United Nations Development Programme

Analysis of likely Implications on Rebasing the GDP of Kenya

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Foreword

Rebasing the national account, which includes the GDP, is the process of replacing an old base year with a new and more recent base year. A base year provides the reference point to which future values of the GDP are then compared. GDP rebasing serves as a normal statistical procedure undertaken by national statistical offices of countries. This ensures that national accounts statistics present the most accurate reflection of the economy as possible. The UN Statistical Commission recommends that countries review or rebase their national accounts/GDP every 5 years.

GDP rebasing is beneficial to a country in many ways. Such benefits include enabling policy makers and analysts to obtain a more accurate set of economic statistics that are a truer reflection of current realities for evidence-based decision-making. Secondly, it reveals a more accurate estimate of the size and structure of the economy by incorporating new economic activities which were previously not captured in the computational framework. Thirdly, it provides better tools for Governments to tackle the challenges of growing the economy and fighting poverty. It further enables Governments to have a better understanding of the structure of the economy, the sectoral growth drivers and sectors where investment and resources should be channeled in order to grow the economy, create jobs, improve infrastructure and reduce poverty.

However, it is important to note that the calculation of GDP is an accounting system, which takes into account the market value of all goods and services produced within a year. GDP per capita on the other hand is simply an indicative average realized within a country by dividing the total worth of an economy by its total population. Unfortunately, in both these calculations, the issue of sustainable human development and how the national wealth is distributed are not taken into account. This is why it is possible to see countries with the same GDP per capita radically having different levels of poverty and inequality. In other words, the calculations of GDP and GDP per capita do not necessarily reflect improvement in the well-being of citizens which would automatically translate into reducing poverty, creating jobs and promoting sustainable human development. It thus requires the right kind of policy-mix, political will and determination to achieve these development objectives.

Whilst GDP rebasing is a good economic practice that will provide the GoK with relevant tools for tackling economic challenges such as growing the economy, fighting poverty and creating jobs, it is important to note that there are other implications arising from it. This is especially so when poverty, inequality, youth unemployment, insecurity and gender inequality are still entrenched in the economy. Such realities have forestalled the celebrations that might have come with the elevation of the Nigerian economy to the biggest economy in Africa and the 26th in the world. This is after the recent rebasing exercise that shot its Gross Domestic Products (GDP) to $509 billion ahead of South Africa's $350 billion.

It is against this backdrop that UNDP has supported this study to undertake an in-depth analysis of the likely implications of rebasing the economy of Kenya.

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Executive Summary

The overall objective of any Government is to improve the welfare of the citizens while narrowing inequality and reducing poverty. To be able to achieve this, the Government needs to acquire accurate, timely and appropriate data to inform and influence the relevant policy interventions. Lack of which will lead to misallocation of scarce resources resulting to welfare loss. To this end, Kenya has been in the process of revising its National Accounts Statistics (NAS) including rebasing of the GDP with a view of obtaining a more accurate estimate of the size and structure of the economy. This is done by incorporating new activities, which were previously not captured in the computational framework.

GDP Rebasing is an exercise undertaken by national statistical offices to ensure that national accounts statistics present the most accurate reflection of the economy. The Kenya National Bureau of Statistics (KNBS) initiated the process of rebasing and revising the NAS in the year 2010 and was expected to complete the exercise by May 2014. However, this was not realized until September 2014 when the results were released. The results have elicited intense debate from policy makers, investors, and international organizations among others. This is because the country will change her global ranking from a low income to a low-middle income country, hence affecting the nature of relationship between Kenya and other countries. These could affect the economy either positively or negatively. The international best practices recommend that national statistics revision should be carried out periodically preferably after 5-year period.

The GDP rebasing is beneficial to a country in many ways including enabling policy makers and analysts to obtain more accurate sets of economic statistics that are a comprehensive reflection of current realities.. This contributes by influencing evidence-based decision-making. Secondly, it reveals a more accurate estimate of the size and structure of the economy and sources of growth by incorporating new economic activities, which were previously not captured. Thirdly, it provides the Government with better tools to address the economic challenges of fighting poverty, unemployment, inequality etc. by informing efficient allocation of resources to achieve economic growth. Therefore, the overall objective of this assignment is to carry out an in-depth analysis of the implications of rebasing Kenya's GDP. The focus is on the implications on trade pacts and access to bilateral, multilateral loans and development assistance and on the social development and key macroeconomic aggregates of the economy.

Rebasing of the national accounts, which includes the GDP, is the process of replacing an old base year with a new and more recent base year. A base year provides the reference point upon which future values of the GDP are compared. According to the 2014 Economic Survey, the revision process involves use of a wide range of information obtained from surveys, censuses and administrative records. This is implemented in a coherent and consistent manner to achieve the overall goal of improved National Accounts Statistics. Output from this exercise includes revised national accounts estimates for the period 2006 to 2013; balanced 2009 Supply and Use Tables (SUT); 2009 Input-Output Table (IOT) and 2009 Social Accounting Matrix (SAM).

This process is necessitated by the fact that economies are constantly changing due to a number of factors. For instance, economies change in their production structure; structural changes in relative prices of various products, changes in consumption patterns, technological innovations and international dynamics among others. However, it is possible that changes in national statistics do not automatically translate into improving the well-being of the people or in equal distribution of wealth. It is important to note that the rebasing of GDP has changed the ranking of Kenya to middle-income status when in fact it still requires substantial structural changes and development assistance mostly provided to countries categorized as least developed countries. In this case, a country assumes a middle-income status due to rebasing of GDP but in reality, it still has many of the features possessed by least developed countries.

Although there is generally no standard way of classifying countries a number of approaches exist that classify countries as either developing or developed or as low-middle or high economies. International organizations including World Bank (WB), International Monetary Fund (IMF), Organization of Economic Cooperation and Development (OECD) and United Nations Development Programme (UNDP) adopt classification criteria of countries. Such criteria continue to be adopted extensively in shaping global economic policy debate and decisions in resources transfers, financing arrangements, and trade relationships, among others.

The review and revision of national statistics is expected to have profound effects on the Kenyan economy. This is despite the fact that the poverty levels and inequality remains unchanged. However, it is important to recognize that the revised GDP offers a better platform to approach these challenges. Nevertheless, there are possible losses that are likely to accrue from this process despite the gains. By updating the base year to 2009, Kenya's GDP statistics will better reflect the performance of the economy. Results from this exercise indicate an estimated GDP increase of 25 percent, such that the national income will increase from $44.1 billion in 2013 to $55.1 billion. Further, the GDP per capita increased from $994 to $1,246. This pushes Kenyan economy above the threshold of $1,035 that the World Bank uses to identify least-income countries. Thus, the Kenyan economy has attained low middle-income status prior to the targeted 2030 date, which is 16 years earlier. This will lead to increased investor confidence and therefore increased foreign direct investments. In addition, a number of macro-economic indicators are to improve with revisions of GDP hence improved reflection of the economy. For instance, public debt, fiscal deficit and current account balance expressed as a percentage of GDP will register a positive improvement and depict a more stable and sustainable economy. Conversely, and within the financial sector, the credit to private sector and securities market capitalization as a share of GDP will tend to decline.

Further, the economy will experience a structural shift and have a more diversified outlook. As more sectors of economic activities are captured in the compilation of GDP, so will changes occur in GDP. Having a diverse economy that is, one based on a wide range of productive sectors has long been argued to play a key role in a sustainable economy. A sustainable economy enhances the standards of living by creating jobs, wealth and encouraging the development of new knowledge and technology. Further, more diversified economies have less exposure to external shocks. There is also the benefits in trade increases, higher productivity of capital and labour; and better regional economic integration. These benefits, in addition to effective public management, facilitate alleviation of poverty and promote human and social development.

With respect to possible losses, Kenya has been dependent on official development assistance (ODA) for promotion of both economic and welfare development since independence. ODA is provided by member countries of Organization for Economic Co-operation and Development (OECD) to promote both economic and welfare development. The target is developing countries and it mainly constitutes of concessional loans with a grant element of at least 25 percent. Should the country graduate from a low to medium income country, it becomes ineligible for ODA. Effectively then, the amount of resources that such a country is likely to lose is well over $ 2.8 billion per annum. 70% of the ODA to Kenya is from bilateral donors while 30% is from multilateral donors. Furthermore, given that Kenya has attained the middle-income status it will no longer be eligible for International Development Association (IDA).This means that alternative sources of financing will be sought equivalent to approximately 50 percent of external financing. The consequence is that loans will be more expensive and aid will become harder to come by. Furthermore, some macroeconomic indicators, such as investment and savings as a ratio of GDP will deteriorate as GDP expands. Similarly social indicators including Government expenditure on education and health as a ratio of GDP will decline.

A larger economy means Kenya needs less support and will not be eligible to access key export markets on preferential terms. Hence, Kenya might experience loss of access to key markets it currently trades in under special terms as a poor country. In overall, there are gains and losses associated with this exercise, the net effect will be determined by the ability of the country to take advantage of the presented opportunity and putting in place measures that mitigates the potential losses. It is noted that the stakeholders, private and public, are not familiar with the exercise and not aware what the results means for them. Therefore, the main recommendation is to intensify on the sensitization of the stakeholders and the citizens to minimize any possible confusion or misinterpretation.

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Acronyms

ACP	-	African Caribbean and Pacific Counties
AGOA	-	African Growth and Opportunities Act
BOP	-	Balance of Payments
CBK	-	Central Bank of Kenya
CIA	-	Central Intelligence Agency
CT-OVC	-	Cash Transfers to Orphans and Vulnerable Children
CT-PWSD	-	Cash Transfer for Persons with Severe Disability
DPs	-	Development Partners
ECA	-	East African Community
EPA	-	Economic Partnership Agreements
EU	-	European Union
FDI	-	Foreign Direct Investments
GATT	-	General Agreement on Growth and Tariffs
GDP	-	Gross Domestic Profit
GNI	-	Gross National Income
HDI	-	Human Development Index
HDR	-	Human Development Report
HIPC	-	Heavily Indebted Poor Countries
HSNP	-	Hunger Safety Net Programme
IBRD	-	International Bank for Reconstruction and Development
IDA	-	International Development Association
IFS	-	International Financial Services
IMF	-	International Monetary Fund
IOT	-	Input-Output Tables
KNBS	-	Kenya National Bureau of Statistics
LDCs	-	Least Developed Countries
LICs	-	Low Income Countries
MDGs	-	Millennium Development Goals
MDRI	-	Multilateral Debt Relief Initiative
NAS	-	National Accounts Statistics
NSNP	-	National Safety Net Programme
OECD	-	Organization of Economic Cooperation Countries
OPCT	-	Older Persons Cash Transfer
R&D	-	Research and Development

SAM	-	Social Accounting Matrix
SNA	-	Systems of National Accounts
SUT	-	Supply Use Tables
TOR	-	Terms of Reference
UFS-CT	-	Urban Food Subsidy Cash Transfer
UN	-	United Nations
UNCTAD	-	United Nations Conference on Trade and Development
UNDP	-	United Nations Development Programme
UNSC	-	United Nation Statistical Commission (UNSC)
UNWTO	-	United Nations World Tourism Organization
WDI	-	World Development Indicators

1.0 INTRODUCTION

1.1 Context

The process of revising National Accounts Statistics including rebasing of the GDP has been finalized. The main objective of the process was to obtain a more accurate estimate of the size and structure of the economy. This was achieved by incorporating new activities, which were previously not captured in the computational framework. Kenya Natural Bureau of Statistics (KNBS) national accounts data was based on figures from 2001, which has now been changed to 2009 – the new base year and reference point - to present an accurate reflection of Kenya's economy. The update is in line with international best practice and will help inform policy makers and analysts in decision making by obtaining an accurate set of economic statistics.

The KNBS was expected to complete the exercise to update national accounts in May 2014 but the results were announced in September of the same year. This process, which is known as rebasing of the economy has already generated a lot of interest among policy makers, development partners, academicians and practitioners. This is especially so coming hot in the heels of the controversial results/outcome of the Nigerian rebasing exercise. The great interest in the outcome of the exercise arises from the implications on the status the country in the global ranking in accordance with income levels as well as the interpretations of the economic wellbeing of residents of the country.

The frequency with which countries change their base periods vary from one country to another. For example, some countries rebase every 10 years, while others carry out the exercise every 5 years. Others do it in less than 5 year interval. This depends on developments within the economy that authorities would want to capture via rebasing. Changes, in consumption and production patterns, and changes in technologies of production, have also been seen as a panacea for a country to rebase its GDP series.

The rebasing exercise has to take into account extensive series including: national accounts, Government budget, price indices, etc.

Issues in rebasing include:

- How long the exercise should take
- Revision of the framework
- Documentation and publication of sources and methods of the GDP compilation
- The conversion and linking methods used in deriving a consistent series of GDP
- The changes in series that occur due to rebasing, and explanations for those changes

1.2 The National Accounts Statistics (NAS)

The National Accounts Statistics (NAS) are a system of measuring all economic transactions taking place in an economy according to a set of rules, which are contained in the UN system of national accounts. By monitoring changes in volumes using constant prices, the economy can compare changes in economic status over time. However, in order to access the actual changes in the economy, there is need to also measure these aspects in terms of current prices.

The spread between constant and current prices has been growing over the last decade owing to increasing inflationary pressures. The constant price method is one that removes the price effects, thus only showing the volume effects. A proper methodology for the preparation of the current price estimates, derived from volumes and deflators or from value added as obtained in reports from various sectors, has become important.

Due to developments in any economy, and change in relative prices of economies over time, there is dire need to revise the base year, one that will reflect those developments. Therefore, an old base year will not give the best information in so far as estimation of GDP is concerned. Further, revision is able to take into account coverage issues. For example, a 1985 base-year GDP series would largely be obsolete since coverage of key sectors or activities would be wanting.

1.3 Rebasing and Revision of the National Accounts

As earlier mentioned, rebasing is the process during which the reference year for the real (or constant price) estimates of national accounts is changed. GDP Rebasing is supposed to serve as a normal statistical procedure undertaken by national statistical offices of countries to ensure that national accounts statistics present the most accurate reflection of the economy. In the course of time, the pattern of relative prices in the base period tends to become progressively less relevant to the economic situations of later periods. This eventually reaches a point which it becomes undesirable to continue using past economic situations to measure volume changes from one period to the next. It is at such point then that it becomes necessary to update the base period. GDP rebasing therefore will also refer to an adjustment in the "base year" or "benchmark year" from which GDP is calculated. Rebasing also includes better coverage (including of the informal sector), the inclusion of new industries, and methodological improvements. In a nutshell rebasing is undertaken to ensure that the principal measure of economic growth yields good estimates over the medium term following the base year.

The base period will typically be a "normal year" in the economy where no major disruptive occurrences took place. In practice, the choice of base year is a function of the availability of the required periodic data. Such data would include income and expenditure survey, population census (community survey), complete coverage of all economic sectors through large sample surveys and finalized Government statistics, (Statistics South Africa, 2009).

The United Nation Statistical Commission (UNSC) thus recommends that countries review or rebase their national accounts/GDP every 5 years.

It is believed that GDP rebasing is beneficial to a country in many ways including enabling policy makers and analysts to obtain a more accurate set of economic statistics. Evidently, such statistics are a truer reflection of current realities, for evidence-based decision-making. Secondly, GDP rebasing would reveal more accurate estimates of the size and structure of the economy by incorporating new economic activities which were previously not captured in the computational framework. Thirdly, it is expected to provide Governments with better tools to tackle the challenges of growing the economy and fighting poverty. In addition to Governments having a better understanding of the structure of the economy, the sectoral growth drivers, GDP rebasing will help to identify sectors where investment and resources should be channeled in order to grow the economy, create jobs, improve infrastructure and reduce poverty.

The calculation of GDP is an accounting system which takes into account the market value of all goods and services produced within a given period of time, usually a year. In contradistinction, GDP per capita is simply an indicative average realized within a country by dividing the total worth of an economy by its total population. It is unfortunate that in both of these calculations, the issue of sustainable human development and the distribution of national wealth are not taken into account. This is why it is possible to observe countries with the same GDP per capita radically having different levels of poverty and inequality. In other words, the calculations of GDP and GDP per capita do not necessarily reflect improvement in the well-being of citizens. It further means that an increase in value of these calculations does not automatically translate into reducing poverty, creating jobs and promoting sustainable human development. It requires the right kind of policy-mix and political will and determination to achieve development objectives.

GDP rebasing is a good economic practice that will provide the GoK with the relevant tools for tackling the challenges of growing the economy, fighting poverty and creating jobs. However, there are other implications arising from rebasing of the economy especially so when poverty, inequality, youth unemployment, insecurity and gender inequality are still entrenched in the economy. Such realities have forestalled the celebrations that might have come with the elevation of the Nigerian economy to the biggest economy in Africa and the 26th in the world. This is after the recent rebasing exercise that expanded its Gross Domestic Products (GDP) to $522.9 billion, ahead of South Africa's $350 billion. It is against this backdrop that UNDP has supported this study to undertake an in-depth analysis of the likely implications of rebasing the Kenyan National accounts statistics.

2.0 OBJECTIVE OF THE ASSIGNMENT

The overall objective of the assignment is to carry out an in-depth analysis of the implications of rebasing the GDP of Kenya. The focus is not only on the social development and key macroeconomic aggregates of the economy, but also on the implications on trade pacts, access to bilateral and multilateral loans, and development assistance.

2.1 Specific Objectives

The specific objectives of this assignment are:

- Carry out literature review on the rationale behind rebasing of GDP;
- Analyze key parameters used by various institutions such as the UNDP, World Bank and other internationally renowned institutions in classifying countries;
- Provide in-depth analysis on likely implications of rebasing of the economy and link such implications to the Kenyan perspective;
- Highlight implications on human well-being and the eligibility of Kenya to access development assistance and loans once it has assumed a middle-income status.
- Recommend practical strategies to cushion any short to long-terms impacts on the economy.

3.0 METHODOLOGY

The research study design is descriptive. This entailed using a highly participatory, broad-based and inclusive approach requiring a desk review of literature on the revision of the national accounts statistics and rebasing of GDP. It also included stakeholder consultations and interviews, collation and analysis of data and information as well as review and compilation of various reports.

This study has nine chapters. Chapter 1, 2 and 3 provide the contextual background information about the study. These include study objectives, context of the study, revision of national statistics, rebasing of the gross domestic product (GDP) and methodology adopted during the study. Chapter 4 summarizes the past experience in rebasing both for Kenya and other countries in Africa while chapter 5 provides a discussion on the justification and rationale for rebasing. Chapter 6 provides an incisive discussion on the various classifications used by international organization to classify countries either for operational or analytical purpose. Chapter 7 gives an in-depth analysis of the implications of rebasing the GDP within the context of the Kenyan economy. The conclusion is in Chapter 8 while chapter 9 provides recommendations and a discussion on a dissemination strategy for implementing the recommendations.

4.0 REVISIONS OF NATIONAL ACCOUNT STATISTICS AND GDP REBASING IN KENYA

4.1 Previous Revisions

Previous revisions and rebasing carried out in Kenya are discussed in the following sections.

4.1.1 1957 Revision

This was the first revision whose main aim was to enhance the quality of the first official estimates of the national accounts that had been compiled by the East African Statistical Department in 1947. The quality of these estimates were seriously undermined by the lack of information on incomes from rents, interests, profits and self-employment and by the limited data on the output of the manufacturing and service sectors. The estimates mainly covered only the monetary economy. The revision facilitated the compilation of the first GDP series to be compiled for Kenya based on the 1954 prices. Nonetheless, the 1954-base year GDP series was rudimentary at best.

4.1.2 1967 Revision

The second revision was undertaken in 1967 to adopt and incorporate the recommendations of 1953 System of National Accounts. It is this particular revision that facilitated the compilation of the third series of national accounts. The accounts incorporated new economic data and improved classification and sub-classification of enterprises as well as a more comprehensive estimate of the size of the economy. Further, the estimates were produced at both current and constant prices.

4.1.3 1976 Revision

In this revision, the base year was revised to 1972. The prices and the GDP series was compiled for Kenya under the international guidelines for national accounts covering a number of issues. However, a lot of economic activities were not captured, including the lack of estimates for imputed rent of owner-occupied dwellings, and FISIM (Financial Intermediary Services Indirectly Measured) among others.

4.1.4 1986 Revision

In 1985, GDP was rebased for the first time in Kenya to 1982 base price. The year was chosen based on available data and stability.

4.1.5 2005/6 Revision

The base year was changed from 1982 prices to 2001 prices and therefore the GDP was revised with 2001 base prices. The revisions of the national accounts were done in accordance with the 1993 SNA framework, which mainly improved national accounts compilation and accounted for FISIM.

The current revision is the sixth revision of national accounts based on 2008 SNA.

4.2 Experience in Other African Countries

South Africa

South Africa historically benchmarked its National Accounts estimates on a periodic basis, typically every 5 years. The previous two benchmarking exercises were done for the 1995, 2000, 2009 reference years, the results of which were published in June 1999 and November 2004 respectively. As per normal practice, the estimates were revised for the period starting two years before the

reference year, i.e. 1993 and 1998. This was done jointly by Statistics South Africa and South African Reserve Bank.

Nigerian Experience

Nigeria carried out a rebasing exercise from 2010 to 2013 the first of its kind since 1990 after a period of 23 years. The rebasing exercise saw Nigeria become the biggest economy in Africa and the 26th in the world. The Gross Domestic Products (GDP) shot to $522 billion, ahead of South Africa's $350 billion with per capita rising to $2, 688. The rebased estimates indicate that the nominal GDP for Nigeria was much higher than previously estimated. In 2010, the estimate was $360b. (N644) billion); in 2011 it was $408.805 billion; 2012 $453.966 billion; and in 2013 $522 billion.

In addition, the share of the various sectors contribution to GDP has also changed in the rebased series. The share of agriculture and industry declined to 24% and 25.8% respectively while the share of services to the country's GDP increased to 50.2 per cent.

The tremendous increase in the GDP was occasioned by the inclusion of Telecommunications and information services; motion pictures and sound recording (Nollywood); cement production; food, beverage and tobacco; construction and real estate sectors in the calculation of the GDP.

However, with a vast array of intractable social problems such as power, poverty, illiteracy, infrastructural deficits, corruption, unemployment, insecurity, etc., which characterizes the economy, the results of the exercise were received with mixed reactions. The National Bureau of statistics admitted that rebasing though commendable, would not make poverty and unemployment disappear overnight. However, it would give the Government the needed tools to tackle the problems in order to reduce poverty and improve the welfare of the people. They argued that the reality was that Nigeria is now bigger, more diversified, has more accurate and current data and is thus in a better position to initiate and execute policies and programmes, attract FDIs and take its appropriate queue in the global GDP medal table. The debt and deficit ratios are more attractive and this allows room for more macroeconomic maneuvering. It will also ensure better diagnosis and intervention by the global partners.

Other Countries

The experience of rebasing in other countries is summarized in Table 4.1 below. Within the East African region, Burundi with 9 years leads with the highest number of years between the base years followed by Tanzania and Uganda with 6 years and 5 years respectively. However, Uganda is leading with the oldest base year followed by Burundi and Tanzania with 2002, 2005 and 2007 respectively. This clearly shows that the EA region is doing very well and was rebasing almost in accordance to the best practice. Kenya was actually running behind its contemporaries in the region. In Africa in general, Cape Verde has the highest number of years between the base year with 27 years. This is followed by Niger at 19, Ghana and Botswana at 13 and Ethiopia at 12 years.

According to Table 4.1, there seems to be no correlation between the number of years of the base year and the percentage difference in the old and new base year GDP series. DRC for example with only 5 years between the base year registered a 66% difference between the old and new base year GDP series. Niger with 19 years recorded only a 2.5% difference. Moreover, it is not always the case that rebasing shall always result in a positive change to the GDP. Botswana, Ethiopia, Lesotho all recorded decreases in GDP despite the number of years between base years being significantly high with 13, 12 and 9 years respectively.

Table 4.1: Countries that have Undertaken Rebasing Exercise in Recent Years and the Magnitude of the Changes

Country	Old Base Year	New Base Year	No. of Years Between Base Years	% Diff Between Old and New Base Year GDP Series
Botswana	1993/1994	2006	13	-10
Burundi	1996	2005	9	40.3
Cape Verde	1980	2007	27	13.7
DRC	2000	2005	5	66.4
Egypt	2001/2002	2006/2007	6	8.9
Ethiopia	1999/2000	2010/2011	12	-1
Ghana	1993	2006	13	62.8
Lesotho	1995	2004	9	-4.4
Morocco	1988	1998	10	11.7
Niger	1987	2006	19	2.5
Nigeria	1990	2010	20+	59.5 (2010)
Sierra Leone	2001	2006	5	25.6
Tanzania	2001	2007	6	10
Tunisia	1990	1997	7	9.8
Uganda	1997/1998	2002	5	10.5
South Africa	1993	1998	5	13.7

Source: IMF

4.3 The 2009 Revision of Kenyan National Accounts

The Kenya National Bureau of Statistics (KNBS) started the current process of rebasing and revision of the National Accounts Statistics in 2010. The process entailed the following:

- Changing the base year from 2001 to 2009, i.e. rebasing.
- Implementing recommendations contained in 2008 System of National Account (2008 SNA)[1].
- Revising the annual and quarterly national accounts statistics for the period between 2006 to2013.
- The development of Supply and Use Tables (SUT) as an integral part of the National Accounts Statistics. This is because the Supply and Use of Tables gives detailed information on the production processes, the interdependencies in production, the use of goods and services and the generation of income in production.

According to the Economic Survey 2014, the revision process involved use of a wide range of information obtained from surveys, censuses and administrative records. This was done in a coherent and consistent manner to achieve the overall goal of improved National Accounts Statistics.

[1] System of National Accounts 2008

The development of 2009 SUT serves both statistical and analytical purposes. As a statistical tool, SUT provides an accounting framework for systematic and detailed description of the economy; its various components on the supply and demand side; and its relation to other economies. Therefore, it presents a powerful tool with which to compare and contrast data from various sources and improve the coherence of the economic information system. The SUT is extensively used to inform policy decisions.

The revision of National Accounts Statistics (NAS) is carried out preferably after every five years to generate estimates that are accurate in reflecting economic realities. The current revision has taken four years since its inception and will be concluded by end of 2014. Targeted output includes revised national accounts estimates for the period 2006 to 2013; balanced 2009 Supply and Use Tables; 2009 Input-Output Table (IOT) and 2009 Social Accounting Matrix (SAM).

The Input-Output Table and Social Accounting Matrix are analytical tools useful in assessing the impact of a change in the final demand of a given sector compared to all sectors of the economy. These tools provide valuable policy guidelines to potential induced linkage effects and can indicate likely supply bottlenecks that may occur in a growing economy. The 2009 SUT provides the basic data necessary for the construction of IOT and SAM.

4.4 Main Results from the Process

The first part of the results entails comparison between the previous estimates (base year 2001) and the new estimates compiled on the basis of 2009 base year. According to the results, the revised GDP estimate for 2009 is Kshs. 486.6 billion. This figure is higher than the previous estimate and it illustrates an expanded economy and a significant shift in the structure of the economy. This change translates to about 20.6 percentage increase in the revised statistics compared to the previous statistics. The increase is attributed to improved and revised input-output production structures which were lower in a number of sectors compared to the revised estimates[2].

4.4.1 Contributions of the Main Sectors to the GDP Change (in %)

The results from the national accounts revision indicate that there are no dramatic differences in the structure of the economy in broadly defined categories. Nevertheless, agriculture, manufacturing and real estate accounted for most of the change. A new sector, Information and Communication Technology (ICT), is established in the reporting format. The revised GDP is higher by 25.3percent in 2013 with a new GDP per capita of $1,246. The highest contribution to the GDP change was by the real estate sector with a contribution change of about 2.9%. This was followed by manufacturing at 2.4% with agriculture and forestry pegged at 1.8%. The contribution by real estate was a clear reflection of the tremendous growth of the sector in terms of increase in the stock of high quality houses witnessed in the last decade. Further, it was a reflection on the higher inter-census annualized growth rate of 6.9 % in 2009 compared to 4.7 % from previous 1999 census[3]. Improved data source from the 2010 Census of Industrial Production (CIP) may have supported the contribution of the manufacturing sector. On the other hand, wholesale and retail trade reduced their contribution to GDP by 6% and 3.9 % Table 4.2 shows these contributions.

[2] Economic Survey, 2014
[3] Ibid

Table 4.2: Magnitude of Revisions by Economic Activities in 2013

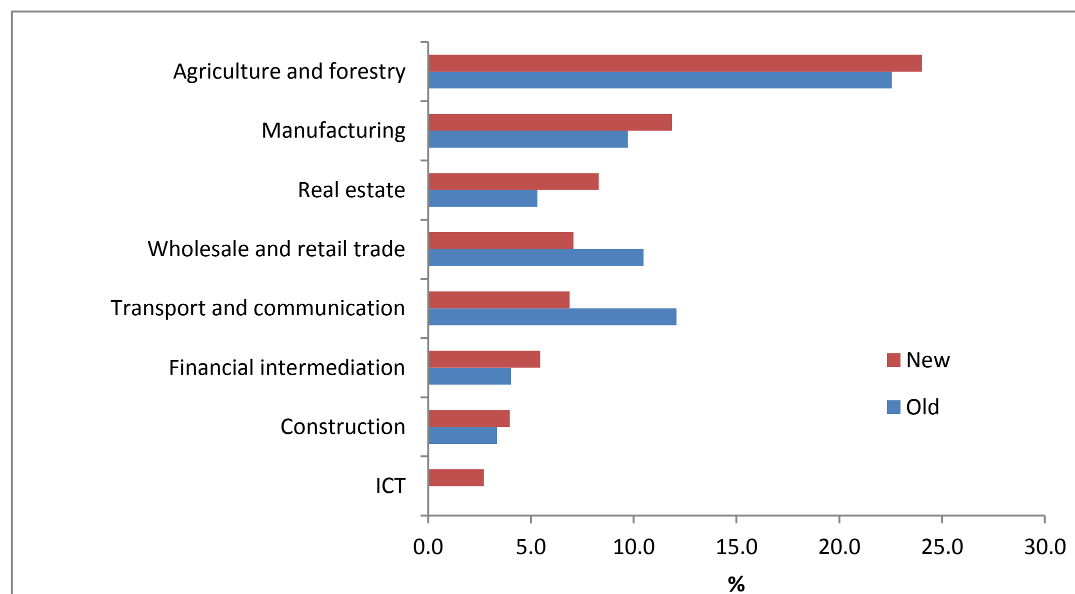
Main Economic Sector	New	Old	Change
Agriculture	23.2	21.4	1.8
Manufacturing	11.9	9.5	2.4
Real Estate	8.1	5.2	2.9
ICT	3.4		3.4
Wholesale and retail trade	7.6	11.5	-3.9
Transport and communication	6.6	12.6	-6.0
Construction	4.5	3.5	1.0
Financial intermediation	5.9	4.4	1.5

Source: KNBS 2014

4.4.2 *Revised Structure of the Economy*

Figure 4.1 presents the results which compare previous estimates based on 2001 base year and the new estimates compiled on the basis of 2009 base year for the period 2009-2013.

Figure 4.1: Revised Structure of the Economy Share of GDP, (2009-2013 Average)

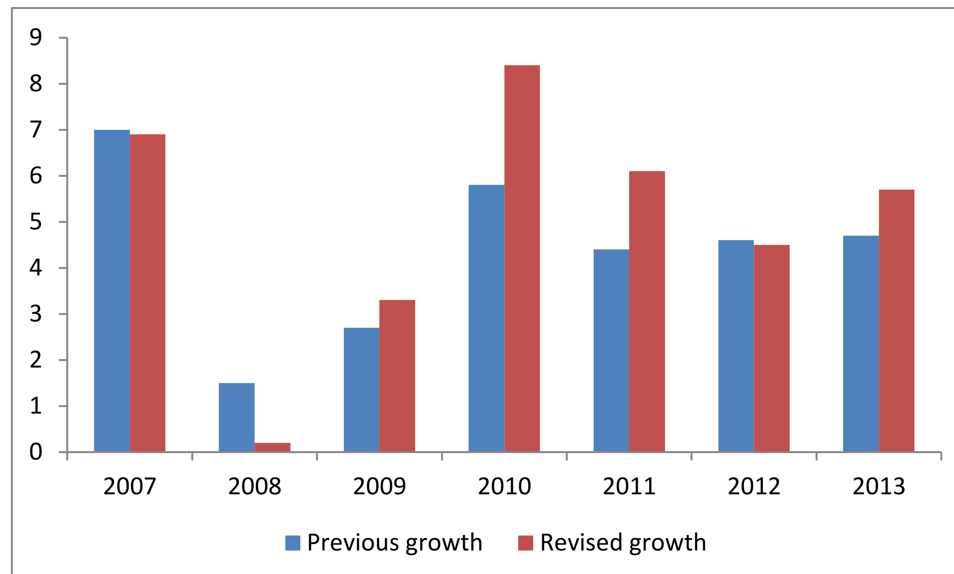


Source: KNBS (Shares Computed on GDP at Basic Prices)

Following the adoption of the new system of national accounts and revision of GDP, the share of real estate, manufacturing and agriculture increased to 8.1%, 11.9% and 23.2% respectively. However, the share of wholesale and retail trade and those of transport and communication reduced to 7.6% and 6.6%, respectively. Nevertheless, agriculture remains the leading sector in the economy accounting for 23.2% The GDP from expenditure perspective experienced minimal change except for exports and imports, where share of exports decreased from 24.1 percent to 20.1 percent and imports from 37.7 percent to 30.9 percent.

It is important to note that the growth of GDP over the period 2009-2013 also changes substantially as shown in Figure 4.2. The year 2010 recorded the highest growth rate of 8.4 percent.

Figure 4.2: Comparisons in GDP Growth Rates



5.0 RATIONALE OF REBASING AND REVISION OF THE NATIONAL ACCOUNTS

5.1 Accurate Data for National Planning

Review of national accounts and rebasing is an important exercise for any economy. It ensures that the statistics that represents a country are accurate, reliable and representative of the economy. This is critical because decisions by policy makers if based on inaccurate statistics would be misinformed and hence ineffective. Consequently, this exercise is quite crucial in the development process of an economy, as recommended by international best practices.

The main consequence of economic growth is the improvement in the standard of living of the citizens. This can be achieved through increased incomes, poverty alleviation, narrowing of inequalities, and provision of social amenities among others. The realization of these outcomes is only possible if proper and effective planning with appropriate implementation is put in place. However, development planning is only beneficial if it is anchored on reliable, accurate and up to date statistical data, which is comprehensive enough to represent the true picture of the economy.

It is because of the aforesaid that all economies have statistical bureaus mandated to collect, analyze, publish and disseminate national and sectoral accounts data. To improve the credibility and reliability of data in Kenya, and in line with international best practices, the Kenya National Bureau of Statistics (KNBS) has since 2010 been collecting data for policy making. . Since 2010, KNBS has undertaken to review and update the national statistics by reviewing the System of National Accounts (SNA) to 2008 framework and rebasing the Gross Domestic Product (GDP). This GDP is the value of goods and services produced within an economy and in this case between 2001 – 2009.

5.2 Provides Better Tools to Handle the Challenges of Growing the Economy, Fighting Poverty and Creating Jobs

In the course of time, the pattern of relative prices in the base period tends to become progressively less relevant to the economic situations of later periods. Eventually, it reaches a point at which it becomes undesirable to continue using previous national accounts to measure volume changes from one period to the next. It is at such a point then that it becomes necessary to update the base period. GDP rebasing is about adjusting the "base year" or "benchmark year" from which GDP is calculated. Rebasing will also include better coverage (including of the informal sector), the inclusion of new industries, and methodological improvements. In a nutshell, rebasing is undertaken to ensure that the principal measure of economic growth yields good estimates over the medium term following the base year.

The base period will typically be a "normal year" in the economy where no major disruptive occurrences took place. In practice, however, the choice of base year is a function of the availability of the required periodic data. Such data includes for instance, income and expenditure survey, population census (community survey), complete coverage of all economic sectors through large sample surveys and finalized Government statistics, (Statistics South Africa, 2009).

Nevertheless, it offers good opportunity for the citizens and the Government to enhance accountability on the acquisition, usage and distribution of resources.

5.3 International Best Practices

The UN Statistical Commission recommends that countries review or rebase their national accounts/GDP every 5 years. The essence of the revision/rebasing is to update the production structure; capture structural changes in relative prices of various products and; incorporate product changes due to developments and innovations. In addition, changes on the demand side like consumption patterns, utilization and acquisition of capital goods are all also updated through rebasing.

The current national accounts data is based on figures from 2001 which are over 12 years. This is completely out of line with the international best practice which requires updates to be made within a period of five years. Such a five year update helps to inform policy makers and analysts in decision making by obtaining an accurate set of economic statistics. There is no doubt that quality statistics is a good basis for sound decision and evidenced based planning decision making. It will also include a review of methodologies in line international best practice such as implementing recommendations contained in 2008 System of National Account (2008 SNA)[4].

5.4 Structural Changes in the Economy

Changes often occur in an economy for a variety of reasons. There may be changes due to the alteration in the variety of products and services. Changes also occur due to technological innovations and developments as well as changes in consumption patterns. There are also structural changes in the acquisition of capital goods and in openness of the economy. These changes imply that

[4] The System of National Accounts (SNA) 2008 is the internationally agreed standard set of recommendations on how to compile measures of economic activity in accordance with strict accounting conventions based on economic principles. The recommendations are expressed in terms of of set concepts, classifications, and accounting rules that comprise the internationally agreed standards for measuring such items as gross domestic product (GDP), the most frequently quoted indicator of economic performance. The accounting framework of the SNA allows economic data to be presented in format that is designed for purposes of economic analysis, decision-taking and policy making. The framework of the SNA provides accounts that are; i) comprehensive, in that all designated activities and the consequences for all agents in an economy are convenient; ii) consistent, because identical values are used to establish the consequences of a single action on all parties concerned using the same accounting rules; iii) integrated, in that all the consequences of a single action by one are necessarily reflected in the resulting accounts, including the impact on measurement of wealth captured in balance sheet.

there are changes in the relative prices of commodities. As consumption and production patterns change over time, the price structure of the economy also changes. This also means that the base year structure becomes less representative of the economy. As the price structure changes over time, a substitution effect also occurs. The substitution effect is a way in which consumers move away from relatively more expensive products to buy goods with relatively cheaper prices. Thus, goods with higher real growth tend to have relatively weaker price increases.

It is therefore important to correct this substitution bias. The revision exercise is used to improve the estimates of economic growth and the changing reality in the economy. However, it is possible that these changes do not automatically translate into the well-being of the people and equal distribution of wealth. It is also important to note the rebasing of GDP could pre-maturely move a country to middle-income status when in fact it still requires substantial development assistance mostly provided to countries categorized as least developed countries. In this case, a country assumes a middle-income status due to rebasing of its GDP but in reality it still has many of the features possessed by least developed countries.

For example, the need to include other sectors and subsectors of the Nigerian economy, has partly explained the recent 2010 rebasing exercise. New activities covered under the new economic reporting classification include: administrative and support services, motion pictures, music production; publishing, arts, recreation, professional, scientific and technical services. This rebasing has implied that Nigeria becomes the largest economy in Africa and 26th in the world. There were significant leaps in her GDP, GDP per capita and overall changes in the contribution of various sectors to the country's GDP. The services sector, which had been grossly underestimated over the years, took the lion's share of growth. Nominal GDP rose consistently by 48% over a period of four years. However, with a vast array of intractable social problems facing the country such as power shortage, poverty, illiteracy, infrastructural deficits, corruption, unemployment, insecurity, etc., it has been a herculean task convincing Nigerians that rebasing make any sense for the economy.

5.5 Harmonization of the Various Approaches in the Measurement of GDP

Rebasing is also necessary as a way of reconciling various measurement tools of GDP, i.e. using the expenditure approach, the income approach, and the value-added approach. Methodological improvements in the process are necessary. For example, the requirement by SNA 2008 to show expenditure on research and development (capitalization of R & D in GDP) means that rebasing would have to take it into account including other improvements which are mandatory.

Prices used to calculate real measures of GDP need to be updated frequently. Using the production approach, GDP is typically calculated as a sum of the "value added" to the production of goods and services in all sectors of the economy. In order to compare one year's "value added" with another year, hence get an idea of whether the economy is expanding or contracting, a new set of numbers for all the sectors are computed. To make the two amounts comparable, they are expressed in constant prices. A way of doing this is to generate a benchmark or "base year" estimate for which future level estimates will be compared to. Thus, the process of replacing the present price and quantity structure of the base year entails changing price and quantity base for individual price and quantity relatives. It also entails updating weights used in aggregating individual quantity relatives into sub-indexes and aggregating these sub-indexes into more aggregated indexes.

6.0 INTERNATIONAL ORGANIZATIONS' COUNTRY CLASSIFICATION SYSTEMS

There is generally no agreeable way of classifying countries. This is because countries are highly heterogeneous. The indicators that exist within individual countries are not comprehensive enough to capture all features without introducing a bias. Secondly in the classification of countries according to their level of development, there is no criterion (either grounded in theory or based on an objective benchmark) that is generally accepted[5]. Thirdly, an explicit system that categorizes countries based on their development level must build on a clearly articulated view of what constitutes development. Despite this, numerous methods of classifying countries and of grouping them exist. Some countries are classified in terms of their socio-economic positions including classification by factors such as the extent (or lack) of potential to grow economically, the anticipated pace of that growth, the potential to dominate a region among others. Some are done in a static manner, reflecting the position that the nation holds now.

Notwithstanding the above, international organizations including World Bank (WB), International Monetary Fund (IMF), Organization of Economic Cooperation and Development (OECD) and United Nations Development Programme (UNDP) have their ways of classifying countries. It is from these classifications by international bodies that is and continues to be used extensively in shaping global economic policy debate and decisions in resources transfers, financing arrangements, and trade relationships, among others.

6.1 World Bank Classifications

The World Bank country classification systems are used both for operational and analytical purposes. It is for this reason that various institutions within the Bank have different criterions that meets their specific operational requirements and mandates[6].

6.1.1 Operational Classifications

The International Bank for Reconstruction and Development (IBRD

The International Bank for Reconstruction and Development (IBRD) was established with the main objective of lending to only credit-worthy member countries that cannot otherwise obtain external financing on reasonable terms from others sources. This statutory obligation required the IBRD to designate a subset of its membership as eligible borrowers. Determination of eligibility was initially judgmental. However, in the early 1980s, the IBRD moved towards a more rule-based system using a GNI per capita criterion. Under this system, countries that borrow from the IBRD and exceed a certain income threshold engage in a process that moves the country to non-borrowing status. When the process of exceeding the income threshold is completed, the country is said to have 'graduated' from IBRD-borrowing.

The use of income thresholds is not because the World Bank equates income with development. It is simply because the World Bank considers GNI to be the best single indicator of economic capacity and progress.

[5] Lynge Nielsen in IMF Staff Working Papers- WP/11/13, IMF 2011

[6] Nielsen,2011 provides a comprehensive discussion on the countries classification by UNDP, WB and IMF

International Development Association (IDA)

IDA is the World Bank's fund for the poorest countries established in 1960 as a concessional financing entity. It identified two lists of IDA member countries. Part 1 - meaning Countries that were expected to contribute financially to IDA and Part 2 - meaning Countries of which only a subset could be expected to draw on the concessional resources. According to the World Bank, IDA concessional debt is defined as loans with an original grant element of 25 percent or more and future service payments are discounted at 10 percent.

IDA which is one of the largest sources of aid in the world., It provides support for health and education, infrastructure and agriculture, and economic and institutional development to the 82 least developed countries (LDCs) —40 of which are in Africa. These LCDs are home to 2.5 billion people, 1 billion of whom survive on $2 a day or less. IDA lends money on concessional terms which means that it charges little or no interest. Repayments are stretched over 25 to 40 years, including a 5- to 10-year grace period. IDA also provides grants to countries at risk of debt distress. In addition to concessional loans and grants, IDA provides significant levels of debt relief through the Heavily Indebted Poor Countries (HIPC) Initiatives and the Multilateral Debt Relief Initiative (MDRI).

A country's eligibility to access development assistance and loans depends on its rankings under the World Bank classification of countries based on per capita incomes. Only Countries that are classified as poor with GNI capita income of $1,045 or less are eligible for the IDA assistance.

There are currently 74 Low-Income Countries (LICs) that are eligible for concessional financing from the WB and IMF. This group of countries has a total population of about 1.3 billion, with an average per capita income of around $850. They typically face the steepest challenges in meeting the Millennium Development Goals (MDGs) and are increasingly the focus of global development assistance to assist them in uplifting their economies.

To this end, IDA is critical to making progress toward the 2015 Millennium Development Goals and the post-2015 agenda for all developing countries**.**

6.1.2 Analytical Classifications

The World Bank analytical country classification was started in 1978 with the authoring of the *World Development Report*. The basis of the report was a set of indicators - *World Development Indicators* (WDI), which provided the statistical underpinning for the analysis.

The first economic classification in the 1978 WDI divided countries into three categories:

- Developing countries
- Industrialized countries
- Capital-surplus oil-exporting countries

Developing countries were categorized as low income (with GNI/n of US$250 or less) and middle-income (with GNI/n above US$250). Instead of using income as a threshold between developing and industrialized countries, the Bank used membership in the OECD. Strangely, four OECD members (Greece, Portugal, Spain, and Turkey) were placed in the group of developing countries, while South Africa which was not a member of the OECD, was designated as an industrialized country.

Since then, the World Bank's main analytical criterion for classifying nations is gross national income (GNI) per capita[7]. Because GNI per capita changes over time, the country composition of income groups may change from one edition of *World Development Indicators* to the next. Once the classification is fixed for an edition, based on GNI per capita in the most recent year for which data is available, all historical data presented is based on the same country grouping. Accordingly, the following are the main classifications according to *WDI 2014*:

- Low-income economies are those with a GNI per capita of $1,045 or less
- Lower-middle income economies are those with a GNI per capita of $1,046 - $4,126),
- Middle-income economies are those with a GNI per capita of more than $4,126 but less than $12,746.
- High-income economies are those with a GNI per capita of $12,746 or more. The 18 participating member countries of the euro area are presented as a subgroup under high income economies[8].

6.2 International Monetary Fund (IMF)

The IMF country classification systems are used both for both operational and analytical purposes.

6.2.1 Operational Classification

The IMF's original Articles of Agreements entered by member countries did not contain any distinction among its membership based on development. For the first three decades of the Fund's existence, operational policies related to financial assistance, surveillance, and technical assistance did not discriminate members based on their level of development. However, this has changed over time with income becoming an important criterion for eligibility in the fund.

The first amendment was in response to the oil price shock of 1973. Following this was the accompanying international economic dislocation with the establishment of two oil facilities in 1974 and 1975. The eligibility for use of the facilities was open to the full membership. However, to assist developing countries meet their debt service obligations stemming from drawings under the oil facilities, the Fund established in 1975 a Subsidy Account. The Subsidy Account was administered as a trustee with a purpose of providing concessional balance of payments support to developing members. The eligibility for Trust Fund loans was limited to 61 members that had per capita income of no more than SDR 300 in 1973.

The second amendment to the Articles of Agreement was adopted in 1978. The amended articles recognized that "balance of payments assistance may be made available on special terms to developing members in difficult circumstances, and that for this (sic) purpose the Fund shall take into account the level of per capita income."

In 1986, the Structural Adjustment Facility (SAF) to make concessional resources available "all low-income countries eligible for IDA resources that are in need of resources and face protracted balance of payments problems would be eligible initially to use the Fund's new facility". The carefully drafted decision made it clear that it was the Fund, and not IDA, that had responsibility for any future changes in the list of eligible countries. Over the years, this concessional facility has been expanded, refocused, and renamed. Currently, the Fund's concessional assistance comes from the Poverty Reduction and Growth Trust (PRGT) and a new framework for determining PRGT eligibility was agreed in early 2010. The new framework determines eligibility based on criteria relating to per capita income, market access, and vulnerability. Based on the new framework, the number of

[7] The gross national income is supposed to be calculated using the *World Bank Atlas* method.
[8] World Development Indicators 2014, The World Bank Group

PRGT-eligible countries was reduced from 77 to 71. These countries are recognized by the Fund to be "low-income developing countries.

6.2.2 Analytical Classification

Member countries of the IMF are obligated to provide economic and financial data to the Fund. The Funding turn is charged with acting as a center for the collection and exchange for information. Some of these data have been included in the *International Financial Statistics* (IFS) publications since 1948. The first classification system by IMF based on international financial services (IFS) data divides countries into:

(1) Industrial countries,
(2)Other high-income countries, and
(3) Less-developed countries.

In the early 1970s, the classification system divided countries into:

(1) Industrial countries,
(2)Primary producing countries in more developed areas, and
(3) Primary producing countries in less developed areas.

By the late 1970s, the classification system had changed to:

(1) Industrial countries,
(2) Other Europe, Australia, New Zealand, South Africa,
(3) Oil exporting countries, and
(4) Other less developed areas.

In early 1980, this classification system was significantly simplified when IFS introduced a two category system consisting of:
(1) Industrial countries and
(2) Developing countries.
The IFS never motivated the choice of classification systems used. In 1997, the industrial country group was renamed the advanced country group "in recognition of the declining share of manufacturing common to all members of the group.

6.3 United Nations (UN)

The United Nations (UN) uses slightly more sophisticated criteria for their classification of countries. For example, those that are least developed, those that are landlocked developing countries, Small Island developing states, transition countries, developed regions and developing regions[9].

6.4 Organization for Economic Cooperating Countries (OECD)

The OECD has two classifications/groups. They are based on "maximum repayment terms and maximum weighted life," with a smaller group of 31 developed nations in one category and 184 less developed countries in the second (OECD 2011). There are two further sets of classifications, one which lists countries that are and are not eligible for "tied aid and partially united aid" and a third categorization, which lists one group of countries that are high income OECD countries and another which contains high income euro area countries (OECD 2011)[10].

[9] Pasquali and Aridas, 2012

[10] Some international organizations have used membership of the Organization of Economic Cooperation and Development (OECD) as the main criterion for developed country status. While the OECD has not used such a country classification system, the preamble to the OECD convention does include a reference to the belief of the contracting parties that "economically more advanced nations should co-operate in assisting to the best of their ability the countries in process of economic development." As OECD membership is limited to a small subset of countries (it has 34 members up from 20 members at its establishment in 1961), this formal approach results in the designation of about 80–85 percent of the world's countries as developing and about 15-20 percent as developed

6.5 United Nations Development Programme (UNDP)

The United Nations Development Programme (UNDP's) country classification system is based on the Human Development Index (HDI) that was launched together with the *Human Development Report* (HDR) in 1990. The HDI was premised on the fact that development should be measured not simply by the national income but as had long been the practice, but by factors affecting the human wellbeing. The HDI thus captures the multifaceted nature of development by measuring achievements in longevity, education, and income development of a country. The objective was to develop a more comprehensive measure of economic development arguing that the World Bank measure of level of economic development based on GNI is narrow and not representative.

The HDI is thus a composite index of three indices i.e. achievements in longevity/health, education, and income. Other aspects of development—such as political freedom and personal security—were also recognized as important, but the lack of data prevented their inclusion into the HDI. Over the years, the index has been refined, but the index's basic structure has not changed. In the HDI, the income measure used is Gross National Income per capita. Over and above income, HDI incorporates health and education indicators. Longevity is measured by life expectancy from birth. For education, a proxy is constructed by combining measures of actual and expected years of schooling.

In the HDR 1990, countries were divided into low-, medium-, and high-human development countries using threshold values 0.5 and 0.8. That is, countries with HDI less that 0.5 are low human development, between 0.5 and 0.8 they are medium and above 0.8 they are high human development[11]. In the HDR 2009, a fourth category—very high human development—was introduced with a threshold value of 0.9. No explanations for these thresholds were provided in either the 1990 or the 2009 report. The *HDR 1990* also designated countries as either industrial or developing (at times the terminology of 'north' and 'south' was used as well). The report did not indicate the origin of the designations. The industrial country grouping was with a single exception a subgroup of the high human development country category. By the time of the HDR 2007/08, the industrial country grouping had been replaced by:

(1) Member countries of the OECD and

(2) Countries in Central or Eastern Europe or members of the Commonwealth of Independent states.,

The developing countries group was retained. Despite these categorizations there were still overlapping in the classifications[12].

In the *HDR 2009* these overlapping classifications were resolved by introducing the new category - "developed countries" - consisting of countries that have achieved very high human development; other countries were designated as developing. The distinction between developing and developed countries was recognized as "somewhat arbitrary." In the *HDR 2010,* absolute thresholds were dropped in favor of relative thresholds. In the new classification system, developed countries are countries in the top quartile in the HDI distribution, those in the bottom three quartiles are developing countries. The report did not provide an explanation for this shift from absolute to relative thresholds nor did it discuss why the top quartile is the appropriate threshold. The UNDP uses equal country weights to construct the HDI distribution. In this distribution, 15 percent of the world's population lives in designated developed countries. The report did not discuss this choice of weights[13]

[11] Human Development Report, 1990

[12] Nielsen,2011

[13] Nielsen,2011, Page 9 & 10

6.6 World Trade Organizations (WTO)

The World Trade Organizations (WTO) adopts the United Nations classification with only three ranking namely:

- Least developed countries,
- Developing countries and,
- Developed countries.

Other classification criterion that has been adopted includes the use of poverty rate and mortality rate as yardstick.

6.7 Classification of Kenya

According to the World Bank classification, Kenya is currently classified as low-income economy as her GDP per capita is estimated at US$ 994 (2013) and hence eligible for IDA. However, with the revised results, the GDP per capita increases to $1246. This means that Kenya is a low middle income country and not eligible for IDA according to the new status. In terms of UNDP classification however, Kenya is in the low human development category's with a HDI value of 0.519 (2012) positioning it at 145 out of 187 countries. Between 1980 and 2012, the HDI value of Kenya increased from 0.424 to 0.519.

7.0 IMPLICATIONS OF REVISION OF THE NATIONAL ACCOUNT AND REBASING OF THE GDP

This section provides an analysis on whether the country stands to benefit or loose from the revision of the national accounts and rebasing of GDP. The review and revision of national statistics will have profound effects on the Kenyan economy. This despite the fact that the poverty levels and inequality remain untouched; the revised GDP offers a better platform to approach these challenges. There is always a good and a bad side of everything; GDP revision is not an exemption. There are benefits that accrue to a country when it's of small size which she might lose as the size increases. Similarly, there are significant gains that a large economy enjoys. Therefore, the size of the loss and the gains will determine the overall effect of GDP revision.

7.1 Expected Benefits from the Exercise

7.1.1 Increased Investor's Confidence

By updating the base year to 2009, and taking into account a new set of data sources, GDP figures of Kenya will reflect more accurately the performance of the most important parts of the economy. The national income increased from $44.1 billion in 2013 to $55.2 billion as shown in Table 7.1[14]. This is evidence that relying on the previous benchmark is like constructing policies with obsolete statistics since the economy has changed substantially.

[14] Economic Survey, 2014, KNBS

Table 7.1: GDP (USD Billions)

	2008	2009	2010	2011	2012	2013
Kenya	30.5	30.7	32.4	34.3	40.3	44.1
Ethiopia	26.6	31.8	29.4	31.4	42.8	46.9
Ghana	28.5	26.0	32.2	39.6	41.7	47.9
Kenya-Re		37.0	40.0	42.0	50.3	55.2
Angola	84.2	75.5	82.5	104.1	115.3	121.7
SA	273.1	284.2	365.2	403.9	382.3	350.6
Nigeria	208.1	169.5	366.4	413.5	459.6	522.6

Source: World Bank Indicators 2014 and Author Computations

The result of the exercise was an in increase in per capital income from the previous $994 to $1,246, which signifies improved economic performance although not necessarily improvement in the standard of living. This pushes the Kenyan economy above the threshold of $1,045 that the World Bank uses to identify least-income countries. Thus, the economy attains low middle-income country status prior to the targeted 2030 date, which is 16 years earlier than predicted.

Under the new calculation, Kenya is the fourth-largest economy on the continent, behind only Nigeria, South Africa and Angola and she overtakes Ethiopia and Ghana in terms of the size of GDP.

Following the revisions, the Kenyan economy will be classified as a low middle-income economy with a GDP per capita of approximately US$ 1,246 from the previous low-income status. To analyze and compare living standards between countries and over time, it is more relevant to study GDP in relation to the price of final domestic demand that is consumption and investment. Living standards are obviously of utmost importance to economics analysis. GDP and GNI per capita are widely used in measuring living standards. GNI measures the income received by residents of the country and hence GNI per capita is a better measure of consumption potential than GDP per capita. Therefore, the increase in GNI per capita as a result of national accounts statistics would imply increase in consumption potential. This therefore places Kenya strategically in Africa in terms of market size.

Arising from the above, one of the main benefits a country might enjoy is the increased investor confidence as a result of the entrepreneur's substantial psychological change of mindset. With a large economy, this translates to an increase in Kenya's ranking as a preferred investment destination based on its perceived purchasing power. There is also an increase in the country's GDP and GDP per capita, which indicates improved standards. Higher GDP means more consumption per capita, boosting its attraction to investors with the enlarged markets which enable investors to exercise economies of scale. Most Governments overhaul the GDP calculations every few years to reflect changes in output and consumption.

Investments play a crucial role in development process of countries since they are capital deficit and they fill this gap. The world's largest economies attract the most foreign direct investments (FDI). Together, the world's 10 largest economies accounted for 47 percent of FDI inflows in 2010., hThis emphasizes the fact that the market size matters as a driver of investments. However, the proportion of FDI to Africa relative to the globe has been declining. Foreign Direct Investment is defined as an investment involving a long-term relationship and reflecting a lasting interest and control of a resident entity. This kind of investment is preferred compared to indirect investment in equities of companies. Indirect investment is referred to as 'hot money' that can easily exit in case of any signs of distress.

Studies have shown that larger African countries tend to attract more FDI than the smaller ones. This is compounded by the fact that countries that manage to attract FDI today are likely to attract more FDI in the future. It is important to note that USA is the largest recipient of FDI and continues to attract more. FDI is ultimately a judgment by the world's investors about the nature of a country's institutions, policies, human capital, and prospects. Further, political stability and high returns on investments are also key determinants.

Therefore, an expanded economy will imply that the future prospects of the economy are upward looking and hence attract more inflows of capital that is rather imperative for the economic development of the economy. Business opportunities—as reflected in the size and growth potential of markets—are the most powerful drivers of FDI. In addition, the upward correction of the GDP will allow the Government to achieve its medium-term objective of narrowing the budget deficit as the more investments flow to finance essential projects.

The increase in FDI would lead to creation of more jobs, which will mitigate high level unemployment. Further, there will be an increase in provision of accompanying services. Moreover, high incomes and high standards of living translates to increased purchasing power, which attracts more investments. In addition, the overall growth and innovation augments economic competitiveness in productivity. The FDI inflows in Kenya are quite small compared to her neighbours at approximately $ 259 million[15].

7.1.2 Improvement in Macro-economic Indicators

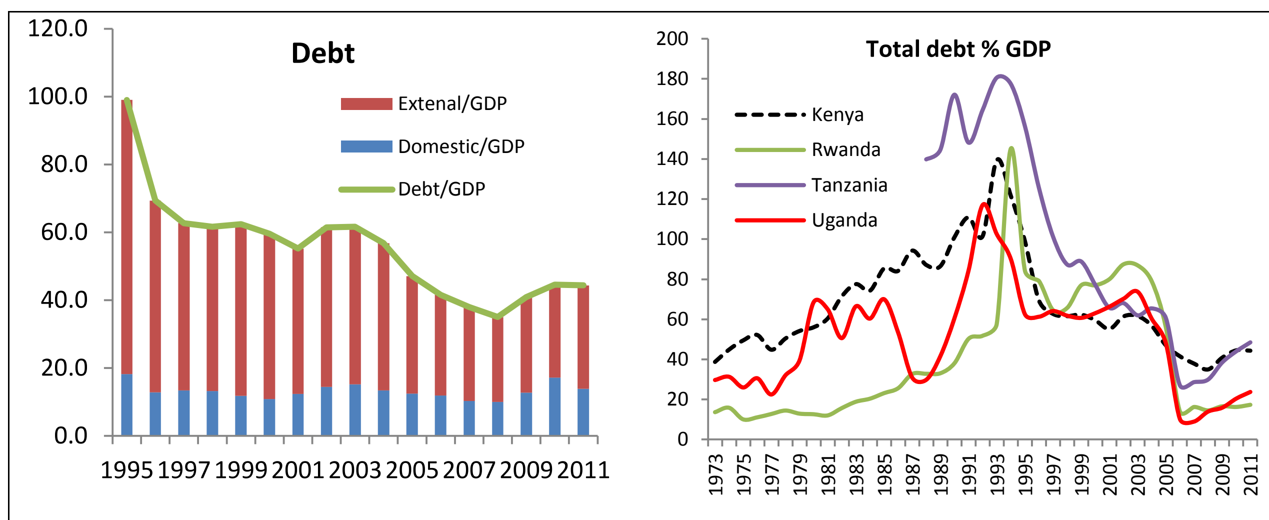
A number of macro-economic indicators are expected to improve with revisions and rebasing of the GPD with positive implications in the economy. These include but not limited to following:

Public Debt as % of GDP

Public debt are the funds borrowed by the Government from domestic and external sources as a percentage of GDP. Public debt therefore shows the extent to which the Government relies on borrowing to finance her development. The overall public debt share in GDP increased from 49.1% in 2012 to 51.7% in 2013. It is expected after rebasing, this ratio is likely to fall to around 40% from the current levels of over 50 %. This will in turn provide the Kenyan Government with a substantial amount of borrowing space on which to drive national development through infrastructure development. The lower the level of public debt and fiscal deficit, the higher the Government's capacity to borrow as the debt ratio is favorable. The reduced debt to GDP ratio will also provide a better possibility of external funding which might reduce the pressure in the domestic market of loans.

[15] World Investment Report, 2013.

Figure 7.1: Public Debt



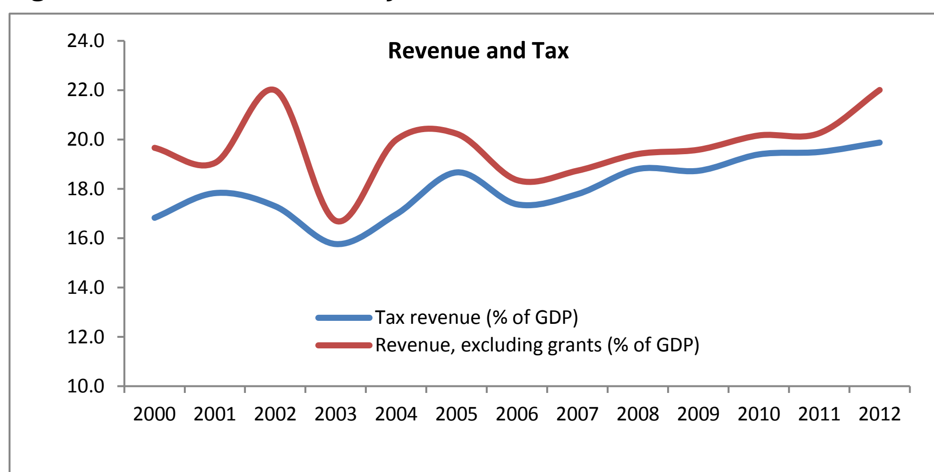
Source: World Development Indicators (WDI)

If we assume that more allowance for borrowing will translate to developmental projects, then, it means the revised GDP will translate into better infrastructure. This is because the Government will obtain more fiscal space to borrow and expand infrastructure and provision of social services hence economic development.

Fiscal Deficit % of GDP

The fiscal deficit shows the extent to which revenue is able to finance Government expenditure. A higher fiscal deficit indicates that the Government has a heavy reliance on external funding to deliver services. Such a situation exposes it to external shocks and hence high vulnerability. The target level of fiscal deficit to GDP has been set at 5 percent by the national treasury, and has been increasing overtime[16]. With the revised GDP this ratio is projected to fall providing more room for Government borrowing. Prior to the GDP revision, tax revenue's contribution to GDP stood at approximately 22 percent (3% lesser than the target) – Figure 7.2. The revision exercise however put a lower figure of 18 percent contribution from tax revenue to GDP, implying the wide gap. This exposes and puts pressure on Kenya revenue authority to mobilize more revenue to Government coffers.

Figure 7.2: Revenue as a % of GDP



Source: WDI

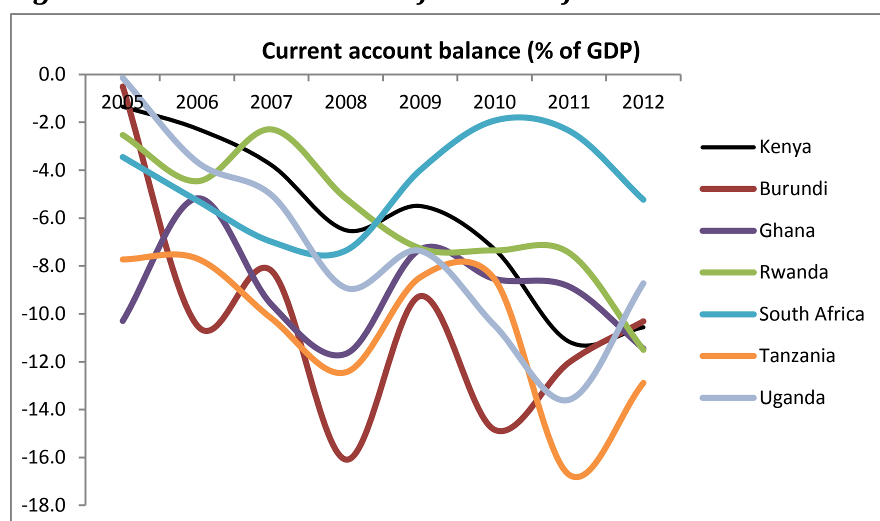
[16] Central Bank of Kenya Annual Report, 2013

The good news is that Government expenditure has been approximately 33 percent of GDP, which is rather high by international standards. This level might decline to as low as 26 percent, which indicates that the Government has space for more expenditure. Further, the revised GDP might bring on board other sources of tax revenue owing to the changed structure of the economy. This might in turn increase the amount of tax collected.

Balance of Payments (BOP)

Although Kenya has experienced a deteriorating current account balance it has recorded better performance than most of her neighbors (Figure 7.3). With the expanded GDP, it is expected that she will improve her status significantly in this respect. This is more so because the import and export price indices as reported by KNBS have experienced a change.

Figure 7.3: Current Account Deficit as % of GDP



Source: WDI

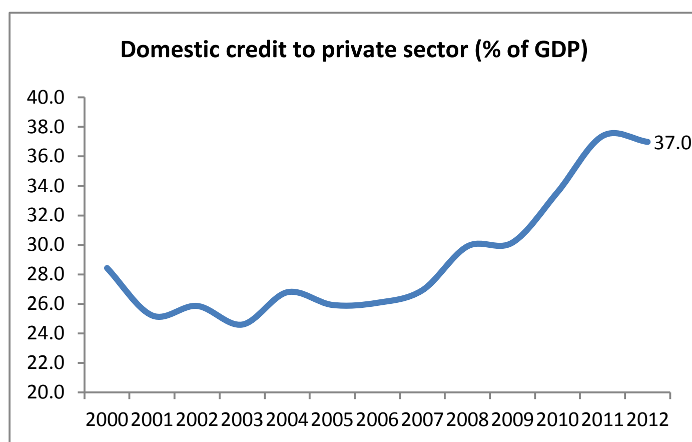
7.1.3 Financial Sector Indicators

Domestic Credit to Private as % of GDP

The financial sector is quite important for economic development. Kenya is among the economies with a robust financial sector in sub-Saharan Africa. In fact, it is hailed for the tremendous improvement in the financial sector where financial access has increased to 66.7 percent by 2013[17]. Credit is owed to the private sector as share of GDP captures bank penetration and financial depth which is currently at 37 percent of GDP (Figure 7.4). The ratio captures the extent of financial inclusion, which is said to be a prerequisite for economic growth. With increased GDP from the revision exercise, the penetration rate is expected to decrease to approximately 30 percent. This figure is relatively the same with Botswana and Egypt. It shows that there is even more potential for growth in the banking sector than was earlier anticipated. Consequently, there is more space for banks to expand their activities and/or for new ones to join in opening up opportunities for job and employment creation.

[17] CBK ibid

Figure 7.4: Credit to Private Sector



Source: WDI

<u>Equity Market Capitalization as % of GDP</u>

In most financial markets, equities market capitalization to GDP is a metric measure usually employed to assess the extent of development of a financial market. Before the rebasing, market capitalization to GDP stood at 36 percent. The ratio is expected to fall to approximately 30 percent after the rebasing exercise (if the expected results are realized). This largely suggests the extent of sophistication of our market relative to other emerging and developed financial markets. This shows that we have more room for growth in the stock market, which is good for the economy.

7.1.4 Economic Structural Shift

The Economy witnessed a structural shift and is more diversified. That is the contribution of specific sectors to GDP changes as more sectors of economic activities are captured in the compilation of GDP. Having a diverse economy— one based on a wide range of profitable sectors—has long been argued to play a key role in a sustainable economy. A strong, growing and sustainable economy is the goal of every nation in the world. A sustainable economy enhances a nation's standard of living by creating wealth and jobs. This encourages the development of new knowledge and technology, while helping to ensure a stable investment and political climate. Agricultural sector has been significant in GDP – 25% and 55% of service sector. With the national accounts revision the relative sizes of different sectors might change.

The inclusion of sectors that were previously ignored enhances the understanding of the structure of the economy to influence policy. The new sectors especially in telecommunication, financial and real estate sectors illustrates that the sources of income within the economy are more diverse. This is important because it improves the resilience of the economy to shocks, which have strongly affected the economy which relies mainly on rain-fed agriculture. Although agriculture controls the lion's share of the economy, vulnerability is likely to be reduced. Kenya has made great strides in boosting certain sectors such as tourism and telecommunications.

There are many benefits that could arise from more diversified economies: less exposure to external shocks; an increase in trade; higher productivity of capital and labor; and better regional economic integration. These benefits, in addition to effective public management, can help to reduce poverty and promote human and social development. Diversification nevertheless remains limited in most African countries, with only a few success stories. There is a link between economic diversity and sustainability. Economic diversification can reduce a nation's economic volatility and increase its real activity performance.

7.1.5 Foreign Direct Investments

Rebased GDP figure would help foreign investors to better understand the size and components of the nation's economy. This would help to attract foreign direct investors into the country as they would see that the size of the economy had increased tremendously.

7.2 Expected Loses

The following are some of the expected losses that the country may suffer:

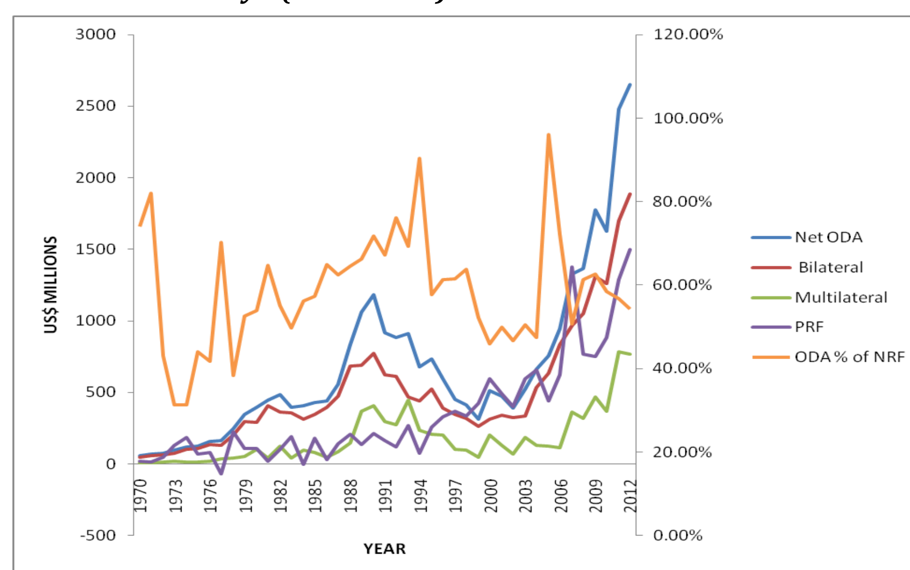
7.2.1 Flow of Official Development Assistance (ODA) and Official Aid

Official development assistance (ODA) is given by member countries of OECD-DAC; to promote both economic and welfare development in developing countries. It is mainly concessional loans with a grant element of at least 25 percent. ODA is either provided bilaterally- direct from one Government to another- or multilaterally through multilateral agencies such as IDA (World Bank), regional development banks and United Nations Agencies.

Just like most developing countries, Kenya has been dependent on ODA for promotion of both economic and welfare development since independence in 1963. Figure 7.5 below shows net ODA flows as a percentage of net resource flows (NRF), private resource flows and net ODA. The figure show that net ODA flows were increasing until 1990 before a decline to a low of US$ 310.47 million in 1999, with some recovery thereafter. The decline was due to suspension of ODA to Kenya by multilateral and bilateral donors in 1991 and 1997 due to issues of governance and corruption. The recovery was accelerated by the election of a new Government in 2002 and renewed Government commitments to reforms.

By 2012, Kenya was a beneficiary of $2.698billion as net ODA and official aid. The Net ODA as percentage of NRF has also been fluctuating over the years reaching a low of 31.45% in 1973 and a peak of 96.09% in 2005. The fluctuation is explained by aid embargo and external shocks such as increase in oil prices and global financial crisis among other factors during the said years.

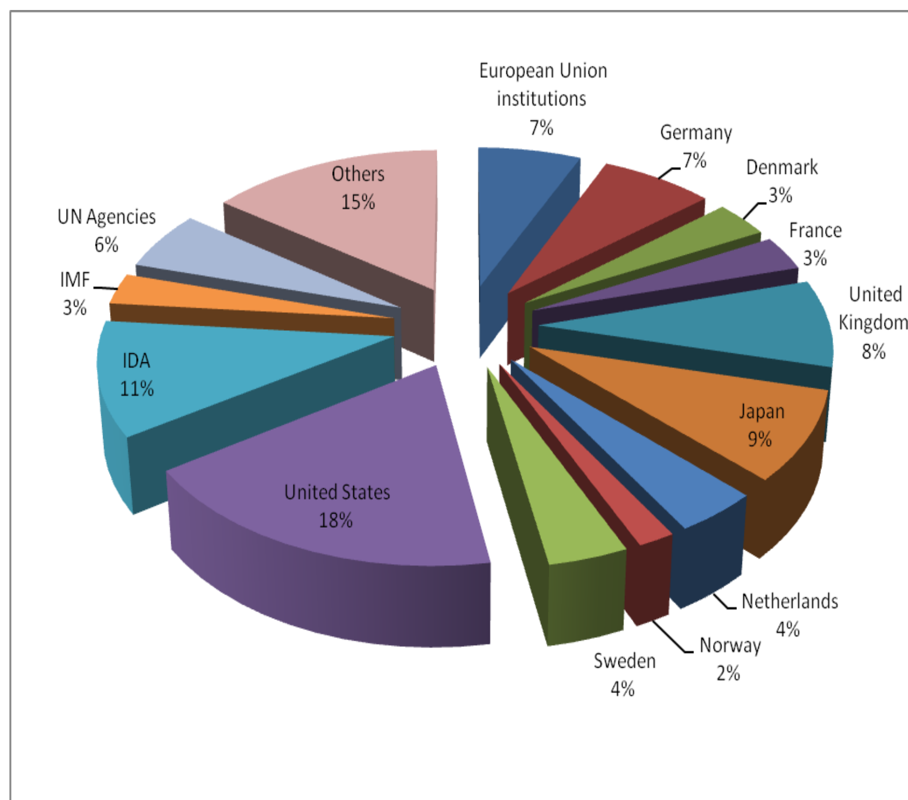
Figure 7.5: Net ODA, Net ODA % of Net Resource Flows (NRF), and Private Resource Flows (PRF) to Kenya (1970-2012) in Millions US$



Data Source: World Bank, World Development Indicators 2014.

Should the country graduate from a low to medium income country and becomes ineligible for ODA, then the amount of resources that it is likely to lose is well over $ 2.8 billion per annum[18]. 70% of the ODA to Kenya is from bilateral donors while 30% is from multilateral donors. Figure 7.6 shows the major ODA donors to Kenya and the proportion of their contribution. The major bilateral donors to Kenya are United States, Japan, United Kingdom, Germany, and European Union which contributes 18%, 9%, 8%, 7% and 7% respectively of the total ODA. Others include Sweden, Netherlands, France, Denmark and Norway. The major multilateral donors on the other hand are IDA (World Bank), UN Agencies, and IMF which contributes 11%, 6% and 3% of the total ODA respectively.

Figure 7.6: Composition of Net ODA Flows by Major Donors to Kenya Over the Period 1970-12



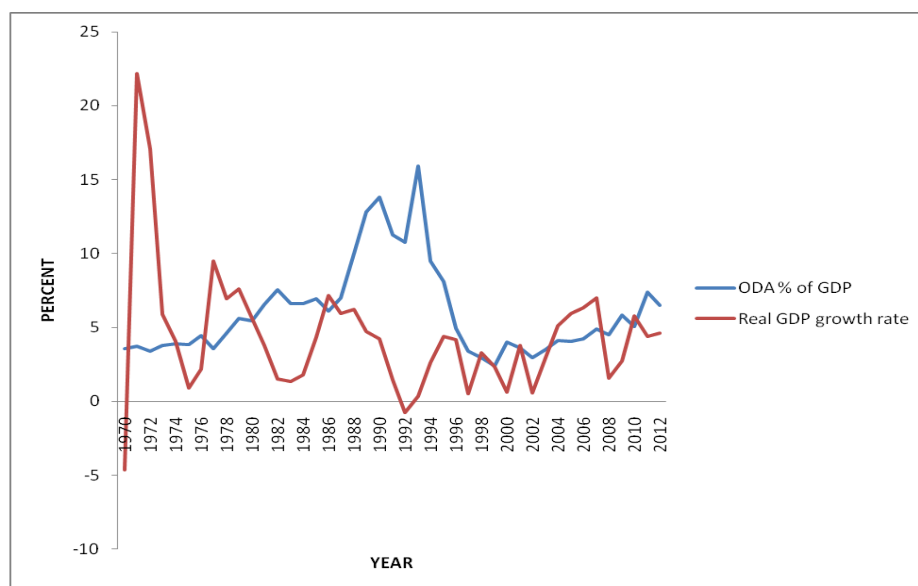
Data Source: World Bank, World Development Indicators 2014

Low and widely fluctuating levels of private resource flows (PRF) in the early years after independence up to 1996, shows that the country had to rely on ODA for its development agenda. This however, improved after 1996 and has been approaching ODA flows. According to World Bank (2014), although Kenya is still a low income country, it is progressing toward graduation from aid dependency. For example Kenya's aid dependence has fallen very sharply over the years with a maximum aid as a percentage of GDP of 15.9% in 1993 and a minimum aid as a percentage of GDP of 2.3% in 1999.

Figure 7.7 shows an inverse relationship between ODA as a % of GDP and real GDP growth rate for period 1970-2012. It also shows that the ratio of ODA as a % of GDP, has been decreasing over the period as real GDP growth rate improves which is a clear testimony to the fact that graduation from aid dependency demands aid flows to be accompanied by capital accumulation.

[18] World Bank 2013

Figure 7.7: Net ODA (%GDP) and Real GDP Growth (1970-2012)



Data Source: World Bank, World Development Indicators, 2014

Between 1970 and 1980, the average real growth rate was 7 %. The period 1980-2002 indicates slow or negative growth in real GDP. This can be attributed to among other factors severe drought (1983/1984, 1991/1992), increase in oil prices, 1982 military coup attempt, aid embargo (1991 and 1997), and unfavorable economic environment for investment. Although Kenya's real GDP growth rate increased from 0.5% in 2002 to 6.9% in 2007 (due to implementation of the economic recovery strategy for wealth and employment creation-2003-2007), the post-election violence crisis impacted negatively on the economy decreasing it to 1.5% in 2008. The Kenya Vision 2030 program targeted a 10% growth rate by 2012 in its first medium term plan (2008-2012) but the annual growth rate in 2012 was 4.6%.

Even with this increasing flow of ODA, economic growth has remained dismal while poverty reduction lags behind growth. Although economic growth is not sufficient condition for poverty reduction, it is essential for sustained progress on poverty reduction.

Hailu et.al (2012) estimated the probability of exiting from aid-dependence and found that the likelihood of exiting from aid reliance increases significantly with the rate of investment and expansion of manufacturing. Policies and institutions that promote both public and private investment should be strengthened to enhance graduation from aid dependence.

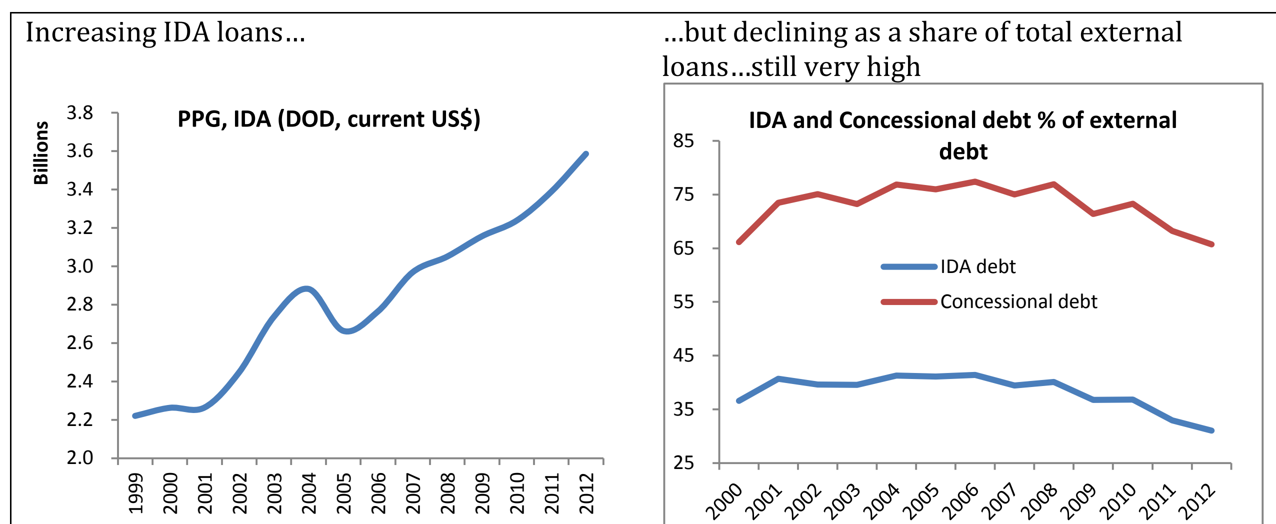
7.2.2 Eligibility of Kenya to Access Development Assistance and Loans from IDA

A country's eligibility to access development assistance and loans depends on its rankings under the World Bank classification of countries based on per capita incomes. As discussed above, only Countries that are classified as poor are eligible for the International Development Association (IDA) assistance, which is the World Bank's fund for the poorest countries. Currently, Kenya is and has been a major beneficiary of IDA support. It still needs its support to achieve not only the MDGs but also the Vision 2030 goals. The big question therefore is whether rebasing would affect this status and what that would mean to the country and especially to the MDGs agenda.

By June 2013, external debt comprised approximately 44.5 percent of total debt and domestic debt 55.5 percent. The total external debt in 2012 amounted to US$11.6 Billion out of which US$ 3.6 Billion was from IDA; an equivalent of 31 percent. The World Bank – IDA is the leading creditor in the external debt portfolio at 38.3 percent of total external debt by June 2013 (Ministry of Finance,

2013). Public debt as share of GDP stood at 51.7 percent in June 2013, which is a slight increase from 49.5 percent in June 2012; a proportion that will change depending on the magnitude of change GDP. If Kenya achieves middle-income status, the IDA of US$2.9b scheduled for disbursement by the end of the year could be suspended. The proportion of concessional debt is shown in Figure 7.8.

Figure 7.8: Concessional Loans



Source: WDI

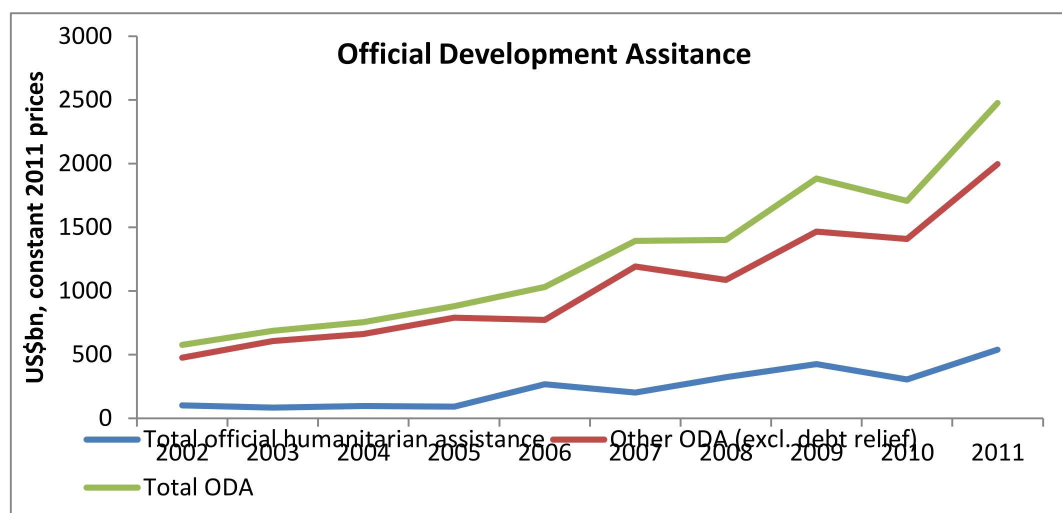
If Kenya attains the middle-income status it will no longer be eligible for IDA. This means that alternative sources of financing will be sought equivalent to approximately 50 percent of external financing. While loans will get more expensive, aid will become harder to come by. The wealthier an aid recipient country becomes, the less willing international donors and international financial institutions such as the World Bank and the International Monetary Fund are willing to provide aid. This will not affect the assistance the country receives from China, but it has serious implications for the funding available to internationally supported NGOs, whose work currently helps to alleviate poverty in some of the most economically marginal parts of the country.

By shifting from IDA to IBRD this will cause the rates at which Kenya can borrow from the World Bank to jump from 1.5% to 2.5%. A reprieve however exists given the fact that the World Bank is considering improving the economic hardship in the middle-income countries by introducing a new bank policy that increases lending to them. This is by reviewing the threshold which determines which countries should be afforded more lenient borrowing terms from the IBRD. However, the country will not be eligible for debt forgiveness.

With the reduced access to IDA and other concessionary loans, achievement of MDGs, which is mainly funded from international sources, might be negatively affected. The main sources of MDGs funding are UNICEF, UNDP, and IDA among others .Further, most of the projects in the social sectors – health, education, water – which are beneficiaries of such loans and grants, will lose their funding which could lead to the deterioration of social service provision and will likely lower the standard of living.

The level of ODA has been increasing and the country might lose access to over $2.5 Billion of ODA as shown in Figure 7.9.

Figure 7.9: Official Development Assistance



Source: WDI, 2014

Kenya was the 8th largest recipient of ODA in 2011 receiving an equivalent of 8.2 percent of her GNI. The loss of these funds will affect provision of social services especially to the most poor and vulnerable citizens. This might reverse the gains already achieved under such programs in reducing poverty, mortality rate, hunger and malnutrition. For example, the entire beneficiaries from the National Safety Net Programme (NSNP) comprising of five cash transfer programmes are likely to suffer. These five programmes are namely; the Older Persons Cash Transfer (OPCT); Cash Transfers to Orphans and Vulnerable Children (CT-OVC); the Hunger Safety Net Programme (HSNP); the Urban Food Subsidy Cash Transfer (UFS-CT); and the Cash Transfer for Persons with Severe Disability (CT-PWSD). These programmes currently provide regular support to about 298,000 households or 1.4 million people or 3 percent of the population which is only a fraction of the population living in absolute poverty.. These programmes target to increase coverage to 534,000 households by 2016/17. Other programmes supported under grants include provision of nutrition and drugs to HIV/Aids patients, school feeding and vaccinations programmes. This means that the Government will have to take up these programmes which in turn could constrain its finances.

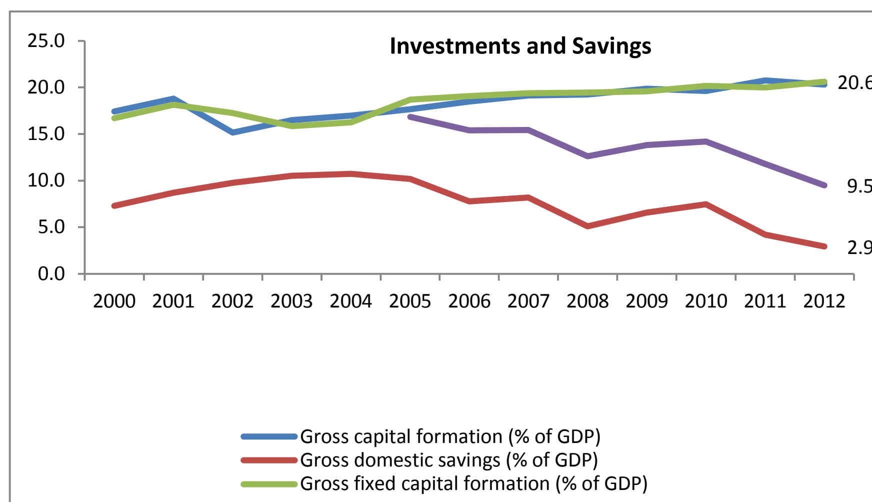
7.2.3 Worsening of Macroeconomic Indicators

Investments and Savings as % of GDP

The ratio of investments to GDP has over the last one decade been experiencing an upward trend as seen in Figure 7.10. This can be explained by the massive infrastructure investments by the Government which also provided a conducive environment for private investments. On the other hand, the savings trend has been declining. This means that GDP has been either expanding at a faster rate than savings or actually savings level has been falling, which will get even worse with the expanded economic size.

These ratios will be expected to change as GDP size increases. The results indicate that investment ratio is estimated to reduce to about 17 percent from the current level of 20 percent, which is considered to be too low to spur a double-digit economic growth. Similarly, the domestic savings that currently stands at 3 percent will decline to 2.4 percent as shown in Figure 7.10. This is also considered too low for mobilization of domestic resources for development.

Figure 7.10: Investments and Savings as a % of GDP



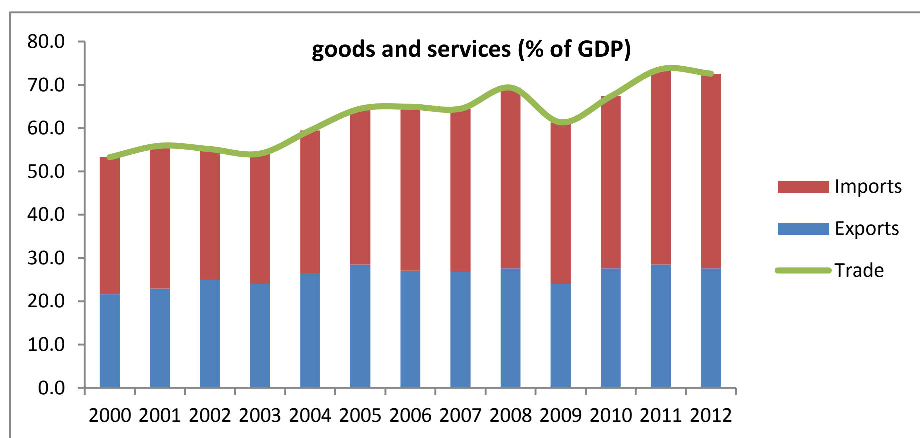
Source: World Development Indicators (WDI)

This shall be even worse for the FDI inflows, which is on average less than one percent of GDP in the last five years because it will relatively decline further.

Trade as % of GDP

Trade as share of GDP shows the level of openness of a country. Kenya has been considered the most open country among the East African countries with a ratio of trade to GDP of 72 percent as seen in Figure 7.11. However, with the rebasing of the GDP this ratio is expected to decline to about 60 percent. The new ratio shall be lower than that of Tanzanian which is 70 percent and the same level with that of Uganda which is about 62 percent but still higher than Rwanda and Burundi.

Figure 7.11: Kenyan Level of Openness



Source: WDI

The impact of a declining ratio is that the country attractiveness to foreign investors is undermined as the other EAC are perceived to be equally competitive.

However, as long as the WTO applies the UN classification of countries, and as long as the status of Kenya remains developing, then she is not affected by the preferential trade arrangements/negotiations. Significant impact would be experienced if the status of the economy shifts to developed economy which is most unlikely.

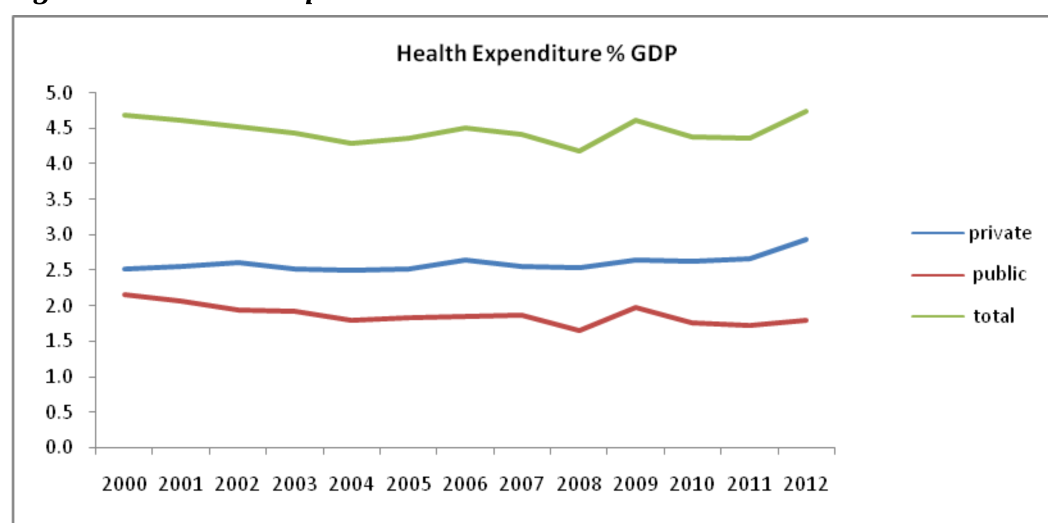
7.2.4 Worsening of Social Indicators

Declining shares of Budgetary Allocations

Among the Vision 2030 goals, achievement of improved healthcare, quality education and higher incomes of ordinary people, stands high in the Government agenda. This is to be achieved among others through increased expenditure on social services such as healthcare, primary, secondary and tertiary education that will act to break the vicious cycle of poverty and hence improve the standards of living.

In the last decade however, budgetary allocation to social sectors such as health sector has been declining. With the improved GDP of Kenya, the health indicators will become even worse off as shown in Figure 7.12. This ratio will be lower than the international recommended ratio. This might put pressure on Government to provide more expenditure allocation to improve the status of health and education.

Figure 7.12: Health Expenditure



Source: WDI, 2014

The changes in macroeconomic indicators, positive and negative, have a lot of information that will inform the citizens on the actual status of the economy. This might be a starting point of holding the Government accountable to explain the reallocation or distribution of national resources among the citizens.

Standards of Living

Overall, despite the outcome of the rebasing exercise, living standards in Kenya remain poor in terms of wealth levels, quality of infrastructure, governance, unemployment, insecurity and financial market development which hampers economic development. Poverty, inequality, and the inability of a large proportion of the population to benefit from economic growth, will remain key concerns. Nevertheless, Kenya will be in a better position to evaluate economic progress with the updated data. Further, the new figures will illustrate the enormous capacity of the economy to achieve rapid and diversified economic development. Further, it will influence sectoral budget allocations in the medium term. With the realization that Kenyan economy is actually larger than has been represented, this will put pressure on the Government to deliver and account more on the distribution of resources. In an extreme case this could lead to significant demand by the citizens for delivery of better services by the Government.

7.2.5 Loss of Preferential Trade Arrangements

A bigger economy means Kenya needs less support and will not be eligible to access key export markets on preferential terms. Hence, Kenya might experience loss of access to key markets it currently trades in under special terms as a poor country. However, this is a challenge that creates opportunity for Kenya to aggressively increase trade and expand her international market. The norm is that poor countries are given preferential trade agreements to help them grow and are seen not to pose any threat to mature markets. But the review will change her status implying that she will have to negotiate trade deals on an equal footing with other developed economies.

Economic Partnership Agreement (EPA) Negotiations

Economic Partnership Agreements are a scheme to create a free trade area (FTA). This FTA is between the European Union and Africa and between Caribbean and Pacific Group of states (ACP). They are a response to continuing criticism that the non-reciprocal and discriminating preferential trade agreements offered by the EU are incompatible with World Trade Organization (WTO) rules. The EPAs are a key element of the Cotonou Agreement, the latest agreement in the history of ACP-EU Development Cooperation. The EPAs were supposed to take effect from 2008, but by March 2012 the negotiations were not yet completed. The negotiations aimed to review the non-reciprocal international free trade treaty between the two parties, but they are yet to arrive at a conclusion. This is because of fear based on differences over access to markets. The EPA is under pressure to align with the World Trade Organization regulation of reciprocity.

To maximize on the benefits of EPA, the five member states of the East African Community (EAC) – Tanzania, Kenya, Uganda, Rwanda, and Burundi – have been negotiating a joint Economic Partnership Agreement (EPA) with the European Union which is good for regional development and integration. This approach is expected to guard against market distortions via a uniform common external tariff (CET). Such an approach would guarantee the integrity of the EA Customs Union, as goods and services imported into the region would be uniformly treated under unitary regulations and procedures. In addition, this would not only enable the region to achieve economies of scale, but also create a win-win situation all round. In any case, as the member countries of the European Union are themselves seeking this kind of trade arrangements as a bloc, the EAC member states also needed to negotiate as a single bloc for maximum gains.

With the attainment of a middle-income status, Kenya would certainly be in a class of its own among EAC members who are all belong to LICs category. This would certainly be expected to affect the ongoing Economic Partnership Agreement (EPA) negotiations between the EAC and the European Union (EU).

African Growth and Opportunity Act (AGoA)

The African Growth and Opportunity Act (AGOA) was signed into law on May 18, 2000 as Title 1 of The Trade and Development Act of 2000. The purpose of the legislation was to enhance market access to the United States of America (US). It was meant for qualifying sub-Saharan Africa (SSA) countries and to assist them to improve economic relations between the United States and the region. The Act offers tangible incentives for the SSA countries to continue their efforts to open their economies and build free markets[19]

[19] *Qualification for AGOA preferences is based on a set of conditions contained in the AGOA legislation. In order to qualify and remain eligible for AGOA, each country must be working to improve its rule of law, human rights, and respect for core labour standards. While the eligibility requirements are set out in the legislation, it is the United States which determines, annually, whether countries have met the published eligibility requirements. Beneficiary status may therefore be granted, or withdrawn, at the discretion of the US President.*

AGOA provides trade preferences for quota and duty-free entry into the United States for certain goods, expanding the benefits under the Generalized System of Preferences (GSP) program. Notably, AGOA expanded market access for textile and apparel goods into the United States for eligible countries. Moreover, many other goods are also included. This has resulted in the growth of the apparel industry in southern Africa, and created hundreds of thousands of jobs.

Bilateral trade between Kenya and the U.S. is largely governed by AGOA. Kenya was among the first countries to qualify to export under AGOA in 2001.Since then, the exports, mainly textiles and apparels, have dominated the composition of trade to the United States. Under AGOA, Kenya has increased employment, provided extra income for urban and rural workers, and boosted its economy.

The AGOA eligibility criteria for countries require that a country to be making continual progress toward establishing the following:

- A market-based economy that protects private property rights, incorporates an open rules-based trading system, and minimises Government interference in the economy through measures such as price controls, subsidies, and Government ownership of economic assets,

- The rule of law, political pluralism, and the right to due process, a fair trial, and equal protection under the law.

- The elimination of barriers to United States trade and investment, including by:

  - ✓ the provision of national treatment and measures to create an environment conducive to domestic and foreign investment;
  - ✓ the protection of intellectual property; and
  - ✓ the resolution of bilateral trade and investment disputes

- Economic policies to reduce poverty increase the availability of healthcare and educational opportunities. They also expand physical infrastructure, promote the development of private enterprise, and encourage the formation of capital markets through micro-credit or other programs. More details of the eligibility criteria are given in ***Annex 3.***

As seen from above and in annex 3, the eligibility criteria does not explicitly include the level of development or income of country as a determining factor for eligibility. At the face value, this means that whatever status the Kenya may assume after rebasing the GDP, it may not have any significance with regard to its eligibility for AGOA benefits. However, it is important to bear in mind that South Africa which is regarded as a medium income country is not eligible for the AGOA. Whether Kenya would join South Africa or not is not easy to predict the moment.

<u>WTO Special and Differential Measures</u>

The World Trade Organization which was established in 1995 is an international body that oversees the conduct of Multilateral trading system by its members. It succeeded the General Agreement on Tariffs and Trade, GATT, which was founded in 1947. The provisions of GATT were applied on provisional basis by its Contracting Parties. Most of the developing and least developed countries did not apply them. GATT had 127 contracting parties.

Unlike in GATT, all the 160 Members of WTO are obliged to implement all WTO agreements that were negotiated during the Uruguay Round (1986-1995) without exception. The WTO members are drawn from Developed, Developing and Least Developed as classified by the UN. The WTO agreements have special and differential treatment clauses that take the concerns of developing and

least developed countries on board. The S&D Clauses are therefore an integral part of multilateral trading system.

Trade preferences such as LOME I to LOME IV and subsequent Cotonou Agreement that allowed duty free market access to products from ACP countries into EU were not challenged during GATT era until WTO came into being. Immediately after the establishment of WTO, this trade arrangement (ACP/EU) was challenged at the WTO. This is because it was not compatible with the principle of "Non Discrimation". However it was granted a temporary waiver and allowed to continue for ten years and subsequently renewed to give the ACP and EU time to negotiate another trade arrangement that was compatible with WTO. The consequence was the "ACP/EU Economic Partnership Agreement". This agreement has not been concluded.

The S&D provisions in WTO run through nearly through all agreements. They are all about:

- Longer implementation periods for certain agreements e.g. agreement on import licensing, agreement on agriculture

- Provisional of technical and capacity building measures to enable developing and least developing countries cope with their multilateral obligations and

- Making lesser commitments e.g. tariff bindings.

The Language of S&D provisions in the WTO agreements is not binding and most of it remains best endeavor clauses. This concern has been expressed at the WTO by Developing and least developed countries.

Lastly, the WTO Agreement on subsidies and countervailing measures provides rules and disciplines for granting of subsidies mainly on industrial products. Agricultural subsidies are covered in the WTO Agreement on Agriculture. If there is any conflict between the two agreements the agreement on Agriculture prevails.

The Agreement on subsidies recognizes the fact that subsidies do play a big role in the economic development of a country. However they can also distort international trade. Thus Developed and Developing countries are prohibited from granting or maintaining subsidies. However some developing countries including Kenya are exempted from the application of this provision until such a time when they reach or attain a GDP per capita of $1000 per annum. Other African countries that are exempted include Egypt, Morocco, Zimbabwe, Ghana and Senegal.

From the foregoing, the consequences of increased GDP are clear.

8.0 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

8.1 Summary and Conclusions

The revision of national accounts and rebasing of the GDP is an exercise whose overarching goal was to improve the accuracy and comprehensiveness of national accounts statistics and align them with recommended international best practice. The exercise has been ongoing for the last four years and the results were expected in September 2014. The results released by KNBS indicate a 25.3percent increase in 2013. This pushed the country from a low-income country status to medium income country. One of the main findings from the consultation with the stakeholders is that there is inadequate information regarding the national accounts revision exercise. This might be a source of confusion with the released results since stakeholders would not appreciate the impacts of the new national statistics, which opens room for speculation.

Findings from the study indicate that the national statistics revisions exercise is likely to have positive and negative implications to the economy. With the expected increased GDP per capita from $994 to $1,246, the country will be ranked as a middle-income country. The first implication of this is that Kenya may become ineligible for IDA support which is mainly for countries classified as low income countries. Secondly graduation to middle income category may impact on existing trade arrangements within the EAC regions and the EPA negotiations with EU. However, the enlarged economy will boost investor confidence and attract more foreign and domestic investments. It will also provide more borrowing space by Government since the public debt as a ratio of GDP which is an indicator for borrowing ability will decline. This means that the Government will be able to access more funds for development projects. In addition the macroeconomic indicators that are evaluated with respect to the size of the economy some will improve. However, some macro-economic indicators will also deteriorate, which brings about mixed results from the exercise. What is important is the extent of change of the relevant indicators. The negotiation capacity and room in regard to preferential trading might be limited since the economy will be classified as a middle income country.

But whatever the results, it must be seen within the following contexts:

- Rebasing will not change the facts of the economy overnight. It will not make poverty and unemployment disappear overnight but it will provide better tools and the policy ability to tackle these problems in order to reduce poverty and improve the welfare of the people. Until we are able to collate, understand and interpret data correctly, it is too early for any predictions. What is needed is to identify key areas in the economy that require interventions and direct policy prescriptions that are more likely to respond to the real needs of the economy. Increase in the overall economic output of a country does not necessarily mean increase in incomes of all individuals nor is growth in GDP synonymous with increase in job creation.

- The increased rebased GDP numbers means that the level of economic activity is much higher than previously reported. It indicates a clearer picture of the economic landscape, and the significant opportunity for growth and wealth creation in the economy. It is also expected to depict a more accurate reflection of the structure and size of current economic activities in the country, presenting a clearer sectoral distribution and performance. As a result, better investment choices can be made resulting in higher productivity, profitability and even higher investments. This would help create jobs and reduce poverty in the medium to long term. In addition, it increases financial market ratings of the country as investors show greater interest in the economy.

- Rebasing the GDP does not necessarily mean the country would not be eligible for concessional borrowing. In essence, there are other criteria that qualify a country for funding. For example, the UNDP HDI classification is one such criterion. In fact a higher GDP means that the ratio of debt to GDP would be lower, thereby increasing the allowance to borrow. However, the repayment ability of the economy will depend on the efficient utilization of the obtained funds.

- A confirmation that a large economy is a positive development and must be seen an opportunity to boost the country's growth and development and not a destination. It should inspire the country to work harder to make the economy work better for Kenyans. Furthermore, it provides accurate data to interrogate the policies in place and the distribution or resources in the enlarged economy.

- Rebasing the GDP provides more accurate data on the economy to enable policy makers make informed decisions and policy choices to tackle social problems like poverty and unemployment.

- Increased GDP will open other economic opportunities to the country such as making it easier for Kenya to borrow money from international markets, – WB and IMF - non-concessional facility. It must however be pointed that, the cost of such borrowing has increased in recent months, and this situation will probably get worse. Further, international credit ratings agencies are likely to downgrade Kenya if terrorism and corruption continue to disrupt the economy. If they do, the cost of borrowing will increase further, and foreign investors might relocate to better locations. The cumulative effect of these developments will be to undermine the capacity of the Government to undertake new projects.

It will be mixed for the fiscal stance of Kenya as well, since there is improved debt-to-GDP ratio, but with a weaker tax base. Lower investment and savings level in the economy exposes the countries vulnerability. Overall all social, economic, environmental and political indicators that are expressed as a ratio to GDP will be affected which will influence the policy maker's decision based on them.

The fact of the matter is that the "overnight" transformation would not address insecurity, high cost of production and infrastructural challenges currently experienced in the country. In addition, GDP revision process that has made the country 'wealthier' is likely to leave some Kenyans worse off, due to the high level of poverty and inequality. It is important to note that revision may still underestimate total GDP as 2009, the new base year, saw the country affected by drought that depressed agricultural output and household spending. In all these computation, a reserved estimate of 20 percent increase is assumed. This implies that if the magnitude of change is higher, then the effects will be equally severe either negatively or positively. Despite the foregoing the revision and rebasing is important and necessary as it depicts the true position of the economy. The importance of accurate and reliable data for planning cannot be overemphasized. As the old adage goes "if you cannot measure it, you cannot manage it". The revision of the national accounts data cannot be further from the truth. Failure to do the revision when due is not an option as this continues to expose the country to the risks of continued planning using inaccurate and unreliable data which may distort policies and strategies for correcting the challenges of the economy.

8.2 Recommendations

To mitigate the adverse effects that may arise from an expanded GDP/economy, the Government will need to put in place remedial measures to address the following issues.

8.2.1 Awareness Creation and Sensitization on the Importance of the Exercise

The gains from the revision of national statistics cannot be gainsaid. The exercise is important to an economy especially in facilitating acquisition of reliable and accurate information for informed economic planning and policymaking. What is required is for KNBS to carry out a sensitization campaign to inform the stakeholders and citizenry about the possible outcomes from the exercise and their possible implications associated with the results. It is critically important for people to understand that a high GDP or GNI per capita is not synonymous to an increased standard of living/wellbeing. That a high GDP/GNI per capital alongside high incidences of poverty, inequality, high unemployment rates, poor infrastructure is a manifestation of poor planning and/or governance on the part of Government and requires to be addressed going forward. To achieve accurate and reliable economic data for effective planning will only be realized through adoption of best practices in national accounts statistics. Further, accurate information and clear understanding provides the citizens with the best tools to hold the Government accountable in its mandate. This is why sensitization is absolutely essential.

8.2.2 Diversification of Sources of Financing

ODA Support

One of the expected outcomes of the GDP rebasing exercise is to expand the GNI per capita of Kenya beyond the US$1,045 threshold. This limit defines developing countries which renders the country ineligible for IDA support. Considering that the country is a major beneficiary of IDA resources that are used to finance most of the social programmes, it means that the Government will have to look for alternative sources to bridge the financing gap.

However, what must be realized is that although most donors are influenced by IDA decisions, it must be remembered that IDA is just one of the many sources of ODA support accounting by up to 11% of the total ODA. Multilateral and bilateral donors accounts for 30% and 70% respectively. Therefore although IDA is important, the Government should exploit other sources as well especially those which do not rely on GNI such UN agencies and bilateral sources. USA, United Kingdom (UK), Germany and EU accounts for 18%, 8%, 7% and 7% respectively, with all the four accounting for 40% of the total which make them possible sources. Most importantly, none of these donors considers GNI per capita as a critical consideration for support. Instead, they consider factors such as good governance, corruption, poverty levels etc. as the primary consideration for eligibility. What the Government then needs to do is to work around improving its standing with respect to these partners so as to become as attractive as possible. Recent initiatives by the Government such as the promulgation of the Constitution 2010, public sector reforms, public financial sector reforms, anti-corruption mitigation measures among others have all endeared the Government to these donors significantly hence increasing the scope for cooperation. However, much remains to be done and it is incumbent upon the Government to do so, especially now with expected reduction of IDA support

FDIs

With an accurate, reliable and more comprehensive data about the size and structure of the economy, as well as attainment of the middle income status, the country shall become an attractive destination for FDIs. Kenya is already developing as the favoured business hub, not only for oil and gas exploration in the sub-region but also for industrial production and transport. With this distinctive advantage, the Government will need to put in place strategy and mechanisms that will enable it to continue optimizing and sustain these favorable conditions. The recent experience with euro-bond that was over sub-scribed is encouraging but the momentum should be sustained.

8.2.3 Trade Relationships within EAC

The country will have to deal with the perception within the EAC that Kenya is not "one" among equals which might rekindle the memories of the defunct East African Community whose break up was occasioned by perceptions rather than real issues of concern. These fears whether real or imagined will have to be addressed if the on-going trade initiatives including the FPA negotiations with EU are to continue without undue tensions.

8.2.4 Trade Concessions

According to the State Department for International Trade, the middle income status arising from rebasing of Kenya's GDP will not affect the EAC/EU EPA negotiations. The old preferential trade arrangement between ACP countries and the EU was challenged by other trading partners and found to be incompatible with the provisions of WTO. The arrangement was one sided as it was only the EU that granted trade concessions to ACP without reciprocity.

In the context of EPA negotiations, EAC partner states are supposed to reciprocate and grant EU concessions as well. They are reciprocating because of the WTO and not due to rebasing of GDP. The EU can only use the middle income status to exert pressure on Kenya to conclude EPA. It is only Kenya that is a developing country in the EAC. The same logic goes for AGOA. It is discriminatory and not compatible with WTO. Africa and USA have to find other ways of trading that has to be compatible with WTO come September 2015. AGOA can only be extended if approved for renewal by US Congress and be granted a waiver from WTO obligations.

Kenya will remain a developing country notwithstanding attaining the middle income status earlier than anticipated and will not lose any trade preferences.

9.0 DISSEMINATION STRATEGY TOWARDS THE IMPLEMENTATION OF THE RECOMMENDATIONS

KNBS should work closely with all stakeholders to develop strategies for disseminating what the exercise is all about. At the moment, other than the technocrats at KNBS who know what the exercise is all about, very few other people know about it. As a result, discussions about rebasing find space among laymen including politicians who unfortunately will interpret them to fit their interests.

Annex 1: List Documents/ Literature that were Reviewed

(i) GoK, Kenya Vision 2030

(ii) GoK, Medium Terms Plans I & II

(iii) GoK, Kenya Economic Survey Reports, KNBS

(iv) The United Nations Secretariat (UN/DESA) - National Accounts Main Aggregate Database

(v) World Bank – World Economic Outlook Database 2014

(vi) IMF – World Development indicators database

(vii) CIA – The World Fact book

(viii) GOK, UNDP, Kenya Human Development Report, 2013, 2014

(ix) The Internet - Experience from Nigeria and other countries

(x) UNDP, Human Development Reports various issues

(xi) Government of Nepal & UNDP, Nepal Human Development Report 2014 Beyond Geography, Unlocking Human Potential, 2014

Annex 2: References

(i) GOK, Kenya National Bureau of Statistics, Kenya Economic Survey 2014

(ii) Central Bank of Kenya, Annual Reports, 2013 & 2012

(iii) Central Bank of Kenya, Statistical Bulletins, 2010, 2011, 2012, 2013

(iv) Central Bank of Kenya, Monthly Economic Report , 2014

(v) World Bank, OECD et el, System of National Accounts 2008, New York, 2009

(vi) IMF, Low-Income Countries Global Risks and Vulnerability Report, 2013

(vii) World Bank, World Development Indicators database, 2014

(viii) Lynge Nielsen, Classifications of Countries Based on Their Level of Development: How it is Done and How it Could be Done, IMF Staff Working Papers, WP/11/13, *, IMF, 2011*

Annex 3: AGOA Country Eligibility

(1) (A country that) has established, or is making continual progress toward establishing:

a) A market-based economy that protects private property rights, incorporates an open rules-based trading system, and minimises Government interference in the economy through measures such as price controls, subsidies, and Government ownership of economic assets.

b) The rule of law, political pluralism, and the right to due process, a fair trial, and equal protection under the law.

c) The elimination of barriers to United States trade and investment, including by:

(i) The provision of national treatment and measures to create an environment conducive to domestic and foreign investment;
(ii) The protection of intellectual property; and
(iii) The resolution of bilateral trade and investment disputes;

d) economic policies to reduce poverty, increase the availability of healthcare and educational opportunities, expand physical infrastructure, promote the development of private enterprise, and encourage the formation of capital markets through micro-credit or other programs;

e) a system to combat corruption and bribery, such as signing and implementing the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions; and

f) protection of internationally recognized worker rights, including the right of association, the right to organise and bargain collectively, a prohibition on the use of any form of forced or compulsory labour, a minimum age for the employment of children, and acceptable conditions of work with respect to minimum wages, hours of work, and occupational safety and health;

(2) (A country that) does not engage in activities that undermine United States national security or foreign policy interests; and

(3) Does not engage in gross violations of internationally recognised human rights or provide support for acts of international terrorism and cooperates in international efforts to eliminate human rights violations and terrorist activities.

On-going Compliance:

If the President determines that an eligible Sub-Saharan African country is not making continual progress in meeting the requirements described in subsection (a)(1), the President shall terminate the designation of the country made pursuant to subsection (a).