TOPIC: GLOBAL ECONOMIC AND FINANCIAL CRISIS AND TRADE: KENYA'S EXPERIENCE

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Paper Submitted to the AERC

For the Conference

Rethinking African Economic Policy in Light of the Global Economic and Financial Crisis Conference

December 2009

Global Economic and Financial Crisis and Trade: Kenya's Experience

Abstract
This paper investigates the effects of the global economic and financial crisis in Africa and whether or not Kenya's trade sector has been a channel for transmitting the crisis in the country. The analysis of the effects of the crisis in Sub-Saharan African countries indicate that, the crisis will slow down poverty reduction efforts, increase hunger and malnutrition and deepen the problem of long-term development in the poorer countries of Sub-Saharan Africa. In the case of Kenya, the analysis suggests that it has not been spared either. Prices of staple foods have been escalating, the price of export commodities have been declining, the volume and value of exports have been on the decline, the tourism industry has been hard hit and remittances have also declined to an all time low. Kenya's balance of trade, terms of trade and the current account have not been spared either. This paper proposes the introduction of subsidies for producers, a stimulus package for those industries that are on the verge of collapse and an increase in government expenditure to stimulate local demand. Donor agencies and development partners should help in this noble cause.

Key words: global economic and financial crisis, transmission channel, financial innovation, poverty reduction.

JEL, F400

1.0 Introduction

It is widely recognized that the current financial crisis is the result of the weaknesses in the neo-liberal model that has been shaping global economic policies in the last three decades, weaknesses that have been magnified by policy failures and lax regulation in the advanced countries. The immediate cause or trigger of the global economic and financial crisis was the bursting of the United States housing and credit bubbles which peaked in approximately 2005-2006 (Lahart, 2007). Between 1997 and 2006, the price of the typical American house increased by 124 per cent. Housing prices reached their peak in mid-2006. Large inflows of foreign money in the U.S. from fast-growing economies in Asia and oil-producing countries in the years leading to the start of the crisis in 2007, combined with low US interest rates from 2002-2004, contributed to easy credit conditions, which fueled both housing and credit bubbles (Bernanke, 2009; Krugman, 2009). These large inflows were attributed to the complex financial innovation in the U.S. that included placing an increasing importance of the shadow banking system and

development of financial institutions such securitization. Subprime mortgages were bundled into mortgage-backed securities (MBS) or collateralized debt obligations (CDOs) for sale to investors, as well as credit default swaps (CDS), a form of credit insurance.

Using securitization, seen then as the greatest financial innovation in the 20th century, banks could pool their various loans into sellable assets, thus off-loading risk loans onto others. Financial innovation greatly increased both the housing and credit booms enabling institutions and investors around the world to invest in the U.S housing market. The pricing mechanism in the widely used financial model did not reflect the level of risk which the innovation introduced in the financial system (Geithner, 2008; Greenspan, 2008). The financial products got good ratings from rating agencies encouraging people to take them up because of soaring profits. Strong demand for MBS and CDOs began to drive down lending standards. Rising housing prices led lenders to think that it was not too risky to lend as bad loans meant repossessing high-valued property, subprime loans. The financial system expanded becoming increasingly fragile.

When prices started falling, confidence fell quickly, slowing lending and economic activity. Assets plummeted in value resulting in subprime crisis or mortgage-backed security losses. Concerns regarding the stability of key financial institutions drove central banks to provide funds to encourage lending and restore faith in commercial paper markets (IMF, 2009). Governments bailed out key financial institutions and implemented economic stimulus programs. Shrinking banks sucked money out of the economy as they tried to build their capital. The crisis resulted in compound effects such as rise in food prices, financial instability and uncertainty in industrialized nations, high fuel costs, soaring commodity prices as well as fears of global recession.

This paper investigates the effects of the global economic and financial crisis in Africa in general and Kenya specifically focusing on various possible channels of transmission.

2.0 The Crisis in Africa

The views of the effects of the crisis on African economies are mixed. *The Least Developed Countries Report 2009 (UNCTAD, 2009),* argues that the impact of the global

economic crisis is likely to be so severe among the Least Developed Countries (LDCs) of Africa that "business as usual" would no longer be possible. The crisis is expected to have both direct and indirect effects on these countries. The direct effects are mainly in terms of interest rates in the financial markets, the stock's price index and bonds spread in the bonds markets. The indirect effects are in terms of economic slowdown, commodity price decline and possible aid effects. The same view was expressed by the United Nations in 2008 predicting that, economies of developing countries including Africa, being commodity-dependent economies, would be exposed to considerable external shocks stemming from price booms and bursts in international commodity markets. Most of developing countries including Africa are dependent on commodities for import and export. In May 2009, IMF warned that Africa's growth will plummet because of the world economic downturn. The Fund predicted that growth in SSA would slow to 1.5 per cent below the population growth due to slump in commodity prices and credit squeeze. Further, the IMF indicates that African countries could face increasing pressure for debt payment as the crisis gets deeper and foreign institutions that have lent money to Africa need to shore up their reserves.

A contrary view holds that, the integration of Africa with the rest of the global economy is generally weak suggesting that many African countries would not be affected by the crisis (Shah, 2009). Further, the view contends that there has been more interest in Africa from the Asian countries such as China in the recent past, and as the crisis is hitting the Western nations the hardest, Africa may not be affected a lot by the crisis. The section examines the effects of the global economic and financial crisis on various sectors in Africa including the millennium development goals (MDGs), food and commodity prices, real GDP, remittances, trade, investment and foreign aid.

The Business Daily reports that Kenya is increasingly feeling the pinch of the crisis, with both Finance minister and Central Bank of Kenya (CBK) governor conceding that the shock of the global financial meltdown and the high commodity prices had put severe pressure on the country's fiscal position, the balance of payments, and the exchange rate, hence the resolve to carry out radical measures (Bussiness Daily, 2009).

"These shocks are threatening to derail our economic recovery. Kenya is likely to face a more difficult time in 2009/10 with low economic growth, increased unemployment and continued high prices for maize if rains become inadequate," they said in a recent letter of intent to the IMF.

2.1 Millennium Development Goals (MDGs) of Poverty and Hunger

The current financial crisis exposes a deeper, long-term development problem. Despite record rates of GDP growth over the last five years, coinciding with the commodity boom, poverty reduction has been slow in the majority of African countries, and most remain off-track to meet the Millennium Development Goals. In addition, many are facing recurrent crises of food security. These patterns are rooted in the combination of an accumulating crisis in agriculture with an inability to generate productive employment outside agriculture. The crisis in agriculture is rooted in structural problems of declining farm size, low productivity, inadequate infrastructure and environmental degradation.

World Food Program (2009) contends that as the global financial downturn continues, hunger and malnutrition will increase as incomes fall and unemployment rises. The poorest and most vulnerable will feel the effects most strongly. With the number of hungry people expected to top one billion in 2009, the need to address urgent hunger needs is greater than ever. In 47 of the 55 countries monitored by WFP, staple commodity prices are still more than 20 per cent higher than the average for the past five years. In 2009, WFP needs US$6.4 billion to meet the urgent hunger needs of 105 million people. This is a fraction of the trillions of dollars spent to rescue financial institutions and stimulate economies.

WFP has designed an Economic Shock and Hunger Index (ESHI), which uses economic variables and food security indicators to identify which countries will be hit hardest by the financial crisis. In the developing countries, the number of hungry people on the planet in 2009 is predicted to reach a historic high of 1.02 billion. The global economic slowdown and stubbornly high food prices in many countries are being named as the cause for the new numbers of hungry people (FAO, 2009).

WFP analyzed 126 countries and produced a 'watch list' of 40 countries which have emerged as vulnerable to the economic crisis in terms of increased hunger and food insecurity. Case studies were recently undertaken in Armenia, Bangladesh, Ghana, Nicaragua and Zambia with the intention of illustrating the situation in countries facing similar challenges. The key findings were:

- The global financial crisis is significantly affecting household food security in these countries.
- The worst affected groups are unskilled workers in urban areas, families who rely on remittances, workers in export sectors and those working in mining and tourism.
- Coping mechanisms included reducing the quantity or quality of food consumed, withdrawing children from school, delaying or reducing health care, and looking for additional job opportunities such as casual work to bring in more income.
- Many communities are still reeling from the food and fuel crisis that peaked in 2008 and prices remain stubbornly high.

WFP reports that the number of hungry people has passed 1 billion in 2009, which is a record high in history. However, the food aid is in a 20-year low, according to the data of UN Food and Agriculture Organization. The executive director of WFP, says the WFP was aiming to feed 108 million people in 2009, but is facing a serious budget shortfall, which is about US$3 billion. In Kenya, food crisis "have pushed almost 4 million into the hunger trap". In 2009, WFP aims to provide food assistance to 5.9 million people in Sudan, including 3.8 million conflict-affected people in Darfur.

2.2 Trends in Prices of Staple Foods

During the second quarter of 2009, the cost of staple commodities in 47 of the 55 countries monitored by WFP is still more than 20 per cent higher than the average for the past five years. Commodity prices still remain high relative to 2007 prices, exacerbated by fluctuations in market stability. Loss of income has created an additional burden on families already trying to cope with higher food prices and increased uncertainty.

Food prices remain high in developing countries. Despite improved global cereal supplies, food emergencies continue in 32 countries (FAO, 2009). According to the WFP (2009), global cereal prices are 74 percent higher than they were in 2005, on average, and

ten percent above 2007 levels (IMF, June 2009). Cereal prices in developing countries remain very high, in some cases at record levels (FAO, April 2009).

A study by FAO (2009) of 58 developing countries shows that in 78 percent of them food prices in April 2009 were higher than April 2008. In 17 percent of cases, prices are the highest on record. Prices on local markets have remained stubbornly high in parts of the world where people are most vulnerable. This phenomenon is sometimes referred to as the 'ratchet effect' – prices adjust upwards more quickly than downwards.

In Mozambique, the price of maize in June 2009 was 146 percent higher and the price of imported rice 123 percent higher than the previous five-year average. In Sudan, prices of sorghum and millet are 106 percent and 63 percent higher, respectively, than the average over the past five years. In Uganda, in June 2009, the prices of cassava and bananas were up 189 percent and 130 percent, respectively, over the five year average for June. Prices for both commodities continue to rise. In Zambia, the price of maize in June 2009 increased by 11 percent compared to the previous quarter and is 35-37 percent higher than 2008 for the same period—and more than 90 percent higher than the five-year average. Global food prices started to rise sharply in 2007 and reached record levels in the second quarter of 2008, contributing to unusually high food prices on most East African markets. Despite falls elsewhere, maize prices in Kenya continued high and upward trends in recent months, causing concern about food availability and access throughout the country. The May 2009 maize prices in Nairobi were Ksh. 3,160 per 90 kg bag, 65 percent higher than during the same period in 2008. However, part of this outcome could be attributed to the early 2008 post election violence.

2.3 Effects on Real GDP

WFP (2009) quoting World Bank (2009) and UN-DESA (2009) argues that global GDP is expected to decline by between 2.9 percent and 2.6 per cent. At least 60 (of 107) developing countries are expected to suffer declining per capita incomes. This impacts poverty reduction efforts as only seven countries are expected to register growth of three percent or higher, down from 69 countries in 2007 and 51 in 2008 (UN-DESA, 2009).

Kenya Business Forecast Report 2009 contends that the effects of the global financial crisis will be felt over the medium term. It predicts that the transmission mechanisms will be manifold claiming that first, commodity earnings will suffer during the global recession, given Kenya's orientation toward luxury exports such as tea and horticulture. Investment, too, will decline, owing to the global capital shortage. Private consumption, however, will be affected more insidiously. The effects will be lagged and several factors will take their toll on consumer spending, including waning remittances, a contraction of the manufacturing sector, and a possible bursting of the real estate bubble. The report forecasts Kenya's economic expansion of just 1.1 per cent in 2009, mainly because of a sharp contraction in private investment and an expected slowdown in the growth of private consumption.

2.4 Effects on commodity Prices

Most African countries and especially Sub-Saharan Africa have traditionally been dependent on commodity exports and hence vulnerable to world price fluctuations. It is due to the combined threat from falling commodity prices, the slowdown in global demand and the contraction in financial flows. As a result, manufactures and service exporters (mostly Asian and island LDCs) are likely to be hit hard, but the commodity-dependent economies (mostly African LDCs) will be hit even harder.

As noted in previous *Least Developed Countries Reports*, most LDCs (with the exception of oil-exporting LDCs) have quasi-chronic deficits in their trade and current accounts. Table 1 presents Kenya's balance of payments (BoP) over the period 2004-2008 (Republic of Kenya 2009; 2008). Kenya's balance of payments (BoP) is generally characterized by a persistent current account deficit. In 2008, the BoP position declined on account of decreased foreign direct investment inflows decreased short-term capital inflows, as well as the ever widening merchandise trade deficit. Net official reserves also decreased.

Table 1: Balance of Payments (Net), 2004-2008 Kshs Million

Year	Current Account	Capital & Financial Account	Errors & Omissions	Total Monetary Movement
2004	-10,433	18,964	-5,455	-3,075
2005	-19,064 (83%)	57,870 (205%)	-17,645	-21,161
2006	-36,803 (93%)	63,780 (10%)	17,469	-44,226
2007	-69,638 (89%)	150,090 (135%)	-17,202	-63,250
2008	-136,851 (97%)	81,055 (-46%)	22,635	33,161

Source: Kenya National Bureau of Statistics

The depletion of reserves was occasioned by the growth in import bill that surpassed earnings from export of goods and services and net capital inflows. Current account deficit expanded by 97 per cent in 2008 compared to 93 per cent in 2007. The surplus in capital and financial account dropped sharply by 46 per cent in 2008 compared to an increase of 135 per cent the previous year due to decreased foreign direct investment (-92 per cent) and short-term capital inflows (-53 per cent).

Other changes in capital and financial account included increased net loan repayments and capital repatriation mainly at the stock market after huge foreign investor participation at Nairobi Stock Exchange. This came with the listing of Safaricom becoming the biggest listed company in the region in terms of market capitalization and profitability.

Faced with decreasing global demand the current account imbalances for Kenya are likely to deteriorate even further as export revenue diminishes. The vulnerability of African countries in general and Kenya in particular is related to the highly concentrated production and export structures of commodity-dependency, as well as the on low-skill manufactures. The global recession is likely to constrain international trade and impede long-term investment, representing an additional source of contraction of African output and exports.

The international reserves of most African countries accumulated during the years of export boom may be insufficient protection from significant and persistent current account shocks associated with the drying up of external sources of finance. Excessive commodity dependence exposes them to large terms of trade shocks. Moreover, external

vulnerability of African countries is further aggravated by their high level of indebtedness. As UNCTAD (2009) has repeatedly warned in recent months, there is the potential for a new debt crisis to emerge in poor countries.

2.5 Remittances

Remittances are also set to decline. Workers' remittances have become an important supplement to basic incomes in LDCs, where they generally support consumption rather than investment. According to World Bank estimates, remittances to developing countries as a whole have been increasing at a slower pace in recent years, with the annual increase down from 18 per cent in 2006 to 9 per cent in 2008. They are expected to decline by 5 per cent in 2009, with a possible slight recovery in 2010.

Remittances, which represent a major source of foreign exchange for developing countries ($63 billion a year for Latin America, nearly $20 billion for sub-Saharan Africa in 2008), and is an important source of income for households, are expected to contract globally by between five and eight percent in 2009 after years of double-digit growth. (World Bank, March 2009). The situation is particularly problematic for those countries for which remittances are a large percentage of GDP. This includes small economies such as Lesotho whose remittances are 29 percent of GDP (World Bank, 2009).

In Kenya, remittances have declined by 15 percent in the first four months of 2009, compared to the same trimester in 2008 (Central Bank of Kenya, 2009). Remittances to Kenya, a key source of foreign exchange for Kenya, rose 6 percent in February to $53.3 million compared with the same month in 2008 (Central Bank of Kenya, 23rd March, 2009). Kenyans overseas sent $50.3 million home in February 2008. The total amount in the first two months of 2009 fell 11 percent to $92.9 million from $104.3 million in the same period of 2008. Total remittances in 2008 were $611.2 million, making the receipts the third largest source of hard currency after horticultural and tea exports. Kenyans expect the receipts to fall in 2009 if the global economic downturn persists.

Table 2 shows an improvement in the monthly flows of remittances since January 2009. It also shows that remittances increased by 17.2 percent (from USD 39.5 million to USD 46.3million) in the period January to June 2009 compared with a 8.2 percent fall in a similar period in 2008. Also, remittances are pro-cyclical. The largest inflow, amounting to USD 67.9 million was recorded in April 2008. The funds were partly for investment in the Safaricom IPO and cumulatively, remittances were 11.4 percent lower in the January-June 2009 period over the comparable period in 2008. The larger inflow in 2008 reflected the need for consumption smoothening especially for families affected by the post election violence and for investment in the Safaricom IPO.

Table 2: Remittances to Kenya 2004-2009

Year	2004	2005	2006	2007	2008	2009
January	25,154	28,564	31,506	40,930	53,925	39,535
February	27,676	26,056	30,283	39,533	50,382	53,353
March	29,944	31,219	36,354	48,562	59,344	55,361
April	27,773	29,216	35,369	38,251	67,872	48,117
May	26,931	32,358	42,427	41,163	48,538	49,180
June	30,047	34,360	35,667	48,643	49,490	46347
July	33,187	29,133	41,065	53,350	44,137	-
August	28,894	31,759	30,587	58,803	43,388	-
September	28,894	31,616	28,841	60,575	48,953	-
October	25,223	33,037	29,633	46,848	61,113	-
November	25,473	34,282	31,403	55,564	43,970	-
December	29,130	40,557	34,459	41,421	40,129	-
Annual Total	338,326	382,153	407,593	573,643	611,241	291,922

Source: www.centralbank.go.ke

One of the benefits of migration is remittances. According to the Central Bank of Kenya, Kenya received US$611.2 million in 2008, from $573.6 million in 2007, about 2.7 per cent of GDP. The reduction of incomes and the loss of jobs by Kenyans in the diaspora is expected to reduce remittances. Table 2 shows that remittances have increased significantly over time and actually increased in 2008, by 6.6 per cent compared with 2007. As shown in the table, while remittances were quite volatile in 2008, there was a general downward decline from May 2008, even though they increased in September and

October. In the second part of 2008, monthly remittances declined relative to 2007, except in October. Remittances declined by 27 per cent in January 2009 when compared with January 2008. From March 2009, remittances have taken a downward trend from a high of 55.4 to a low of 46.3 in June 2009.

2.6 Exports and Trade

The World Trade Organization (WTO, 2009) forecasts a decline of nine percent in international trade in 2009. The IMF predicts five percent, the World Bank predicts a ten percent drop, and UN/DESA 11 percent. This decline is affecting all regions of the world, including Africa where demand for primary commodity exports, such as timber, cotton and copper, is decreasing. These commodities are often big foreign exchange earners as well as an important source of employment. Copper prices in Zambia are still much lower than the 2008 rates, and the copper export economy has left 8,000 people without jobs (more than 25 per cent of the industry workforce). In the Democratic Republic of Congo an additional 350,000 people could find themselves unemployed in Katanga province as mineral companies slash production.

Tea; horticulture, especially cut flowers; and, to a lesser extent, coffee are Kenya's main individual commodity exports. At the aggregate level, a large proportion of Kenya's exports are sold in Africa. COMESA (the Common Market for Eastern and Southern Africa) accounted for 31.4 per cent of Kenya's total exports in 2007 (with 70 per cent of these going to the EAC (East African Community) countries of Uganda, Tanzania, Rwanda and Burundi). While these are mainly essential manufactured products, the high reliance on regional markets makes the country vulnerable to an economic slowdown in the region, which may come from reduced aid flows to these regional trading partners. Europe accounts for another 29.2 per cent, which comprises mainly agricultural products like tea, cut flowers, vegetables, fruits and coffee. Asia accounts for 16.4 per cent of the export share while the US accounts for 6.6 per cent. A depreciating currency has helped cushion export earnings.

2.6.1 Tea Sub-sector

Kenya tea is facing increasingly stiff competition in world market. Former importers including Rwanda, Malawi, Vietnam and Nepal have become exporters of tea. Pakistan entering Free Trade Area (FTA) pacts with several of its neighbors under the ambit of South Asian Association for Regional Cooperation (SAARC) threatening Kenya-Pakistan multi-billion annual tea trade (Odhiambo, 2008). For many years Pakistan has been the single largest buyer of Kenya tea but trade has been a slump between the two countries over the last 3 years. A section of SAARC countries, including India and Sri Lanka, directly rival Kenya in tea business. Tea prices have been on the rise since 2008 surging in June 2009. Rising prices were caused by increased demand for tea following supply shortage in world markets as a result of prolonged drought and worldwide climate change affecting the three largest tea producing countries (Kenya, India, Sri Lanka).

Table 3 indicates the performance of Kenyan tea exports over the period 2004-2008 (Republic of Kenya, 2009; 2008). The volume of exports shows an upward trend although marked by a sharp drop in 2006 of 7 per cent from the 2005 level. The trend of the tea prices fluctuated widely between a low of Kshs124 per kilogram in 2005 and a high of Kshs164 per kilogram in 2008. The value of tea exports shows an upward trend with a sharp drop in 2007 caused by low prices of Kshs126 per kilogram. Overall, the changes in tea export quantities and prices are reflected in a downward trend of tea export earnings as a per cent of the total exports. In 2008, the sub-sector was second largest foreign exchange earner in the country after the horticulture sub-sector.

Table 3: Performance of Kenya's Main Exports, 2004-2008: Tea

Year	Tones	Kshs. per Kg	Tea Exports Earnings	
			Value (Kshs '000s)	% of total exports
2004	275,307	131	36,065	22.7
2005	341,171 (24%)	124 (-5%)	42,305 (17%)	20.2
2006	318,896 (-7%)	148 (19%)	47,197 (12%)	20.8
2007	370,245 (16%)	126 (-15%)	46,651 (-1%)	17.9
2008	390,245 (5%)	164 (30%)	64,000 (37%)	19.8

Source: Kenya National Bureau of Statistics

2.6.2 Horticulture Sub-sector

The sub-sector is Kenya's fastest growing in the agricultural sector. In the recent, it has become a major foreign exchange earner, employer, and contributor to food needs in Kenya (Republic of Kenya, 2009) . Cut flowers dominate horticulture exports followed by a variety of fruits and vegetables. The main market for Kenyan fresh horticultural produce is Europe (Britain, Germany, France, Switzerland, Belgium, Holland and Italy), Saudi Arabia and South Africa. Table 4 shows the performance of Kenyan horticulture exports over the period 2004-2008 (Republic of Kenya, 2009). The quantity of horticulture exports indicate an upward but fluctuating trend, dropping to 1 per cent in 2006 from 9 per cent in 2005 and to 4 per cent in 2008 from 32 per cent in 2007. The trend of the horticulture export prices is also marked by fluctuations being lowest in 2005 and 2007 and highest in 2008 and 2006. The changes in both quantities and prices of horticultural exports give rise to a rapid upward trend of horticultural earnings. In 2008, the horticulture industry generated more than Kshs71 billion, becoming the leading single most foreign exchange earner in Kenya. However, as a percentage of total export earnings, the horticultural export earnings since 2005 have remained at lower than the 2004 level.

Table 4 Performance of Kenya's Main Exports, 2004-2008: Horticulture

Year	Tones	Kshs. per Kg	Horticulture Export Earnings	
			Value (Kshs '000s)	% of total exports
2004	274,186	144	39,483	24.8
2005	298,464 (9%)	140 (-3%)	41,785 (6%)	21.3
2006	301,007 (1%)	155 (11%)	46,656 (12%)	21.4
2007	397,271 (32%)	143 (-8%)	56,810 (22%)	21.7
2008	414,703 (4%)	172 (20%)	71,329 (26%)	22.0

Source: Kenya National Bureau of Statistics

2.6.3 Coffee Sub-sector

Table 5 presents the performance of Kenyan coffee exports over the period 2004-2008 (Republic of Kenya, 2009; 2008). The quantity of coffee exports, demonstrate a downward trend with some recovery in 2007 while the prices indicate an upward trend with some drop in the same year. The output of coffee dropped to its lowest in 2008 such that even with high prices (Kshs244), the earnings remained lower than the level reached in 2007. As a percentage of total export earnings, coffee-export earnings have remained al lower than the 2004 level since 2005. However, coffee output declined in the June

2007-April 2008 period, by 21.7 per cent, owing to drought in the country. In the first 10 months of 2008, coffee production was down by 29 per cent.

Table 5: Performance of Kenya's Main Exports, 2004-2008: Coffee

Year	Tonnes	Kshs per Kg	Coffee Export Earnings	
			Value (Kshs '000s)	% of total exports
2004	50,069	139	6,960	4.4
2005	46,962 (-6%)	193 (39%)	9,064 (30%)	4.3
2006	45,739 (-3%)	200 (4%)	9,148 (1%)	4.0
2007	55,151 (21%)	189 (-6%)	10,424 (14%)	4.0
2008	41,470 (-25%)	244 (29%)	10,119 (-3%)	3.1

Source: Kenya National Bureau of Statistics

From the foregoing, it has emerged that Kenya's exports have adversely been affected by the financial crisis due to a drop in the demand in the destination countries and a fall in prices of these export commodities. There have been reductions in the purchase of Kenyan export produce mainly tea, coffee and flowers. As early as August 2009 some flower companies in Kenya were feeling the effects of the crisis. The Dutch auction house Floraholland through which most Kenyans export flowers said that flower exports were in a decline. More than 90 per cent of flower exports are sold to the European markets and demand has been slumping with the crisis.

2.7 Foreign Direct Investments

The current global financial and economic crisis influences firms' capacity to invest as a result of reduced availability of finance and their propensity to invest due to gloomy economic and markets prospects. UNCTAD (2009) argues that the fall in FDI in 2008-2009 is the result of two major factors affecting domestic as well as international investment. First, the capability of firms to invest has been reduced by a fall in access to financial resources, both internally – due to a decline in corporate profits – and externally – due to lower availability and higher cost of finance. Second, the propensity to invest has been affected negatively by economic prospects, especially in developed countries that are hit by severe recession. The impact of both factors is compounded by the fact that, as of early 2009, a very high level of risk perception is leading companies to extensively curtail their costs and investment programs in order to become more resilient to any further deterioration of their business environment. All the three major types of

FDI (market seeking, efficiency seeking and resource seeking) will be impacted by these factors, though with different magnitudes and consequences on location patterns.

The IMF estimates that foreign investments to developing countries are expected to decline by 32 percent from 2008 levels. Total debt and equity flows are expected to decline in 2009 by 82 per cent from 2007 levels, from $929 billion in 2007 to $165 billion in 2009 (Institute for International Finance, 20) Total private capital flows are expected to decline in 2009 by 70 per cent from 2007 levels, from $1.2 trillion in 2007 to $363 billion in 2009 (World Bank, 2009).

FDI in Kenya is defined as investment in foreign assets, such as foreign currency, credits, rights, benefits or property, undertaken by a foreign national for the purpose of production of goods and services which are to be sold either in the domestic market or exported overseas. FDI includes equity capital, reinvested earnings and intra-company loans, with the first two dominating net FDI to Kenya. FDI brings investable financial resources to host countries, provides new technologies and may enhance the efficiency of existing technologies. FDI may facilitate access into export markets, thereby playing an important role in strengthening the export capabilities of domestic economies. It may enhance skills and management techniques and may provide cleaner technologies and modern environment management systems. FDI has also the potential of enhancing growth of domestic firms through complementarity in production and productivity spillovers. The anticipated decline in FDI as a result of the financial crisis would therefore adversely affect the country's performance. Table 6 shows FDIs to Kenya from 1980 to 2008.

Table 6: Foreign Direct Investments in Kenya 1980-2008

Year	Net Inflows (BOP, current US$ million)	Net Inflows) (% of gross capital formation)	Net FDI stock (US$ million)
1980	79.0	4.44	385.7
1981	14.1	0.90	399.8
1982	13.0	1.11	412.8
1983	23.7	2.17	436.5
1984	10.8	1.01	447.3
1985	28.8	2.12	476.1

1986	32.7	2.51	508.9
1987	39.4	2.38	548.3
1988	0.4	0.02	548.6
1989	62.2	3.62	610.8
1990	57.1	3.40	667.9
1991	18.8	1.17	686.7
1992	6.4	0.58	692.7
1993	1.6	0.18	694.7
1994	3.7	0.32	699.0
1995	32.5	2.05	732.0
1996	12.7	0.82	742.6
1997	19.7	1.21	795.1
1998	11.4	0.65	806.5
1999	13.8	0.90	820.3
2000	110.9	7.76	931.2
2001	5.3	0.36	936.5
2002	28	3.3	964.2
2003	82	3.5	1045.9
2004	46	2.3	1092.0
2005	21	8.2	1113.2
2006	51	11.5	1164
2007	728	13.1	1892
2008	96	1.5	1988

Source: UNCTAD, World Investment Reports (2009).

The country does not have significant mineral resources and this means that much of the FDI goes to agriculture, manufacturing and services. FDIs in Kenya have not only been highly volatile, they generally declined in the 1980s and 1990s despite the economic reforms that took place and the progress made in improving the business environment. However, they picked up in the year 2000 (this may be due to new investments by mobile phone companies and accelerated offshore borrowing by private companies to finance electricity generation activities which became necessary because of the drought that prevailed that year) but fell again in 2001 as the country prepared for a general election in 2002. After a new government was installed in December 2002, FDIs to Kenya increased but fell again to a low of 21US$million as the country witnessed unrest during the referendum in 2005. After that there was an increase in FDIs in 2007 but this was overshadowed by the huge decline in 2008. This could be partly as a result of the financial crisis as well as the post election violence following the 2007 general elections.

2.8 Foreign Aid

Aid budgets are under pressure in developed countries. At the G20 meeting in April, 2009 leaders reaffirmed their commitments including to Africa. As yet it is unclear what the effect lower GDPs will have on overseas development assistance (ODA) pledges. Global food aid supplies are at a 20-year low. Only 6.3 million tons of food aid was delivered globally in 2008 compared to 13.2 million tons in 1990. UNCTAD (2009) argues that the current recession, and some of the stimulus measures being introduced to combat it, is compounding budget deficits and budget reallocations in many donor countries. ODA is a soft target in such situations; during past banking crises, it has dipped anywhere from 20 per cent to 40 per cent. Furthermore, ODA levels tend to recover very slowly. Given the depth of today's crisis, the recovery period is likely to be long.

What will this mean for developing countries, especially those whose development, domestic spending and daily survival depend heavily on foreign aid? First of all, if ODA recovers from the present crisis as slowly as it did previously – say, three to four years hence, just when world markets are beginning to pick themselves up again – developing countries will be caught short, lacking the productive capacity they need to take advantage of reviving opportunities. Second, since some donors set their aid targets as a percentage of GDP, a drop in GDP could lead to a drop in aid. Moreover, aid budgets are usually fixed in domestic currency; and if that currency depreciates against the recipient's currency, the value of the aid budget in the recipient currency will decrease as well. The UK's aid budget, for example, is expressed in pounds, whose exchange rate has fallen steeply in recent months. Its recent depreciation will thus translate into a real decline of British ODA for most of the countries receiving that aid.

Most developing countries foreign aid provides the main and in some cases the only source of the financing needed to prevent their sliding into recession and losing their hard earned productive and exporting capacities. For these countries, the kind of stimulus package that more advanced nations are able to offer themselves is simply out of reach. But their economic survival depends on keeping demand healthy. And given the extent of

global interdependence today, maintaining aid commitments and stabilizing aid flows will do much more than help recipient countries. It will also help stabilize global demand.

Quite some amount of Kenya's budget was to be raised from external sources but now that prospect is uncertain. As at October 2008, statistics from Treasury indicated that, the Government had a budget deficit of KSh127 billion. Also the Kenya Revenue Authority missed its target for September by KSh10 billion. The sovereign bond was meant to net KSh33 billion from international markets but has since collapsed mainly due to strains caused by the global crisis. In the June 2007 budget, the Government planned to raise KSh633 billion from tax and external financing (grants and loans). Table 7 shows total disbursed aid to Kenya from 2000 to 2008.

Table 7: Evolution and Pattern of Total Disbursed Aid to Kenya

Year	ODA (at Curent Prices, US$M	ODA as share of GNI (%)	Bilateral as share of total ODA
2000	509.94	4.16	57.8
2001	461.55	3.59	58.6
2002	391.04	2.94	75.3
2003	521.45	3.51	62.2
2004	654.42	3.97	71.6
2005	767.08	3.86	68.1
2006	943.40	4.00	82.4
2007	1084.1		82.2
2008			

2.9 Tourism sector

Tourism earnings have fallen by more than 30 per cent, caused by increased fuel prices and the global financial crisis. Slowed activity in tourism has also contributed to shilling loosing value to the dollar. Table 8 presents the performance of the tourism sector over the period 2004-2008 (Republic of Kenya, 2009; 2008). The sector maintained an upward trend over the period of four years 2004-2007 with fluctuations of increases between 9 per cent and 14 per cent. The corresponding earnings during this period increased at a decreasing rate. However, in 2008, the sector witnessed one of its worst performances in recent history. This was mainly as a result of the political violence that erupted in the country during the first quarter of the year after December 2007 General Elections and the subsequent travel bans by major tourism source countries. As a consequence, tourism earnings decreased from Ksh. 65.5 billion in 2007 to Kshs 52.7 billion in 2008,

representing a 20 per cent drop. The volume of international arrivals decreased sharply by 34 per cent from 1,817 thousand in 2007 to 1,203 thousand in 2008. Other factors that impacted negatively on the sector included the high cost of jet fuel, the global financial meltdown, and rise in commodity prices and exchange rate fluctuations that occurred in the year.

Table 8: Tourist Arrivals and Earnings in Kenya, 2004-2008

Year	Arrivals ('000s)	Earnings (Kshs million)
2004	1,361	38,434
2005	1,479 (9%)	48,899 (27%)
2006	1,601 (8%)	56,200 (15%)
2007	1,817 (14%)	65,478 (17%)
2008	1,203 (-34%)	52,700 (-20%)

Source: Kenya National Bureau of Statistics

2.10 Balance of Trade

Table 9 presents details of balance of trade over the economic and financial crisis period 2004-2008 (Republic of Kenya, 2009; 2008). Trade balance shows an expansionary deficit trend marked sharply at a maximum of 48 per cent in 2006 over 2005. This difference is reflected in the drastic drop in the value of exports of (-4) per cent. After the decline in 2006, the value of exports picked up an upward trend increasing by 26 per cent over 2007-2008 as compared to 9 per cent over 2006-2007 period. The trend of imports indicates growth at a declining rate over the period 2005-2007.

Table 9: Balance of Trade 2004-2008 Kshs. Million

Year	GDP current prices	Exports	Imports	Imports as % of GDP	Trade balance
2004	1,273,975	214,793	364,557	28.6	-149,764
2005	1,418,071	260,423 (21%)	443,093 (22%)	31.2	-182,670 (22%)
2006	1,620,732	250,994 (-4%)	521,483 (18%)	32.2	-270,489 (48%)
2007	1,814,243	274,658 (9%)	605,112 (16%)	33.4	-330,454 (22%)
2008	2,099,798	344,947 (26%)	770,651 (27%)	36.7	-425,705 (29%)

Source: Kenya National Bureau of Statistics

2.11 Volume and Price Changes

Table 10 summarizes the movements in both the volume and prices of merchandise trade using quantum and price indices as well as the terms of trade (Republic of Kenya, 2009; 2008). The movement in export and import quantum indices is marked by a sharp drop in 2006, the drop being more pronounced in exports. Over the 2007-2008 period, both exports and imports volumes are rising but at a declining rate in case of exports. The

movement in export and import price indices also indicates a sharp drop in 2007 instead of 2006 experienced in volume changes. The price indices give rise to a deteriorating pattern of terms of trade over the period 2005-2007. The improved favorable terms of trade in 2008 compared to the 2005-2007 period suggest rise in the relative price of exportable to importable goods. Aggregate export prices generally increased, although the country experienced declining terms of trade, with import prices increasing faster than export prices.

Table 10: Volume and Price Changes and Terms of Trade, 2004-2008

Year	Quantum Indices		Price Indices		Terms of Trade 1982 = 100
	Exports	Imports	Exports	Imports	
2004	296	246	638	824	77
2005	318 (7%)	254 (3%)	676 (6%)	942 (19%)	72
2006	256 (-20%)	238 (-6%)	869 (29%)	1,215 (29%)	72
2007	279 (9%)	270 (13%)	866 (0%)	1,244 (2%)	70
2008	294 (5%)	320 (19%)	1,030 (19%)	1,339 (8%)	77

Source: Kenya National Bureau of Statistics

2.12 International liquidity

The Kenya Shilling weakened annually against the US Dollar and the Euro by an average of 0.9 per cent and 2.0 per cent, respectively as shown in Table 11. In 2008, the Kenyan Shilling notably weakened against the trade weighted exchange rate index by 18.0 per cent, Euro by 21.4 per cent and the US Dollar by 23.9 per cent. The weakening of the Kenyan Shilling against the major world currencies during 2008 can partly be attributed to the global economic and financial crisis (Republic of Kenya, 2009).

Table 11: Foreign Exchange Rates of Kenya Shilling for Selected Currencies, 2004-2008

Year	31st Dec. 2004	31st Dec. 2005	31st Dec. 2006	31st Dec. 2007	31st Dec. 2008
1 US Dollar	77.3	72.4 (-6.5%)	69.4 (-4.1%)	62.7 (-9.7%)	77.7 (23.9%)
1 Pd Sterling	149.0	125.0 (-16.1%)	136.3 (9.0%)	124.3 (-8.8%)	112.3 (--9.7%)
Euro	105.3	85.9 (-18.4%)	91.4 (6.4%)	90.2 (-1.3%)	109.5 (21.4%)
100 Jap Yen	75.4	61.7 (-18.2%)	58.3 (-5.5%)	54.5 (-6.5%)	53.8 (-1.3%)
Overall weighted index 1982=100	754.2	623.7 (-17.3%)	639.6 (2.5%)	604.0 (-5.5%)	712.9 (18.0%)

Source: Kenya National Bureau of Statistics

3.0 Summary and Conclusion

The recent financial and economic crisis has exposed the myth of self-regulating markets. In response to the crisis, most developed market economies have shifted away from free market-based forms of economic governance to alternatives that include a much bigger role for the State in economic management through regulation and Keynesian fiscal stimulus packages. Several larger developing countries such as China, Brazil and South Africa, have recently also begun to deploy public stimulus packages to revive their economies. However, most sub-Saharan African (SSA) countries, Kenya included simply cannot afford to deploy similar packages and have continued to follow economic reform programs which have severely reduced government involvement in promoting development. The programs have major limitations in addressing the key structural constraints such as: (a) bottlenecks in production related to the structure of the balance-of-payment deficits; (b) inadequate infrastructure; (c) chronic deficits; (d) serious skills and knowledge shortages; and (e) vulnerability to external shocks. The minimal government action policies pursued by the Sub Saharan African countries have not led to structural change and economic diversification, rather African countries have even further deepened their unfavorable production patterns and specialization in exports of commodities. Many African countries have undergone deindustrialization and seen stagnating performance of their manufacturing sectors. This has increased their exposure and vulnerability to external market shocks.

The effects of the crisis in poorer nations of Africa, Kenya included, include a decline in per capita incomes and remittances, rise in unemployment and food prices, fall in commodity prices due to decreasing global demand and contraction of financial inflows (FDI and foreign aid) and declining international trade as well as global recession. These effects will slow poverty reduction efforts as enshrined in programs such as MDGs, increase hunger and malnutrition and deepen problems of long-term development in SSA. There have been different reactions to the global financial crisis with some saying that Kenya is not so much exposed to the international banking and therefore it may not feel the effects. Others have a different view saying that Kenya is actually experiencing the effects of he global financial crisis. Both Finance minister and Central Bank of Kenya

(CBK) governor have conceded that the shock of the global financial meltdown and the high commodity prices have put severe pressure on the country's fiscal position, the balance of payments, and the exchange rate, hence the resolve to carry out radical measures.

"These shocks are threatening to derail our economic recovery. Kenya is likely to face a more difficult time in 2009/10 with low economic growth, increased unemployment and continued high prices for maize if rains become inadequate," they said in a recent letter of intent to the IMF.

There is therefore a need to put in policy measures to curb the effects of the financial crisis to cushion the economy from sliding down into deeper recession. Such measures include increasing government expenditure and through the multiplier effect, create jobs for those who have been laid off, increasing demand for locally produced goods to prevent closure of industries that would otherwise close due to lack of demand for their products.

The government should also come up with a stimulus package for those industries that are on the verge of collapse due to low demand. Such industries include the horticultural industries.

To curb the escalating prices of staple foods, the government should introduce some form of price control or introduce subsidies for producers.

However, this may require some form of aid and donor agencies and other development partners should be help in this noble cause.

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