same way as import controls, and with identical anti-export effects. Benjamin Cohen finds a negative correlation between net capital inflows and export expansion for a cross section of LDCs.⁴¹ In a statistical analysis of two separate periods, he finds, furthermore, that an extra dollar of exports contributed substantially more than an extra dollar of foreign investment to the growth of GNP.²⁰ This finding runs counter to the previously held notion that a dollar's worth of aid made a greater net contribution to development than the equivalent amount of export earning. (In part the former notion was based on the rather patronizing assumption that foreign aid permitted string-pulling that could be used to improve the development policies of the recipient country). The finding suggest that while massive aid inflows may well be helpful, they do permit economic policies that can make the recipients worse off than ~~they~~ might have been if they had rejected the aid and expanded exports.²¹

19. cont./ firm's reward is for exporting and foreign exchange earning, as opposed to import substituting and foreign exchange saving. Both an export subsidy and an import tariff or control are implicit admissions that the local currency is overvalued and can be thought of as exchange rate correction mechanisms for particular industries, with the former applying to the overseas market and the latter applying to the domestic market. The dangers of irrational non-uniformity of these corrections between industries persist, but an export subsidy equivalent to the tariff (or implicit tariff) at least equates the incentive to the firm between exporting and import substituting, and equates the premium that the economy is seen to place on foreign exchange earning and foreign exchange saving, with the result that the domestic cost of balancing foreign payments is likely to be reduced.

20. The regression equations for the two periods were in the following form (T-ratios in parentheses):

$$\begin{array}{l} 1955-60 \quad \frac{\Delta \text{GNP}}{\text{GNP}} = .194 + .621 \frac{\Delta \text{E}}{\text{GNP}} + .130 \frac{\text{F}}{\text{GNP}} \quad \bar{R}^2 = .627 \quad \text{F} (2,24) = 22.806 \\ \hspace{15em} \hspace{15em} (9.27) \quad (4.69) \hspace{15em} (5.37) \\ 1960-65 \quad \frac{\Delta \text{GNP}}{\text{GNP}} = .243 + .215 \frac{\Delta \text{E}}{\text{GNP}} + .101 \frac{\text{F}}{\text{GNP}} \quad \bar{R}^2 = .250 \quad \text{F} (2,38) = 7.681 \\ \hspace{15em} \hspace{15em} (8.77) \quad (2.15) \hspace{15em} (3.47) \end{array}$$

Where F and ΔE are net foreign investment and the increase in export earnings respectively over the six year periods specified. See Benjamin I Cohen, "Relative Effects of Foreign Capital and Larger Exports on Economic Development" Review of Economics and Statistics, vol L. No. 2, May 1968. (p.281)

21. See Harry G. Johnson, Economic Policies Toward Less Developed Countries George Allen and Unwin, 1967 (Chap.2)

This may be an appropriate point for a brief comment on private capital inflows into Kenya. In view of the artificial nature of the profits that are made available by unilateral import restrictions (i.e. value added at domestic prices considerably overstates value added at world prices, the firm is therefore granted financial profits which may be partly, or even totally, washed out in an economic analysis), foreign firms that produce for the protected domestic market and then repatriate (as they presumably must) foreign factor payments and profits, are likely to be particularly disastrous in terms of foreign exchange efficiency.²² When imported factor payments, imported intermediate good payments, and profit remittances are all subtracted from the c.i.f. value of the imports substituted, the net saving of foreign exchange may be negligible, and in some Kenyan cases it is negative.²³ The local resource cost, in the meantime, may be substantial. The result is clearly exploitation in the least favourable of its definitions. The firm is exploiting the foolishness of policy makers, and making its profits in the absence of any profit to society. This possibility suggests that foreign private projects that plan to look exclusively toward the local market should be examined with some care, particularly in the area of requests for protection from their foreign competitors. One of the main advantages of foreign firms is their knowledge of foreign markets. This is knowledge that should clearly be exploited by Kenya in the efficient use of its resources in earning foreign exchange; foreign firms should therefore be encouraged into export production and out of protected import substitution.²⁴

22. "Foreign exchange efficiency" refers to the local cost of the resources used in the net saving or net earning of one unit of foreign exchange. If this local cost is greater than the exchange rate, the activity is inefficient, if it is less than the exchange rate (K.Shs/£), it is efficient by this definition.

23. See Phelps Wasow, *op.cit.*

24. If purely negative means are used to divert foreign investment from import substituting to exporting industries, e.g. introducing economic criteria into the project selection mechanism and simply not permitting foreign investment into industries that rely for their profitability on the distorted prices of a protected local market, the volume of foreign investment would undoubtedly go down. If, however export industries were made more attractive by the removal of the commercial policy and exchange rate biases against them, there is no reason why the aggregate inflow of foreign investment should not be at least as high, and probably higher than it would otherwise have been. The real payoff to the local economy of that investment, furthermore, would be very much higher.

The first part of this paper discussed the necessity of considering manufactured exports as part of a rational industrialization strategy, and the hazards involved of biasing Kenya's industrialization and development strategy away from exports. The second section has looked at some of the biases and discriminations against exports that have unintentionally been incorporated into the price system either in the interests of balance of payments equilibrium or in an attempt to promote "industrialization." The problem has been that import curtailment promotes only import substitution, it counter-promotes exports. In the longer run, export suppression has been the inevitable, though unintended, corollary of import suppression.

Economists are generally loathe to make blanket policy recommendations of too specific a nature, lest they be generalized to situations where they do not apply, and this writer is no exception. In such areas as the choice of labour intensive products, the choice of "appropriate" technology (again generally referring to factor intensity), the encouragement of industries with backward linkages, preferably into agriculture, the subsidization of exports, and the encouragement or discouragement of foreign capital, horrendous mistakes have often been made by the application of a policy prescription that was just right for some situation other than the one where it is religiously applied.

The danger on the other side is that if appropriate blanket recommendations are made: remove factor and product price distortions, correct for any divergences between social and private profitability, get on with social and promotional infrastructure and let profit-maximizing enterprises, be they government or private, figure out rational product choices, factor intensities, linkages, imports and exports, etc., one is accused of impracticality and retreating into bland theorizing.

Now we have mapped, in self-defence, some of the hazards of the task, let us proceed to the final section of this paper. In view of John Power's clearly written and well-reasoned paper proposing a simple, feasible policy package to promote an unbiased, dynamic, exporting economy,²⁵ I shall not attempt to outline any comprehensive scheme to remove the anti-export and other biases from the incentive system. Nevertheless, it is worth recognizing that attempts at export promotion that do not correct for these

25. John H. Power, The Role of Protection in Industrialization Policy, IDS Discussion Paper No. 136. April, 1972.

biases are not going to scratch the surface of the problem. If the current trend toward protectionism not reversed, there can be little doubt that Kenya will increasingly get into a situation of export lethargy, chronic balance of payments disequilibrium and eventually, declining industrialization and growth. Exhortations to local manufacturers, President's prizes to exporters, attractive industrial stands at trade fairs all over the world, and vigorous speeches about preferential trade in the various forums where such speeches should be made notwithstanding, if the anti-export price distortions, some of which are mentioned in this paper, are not corrected, manufactured and non-traditional exports from Kenya will get nowhere. And policy-makers will have no-one to blame but themselves and those who misadvised them.

The employment implications of these export lines must be regarded as very considerable. I have discussed elsewhere²⁶ why the labour-intensity of Kenya's exports might be expected to be greater than the labour intensity of imports and the sorts of import substitutes that would require protection.²⁷ Other factor intensity questions have already been raised in this paper, and while the magnitude is unknown, the direction of the bias introduced by protectionist policies is clearly away from labour intensity. One might even go further and suggest that the disequilibrium labour price that is increasingly a feature of Kenya's industrial sector is a creature at the artificially high profits made possible by protection.²⁸ Even if the factor-intensity effect was negligible, however, more liberal policies tend to encourage the local production of commodities which, because they are exported, have far better prospects for expansion than commodities that are restricted to the domestic market.

26. Peter N. Hopcraft, *op. cit.*

27. Bernard Wasow has correctly pointed out to me that predictions based on a conventionally over-simplified two factor world are likely to be misleading. The introduction of differences in relative natural resource abundance can, for instance, lead to insuperable difficulties in predicting appropriate capital-labour ratios, even if human capital is included in the capital definition. A number of highly efficient "natural resource intensive" industries in Kenya which may perforce be capital intensive, may explain the lack of any significant relationship between, capital labour ratios and his measures of protection and viability(*op.cit.*). There is also the possibility that some of Kenya's LDC trading partners may be relatively more capital scarce than we, which would, of course, lead to the prediction that our imports from them would be more labour intensive than our exports to them

28. This high wage, in turn, means that in the kinds of labour
cont...pg.16

In short, what is offered by an outward orientation is the rapid expansion of efficient labour intensive lines of production. No rational strategy for employment can afford to ignore such a possibility. In discussing the industrial policies of two of the countries that have chosen outward looking development strategies, Bela Balassa writes:²⁹

Exports of labour-intensive manufactured goods have contributed to the growth of the national economies of Taiwan and Korea by utilizing the two countries' abundant resource, labour, and economizing on its capital; by permitting the use of large-scale export industries; as well as by creating demand for domestic materials, raising incomes, and augmenting the availability of imports. The contrast with other developing countries is evident: during the sixties, per capital incomes rose at an annual rate of 6.5 percent in Taiwan and Korea, compared to slightly over 2 percent a year in the non-oil-producing developing countries.³⁰

Some further comments and observation on policies and prospects for Kenya's manufactured exports are perhaps in order. It must be recognized, however, that the price dis-incentive for manufacturers to consider exports, quite apart from the normal problems of breaking into new markets, has made exporting, with some exceptions, the virtually forgotten aspect of industrialization. The Export Promotion Council report refers to considerable "slack" in the exporting sector (p.4) by which they appear to mean that the scope for expanding export production is considerable. Under these circumstances it is not easy to speculate as to the sort of export performance to predict in a non-distorted situation. One does not get far with trend lines or the extrapolation of historical performance, for instance; and while at least some of the industries that could get ^{into} exports are often in existence, they are completely unaccustomed to thinking in any but domestic market terms. Other viable industries, furthermore, in view of the investment incentives bias away from export lines and toward import substitution, have never got off the ground.

28. cont./ intensive lines in which the country might have a comparative advantage, it is priced out of the market. As John Power has pointed out (op. cit.), an inflated wage in one sector makes it erroneously appear that the country has a comparative advantage exclusively in the goods of the sector in which the high wage does not prevail. Again the result is increasing reliance on traditional primary exports.

29. Bela Balassa, "Industrial Policies of Taiwan and Korea," Weltwirtschaftliches Archiv, band 105, heft 1 (1971)

30. At the recent UNCTAD conference in Santiago, Chile, a source of some embarrassment for the hard-won Generalized System of Preferences for the goods of the less developed countries was that only a dozen or so countries are taking any advantage of it.

It is worth noting that the East African partner states have been the major markets for Kenya manufactured products. Exports to our Community partners however, have been growing erratically, if at all, at an average rate of about 1½%, which represents a declining share of total Kenya exports which have themselves been growing at less than 2%.³¹ The commodity composition of what has been happening to these exports is also of considerable interest. The percentage of manufactured products in Kenya's East African Exports has always been far greater than the same percentage in total exports. In part this market for Kenya manufactures has been a reflection of natural advantages Kenya has over suppliers from outside East Africa, in part it has been a result of a common tariff against non-East African imports, implying that these countries imports from Kenya have not necessarily been competitive with imports from the rest of the world.

The problem has been that Kenya, despite transfer taxes and the various other community arrangements to try and redress the situation, has run a continuing trade surplus with its two partner states as follows:

Kenya's Trade Balance with Tanzania and Uganda, 1966-71 KE'000

	1966	1967	1968	1969	1970	1971 *
Exports-Imports...	17,778	12,725	13,992	16,974	15,465	18,745

*Provisional from Economic Survey, 1971 & 1972

It is hardly surprising that under these circumstances Tanzania and Uganda have been increasingly reluctant to buy Kenya goods at greater than world prices. The result has been that a number of mechanisms such as state trading have been employed to, in effect, shelve the common market agreement and buy from the cheapest source, c.i.f. ignoring the common tariff, or else buy from local producers regardless of higher costs. These two countries, in other words, are blowing the whistle on Kenya's exploitation of their foreign exchange earning capacity to support high cost Kenyan industries. The pressure is already on for interterritorial payments settlement to be made in local currencies.³²

31. Calculated for the years 1966 through 1971 from the Economic Surveys of 1971 & 1972, Republic of Kenya Tables 3.11 and 3.12 respectively.

32. The Export Promotion Council survey (op.cit.) recorded anguished cries from exporters to East African partner states who have found growing impediments put in their way by the importing countries. It concludes: "Rapid moves towards self-sufficiency in Uganda and Tanzania despite EAC arrangements, are making a growing number of Kenyan Exporters increasingly despondent about their chances of maintaining sales in these territories."

It is interesting to note that since 1966, the composition of East African imports from Kenya has been shifting away from the somewhat more easily substitutable lines and towards lines where Kenya appears to be more competitive with the rest of the world. Consumer goods and textiles, for instance, where Wasow's data suggests that effective protection is high and profitability at world prices is low, have shown a marked decline. "Other capital goods" and "semi-manufactures", on the other hand, for which Wasow's data generally indicate low or negative effective protection in Kenya and high "world price profitability" (the data classifications are not quite equivalent, detailed comparisons are therefore precluded) have increased markedly in the imports of these countries from Kenya. Total Kenya exports to these countries have fluctuated, around a zero growth rate, and when more recent figures become available, a substantial decline would not be surprising.

There is little doubt that the East African experience can be to some extent generalized to a number of other African and so-called "possible radius" markets. It became painfully evident at the All African Trade Fair that almost every country was producing the same "easy import substitutes", and generally doing so inefficiently behind protective barriers. (Particularly embarrassing were the not infrequent instances where the same foreign firm was producing the same import substitute behind similar protection in a number of different countries and presumably justifying their protection on scale economy and "keep out those nasty foreigner" grounds.) The Kenya Export Promotion Council's series of Market Survey Reports for these near by country markets frequently comes to similar conclusions.

Volker Vinnai looks at Kenya's African Trade in recent years³³ and finds a shifting composition of buyers from Kenya which can largely be explained on grounds of market countries' local protection of these easy import substitutes. While Sudan, for instance, purchased goods worth K£ 1.4 mill. in 1964, by 1970 this figure had dropped to K£ 0.2 mill.³⁴ Exports

33. Volker Vinnai "Kenya's African Trade 1964-1970" IDS Working Paper No. 30, March 1972.

34. Mr. Brian Hobson Chairman of the Kenya Export Promotion Council, in some helpful comments on an earlier draft of this paper has pointed out to me that political factors and bilateral deals with customers for Sudan's rather limited range of exports goes some distance in explaining the Sudanese figures.

to all African countries have maintained a reasonably respectable growth, with Ethiopia, Zaire and Somalia recording substantial growth in imports from Kenya. 35% of non-East African exports within the continent however, went to Zambia, which, in large measure was attributable to that country's distaste for trading with her southern neighbours. Zambia's recent decision to forget ideological differences in her choice of suppliers is already cutting very substantially into Kenya's market there.

The general comment that seems justified in looking at the prospects for Kenya's exports to neighbouring countries is the rather obvious one, and this is born out by both the exporter survey and the market survey referred to, and by discussions with exporters: Kenya products that are not competitive in price and quality do not stand a chance. Reliance on some preferential market arrangement, or the fruits of some official trade delegation, to sell non-competitive Kenya products will get nowhere. If, on the other hand, the exchange rate and fiscal biases against exports were removed, Kenya industries would not remain exclusively ensconced in a protected local market; they would be given the chance to, and perforce would have to, compete on equal terms with overseas suppliers. With minimal help and advice on such problems as marketing links, Kenya industries would have a very good chance of capturing a large share of nearby countries' markets in a limited range of products. While it is obviously possible to be overly sanguine about the trade prospects within groups of less developed countries, access to each other's markets and movement toward specialization between countries would appear to be far superior to the duplicative development of inefficient, inward looking, and eventually stunted industrialization in each of them.³⁵

As far as markets in the more developed countries are concerned, again much of the pessimism that pervades Kenyan industry is a consequence of the anti-export distortions referred to earlier and the pattern of investments that they have spawned. Despite a number of pernicious price distortions in Kenya's agricultural sector, and the seemingly insuperable institutional problems that often seem to prevent the development of adequate, reliable, industrially oriented supplies, it is a sector with a great deal of potential and considerable dynamism. It has the added

35. To put the comparative advantage argument in its simplest form: if for the same local resource cost we can produce five bicycles and two fridges on the one hand, and ten bicycles on the other, and if we can trade four bicycles for two fridges, we are not very sensible to be in fridge production. In general, the same resources obviously produce a larger national product as a result of this kind of trade.

advantage of not being burdened with artificially high labour costs, its land resources are remarkably diverse and productive, its technology generating and problem solving research establishment is hard to match in middle Africa. There is every reason why it should be the supply base for a series of processing industries geared toward the industrialized countries.

This paper has been written without the detailed research necessary to make specific industry by industry recommendations, but the sorts of agriculturally based industries that come to mind are leather goods of a large variety, vegetable oils of the manufacturing, intermediate and industrial lubricant as well as the edible type, insecticides, animal feeds, natural fibre products such as sisal mats of various types, ropes, and, certain textiles to mention only the non-food items. In the food categories the much touted discrimination of European consumers against African products is being belied daily by the burgeoning (but still grossly underdeveloped) market in Europe for Kenya horticultural products, Fresh, frozen, dried and canned products, particularly in the vegetable and beef lines, not to mention a range of speciality products of the confectionary and condiment variety, would undoubtedly develop if the incentives were right and the lethargic bureaucratic habits and the institutional bottlenecks were broken.

In terms of the capital requirements for the types of developments to which I have referred, I think most observers would agree that there are unlikely to be constraints. I have already referred to the export versus import substitution choice for investors and the fact that the lack of enthusiasm in the former direction is likely to be the result of the incentive structure being toward the latter.

Skill constraints are clearly a continuing problem in Kenya and, again, here is where the opportunity cost of the biases we are talking about are likely to be most evident. Skill and entrepreneurship, however, must be regarded as self-generating resources. The more they are put to work the more they develop. It is likely that relevant skills and entrepreneurship are increased more by experience and productive activity than by the expansion of University courses for instance (an unholy admission for an academic), though training programs of various sorts can obviously play a crucial part. In the meantime, skills that are necessary can and must be imported. The enterprises in which Kenyans can gain the experience and skill will simply not get off the ground at an adequate pace if they are unable to draw in good enough expatriate skills on a reliable enough basis.

Expatriate personnel are expensive and firms will have the incentive to replace them with Kenyans as the Kenyans develop the necessary skills and experience; there is even a good case for increasing this incentive for replacement by a tax on expatriate personnel. It is unlikely, however, that rule-of-thumb criteria and work permit allocation by government personnel, who cannot possibly acquire or process the information necessary for making anything but a totally arbitrary intervention in the affairs of a particular enterprise, will help in making rational progress toward more rapid Kenyanization.

On the question of technology, export oriented industries, forced, as they will be to face the bracing winds of price and quality competition, are likely to be far more innovative than the category of inward looking, protected industries we have been discussing. Government's policies and contribution in this area are crucial; it is particularly important that individual enterprises should not be faced with inappropriate input and factor prices; wage policies are particularly significant in this regard, as are policies affecting the capital price. Once again, however, it must be recognized that arbitrary and ill-informed interventions from government into the decision making of a particular industry on such questions as what technology to use, who and when to employ, where to locate, etc. can only have the effect of reducing that industry's competitiveness.

Apart from the general government function of smoothing the pathway (rather than creating impediments) for exporting industries, a good deal can be done in the area of information market research and advisory services. Foreign exporting firms, as has been pointed out, very often know the ropes and have market links in other countries which they should be encouraged to use. The same is not true of the local and especially the smaller firm. The current programme of trade exhibitions and commercial attaches is an effort in the right direction but, as it stands, it is little more than an empty institutional gesture. Its current contribution to increasing Kenya's exports is negligible. Trade attaches are generally not familiar with Kenya products or potential; enquiries at trade stands are not followed through, and virtually never result in finalized orders. Both Government and the private sector, in other words, are lethargic, unimaginative, inconsistent, and virtually oblivious of the development potential of outward looking industrialization. This private sector lethargy, in turn, results from the existing

36. Expatriate personnel also cost foreign exchange. If they are coming into foreign exchange efficient firms, however, they may well be worth a good deal more than is paid for them.

structure of Government policy and the consequent anti-export distortions in the incentive and price system.

If the industrial sector is to break the constraint of the small local market and make its contribution to employment, foreign exchange earning and growth, a major reorienting of skills and investment into efficient exporting industries is required. To accomplish this reorientation, a few random "export promotion" policies and measures will not suffice. What is needed is a revamping of the trade, commercial and exchange rate policies that currently conspire to inhibit non-traditional and manufactured exports, and keep the industrial sector looking inward.³⁷

37. I am grateful for the time that Government and semi-government personnel, and private exporters have allowed me to discuss the topic of this paper with them. I am also grateful to the stimulating environment and specific help that has been provided by my University of Nairobi colleagues Stephen Lewis, John Power and Bernard Wasow. Each of the above should be blamed in part for some part of the views expressed, but I will not identify which.