

Articulating the pathways of the impact of terrorism and violent extremism on the Kenyan economy

Summary

In recent years, Kenya and its people have witnessed a surge in terrorist attacks, violent extremism recently. The impact of these have been most felt on infrastructure, physical and human capital, productivity and economic growth. Furthermore, terrorist attacks and violent extremism have increased uncertainty in the investment climate, disrupted household spending and livelihood, dissuaded foreign direct investment (FDI) and led to a reallocation of resources from growth-enhancing investment to spending designed to increase national security. This policy brief highlights the impact of terrorism and violent extremism on the Kenyan economy with specific focus on the uncertainty effects on the tourism sector, foreign direct investment, the Nairobi Stock Exchange, effects on resource allocations and economies of counties. The policy brief shows that terrorism and violent extremism have led to destruction of infrastructure and physical and human capital with dire consequences on productivity and economic growth in the economy. Furthermore, the increase in the number of terrorism incidents has led to businesses facing higher operating costs including high insurance premiums, enhanced security measures and high labour costs to attract workers. In urban areas, massive investments have gone into expensive installations such as security cameras, metal detectors and advanced security systems to avert terror attacks.

Drawing from the literature, the policy brief offers some policy implications to Kenya as high levels of multidimensional inequalities (socio-economic and political inequalities), high poverty levels and high youth unemployment are the key drivers of terrorist attacks and violent extremist. Promoting socio-economic and political opportunities, including job opportunities, access to finance, access to education and health services among others, is important to prevent terrorism and violent extremism in Kenya. This should be complemented by a labour-intensive growth model that generates rapid growth that is equitably distributed and generates employment for the poor and youth. This is vital to reduce the supply of labour to prosecute terrorist attacks and violent extremism.

Introduction

In recent years, Kenya and its people have witnessed a surge in terrorist attacks and violent extremism. The impact of these have been most felt on infrastructure, physical and human capital, productivity and economic growth. Furthermore, terrorist attack and violent extremism have increased uncertainty in the investment climate, disrupted household spending and livelihood, dissuaded foreign direct investment (FDI) and led to a reallocation of resources from growth-enhancing investment to spending designed to increase national security. Although studies investigating the impact of terrorism and violent extremism on economies are relatively new, they are currently gaining popularity, following the September 11, 2001 terrorist attack in the United States and the surge in violent extremism and youth radicalization in Africa and other parts of the world.

With specific reference to Kenya, studies have focused on the uncertainty effects of terrorism and violent extremism on the tourism sector, FDI, the Nairobi Stock Exchange (NSE), effects on resource allocations and economies of counties. Most of these studies show that terrorist attacks have significant macroeconomic and sectoral costs; where macroeconomic costs have an impact on the whole economy as measured by GDP, FDI, exchange rates, imports/exports

indicators whereas sectoral/microeconomic costs are welfare losses associated with losses to certain sectors of the economy, such as transport, energy, and telecommunications. This policy brief highlights the impact of terrorism and violent extremism on the Kenyan economy with specific focus on the uncertainty effects on the tourism sector, foreign direct investment, the Nairobi Stock Exchange, and effects on resource allocations and economies of counties.

Impact of Terrorism and Violent Extremism on the Tourism Sector

Tourism is a major source of foreign exchange¹, tax revenues and employment in Kenya. The sector contributes about 27% of the country's foreign exchange². It also contributes about 25% to the country's GDP. In 2015, the sector earned about Ksh84.6 billion comparable to Ksh118.4 billion and Ksh90.4 billion marketed production for the Tea and Horticulture sectors, the two leading foreign exchange earners. The sector also contributes about 9% of the total employment in the economy³.

However, the country currently faces terrorism threats especially from Al-Shabaab which is affiliated to Al Qaeda terror group. In recent years, several terrorist attacks have occurred in Kenya causing injury, deaths of both citizens and tourists and destruction of property. Frequent and increased intensity of attacks led to Kenya's military intervention in Somalia in 2011 to forestall further attacks. The 2015 Global Terrorism Index (GTI) report estimates an increase in the GTI score for Kenya of about 0.362 to reach 6.66 in their zero to ten score index during the period 2013/2014⁴. It can be argued that the purpose of these attacks is to cripple the economy by making Kenya a hostile environment for FDI and tourist visits.

Buigut and Amendah (2015) show that terrorism has indeed significantly affected tourist arrivals and earnings in Kenya. Their results show that a 1% increase in fatalities decreases the arrivals of tourists by about 0.132% which suggests an annual loss of about Ksh157.1 million in tourism revenues per unit increase in fatality for the country. In another study, Buigut (2015) used a dynamic panel model to compare the effect of terrorism on developed and emerging country demand for tourism in Kenya using quarterly data spanning 2010Q1 to 2013Q4. The estimated results showed that a 1% increase in fatality reduced arrivals from developed countries by 0.082%. This translated to 2,487 visitors per year, or roughly Ksh155.8 million lost annually from an increase of one fatality per quarter.

A more recent study by Masinde, Buigut and Mung'atu (2016) which used Autoregressive Distributed Lag (ARDL), Vector Error Correction Model (VECM) techniques and Granger causality tests to empirically determine whether terrorism has an adverse effect on tourism between 1994 and 2014; found that there is no long-run relationship between terrorism and tourism in Kenya and that terrorism did not Granger cause tourism and vice versa. However, short-run effects showed terrorism had negative and significant effects on tourism. The lack of a long-run equilibrium relationship between the two variables is a bit surprising although the authors explained their findings by arguing that terrorism activities have been less frequent in Kenya and have been a recent problem with a spike after 2011.

Kenya lost a quarter of its visitors in the first five months of 2015 – 284,313 down from 381,278 in 2014⁵. This was followed by a fall of 4.3% the year before. This resulted in a decline in tourist receipts of 16.7% in 2013, with about 10% decrease specifically in hotels and restaurants in Kenya, which continued in 2014⁶.

The decrease in tourism shows the effect that a spate of Islamist militant attacks has had on Kenya's tourism sector. Following dramatic kidnappings in 2014 that occurred at beachside resorts, operators were especially concerned with the security of the Kenyan coast, responsible for about 65% of the industry's tourist visits⁷. The reports on terrorist attacks and travel advisories, including travel bans to Kenya from the main source of tourist markets such as U.S.A and Europe

¹ Kenya Economic Survey 2016.

² National Tourism Strategy, 2013, 2013-2018.

³ Kenya Institute for Public Policy and Research, 2017, Kenya Economic Report 2017,

⁴ Institute for Economics and Peace, 2015.

⁵ Kenya Tourism Board, 2015.

⁶ Central Bank of Kenya, 2015.

⁷ Ongoma, V. and Onyango O. A. (2014). A Review of the Future of Tourism in Coastal Kenya: The Challenges and Opportunities Posed by Climate Change.

led to reduced tourist numbers. For example, tourism businesses which has been bringing about US\$500 million annually were seriously affected by travel warnings since 2013. In 2014/15, the tourism sector has been losing at least US\$1 million everyday due to the decline in tourist numbers and activities. The losses have been attributed to the depressed performance of the tourism sector due to insecurity associated with terror attacks and adverse travel advisories⁸.

The decrease in tourist arrivals especially in 2013/14 had a ripple effect on all sectors of the economy. Kenya's reputation plummeted and this led to the loss of its tourism competitiveness. Kenya was no longer an option to be considered for vacation or investment. The tourism sector employed over 500,000 Kenyans ranging from tour operators, tour guides, travel agencies, safari drivers, dancers, hoteliers, restaurateurs, small businesses operators to airports and airline personnel. Consequently, there was a significant increase in unemployment as many Kenyans lost their jobs. Employees that were still employed received salary cuts. For instance, at the Carnivore restaurant; all the 330-staff had their salaries reduced, including Dunford the chairman⁹

Impact of Terrorism and Violent Extremism on Foreign Direct Investment, Nairobi Stock Exchange and Resource Allocations

With respect to foreign direct investment, Collier et al. (2003) contend that terrorist incidents have economic consequences by diverting FDI, destroying infrastructure, redirecting public investment funds to security, or limiting trade. Just as capital may take flight from a country plagued by a civil war, high incidence of terrorism may also reduce capital inflows. Investors are inclined to exclude Kenya in their FDI plans due to some shocks such as the direct destruction of infrastructure that raise operating costs due to an increasing need of security measures and the rise of recruiting costs due to missing incentives to work in terrorism-prone country. Terrorism also raises the costs of doing business in terms of raising the insurance premiums, increasing the costs for security precautions, and larger salaries to employees at-risk.

An empirical study by Kinyanjui (2014) using FDI as measured by Net Foreign Direct Investment in US\$ and terrorism as measured by number of terrorist attacks in Kenya during the period 2010-2012 found out that terrorism activities negatively affected FDI in Kenya through a negative effect on confidence. Indeed, the empirical results revealed that the presence of terrorist risk corresponded to a decline in the net FDI of 14% of GDP. A recent report indicates that about 70% of investors perceived security to have deteriorated in the past 2 years¹⁰. This vindicates the worsening security situation in 2013 and 2014 although security situation has improved since 2016.

A study by Wesley and Lumumba (2013) on the effect of terrorism on the Nairobi Securities Exchange (NSE) found that terrorist activities significantly lowered stock returns at the Nairobi Securities Exchange market on the day of terrorist attack occurrence. The authors found significant short-term negative stock returns around the terrorist event dates as evidenced by the decline in the NSE 20 share index, abnormal returns (AR) and the cumulative abnormal returns (CAR) around the terrorist event dates. They further concluded that terrorism has a negative effect on Kenya's stock market as it negatively affects transactions processing in the market place and impedes the buying and selling of securities by instilling fear as well as destroying infrastructural facilities.

Terrorism has also led to a reallocation of resources from growth-enhancing investment to spending designed to increase national security in Kenya. The Kenyan Government has over the recent years increased significantly spending on the security sector to over US\$1.3 billion per year compared to US\$0.6 billion to the health sector¹¹. Despite, the supply induced demand of the spending on security, the country is diverting spending from productive investment designed to promote growth, eradicate poverty and sustain tourism development to security, as shown by the increased expenditures on high tech security equipment such as surveillance cameras, metal detectors and screening machines that were procured to counter the threats of terrorism and violent extremism.

⁸ Economic Survey, 2015.

⁹ National Geographic, 2010.

¹⁰ Kenya National Bureau of Statistics, Kenya Investment Authority and Central Bank of Kenya, (2015) Foreign Investment Survey, 2015.

¹¹ 2017/18 Budget Statement.

In early January 2017, the United States of America's State Department approved a deal to sell military aircraft worth approximately US\$418 million to Kenya which included weapons package, technical support as well as programme management.¹² The weapons are meant to enhance security to curtail and fight terrorism and violent extremism among other security challenges.

Impact of Terrorism and Violent Extremism on Economies of Counties

A recent study by Institute of Diplomacy and International Studies at the University of Nairobi (2017) on "Strengthening Community Resilience against Radicalization and Violent Extremism: An Assessment of the Economic Impact of Terror Activities in Specific Locales", found that terrorism had a huge impact on the economies of counties affected by terrorism (especially the coast and north eastern regions) which have suffered heavily economically due to decreased tourist numbers resulting from travel restrictions by foreign governments. Hand grenade attacks in Nairobi, which contributes about 60% of the country's GDP that were experienced in 2013/14 greatly affected business operations in the capital city and Mombasa port city. This has led to a near collapse of the sectors that support tourism like local businesses, farming and other forms of livelihood supported by tourism like crafts, embroidery and curio businesses. The decline of tourist numbers especially in the coastal region which is the major market for tourists in the country led to large hotel chains laying off workers. Tourist numbers declined from 1,710.8 thousand in 2012 to 1,519.6 thousand in 2013 and further to 1,350.4 and 1,180.5 thousand in 2014 and 2015 respectively. This translated to a decline of tourist earnings of 11.9% from Ksh96 billion in 2012 to Ksh84.6 billion in 2015¹³.

Conclusion and Policy Implications

This policy brief highlights that the impact of terrorism and violent extremism on the Kenyan economy is through the uncertainty effects on the tourism sector, foreign direct investment, the Nairobi Stock Exchange, and effects on resource allocations and economies of counties. The policy brief shows that terrorism and violent extremism have led to destruction of infrastructure and physical and human capital with dire consequences on productivity and economic growth in the economy. Furthermore, the increase in the number of terrorism incidents has led to businesses facing higher operating costs including high insurance premiums, enhanced security measures and high labour costs to attract workers. In urban areas, massive investments have gone into expensive installations such as security cameras, metal detectors and advanced security systems to avert terror attacks. Although such efforts have yielded positive results, the economic cost is massive considering that these resources could have gone into more productive investments.

The literature shows that there is a relationship between terrorism, violent extremism and youth radicalization and high multidimensional inequalities, high poverty levels, and high youth unemployment. These findings offer some policy implications to Kenya as high levels of multidimensional inequalities (socio-economic and political inequalities), high poverty levels in certain regions of the country (such as the North Eastern and the Coast regions), and high youth unemployment alienate communities, especially the unemployed youths who are easily recruited by militant groups. Thus, promoting socio-economic and political opportunities, including job opportunities, access to finance, access to education and health services among others, is important to prevent terrorism, violent extremism and youth radicalization in Kenya. This should be complemented by a labour-intensive growth model that generates rapid growth that is equitably distributed and generates employment for the poor and youth. This is vital to reduce the supply of labour to prosecute terrorist attacks and violent extremism.

¹² <http://www.hivisasa.com/posts/us-approves-sale-of-sh42bn-military-equipment-to-kenya>

¹³ Economic Survey 2015 and 2016,

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