UNIVERSITY OF NAIROBI

DEPARTMENT OF POLITICAL SCIENCE AND PUBLIC ADMINISTRATION

EFFECTS OF IMPORT SUBSTITUTION TRADE POLICIES ON KENYAS INDUSTRIALISATION SINCE INDEPENDENCE

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A project submitted in partial fulfillment of the requirements for the award of a Masters Degree in Political Science and Public Administration, University of Nairobi.2014.

DECLARATION

This Project is my original work and has not been submitted for award of a degree in any other university.

Stellamarie Wanja Ireri Date

This project has been submitted for examination with my approval as University of Nairobi Supervisor.

Dr. Fred Jonyo Date

DEDICATION

This research project is dedicated to my loving sons Mark Anthony Ireri and Ira Nathaniel Njagi, my parents Gerald Ireri Njagi and Agnes Kageni Ireri and my siblings Annrita Karimi Ireri and Maurice Njagi Ireri, for there constant and unfailing support, encouragement and prayers, financial and moral support during and throughout my entire course. I really appreciate them and God bless them.

ACKNOWLEDGMENT

I would like first and foremost to thank God for his grace and faithfulness and for seeing me through my entire course and most of this entire research project up until its completion. My supervisor Doctor Fred Jonyo, for his endless support and guidance which has enhanced and enriched my study. My sons, Mark Anthony Ireri and Ira Nathaniel Njagi , my parents Gerald Ireri Njagi and Agnes Kageni Ireri and my siblings Annrita Karimi Ireri and Maurice Njagi Ireri. I also cannot fail to mention the Ministry of Industrialization and Enterprise Development staff for their cooperation, patience and assistance towards the completion of this research project. I am sincerely grateful and thankful to all of their individual contributions.

ABSTRACT

This study examines the effects of Import Substitution trade policies on Kenya's industrialization since independence. The general objective of the study is to find out the effects that Import Substitution trade policies had on the structure of the manufacturing sector, income distribution, employment creation and the operations of multinational corporations in Kenya. The study assumes that Import Substitution trade polices as an industrialization strategy remains viable and of great importance for less developed countries.

The study has utilized both primary and secondary data. While primary data will be generated through interviews, secondary data will be obtained from books, journals, magazines and official publications by the government. A conceptual framework has been adopted in the study so as to help the researcher make sense of the problem statement of the study.

The study tentatively concludes that the type of industrialization that occurred did not lead to a structural transformation of the Kenyan economy. The structural change was to be brought about by creating gaps in the process of eliminating imports and making investment possible in the Non-Traditional sectors. However resources were concentrated on a small part of the economy and to a large extent neglected others and in particular agriculture. Consequently Import Substitution did not lessen Kenya's external dependency but merely changed its nature. The considerable outflow of dividends and other payments for instance foreign investors made Kenya rely more on imports in order to achieve further industrial growth.

This deprived the country of the first learning steps in the industrialisation process and in building manufacturing capacity and capabilities. Thus industries worked below their full capabilities. Therefore the government needs to reconsider and concentrate on neglected industries with of course putting in mind the lessons learnt from past mistakes from the first regime of Import Substitution trade policies. The paper also emphasizes the need for the government to continue pursuing policy measures that strategically focuses on the growth of the sector by taking into account their backward and forward linkages in the economy.

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ABBREVIATIONS

DFCK - Development Finance Company of Kenya

EAC - East African Community

ECLA - Economic Commission for Latin America

ESI - Export Substitution Industrialization

FDI - Foreign Direct Investment

FIPA - Foreign Investment Protection Act

GDP - Gross Domestic Product

ICDC - Industrial and Commercial Development Corporation

IDB - Industrial Development Bank

ISI - Import Substitution Industrialization

KEBS - Kenya Bureau of Standards

KIE - Kenya Industrial Estates

KIRDI - Kenya Industrial Research and Development Institute

KNA - Kenya National Academy

LBDA - Lake Basin Development Authority

MIED - Ministry of Industrialization and Enterprise Development

MNCs - Multi-National Corporations

NPC - New Projects Committee

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CHAPTER ONE

INTRODUCTION TO THE STUDY

1.0 Introduction

Kenya's industrial development after independence in 1963 is not complete without taking into account its colonial history. Kenya was a British Colony in 1890s and converted into a Crown colony in 1920. As a British colony, Kenya's role was reduced to raw material production due to commercial agriculture which turned out to be the main mode through which raw materials were generated and exported to Britain. The settler economy met this need sufficiently by supplying such products as cotton, sisal, hides and skins, meat. These products were manufactured in Britain and then be re-exported back to the Kenyan market (Swainson, 1980:182).

The colonial office which wanted to develop Kenya into a market for British industrial goods viewed colonial industries as a threat to British products in the home market as well as in other colonial markets. In her study of foreign corporations in Kenya, Swainson argued that the British colonial policy towards the extraction of raw materials from the colonies, involved the positive discouragement of colonial industrial development, with the exception of such industries as were linked to the agricultural sector of the economy (Swainson, 1980:174).

By doing so the structure of the domestic economy was transformed to produce agricultural goods and to import consumer goods and machinery from the external economy. This had a negative implication in that it did not stimulate strong domestic manufacturing capacity development in Kenya. It was therefore clear that from the outset of British colonial rule a policy of simple primary production without any substantive and immediate policies towards industrial development was established. Hence the manufacturing industry in Kenya remained nascent characterized by low technological capability development and thus low value added manufacturing activities. As Brett put it:

> During this time the colonial office was indifferent and often hostile to colonial attempts to develop manufacturing industry. The Colonial Development Advisory

Committee placed no limit on its sphere of activity, but ignored the industrial sector (Brett 1973:268).

However WWII brought about a significant change in economic policy relating to industrialization. During the war, the colonial office emphasised on the need to exploit colonial resources for the benefit of the war battered British economy. The secretary of state for the colonies, for instance, sent out a circular on economic policy stressing the need for increasing the flow of colonial supplies to help Britain meet its war requirements. Thus a new colonial economic policy was prompted by the changed position of Britain in the world economy after the war that led to the increased production of raw materials and Import Substitution manufacture of products hitherto imported from Britain which became pressing to help earn dollars to offset the rising dollar deficit of their "mother country" (Lee, J.M, 1967:47).

It became imperative, then, for the colonies to either reproduce manufactured goods to meet their own demand, or to import them from Britain rather than from outside the sterling area. This policy meant that the Kenyan economy, by being structured as a supplier of primary materials to the mother country and an importer of the latter's industrial goods, was geared to fulfilling the economic needs of its colonial power.

The colonialists therefore implemented radical policy change of extraction of raw materials and restriction of industrialization to promotion of industrialization alongside agricultural production. Foreign Direct Investment initially concentrated in the field of commercial farming and raw material extraction also began to change in favor of foreign investment in manufacturing industry, albeit gradually (Swainson, 1980:284).

Therefore WWII and the decolonization era in Kenya witnessed the first real attempt to encourage local industries. This period not only established a policy of state intervention to facilitate industrialization, it also created a policy framework for industrial development that would survive into independence. Nonetheless, no concrete policy was formulated in favor of industry which still reflected lack of colonial will, commitment and effort to establish a dynamic manufacturing base in the country (Munene and Wandibba, 1989:89).

The existence of a non-African population, both as producers and consumers provided the initial stimulus for the development of manufacturing and processing in Kenya by foreign capital. This population coupled with the slowly rising purchasing capacity of the non-white population provided a significant market for a range of industrial consumer goods.

This forced many British manufacturing firms to move to Kenya after 1945 to manufacture goods previously imported under protected conditions. A rapid expansion of industrial development followed with increased supportive government intervention policies in the post-war years. Broad based economic controls in favor of the industrial sector were implemented in order to promote the development of secondary industries in addition to agricultural production. A combination of tariffs and quotas supplemented by foreign exchange allocation measures; use of overvalued exchange rates to maintain import costs low; favorable credit and interest rate policies intended to subsidies manufacturing of consumer goods. As a result of the high increase in overall demand for consumer products in the domestic market, the implementation of ISI framework encouraged production for domestic market shielded from imports and international competition (Nyong'o, 1988:9).

A few manufacturing industries such as those producing flour (1909), sugar (1922), beer (1922), tea and coffee (1924), meat products (1935), blanket, soap and leather goods (1938), canned fruits and vegetables (1948), cigarettes and tobacco, matches (1958) clothes (1960) were therefore established during the colonial era, all foreign owned and performing simple and basic manufacturing activities characterized by limited value added (Van Arkadie, 1964:98).

Upon the achievement of independence in December 1963, the newly formed government of Kenya adopted `development' as its principle objective and promulgated policies and programmes designed to ensure a smooth transfer of responsibility. Therefore the government produced two development plans 1963-1970 and 1970-1974 followed by the Sessional Paper No.10 on African Socialism and its Application to Planning in Kenya which defined development in terms of continued growth and the elaboration of political and economic institutions established in the country during the colonial period (Barkan, 1984:11).

Therefore it is in this historical context, beginning from the period of independence that this study will examine the effects of Import Substitution Trade policies on Kenya's industrialization after independence.

1.1 Statement of the Research Problem

Developing countries (LDCs) adopted a number of approaches in their attempts to move their economies and societies from a so-called "backward" orientation towards a more "modern" one. Crucial to this process was a desire to change from a rural-traditional dominance to a more modern-industrial mode for the simple reason that development was equated with industrialization. As a result, LDCs pursued a policy of rapid industrialization primarily through a process of Import Substitution Industrialization as a strategy for development due to its economic gains and its prospects of industrialization so as to bring structural changes in their economy (Todaro, 2003:556).

During the initial phase of adopting ISI in Kenya, the underlying assumption was that for an economy to develop it had to be based on agriculture and industry. Whilst Kenya's industrial policy was driven by the desire to break free from the restrictions of underdevelopment towards an industrial trajectory, it was thought that industry, rather than agriculture, would be the means by which Kenya achieves rapid economic growth.

However the colonial economy in Kenya not only created a weak socio-economic base but it also sowed the roots of socio-economic problems that would prove decisive in shaping the pattern of development after Independence. And according to Jorgenson the industrialization process was accompanied by increased imports of semi-processed raw materials, foreign machinery and technology which more than offset the anticipated savings in imports of consumer goods (Jorgenson, 1975:445).

Therefore in the immediate post-colonial era, Kenya's industrial policy was driven by the desire to break free from the restrictions of underdevelopment towards an industrial trajectory that would enable the country to shake off the shackles of unequal colonial trading patterns. However the pursuit of industrialisation without upgrading agricultural production and techniques, limited the impact of Import Substitution

Industrialisation strategy. In addition the sectoral dichotomy between agriculture and industry, private and public, formal and informal sectors undermined the industrial development process in the country.This study therefore seeks to examine the effects of Import Substitution Trade Policies on Kenya's Industrialization since independence.

1.2 Research Questions

A. Why did Kenya adopt Import Substitution trade policies after independence?
B. What were the effects of Import Substitution trade policies on Kenya's industrialization after independence?

1.3 Objectives of the Study

The overall objective of the study is to examine the effects of Import Substitution trade policies on Kenya's industrialization process since independence. The specific objectives include:

A. To examine the reasons why Import Substitution Trade Policies were adopted in Kenya after independence.
B. The experience of the manufacturing sector in Kenya under Import Substitution trade policies.

1.4 Justification of the Proposed Research

This research undertaking is motivated by both academic and policy considerations. The research is not only important to researchers interested in economic development but also to people responsible for formulating development policy.

On the academic front the results of this study will contribute to the policy debate on the impact of trade policy in Kenya and help in evaluating its growth effect. This will be recognized through the relationship between industry and agriculture. The study has also highlighted the problems that are hindering Kenya's industrialisation and which will help academicians do more research on the gaps. Therefore this study will focus on the Ministry of Industrialization and Enterprise Development so as to gather ample information and provide useful literature to the study.

On the policy front, this study will help policy makers and the government at large in accounting for sectoral growth successes and failures in Kenya since independence and to rethink its industrialization policies and also offer solutions to the stated problems in the research study and thus contribute to the improvement of people’s livelihood. The research will also identify policy sources of productivity growth in the agricultural and industrial sectors. It will also highlight the attention that needs to be enforced that will enable Kenyan firms to cut costs and become competitive by promoting competition in the manufacturing sector.

1.5 Scope and Limitations of the Study

The main objective of this study will be to examine Import Substitution Trade Policies on Kenya’s industrialization after its independence. In the course of conducting the study the main challenge and limitation was in the area of data collection. This included Lack of available or reliable data, due to confidentiality, whereby the participants of the research are not truthful as they feel the need to tell the researcher what they think the researcher need to hear. This was particularly difficult during interviews.

Also self-reported data was another limitation this was through selective memory (remembering or not remembering experiences that occurred at some point in the past), exaggeration (the act of representing outcomes as more significant than is actually suggested from other data); in other words the researcher had to take what people said and responded to the questionnaires.

However to overcome these limitations and so as to gather enough information for the study, official publications from these ministries were useful, with also the use of internet sites enabled the study to obtain relevant information. In terms of the geographical scope, the study was in Nairobi County.

1.6 Definition of Concepts

1. **Import Substitution Industrialization (ISI)** – is Industrial development based on the protection of local infant industries through protective tariffs, import quotas, exchange rate controls, special preferential licensing for capital goods imports, and subsidized loans to local infant industries. ``A deliberate effort to replace major consumer imports by promoting the emergence and expansion of domestic industries such as textiles, shoes, household appliances, usually requiring the imposition of protective tariffs and quotas to protect new or infant industries''(Todaro 1994:681).

2. **Industrialization** – is referred to a marked departure from a subsistence economy that is largely agricultural towards a more mechanized system of production that entails more efficient and highly technical exploitation of natural resources in a highly formal and commercialized economic setting (Rapley,1997:27).

As such, industrialization was understood purely in economic terms particularly the physical presence of industrial plants that were involved in manufacturing capital goods as well as processing raw materials into finished goods either for further industrial use, general commercial use or purely for domestic use or purposes (Todaro, 1994:62)

3. Tariff – Also known as customs duties, a tariff is a tax on imports or exports on international trade. The effects of tariff are to artificially raise the price of foreign products as they enter the country.

Tariffs were ad valorem taxes imposed on imported products to make them relatively more expensive than comparable domestically produced goods therefore tariffs and quotas were often combined to protect infant industries from unfair foreign competition in the domestic consumer market(sharply and Lewis 1988:45).

4. Quota - A Quota is a quantitative limit on imports which presents a fixed limit on the quantity of goods that may be imported. Quotas may be assigned to suppliers or they may be auctioned, creating revenue for the central government (World Bank, 1995:7).

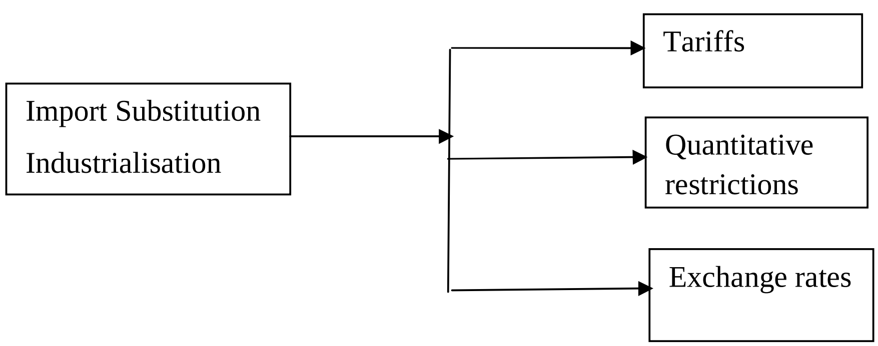
5. Exchange rate - an exchange rate refers to the price of one currency in terms of another and the determination of the exchange rate of a country depends on the exchange rate system in use (Robert Mudida, 2009:380).

1.7 Conceptual Framework

In this section of the research study, a conceptual framework has been used to define the main concepts of the study. The conceptual Framework adopted in the study helped to clarify concepts and propose relationships among the concepts in the study and provided a context for interpreting the study findings. The independent variable of the study is Import substitution Industrialization whereas the dependent variables are Tariffs, Quantitative restrictions and Exchange rate all of which were used during the Import Substitution Industrialization period in Kenya.

The growth of state and private enterprises in Kenya after independence was encouraged under the protection of high tariff and trade restrictions. These protective walls were designed to give less-competitive national industries, conceived of as infant industries, the chance to develop without the competition of large multinational firms. There was a perceived need for protection while an economy developed the necessary conditions to promote learning and innovation within the firm. The policy objective wasn't to ignore exports; rather, the hope was that temporary protection would lead to the development of new products.

Figure 1.1 Conceptual Framework



Source: (Research Data, 2014)

1.7.1 Import Substitution Industrialisation

The history of Import Substitution Industrialisation in Kenya can be sub-divide into three main phases: the colonial phase, the post-independence establishment of ISI

(1964-1974) and the crisis phase (1974 to present. This research study, however, will study the post-independence and especially the crisis phase when the limitations of ISI emerged.

On attaining independence in 1963, the Kenyan government continued with the Import Substitution policy from the colonial administration, notably the system of incentives and the use of protection, which were rationalized as having the objective of laying down the foundations for the development of an industrial sector while reducing excessive dependence on primary production and the importation of manufactured and processed goods. The era witnessed the setting up of manufacturing establishments of different types and sizes that achieved a high level of self-sufficiency in the production of local consumer goods and introduced some of Kenya's industrial products to the international export market (Wagacha 2000:23).

Therefore the Import Substitution Industrialization strategy pursued in Kenya was articulated in the publications of the first, second and third development plans and in Sessional Paper No. 10 of 1965 on Africa Socialism and Its Application on Planning in Kenya. The ISI policies as outlined in the first development plan of 1966-1970 had the stated objectives of raising the standard of living for Kenyans; enhancing technical progress, protecting infant industries, increasing the domestic value added of domestic products, and promoting export-oriented industries (1966-1970:235). The first development plan stated that:

> If the factories required for rapid industrialization and economic growth are to spring up throughout the country, the government's limited resources must be supplemented with domestic, private and foreign capital. The Government's policy towards investment and industrialization is therefore basically positive and non-restrictive, characterized by encouragement and support where needed, in order to secure a maximum rate of economic growth (Kenya, 1964:235).

These policies were restated in the 1970-1974 second development plan which advocated increased protection by the use of import licensing, quantitative restrictions and by duty drawbacks on imported raw materials(1970-1974:320). It stated that:

> Government aims to increase its own participation in the growth of industry, both in terms of the promotion of new projects and in the financing of them. The government is, on occasion, able to take a wider view of industrialization than a single private

> investor. Linkages between projects may make them viable when carried out together, whereas they might not be viable if considered separately. The government is in a unique position to consider such complementary projects (Kenya, Development 1969:305).

The publication of sessional paper No. 10 of 1965 on African socialism and its applications on planning in Kenya which was adopted by the Kenya African National Union shaped the future course and direction of the country's industrial policies and strategies. It mainly centered on industrial development and pursued enhanced protection of the domestic market to help develop industries. Its objectives were to generate rapid growth of industry, ease balance of payments pressure and increase employment. On Import Substitution Industrialisation the sessional paper stated that:

> In order to produce more goods and services for either export or import substitution Kenya must use borrowed funds and imported capital goods efficiently so as to develop industry as rapidly as opportunities are created-first through the processing of agricultural products, livestock and forestry products and natural resources for domestic demand in a progressively more fully integrated manner (Sessional Paper No.10, 1965:37).

Therefore the policy of Import Substitution Industrialisation was adopted in Kenya through the discrimination of capital goods against consumer goods with the manufacturing industry supported by high tariff barriers, quantitative restrictions to protect local producers against foreign competition, an overvalued exchange rate that kept imported capital goods intermediate inputs relatively cheap and import licensing.

1.7.2 Tariffs

During the post war period, in order to protect their colonial market against foreign competitors, Britain erected various types of tariffs in Kenya. These tariffs were put against imported foodstuffs which were meant to encourage the export of processed foodstuff from the colony. Such tariffs were subsequently extended to protect all local industries in Kenya (Swainson 1976:43).

However when Kenya gained its independence it continued using tariffs with the attraction of foreign capital in mind and also as a means of protecting local producers from foreign competition and in line with the governments industrial policy of Import Substitution and which was stated in the third development plan (1974-1978):

> The high rate of growth in manufacturing since independence has been based primarily on Import Substitution which has been encouraged through tariff protection of consumer goods (development plan,1974-1978:19).

These protective walls through the use of tariffs were designed to give less-competitive national industries, conceived of as infant industries, the chance to develop without the competition of large multinational firms. In Kenya tariffs were generally high on imports of final products relative to capital and intermediate goods. However the policy's objective wasn't to ignore exports; rather, the hope was that temporary protection would lead to the development of new products (Rosemary Thorp 1996:140-146).

Two concepts of protection, nominal and effective rates of tariffs, were used in Kenya after independence. Nominal tariff levels appeared to be determined simply by what was deemed necessary to allow an activity into existence, that is by looking at the tariff rate on the final manufactured good, while the effective rates of protection (ERPs) which were generally higher, tariffs were put on intermediate inputs, had important effects on what was imported and what was not, and hence on the allocation of investment (Bhagwati and Desai 1970:363).

Little asserted that protection provided by nominal and effective tariff rates in Kenya were supplemented by numerous quantitative and direct controls on the availability of foreign exchange. These were often imposed as a quick fix to the balance of payments problems that emerged as the import substitution policies continued, rather than as a means of implementing the basic objectives of the policy (Little 1982:136).

Therefore when tariffs were used in this manner by the government, they played little role in regulating foreign investment and instead influenced foreign firms to set up behind the ever rising tariff barriers against their traditional exports to Kenya as indicated in the table below which shows the increases in tariff rates that coincided with the establishment of local production by foreign capital. The table below shows the percentage of tariff that were imposed on different products.

Table 1.1 Foreign Investment and the provision of Tariff Protection in Kenya

Product	**Company**	**Began Production**	**Duty Imposed**	**Previous Year**	**Duty Imposed**
Multiwall Paper Sacks	E.A Packaging Industries	1963	17.5%	1962	12.5%
Bicycle Tyres	Dunlop (Uganda)	1964	Shs 1/25per Lb	1963	Free
Radio, TV Assembly	Sanyo (Through ARMCO)	1966	50%	1966	37.5%
Light Bulbs	Philips Lamps	1966	30%	1965	Free
Batteries	Union Carbide	1967	30%	1967	22%
Stainless Steel Tanks	Hall Thermotank Overseas	1967	15%	1967	Free
Electrical Cables	E.A Cables	1967	15%	1966	Free
Toothpaste	Colgate Palmolive	1967	30%	1966	Free
Vehicle Tyres	Firestone E.A	1969	Shs 1/50 Per Lb	1968	Free
Chocolate Confections	Cadbury	1970	50%	1968	Free
Fishnets	Kenya Fishnets Industries	1970	20%	1965	12.5%

Source: (Eglin, 1978:107)

However the use of tariffs as a means of protecting the domestic industry led to consequences that were not intended. There was the discouragement of the development of domestic capital and intermediate goods industries, discouragement of the use of local raw materials and encouragement of transfer pricing practices, in particular, over-invoicing of imports and the fact that tariff protection worked on an

East African basis, it was dependent on agreement from all three territories, which caused frustration amongst the Kenyan officials over the failure to agree on protective tariffs (V. A Madisson 1961:1).

1.7.3 Quantitative Restrictions

Therefore weak administrative capacity and the fact that Kenya could not unilaterally alter the common external tariff within the East African Community made the government implement quantitative restrictions as an instrument of protection. This led to discussions within the Ministry of Commerce and Industry about the viability of quantitative restrictions on imports. A file note from the Permanent Secretary argued that:

> There is little doubt that in appropriate cases, where we cannot get agreement on a tariff that we will have to press the Secretary of State for permission to use quantitative restrictions in order to help selected local industries against unfair competition from imports (V.A Madisson 1961:2)

Quantitative restrictions proved to be more effective in controlling import compared to tariffs. Import license requirement was the main instrument for quantitative regulation with inputs and certain products receiving preferential treatment in the issuance of import licenses. Import licensing boards evaluated the quality and availability of national substitutes, their prices, and their importance in the production process before allocating cheap foreign exchange. Therefore Essential products were put in the less restrictive license categories while the non-essential products were put in the more restrictive import categories or completely banned. Essential products were put in the less restrictive license categories while the non-essential products were put in the more restrictive import categories or completely banned. (Robert Bruce, 1980:122).

The Kenyan government used import licensing for both general balance of payments control and for protecting particular industries. Imports were classified into groups, some of which were banned completely and others subjected to various levels of quotas. The industrial protection committee, set up in the late 1960s as the government's main agency for protection issues, administered the process. The most restricted category required the assignment of specific quotas to eligible importers and generally consisted of items produced in Kenya with which imports would compete directly. Importers of non-exempted items had to apply for foreign exchange license before placing firm orders (Sharply and Lewis, 1988:60-65).

1.7.4 Exchange Rates

Ideally, exchange rates should equate the value of one nation's goods with those of another's however the exchange rate adopted during the Import Substitution Industrialisation phase was that of the overvalued rate. Kenya's exchange rate policy has undergone various regime shifts over the years, largely driven by economic events, especially balance of payments crises. A fixed exchange rate was maintained in the 1960s and 1970s, with the currency becoming over-valued in order to allow the relatively cheap importation of capital goods and raw materials and the taxes and/or quantitative restrictions on selected consumer goods imports guarantee the profitability of domestic production of these items at output prices above those prevailing in world markets. An overvalued exchange rate was defended, not only as a subsidy to capital formation, but also on the grounds that the economy would grow into higher rate as the productivity of capital and labor increased. A failure of productivity to grow meant, among other things, that the exchange rate remained overvalued, and exporting continued to face an extra high hurdle (Victor Bulmer-Thomas 1994:280).

During the fixed exchange rate system the shilling exchange rate was only adjusted three times in 1967, 1975 and 1981 with a view to maintaining competitiveness of exports. Up to 1974, the exchange rate for the Kenya shilling was pegged to the US dollar, but after discrete devaluations the peg was changed to the special drawing rate (sDR). However between 1974 and 1981 the movement of the nominal exchange rate relative to the dollar was erratic, that is, the rate depreciated by about 14% and this depreciation accelerated in 1981/82 with further devaluations (Njuguna S. Ndungu, 2000:3)

At the end of 1982, the exchange rate regime was changed to a crawling peg in real terms which were in place up to 1990 and which were maintained initially in response to the balance of payments crisis in 1971 /72. In order to conserve foreign exchange and control pressures on the balance of payments, the government chose controls instead of liberalization. The controls were an easy response to contain balance of payments and inflationary pressures, but they created major distortions in the economy that were not evident until the early 1980s (Njuguna S. Ndungu, 2000:4). States therefore tended to maintain overvalued exchange rates, making imports relatively cheaper to purchase. Imports and access to this under-priced foreign exchange were often licensed to limit imported goods to those critical to the industrialization process.

1.8 Methodology

1.8.1 Research Method

The research has used a qualitative method of data collection. This was appropriate because data was collected through direct encounters such as interviews and the distribution of questionnaires. The study was also able to describe the situation as it occurred through opinions and experiences of the participants.

1.8.2 Research Design

The study has used a descriptive research design which was appropriate as it helped the researcher to gather answers to questions of who, what, when, where and how associated with the research problem. The descriptive research design also helped to obtain information concerning the status of the research and to describe what exists with respect to the variables of the study.

1.8.3 Sampling Technique

The study used Purposive Sampling and this was based on the judgement of the researcher when it came to selecting the people that were to be issued with questionnaires and also to be interviewed. The main goal of purposive sampling in the research was to focus on a particular population that were of interest and who were able to answer the research questions.

1.8.4 Sample Size

The study was conducted at the Ministry of Industrialization and Enterprise development where a population of 150 individuals was selected for the study. From the targeted population of 150 individuals, the research's designated sample size, which is the number of sample units selected for contact or data collection, was 108 participants. However the research study had a finals sample that is, the number of completed interviews and participants for which data was actually collected, was 60 participants.

1.8.5 Data Collection Techniques

In terms of data collection, the study has utilized both primary and secondary sources of data. Primary data adopted the use of questionnaires where a list of questions relating to the study were prepared and distributed to the Ministry of Industrialization and Enterprise Development and also interviews with different senior personnel's was accorded. Secondary data collection involved the use of official publications from the ministries, publications by research institutions, journals and periodicals.

1.8.6 Data analysis

The collected data was coded and edited for completeness and consistency with the research study. Tables have been used in the research so as to help the reader understand the purpose of the research and this helps the research give more information that might be complicated, more meaning and in simpler terms.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

Chapter two of this study gives an overview of the reasons why Kenya continued with the policy of Import Substitution Industrialization for two decades. This is done thematically around the following: ISI as premised on the infant industry argument, Kenya's industrial progress from the colonial period through the post-independence era up until the 1980s, criticisms of ISI and the positive and negative implications of ISI trade policies in Kenya.

2.1 Infant Industry Argument of ISI

Until the mid-1980s, the preferred strategy for nearly all late industrialising countries to attempt to catch up with the industrial core countries of Western Europe and the United States was Import Substitution Industrialisation which was a set of policies with the objective of developing an internal manufacturing sector, granting high levels of protection to domestic producers and essentially closing these countries to international trade. Most of the Import Substitution Industrializations trade policies were premised on the infant industry argument where the local industries were made to operate under protectionist trade policies to enable them to develop inwardly (Baer, 1972:96).

The protectionist trade policies were meant to enable "infant" industries to develop first to the level of accumulating enough capital and sufficient industrial knowledge to enable them to compete favorably on the world market. The idea of pursuing inward-looking protectionist trade policies such as imposing high tariffs on imported goods were mostly aimed at deterring local consumers from demanding more of the imports at the expense of the locally produced goods. Therefore the real objective of import substitution trade policies was not to only trade but also to enhance the local industries to the level of adding value to the local products to make them competitive internationally.

The infant industry argument advocated for protectionist trade policies for the purpose of allowing new and undeveloped local industries to establish themselves first before subjecting them to international competition. The argument bordered on the notion that an infant industry did not have the ability to compete with mature established industries due to its smallness in terms of economics of scale and therefore had to be large enough to harvest the economics of scale in production to become competitive. The temporary shielding of infant domestic industries from severe competition gave them the opportunity to develop and become efficient producers to compete effectively with more mature and efficient foreign industries (Baer, 1972:108).

Therefore it was found that even among the new industrialized countries, protective measures on infant industries had to be put in place before fully exposing them to international competition. Great Britain, which in the mid nineteenth century, was the leading industrial country made it difficult for Germany to compete with its older and more established British industries (Sorderstein,1980:196). In spite of having a free market economy, Germany had to ensure that her local industry was fully developed in production efficiency before letting it to stand up to the British industry on the international market.

The south-east Asian economies such as that of Japan and South Korea were purported to have recorded a lot of inward successes in its industry development through the ISI trade policies protectionist tendencies over its industries by successfully promoting steel and car production and cooperative efforts in basic research – especially in electronics (World Development Report, 1987:70). These economies' successful performance suggested that government intervention in industry by offering protection, promoted specific industrial activities to enhance industrial productivity. Therefore all countries which industrialized after Great Britain went through a stage of ISI and in Europe and the United States ISI occurred in the middle and second half of the 19^{TH} century where governments played an active role in encouraging and protecting the development of infant industries (Landes, 1966:373).

In Latin America, ISI was first initiated after WWII in the 1950s to early 1960s as a response to the disruption resulting from the war and the international depression when there was insufficient foreign exchange to pay for imports or when the imported goods were not available. Also the interruption of shipping and the decline of non-military production in Europe and the US during World War II created severe shortages of manufactured goods in Latin America which raised the relative prices of goods and increased the profitability of IS industries (Baer, 1972:106).

Like other developing countries Kenya adopted the strategy of Import Substitution industrialization strategy of manufacturing consumer goods such as foodstuffs, beers, blankets, shoes and soft drinks, using imported capital and intermediate inputs for highly protected internal market and, in the early years, for export to neighboring Uganda and Tanzania.

However because of market and institution forces inherited from the colonial economy luxury goods for wage earning and urban elites were also produced. Among the luxury goods produced were refrigerators, motor vehicles, radios, air conditioners, television sets. The production of these luxury goods required complex technology, the importation of machinery and experts. Thus while writing on ISI in Zambia, Seidman commented that:

> To build industries to produce goods previously imported primarily to supply demands of the elite in Zambia is to perpetuate an economy geared to their needs. It is almost inevitable that the technologies of such industries will be relatively capital-intensive, and reliant on imports of parts and material (Seidman 1972:100-127).

At the beginning of the Import Substitution process, it is the consumer goods that are sealed off from foreign imports. The reason for choosing consumer goods sector is that the cost disadvantage is comparatively less in this sector as compared to either capital goods or intermediate goods. As David Felix argues:

> The initial industries are generally consumer goods or building materials products with a relatively simple technology and a low capital requirement per worker and per unit of output. They are then followed by consumer goods industries requiring a more

> sophisticated technology and larger capital outlay, shading subsequently into industries producing relatively complex consumer durables, steel; engineering and chemical products. This description was especially relevant in the cases of countries such as Argentina, Chile, and Venezuela (Hirschman, 1968:17-24).

Thus the policy of Import Substitution was therefore achieved through the discrimination of capital goods against consumer goods by tariffs, quotas, exchange control barriers, exchange rate policies and fiscal and credit policies.

2.2 Import Substitution Industrialization Strategy

Import Substitution Industrialization Strategy (ISI) that was in place well before independence, to encourage the few industries that catered for the needs of the settler community market, was an important policy in Kenya's development history after independence. Therefore the foundation of Kenya's industrialization progress was laid during the colonial period and was attested by the establishment of a number of industries processing agricultural commodities and other non-agricultural products.

The Table 2.1 below shows that between 1909 and 1938 when a number of processing industries were set up with official assistance from the colonies with wheat-milling and maize flour industries benefiting directly from tariffs and protective railway rates and in 1931 an ordinance was passed giving the government power to give a Sisal Bag factor monopoly in the home market to establish a new industry, which was established in 1934, so as to assist local producers (Brett, 1973:277).

Table 2.1 Major Processing Industries Established in Kenya before WWII

Company	Product	Year of Production	Location
British East Africa Co.	Ginned Cotton wool	1906	Mombasa
Uganda Limited	Wheat, Maize Flour	1909	Nairobi
Magadi Soda Co.	Processed Soda Ash	1911	Magadi
Kenya Co-operative Creameries	Dairy Products	1911	Lumbwa
Victoria Nyanza Sugar Company	Sugar	1922	Miwani
Kenya Tanning And Extract Company	Wattle extracts	1922	Limuru
East African Breweries	Beer	1922	Ruaraka
African Highland and Kenya Tea Company	Tea and Coffee	1924	Kericho and Limuru
Associated Portland Co.	Cement	1933	Nairobi
East African Bag and Cordage Company	Sisal products	1934	Ruiru
Leibig Company	Meat Products	1935	Athi River
Nakuru Industries	Blankets,Leather	1938	Nakuru

Source: (R. B. Ogendo, 1967:121).

Therefore WWII and the decolonization eras witnessed further expansion of this industrial base with the proliferation of Import Substituting Industries.

Table 2.2 Major Industries Established in Kenya, 1945-1963

Company	Product	Year Began Production
House of Manji	Confectionery	1946
Metal Box Co.(E.A)	Metal Containers	1948
E.A Stationery	Stationery	1949
Kenya Canners	Fruits And Vegetables	1950
East African Breweries	Beer	1952
Kenya Meat Commission	Meat Products	1952
Bamburi Portland Cement	Cement	1953
Allsopps E.A.	Beer	1954
E. A. Tobacco	Tobacco, Cigarettes	1954
Coca-Cola Company	Soft Drinks	1956
E. A. Portland Cement	Cement	1956
Kenya Meat Commission	Meat Products	1958
E. A Bata Shoe Co.	Leather. Shoes	1958
Lyons Maid	Ice Cream	1959
Sadolin Paints	Paints, Varnishes	1959
Kenya Textile Mills	Clothes	1960
United Textile Factory	Clothes	1963

Source: (R. B. Ogendo, 1967:154).

The Table 2.2 above shows the list of industries such as Portland Cement Company, Allsopps Breweries, Metal Box Company and Bata Shoe Company that sprung up after WII and most of which were ran by international corporations. The colonial administration used a number of strategies as incentives for the promotion of industrial production, through high tariff protection which began to operate from 1922 and which continued after independence, there was the policy of differential rail rates, whereby imported goods were charged higher rates than the domestically produced ones, duty remissions and refunds, industrial licensing, allocation of industrial land and financial assistance. Thus the decolonization era witnessed the implementation of policy instruments that would be inherited by post-independence Kenya.

2.3 The Manufacturing Sector at Independence

The Manufacturing Sector at Independence constituted 9.5% of GDP, which was amongst the highest in Sub-Saharan Africa at the time. Industries that recorded rapid development during this period were processing of plastics, pharmaceuticals, and steel rolling and galvanizing, electrical cables, paper, vehicle assembly, industrial gases rubber ceramics and batteries manufacture. Some of the industries such as paper, textiles, and garment manufacturing, food processing, leather tanning and footwear expanded from a few establishments during the colonial era into industries with a wide range of products and a large number of employees (Kilby, 1975:135). Some of these industries are shown in the Table 2.3 below.

Table 2.3 A Select List of Industries Established in Kenya Since 1963

Company	Product	Year Established	Location
E.A Packaging Industries	Multi Wall Papers, Sacks	1963	Nairobi
Kaluworks	Galvanized Sheets	1963	Mombasa
Glaxo Allenbury E.A Ltd	Baby Foods	1964	Nairobi
Cow And Gate E.A Ltd	Baby Foods	1964	Nairobi
Associated Motor ltd	Motor Vehicle Assembly	1964	Nairobi
Chemilil Sugar Factory	Sugar, Molasses	1965	Kisumu
Colgate Palmolive E.A	Toothpaste, Soap	1965	Nairobi
East Africa Cables Ltd	Electrical Cables	1965	Nairobi
Leyland Paints Kenya Ltd	Paints	1967	Nairobi
Impala Glass Industries	Glasses	1967	Nairobi
Kentainers Ltd	Plastic Containers	1968	Nairobi
Firestone E.A Ltd	Vehicle Tyres And Tubes	1969	Nairobi
Clay works Ltd	Tiles And Bricks	1970	Nairobi
Steel Rolling Mills	Steel Products	1970	Nairobi
Galsheet Ltd	Corrugated Roofing Sheet	1971	Nairobi
Simbarite Ltd	Asbestos Cement Sheeting	1972	Mombasa
Mumias Sugar Factory	Sugar ,Molasses	1973	Mumias
Pan African Paper Mills	Pulp, Paper	1973	Webuye
Kenya Salt Industries	Salt, Baking Powder	1974	Nairobi
Rift Valley Textiles Ltd	Textiles	1975	Eldoret
Associated Vehicle Assembly	Motor Vehicle Assembly	1975	Mombasa
General Motors (K) Ltd	Vehicle assembly	1976	Nairobi
Milling Co. Kenya Ltd	Sifted Maize Mill	1977	Nakuru
Steel enterprises Ltd	Corrugated Sheets	1978	Nairobi
South Nyanza Sugar Co.	Sugar, Molasses	1980	Awendo
LBDA	Bricks, Tiles	1984	Kisumu

Source: (Republic of Kenya, Directory of Industries 1986)

The contribution of the manufacturing sector to the Gross Domestic Product was 10.1% in 1964 and this rose to 13.3% in 1980. Further progress can be illustrated by the rates of industrial growth of 5.4% in 1964 and 5.7% in 1980 as well as the overall economic growth rates of 1.9% and 5.3% in the respective years. There was also the substantial progress in the field of industrial development with the setting up of manufacturing establishments of different types that achieved self-sufficiency in the production of local consumer goods and introduced some of Kenya's industrial products to the international export market. The table below shows the annual rates of Kenya exports after independence (Kilby, 1975:135).

Table 2.4 Annual Growth Rate of Kenya Exports

Period	Total exports	Manufacturers	Food beverages	Primary products
1965-1971	6.55	17.94	5.85	-
1971-1976	4.85	10.45	2.55	3.26
1976-1984	-2.13	2.83	0.66	-3.38

Source: (Republic of Kenya Statistical Abstracts and Economic Surveys)

Table 2.5 below shows that at independence Kenya's early manufacturing activities were dominated by agro-processing products such as cotton, coffee, tea, maize, and milk that catered for the consumption needs of the expatriate community. Industrialisation was based on traditional Import Substitution that focused on producing light consumer goods for the domestic and regional markets, that is processing of primary products and last stage assembly production. The main products were: processed foods, beverages, tobacco, textiles and clothing, footwear, paper, soap, toothpaste, and other personal hygiene products (Seidman, 1972:24).

Table 2.5 Kenya's Manufacturing Sector at Independence, 1963

INDUSTRY	**25516**
Beverages and Tobacco	8016
Textiles and Clothing	3769
Footwear	1792
Wood and Furniture	2529
Paper and Printing	5623
leather and Rubber	1096
Clay and Glass	763
Basic chemicals and Petroleum	10570
Cement and other minerals	2312
Metal products	5276
Machinery and ship building and repair	1839
Railway rolling stock, motor vehicles	4913
Miscellaneous	792
Total	**74806**

Source: (Statistical Abstract 1968)

Although the agro-export sector became the principle engine for growth in Kenya, the dependence on a few commodities, sisal, tea, coffee, two of which were beverage crops created an unbalanced and weak economic base which made Import Substitution Trade policies become unsustainable over time.

2.4 Criticism of ISI Trade Policies

Despite its apparent gains, Import Substitution Industrialization was both unsustainable over time and produced high economic and social costs. In theory, ISI should have developed an internal momentum, expanding industrialization through interindustry linkages. In the early 1960s the achievements of industrialization in Brazil and Latin America gave way to pessimism and mounting criticism of the indiscriminate nature of Import Substituting Industrialization led to the development of deeply inefficient and high-cost industries. (Hirschman, 1968:4).

According to neo-classical economists, the poor development of LDCs was as a result of distorted and inefficient factor and goods markets. Little, Scitovsky and Scott argued that excessive protection, permitting or encouraging the overdevelopment of ISI, violated the principle of comparative advantage, the existence of import restrictions led to higher exchange rate thus reducing the relative gains from exporting and the bias against agriculture, vis-a-vis manufactured goods undermined the IS strategy and created new and aggravated existing distortions in domestic factor and product markets.

Bulmer-Thomas, argued that the problem with ISI lay not in its excesses, but rather in its use of distorting policies (mainly trade protection) which generated deep-rooted inefficiency. By suppressing imports, there was no way of keeping “the productive apparatus efficient and technologically up to date”. Thus, according to Bulmer-Thomas, “the inward-looking model, particularly in the 1950s, is now seen as an aberration although the excesses were often unnecessary the model – even in a less distorted form – still cannot be defended” (Bulmer-Thomas, 1994:283).

Therefore Neo-Classical economists argued that developing countries needed to focus on product specialization and comparative advantage in order to maximize output and therefore emphasized on the production of primary products. Hence the disregard of any potential comparative advantage was criticized and inward looking strategies were regarded as disadvantage for technological advancement (Baer, 1972:102).

Neo-Marxists and structuralists saw the inefficient productive structure of ISI as a result of the colonial heritage, the social class formation and the economic control measures that were adopted in the neo-colonial period. According to them the main reason for the failure of ISI trade policies was that it was based on the existing pattern of demand and distribution of income, foreign penetration of subsidiaries under tariff barriers which led to the elimination of domestic producers.

Hazlewood examined that Import Substitution policy was in itself very successful in terms of growth but it did not basically transform the structure of the industrial sector due to the increased imports of semi-processed raw materials, foreign machinery and technology, which more than offset the anticipated savings in imports of consumer goods(Hazlewood,1979:65).

However, Rosemary Thorp argued that Latin Americas economic history showed “a reality that is complex and contains both good and bad”. There were “distortions, inefficiencies and lost opportunities” but there was also “a radical transformation of infrastructure and institutions”. She argued that industrial firms gradually acquired new skills and engaged in assimilating, adapting and developing new technologies which increased the numbers of manufactured exports and manufacturing productivity and that industrial and infrastructural change was achieved (Thorp, 1998:197).

2.5 Positive Implications of ISI in Kenya

The initial implications of the Import Substitution trade policies in Kenya were positive while the easy phase of industrialization was undertaken. The importance of ISI in the manufacturing sector in Kenya was demonstrated with the fact that 1964-1974 a large proportion of direct foreign investment went to the manufacturing sector and particular to the Import Substitution Industries (Eglin 1978:96-133).

During the first decade of Independence, the Kenyan government maintained an impressive record of macroeconomic management. A cautious financial policy was pursued which saw inflation and external debt kept within manageable levels and avoided major balance of payments disequilibrium. The government was also able to reverse the fiscal position that it had inherited at Independence. It turned the deficit in the recurrent budget into a sizeable surplus, increased its development expenditure sevenfold, and reduced its relative dependence on foreign aid. Government recurrent revenue grew at an impressive average annual rate of 15% between 1965 and 1973 (World Bank, 1975:217).

Total tax revenue increased from K£39.8 million in 1964/5 to K£265.9 million in 1976/7. This was a result of an increase in direct taxes from K£14 million to K£108 million and an increase in indirect taxes from K£39.8 million to K£265.9 million which was helped in large part by the introduction of a sales tax.

Kenya was also able to maintain a balance of payments equilibrium, with the balance of payments recording a surplus for much of this earlier period. From the beginning of 1968, foreign exchange reserves accumulated rapidly. In every quarter, except one, the reserves increased. By the end of the first quarter of 1971 these reserves had nearly trebled, and totaled K£89.1 million. In turn external debt was kept low: debt service charges on external debts in 1976/7 amounted to less than 4% of government expenditure, to 1% of monetary GDP, and to 2.3% of the value of exports (Hazlewood, 1979:143).

Kenya's impressive record faltered in the second decade of the post-independence period. From 1972-82 the growth rate averaged 4.8%. Although this was high in comparison to much of Africa, it was a significant decline from earlier periods. Kenya's economic performance during the 1970s was dominated by variations in the country's international terms of trade (World Bank, 1983:4).

2.6 Negative Implications of ISI in Kenya

Towards the end of the 1970s in Kenya, there was a general deterioration in the country's overall economic performance and the scope for further Import Substitution had been exhausted as domestic demand slackened due to deceleration in agricultural production. Foreign demand also slackened following loss of regional markets after the collapse of the East African Community. The inward looking nature of ISI also undermined the competitiveness of Kenyan products in the export markets.

Import Substitution Trade Policies constraints contributed to severe balance of payments deficits and by 1971 it caused the government to decide to effect a number of import control measures. Between 1973 and 1977 there was a triple effect on the current account deficit which was attributable to the fact that the Import Substitution Industries depended on the imports of fuels, industrial materials and capital goods. For instance the balance of payments position changed from a surplus of KSh183 million in 1973 to a deficit of KSh538 million in 1974 (Robert Mudida, 2009:459).

Following a series of external shocks in the 1970s, the inefficiency and inadequacy of the Import Substitution policy became apparent. The first oil crisis (1973) and a mini-crisis precipitated by transitory inventory build-ups and deepened deficit fiscal financing that spilled into increased demand for imports played havoc with Kenya's growth prospects whereby the import bill in 1974 grew by 68% with the value of oil rising 3.5 fold and that of non-oil imports increasing by nearly 50%.

A foreign exchange crunch triggered by the oil price crisis precipitated tariff and quantitative import restrictions, deeper foreign exchange controls, and the strengthening of the Price Control Act in 1972, ostensibly to align the price control system with the country's income policy, which required, from 1973, control of wages through wage industries that used imported raw materials mainly for packaging. This also coincided with the aftermath of a severe drought in 1973 (KNA ACW, 1979:5). By the end of the 1970s, industrialisation had slowed considerably, and dissatisfaction with ISI paved the way for the structural adjustment programmes that became watershed in the history of Kenya's industrial policy.

Furthermore, ISI laid little emphasis on the production of intermediate and capital goods, so that the expansion of manufacturing precipitated a rapid increase in demand for imports of intermediate and capital goods by an increasing group of manufacturers of consumer goods. An over-valued exchange rate made imported capital goods relatively cheap, further reducing the incentive for domestic production.

It also discouraged technological adaptation, research and development. By encouraging low or no tariffs on machinery, on the one hand, and high tariffs on engineering raw materials, on the other, the ISI policies encouraged imports of whole plants, undermining the development of suitably skilled manpower.

There was also foreign investment which focused on manufacturing rather than agriculture and this made investment to shift from agriculture to industries in order to exploit import substitution opportunities. Some well established trading houses and service agencies also shifted to manufacturing and, a few years after independence, new foreign investment was flowing into other industries attracted by opportunities for exploiting the business environment resulting from the protection act of 1964 by the government which allowed owners of approved enterprises to repatriate profits, loans, interest on loans and approved portion of proceeds from the sale of all or part of the enterprise. Policy makers saw foreign capital as a necessary supplement to domestic capital in the financing of industry (Kenya, 1966:236).

The fact that most Import Substituting Industries in Kenya were multinational corporation subsidiaries posed a threat to domestic industries which could not afford the expenses of artificial production. In 1963, 42.5% of all inputs used, came from abroad. This indicates that manufacturing as a whole used few local resources (apart from agriculture). In some industries almost all basic materials were imported: soft drinks (90%); footwear (85%); paints (905); soap (67%), metal products (90%); rubber products (95%) indicating the last stage processing or assembly character of many industries (Seidman, 1972: 24).

Also local inputs were little used in multinational corporation subsidiary operations owing partly to the fact that import licenses were readily available. Thus import substitution which was initially rationalised as a means of reducing dependence on the international economy actually seemed to increase it. Even the textile industry which was expected to boost a cotton-based local industry depended on imported raw materials. Thus apart from failing to promote forward linkages by increasing the costs of inputs to potentially forward-linked industries ,backward linkages were also hindered by the purchase of inputs from overseas sources rather than from the domestic suppliers (Robert mudida,2009:460)

CHAPTER THREE

KENYAS INDUSTRIALISATION EXPERIENCE UNDER IMPORT SUBSTITUTION TRADE POLICIES

3.0 Introduction

The Government of Kenya regards industrial development as a cornerstone of development, with manufacturing as the engine for export growth, employment creation and income generation. This chapter will look at the experience that Kenya had under Import Substitution trade policies and especially the effects it had on Foreign Investment and Multinational firms, Income Distribution, Employment and ISI Institutions.

3.1 Foreign Investment and Multinational Corporations

Foreign Investment and Multinational Corporations in production followed the arrival of British settlers who began to move into the interior in the late 19th century. Almost without exception early manufacturing arose out of the entrepreneurial activities of British and Asian settlers beginning with basic products such as timber, flour milling and construction. But with the increasing role played by commodity production in agriculture, foreign investment made its entry production in the primary sector, accounting for significant shares in tea and coffee production and wattle processing.

At independence, Kenya was ambitious to diversify her foreign investment by attracting FDI from different countries in the world. Unfortunately, during this period of transition to independence, the country was faced with capital disinvestment problem and severe outflow of foreign capital was taking place following the eroding confidence among foreign investment resulting from the intended indigenisation of economic activities contained in the 'Kenyanisation' policy which aimed at increasing employment opportunities for Kenyans through replacement of non-citizens. Therefore in order to revert this process and to attract more diverse foreign investment, the Kenyan Government decided to enact the Foreign Investment

Protection Act (FIPA) in 1964, which guaranteed foreign investors the right to transfer profits, dividends and capital out of the country.

Under FIPA Act, the foreign investors were assured that their firms would not be compulsorily acquired under the indigenisation policy, which was launched upon independence (Langdon, 1978:230). This was also supported by Sessional Paper No. 10 of 1965 entitled: African Socialism and Its Application to Planning in Kenya which reaffirmed the government's commitment towards attracting more foreign firms with no nationalisation unless state intervention was deemed necessary to prevent wastage of raw materials.

It is no wonder then that Foreign Investment and Multinational Firms were engaged in Kenya’s industrial development following a generous open-door policy to foreign firms by the Kenyan government. This was emphasised in its 1979-1983 development plan that stated:

> Government will continue to maintain that open door policy to foreign capital. Foreign investment will be encouraged particularly in priority industries and to provide adequate measures to safeguard such investments (Development Plan, 1979-1983:335).

As a result, Kenya attracted a substantial amount of FDI in the period1960s - 1980s where in most cases the investors were subsidiaries of wholly owned MNCs and occasionally joint participation between MNCs and the state. A large share of this investment went into Import Substituting Industries.

Therefore from 1966 onwards international capital poured into Kenya and became dominant particularly in large scale manufacturing. According to the Census of Industrial Production undertaken in Kenya in 1967 and covering 607 establishments, it was noted that 433 of these establishments with 50 or more employees were mainly or wholly foreign owned by non-citizens. Detailed analysis of the Census of Industrial Production data further revealed that these enterprises accounted for 71% of the total value-added in Kenya's manufacturing sector and 72% of the total sales for manufacturing firms employing 50 people and above, which in turn, generated more than 82% of the gross manufacturing product (Eglin, 1978:433).

The MNCs in Kenya were involved in a wide range of products such as petroleum refining, food and beverages, industrial chemicals, pharmaceuticals metal products

(Langdon, 1978:142). In the table below we see the share of this foreign investment and how it changed in the period between 1966 and 1976.

Table 3.1 Foreign ownership of large scale manufacturing 1966-1976

Type of firm	**1966**			**1976**				
	Total capital	**Total foreign owned capital**	**%**	**Total capital**	**Total foreign capital**	**%**	**Growth of capital 1966-1976**	**Growth of foreign capital 1966-1976**
Food	14876072	7250526	48.7	45863454	13253442	28.9	308	183
Textiles	2150727	1223597	56.9	14849560	8393968	56.5	690	686
Furniture	435660	5000	1.2	1264697	189546	15	290	3791
Paper	528486	5291	1	8104734	3279144	40.5	1534	61976
Chemicals	8628955	7698132	89.2	19121916	13607520	71.2	222	177
Pottery	2241450	1126352	50.3	2337000	1036980	44.4	104	92
Basic metals	300004	100003	33.3	2100000	571725	27.2	700	572
Metal products	1814776	1154340	63.3	9713301	4438560	50.9	480	385
Manufacture	103770	73614	70.9	443008	143459	32.4	427	
Total manufacture	31079540	18636831	160	44914116	19627468	43.7	331	241

Source: (Central Bureau of Statistics)

The Table 3.1 above shows a study that was undertaken by Kaplinsky on the ownership of all large scale manufacturing showed that between 1966 and 1976 which showed some significant changes that occurred in foreign investment where the share of total issued capital, owned by foreign firms, declined from 59.3% in 1966 to 42% in 1976. This reflected a selling off of a minority stake holding to local firms, the growth of small indigenously owned enterprises and the increasing role of parastatals in joint venture with foreign capital (Kaplinsky, 1981:443)

This clearly demonstrated the significance of foreign investment in the early decades of Kenya's independence and as noted by Vaitsos:

> Long-term capital inflows, especially by TNCs, strongly influenced the evolution and growth of modern manufacturing and services during the first decade after independence as confirmed by macro, sectoral and sub-sectoral evidence (Vaitsos, 1991:55).

However, the merits and demerits of Foreign Investment was assessed in terms of the impact on several economic factors in terms of choice of production techniques, type of products, use and creation of employment, and there involvement in the determination of the extent and structure of protection to be granted under the Import Substitution Industrialisation period (Kaplinsky, 1978:198).

The implication of foreign investment in Kenya was the large outflow of profits and dividends. MNCs tried to maximize accumulation of capital and profits at a global level. Therefore their operations diverged from the needs of national society and also contradicted national government policy goals. As Stewart noted:

> One of the dilemmas facing an economy pursuing a strategy of encouraging foreign investment from abroad. Once foreign assets form a sizeable proportion of the total stock, the potential dividend outflow also forms a sizeable proportion. Hence a high rate of growth of foreign investment must be maintained to offset the potential outflow. The maintenance of such a rate of growth leads to further potential, dividend outflow and hence the need further to encourage foreign inflow (Stewart, 976:87).

Another effect of MNC's operations in Kenya was the choice of technology in the industry where foreign owned subsidiaries tended to be more generally capital intensive than their locally owned counterparts. However the higher capital intensity of foreign owned subsidiaries was a reflection of the sectors in which they predominated if comparison was made between local firms and foreign companies in the same industry. A survey of several British MNC's in Kenya revealed that "parent corporations were anxious to control the generation of a new technology in their subsidiaries and that, particularly in the consumer and intermediate goods sectors, the subsidiaries are largely dependent upon parent companies for the generation (and choice) of new technology" (Kaplinsky,1978:11). However the ILO report on Kenya observed that foreign subsidiaries made use of more labour intensive techniques noted that:

> Perhaps surprisingly, in view of the conventional wisdom that foreign owned firms will duplicate western methods, it was typically a subsidiary of a foreign firm which carried out labour intensive adoptions and was more willing to use older equipment.

Large MNC's successfully gained protection privileges in bargaining with government institutions. According to Langdon the oligopoly perspectives of multinational companies suggested that they sought their investment and available evidence showed that this was their primary objective in negotiating entry into African countries. He further argued that even when negotiation took place in Kenya, the effect was not necessarily to constrain the MNC sector, but to obtain economic privileges, particularly freedom from external (and sometimes internal) competition and from duties on their imported machinery and inputs (Langdon, 1976:122-124).

In fact one of the reasons that made foreign firms invest in developing countries including Kenya, was that they could exploit the existing imperfections in the factor and product market giving them monopolistic advantage and these is due to the fact that MNCs were not affected by market price competition due to the high levels of protection. Hopcraft set out the negative results of the heavily protected economy, that import bans or controls leads to distortions in prices structure by increasing the domestic price of non-essential products. Hopcraft noted that:

> The problem comes not with items but with irrational distortions that bias incentives toward inward looking luxury goods production. The bias is simultaneously towards import –intensive, capital intensive lines and away from internationally efficient, portable lines (Hopcraft.1972:6).

Also the tendency to change consumer taste in the host country towards the particular branded products which they produced at home was provided by Langdon in his 1973 survey of his `soap case study' where he found out that the locally owned firms were being forced to replicate the products and production techniques of the foreign owned subsidiaries. Therefore local entrepreneurs, mostly the Kenyan Asians, were unable to compete with the foreign firms in the import substituting consumer industries (Langdon, 1976:55)

Since the rationale of Import Substitution Industrialisation policy was to generate further industrialisation through backward linkages, evidence of these was small in that western type of products blocked off many potential linkages to an integrated national economy. In his sample of import substituting firms Langdon found that 97.9% imported more than 70% of their machinery,79.2% imported more than 95% of their machinery and 68.8% imported more than 70% of their raw materials. He concluded that these were small backward linkages into the capital goods sector (Langdon, 1975:213).

The MNCs further tended to contribute to a polarisation of the national labour market by paying relatively high wages and salaries to their labourers and managerial staff. Langdon (1976) found that Kenyan executives were given salaries based upon the global intra corporation salary scales, rather than on Kenyan per capita income. He also found that wages were higher in foreign owned soap industries than in their locally owned counterparts $73 per month versus $36 per month in 1972 (Godfrey and Langdon, 1976:51)

Therefore it seemed unlikely that multinational corporations were contributing to the process of genuine industrial development in Kenya and as Kaplinsky (1978) remarked:

> It is one thing to highlight the negative characteristics of this foreign investment, but the question remains whether the host state or an indigenous bourgeoisie would have undertaken similar or equivalent investments and, if so, whether the impact of their investment would have been substantially different. The nature of the political formation in Kenya with a passive state, a fleeing Asian industrial bourgeoisie and a slowly emerging African industrial bourgeoisie makes it difficult to envisage industrialization without the extensive and relatively unrestrained participation of direct foreign investment (Kaplinsky, 1978:20-21).

3.2 Income Distribution

Unlike other sectors, industrial growth relieves fluctuation and encourages stability of incomes, government tax receipts, and so on. At independence the structure of Kenya's manufacturing sector reflected the policy of import-substitution. It also reflected the colonial inheritance of a very Uneven Distribution of Income. As the I.L.O. 1972 report put it:

> The inequality in incomes had led to a pattern of demand which in turn had established a structure of supply to meet it. The supply of goods from local production and from imports was sharply divided between suppliers to meet the high income luxury market and those for the low-income market, primarily basic goods for Africans and some Asians (I.L.O., 1972:86).

Protection from outside competition had the effect of raising manufacturing prices and profits to the detriment of domestic consumers in that it did not allow ISI to stimulate export-led growth and development as well as the development of technological capacity.

With resources focused on industrialization, agriculture was neglected. Necessary investments in agricultural infrastructure were not made as capital was directed to the industrial sector. Labour also gravitated toward urban industrial regions, pressuring cities. In some cases the decline in agricultural production meant an increase in the quantity of food imports, further pressuring income distribution. The neglect of agriculture weakened not only a source of profits but also the food security of nations.

Therefore much of the gains realized in the manufacturing sector, "as a result of the distorted price structure (inherent in an import-substituting policy) was interpreted into losses for other sectors of the economy, in particular agriculture hhappened because protection raised the prices paid for manufactures while depressing those for farm produce.

A difference was created in the domestic terms of trade between industry and agriculture, and the external terms of trade, which show the same price relations but at world prices. The net result was a redistribution of income from agriculture to industry.Import substitution policy therefore enhanced inequalities of income between agriculture and industry. The relative loss, suffered by farmers, was measured by the evolution of the terms of trade between these two sectors. Available data suggested that in the years 1969 - 1976 period, prices for farm products had risen more slowly than those of manufactured goods. This implies that farmers have subsidized industry during most of that period (Kaplinsky, 1978:6). There was also a substantial net capital outflow from agriculture to industry which rose from K£ 50 million in 1964 to K£ 124 million in 1974. During 1961-74 over K£ 680 million was transferred out of agriculture (Sharpley, 1979:560).

Therefore Growth in one sector, with limited spread effects to the rest of the economy, contributed little to the objective of engaging more people in productive activities. Although the agricultural sector provided certain inputs for industry, the reverse supply linkages between industry and the agricultural sector only developed to a limited extent. In fact, agriculture suffered from the policy of import substitution through an overvalued exchange rate, through monopoly pricing in the manufacturing sector and through surplus transfer to the manufacturing sector.

In addition, the growth of income resulting from the policy had the effect of increasing leakages into other imports; it was mostly urban dwellers with a high import component of demand that benefited most from this "modernization." Furthermore, it was not unable to create enough jobs for the masses in the urban areas nor was it able to change the emphasis on exports of primary goods. The large net capital outflow from agriculture contributed to a widening of urban-rural imbalances which enhanced migration into urban areas.

Another related effect of the Import Substitution Industrialization was the favoring of profits over wages within the manufacturing sector with a resulting increase in inequity of income distribution. Since import substitution initially focused on the production of final consumer goods it created a demand for a variety of new imports to be used in production processes. This led to an increase in dependence on imports with even more serious consequences in the event of foreign exchange shortages.

Statistical data showed that during 1966-1970, average real wages rose gradually until 1973, but dropped sharply in 1973-1976. The 1978 Economic Survey estimated that average real wages decreased by 11% during that period and also suggested that wage earners in the lower income group suffered a larger fall in their real wages than those in the middle and upper income groups' (economic survey, 1978:62). The unequal income distribution effects, as a result of the advocated industrial policy was as sine qua non for capital formation and an inevitable outcome of development in the early stages of growth.

Income data for enumerated employees reveal that in 1961 about 22,000 Europeans (45 of total employment) earned one third of the total wage bill set at K £ 90 million in that year. Average European earnings were 18 times the average African earnings. By 1970 the reduced number of European employees (14,000) still accounted for 18% of the total wage bill, while average income for this group was still12 times as high as the average income of the African employee (Statistical Abstract, 1971:187-196).

Past attempts to estimate the overall income distribution in Kenya yielded values of the Gini coefficient (a measure of statistical dispersion intended to represent the income distribution of a nations residents. The coefficient varies between 0 which reflects complete equality and 1 which reflects complete inequality which is widely used as a measure of income) 0.60 which showed Kenya's income distribution to be unequal. In 1969, the poorest 50% of the population received some 14% of total income while 56% accrued to the richest 10% found a Gini coefficient between 0.50 and 0.55. Therefore the import substitution policy which inherently favoured the urban industrial sector led to a less unequal distribution of income (Hazlewood, 1978:85).

3.3 Employment Creation

The connection between industrial growth and expansion of employment is the most widely used argument for industrialisation. In Kenya, the manufacturing sector is second to agriculture in the creation of employment opportunities. Since independence the creation of productive and sustainable employment opportunities has remained a central policy priority of the Kenya government. A number of policy interventions were formulated and variously implemented in that period. Key among these policies was the growth-oriented development strategy augmented by a high wage and Kenyanization policies adopted at independence. It was believed that long-term and sustained high rates of economic growth would facilitate generation of employment opportunities at rates higher than the proportionate increase in the labour force (Development plan, 1966-1970.). Therefore one of the main objectives of Kenya’s Development Plans was to provide employment for its rapidly expanding labour force.

Unemployment and Underemployment have been identified as Kenya’s most difficult and persistent problems and the Kenyan government has continuously articulated the need to create sufficient employment opportunities to absorb the country’s growing labour force. One of the earliest attempts to identify the nature and causes of unemployment in Kenya was stated in the 1970-74 Development Plan (Republic of Kenya, 1969). In this Plan, the government identified three “kinds” of unemployment namely: “urban unemployed, rural unemployed and educated unemployed and underemployed”.

The causes of such unemployment were identified as high labour force growth rates, use of modern capital-intensive technology and attendant increase in labour productivity in addition to high wage. According to the Plan, the identified causes of Kenya’s unemployment were linked to inadequate training and consequent lack of skills, shortage of land and other resources, rapid expansion in school enrolment, skills mismatch and rural-urban migration.

Another stab towards understanding the nature and causes of unemployment in Kenya was made in 1983 in the Report of the Presidential Committee on Unemployment (1982/83) and the Sessional Paper No. 2 of 1985 on Unemployment, which provided the government’s official response to the Committee’s Report. The Committee’s Report considered the problem of unemployment as one of lack of access to income earning opportunities, whether in wage or self-employment. Both the Report and the Sessional Paper identified the major causes of unemployment in Kenya as rapid growth of the labour force, low economic growth rate, job selectiveness, seasonality of some of the industries and skills imbalance. Others were inappropriate technology and failure of development programmes to focus on areas with greater employment potential.

Despite all these interventions, creation of adequate, productive and sustainable employment in Kenya continues to be the greatest economic challenge for Kenya and this was due to the policies that were pursued during and after the colonization of Kenya. Therefore to understand the employment crisis in Kenya it is thus necessary to consider the extent to which the structures that were in place at the end of colonialism predetermined the pattern of development that would emerge in the post-independence era.

Kenya's most pressing problem was unemployment, the roots of which were sown in the colonial period. In a memorandum on the growth of the economy in 1963, the Ministry of Finance and Economic Planning argued that with a population growth rate of 3 per cent, Kenya had one of the highest population growth rates in Africa and, indeed, the world. The impact of this growth was particularly apparent in Kenya's ten largest urban centers, which had witnessed an average annual population growth rate of 5.8 per cent. Given Kenya's large reservoir of unemployed labor, one of the challenges facing the government was the absorption and productive utilization of this ever increasing labor supply (KNA AE 3/259 1954:1).

Between 1963and 1968 the share of agriculture in Kenya declined from 39.5% of the GDP to 34.85% due to the effect of the economic strategy of the import substitution emphasized in the 1964-1968 development plan because more emphasis was placed on manufacturing than agriculture. This was after the 2nd world war and the decolonization eras which witnessed the expansion of an industrial base with the proliferation of import-substituting industries.

Also the inherent 'side effects of massive surplus transfers abroad and the intensification of import dependence caused by the implementation of modern capital intensive techniques that is the nature of the product-mix, these are industries that are mainly owned, finished and managed by foreign companies, reinforcing dependence on extreme capital skills and technology. Moreover, because imported equipment was made artificially cheap (through low or non-existent import duties and an overvalued exchange rate) it becomes attractive for companies to import their requirements rather than to obtain them from local suppliers. This not only aggravated the country's balance of payments, but it also stimulated the use of capital-intensive techniques, which in turn had a detrimental effect on the amount of labour used in the production process. Capital-intensive technologies are in general inconsistent with widespread unemployment and rapid population growth.

In 1972 an I.L.O. team produced an important report which extensively discussed a wide range of issues relevant to Kenya's pressing unemployment problem. Early gains in per capita GDP had declined since 1972, due to poor ISI policies, which had adverse effects on industrial development and competitiveness and a failure to position the country to unfolding global changes.

From Table 3.2, Appendix II, shows that in 1972-1977 the manufacturing sector expanded at an average rate of 10% per year despite a significant slowdown in 1975 following the oil crisis. In 1972 employment in the manufacturing sector rose from 84,804 to 117,979 in 1977 which represented an average growth rate of 6.9%.

Table 3.3 Wage Employment in the Public Sector, 1973-1976

`000's	1973	1974	1975	1976
Central Government	135.7	139.5	142.4	153.3
Parasternal Bodies	76.1	101.1	110.8	117.0
Majority Control by the Public Sector	10.0	12.6	15.3	11.8
Local Government	27.0	27.8	26.2	25.5
E.A. Community General Fund	3.8	4.2	3.7	4.2
Railways Corporation	23.4	21.6	21.2	21.0
E.A. Harbours Corporation	3.3	3.2	3.2	3.7
E.A. Posts and Telecommunication	9.4	9.3	8.7	8.7
Other E.A. Public Bodies	1.1	1.1	1.2	1.1
Total	298.9	330.1	342.4	356.4

Source: (Economic Survey 1977:42)

The Table 3.3 above show that the decrease of 1 per cent in numbers in paid employment in 1975 was particularly worrying. In 1976, however, there was a welcome and much needed turnaround: paid employment in the private sector increased by 5.1% and in the public sector by 4.1%. Despite these increases, urban unemployment and under-employment almost certainly remained high.

Table 3.4 Wage Employment in the Private Sector by Industry, 1973-1976

	1973	1974	1975	1976	% Change 1975/1976
Agriculture and Forestry	220.6	213.7	195.8	197.7	1.0
Mining and Quarrying	2.4	3.1	2.7	3.1	14.8
Manufacturing	73.3	81.7	82.1	87.7	6.8
Construction	23.7	29.3	24.6	30.1	22.4
Trade. Restaurants and Hotels	44.7	55.4	51.7	57.9	12.0
Transport and Communication	16.6	17.6	16.5	18.0	9.1
Finance, Insurance, Real Estate and Business Services	17.1	18.7	20.2	20.9	3.5
Community, Social and Personal Services	64.1	76.7	82.9	85.4	3.0
TOTAL	462.4	496.2	476.6	500.8	5.1

Source: (Economic Survey 1977:43)

From the Table 3.4 Kenyan economist noted that manufacturing employment in Kenya failed to grow at approximately the same rate as industrial output. This to say was due to the existence of 'capital intensive production techniques' in the industrial sector, induced by artificial cheap capital (through capital Investment allowance, accelerated depreciation allowances and refund of customs duty on capital goods imports)resulting in high capital-labour ratios. Thus slow growth of labour absorption was attributed to capital labour substitution stemming from existing unbalances in the relative prices of capital and labour" (Maitha 1973:49-50).

Therefore the extent, to which the capital-labour ratio could have been altered, depended on the value of the elasticity of substitution between the two production factors. Zero elasticity means no substitution is possible. This measure (employment elasticity) serves as a useful way to examine how growth in a country's GDP and growth in employment evolve together over time. Employment elasticity can also provide insights into trends in labour productivity and employment generation for different population subsets in a country, and assist in detecting and analysing structural changes in employment. Kenyan manufacturing firms and showed that by international standards, Kenyan firms are relatively labour intensive, and that increases in labour productivity were linked more to the use of excess capacity and improved organisation and training of labour than to increased capital labour ratio's, capital intensity (Pack 1972,320).

Table 3.5 Growth in Employment, Labor cost and Value-Added in Kenya's Machinery Industry (1964, 1976-82)

	Employment		Labour Costs		Value Added	
Year	No's	index	K(000)	Index	K(000)	Index
1964	316	82	161	102	159	73
1976	386	100	299	100	413	100
1977	528	137	360	112	439	99
1978	591	153	486	139	671	139
1979	586	152	549	148	1000	195
1980	825	214	779	188	1446	256
1981	736	191	871	190	1562	247
1982	539	140	697	140	1238	179

Sources: (Central Bureau of Statistics).

To address the employment challenge, the government has, over time, developed three broad employment creation policy approaches. These approaches are the Kenyanization policy, which was pursued during the first decade of independence; active labour market policies undertaken in the second and third decades; and a return to macro measures aimed at creating an enabling environment, and private sector-led economic growth for employment creation, which have been followed from the third decade to date. These policy interventions have had varied employment outcomes. However, it remains clear that creating sufficient employment still remains a major problem in Kenya.

3.4 Institutions participation in ISI

During the colonial days, Africans served as labourers in the commercial firms owned by the foreigners and were not allowed to participate in any form of trade or manufacturing activities neither could they obtain any form of loan or financial credits to support and nurture their ambition into either trade or entrepreneurship. During that period were not even allowed to acquire and/or own land title deeds, which could serve as collateral with existing financial institutions. This notwithstanding, the existing Banks viewed Africans as depositors but not as potential borrowers claiming that Africans had a different mentality on repaying loans as they failed to see it as an obligation. The banking style relied to a large extent on social interaction with British banks funding British firms, Asian banks funding Asians and since there were no African banks, no one had the will to extend loans to indigenous African firms (Jorgensen, 1975:90).

As a result of this disequilibrium in the economic setting, there was a need to indigenise commerce and manufacturing industry at independence. The Kenyan Government established a Kenyanisation of Personnel Bureau (KPB) with an aim to Africanise senior positions in the civil service including parastatals and to also regulate the number of foreign workers in the private sector by introducing work permits. The greatest effort by the government towards indigenisation took place in the creation of support institutions. Kenya enacted and implemented several industrial promotion policies within ISI framework particularly meant to stimulate and strengthen the industrial base and especially within manufacturing sector; therefore several development finance and industrial promotion institutions intended to cater for small and large scale firms were established.

Ideally, these institutions were supposed to play a facilitation role in industrial development by advancing indigenous manufacturing technology; assisting in technology transfer; offer industrial training, promote Industries that exploit locally available raw materials; promote linkage (e.g. between locally owned firms and

MNCs); offering financing capital, enhance production of goods that are competitive for exports. Such institutions included Industrial and Commercial Development Corporation (ICDC); Development Finance Company of Kenya (DFCK); Industrial Development Bank (IDB); Kenya Industrial Estates (KIE); Kenya Bureau of Standards (KEBS); Kenya Industrial Research and Development Institute (KIRDI). Therefore this study will examine the role played by these institutions during the Import Substitution Industrialisation period.

Formerly Industrial Development Corporation (IDC), ICDC was mandated to promulgate industrial capabilities by promoting participation of indigenous Kenyans in industrial and commercial development, encouragement of Industries with capacity to earn foreign exchange, facilitate rural development, increase use of locally available raw materials, create job opportunities and enhance diversification of the economy. As the main government agency for stimulating small industrial and commercial enterprises under African ownership and management, the industrial and commercial development was facilitated through: venture capital finance; export financing; management, support and consultancy services and administration of funds on social-economic programmes at agreed terms.

However, despite a relatively good performance in industrial ventures in Kenya ICDC was criticized for failing to meet one of its major objectives to reach the small entrepreneurs. These was because of the security that was required for ICDC's loans which tended to favour the already established entrepreneurs and to those already owning other enterprises and therefore it failed to promote participation of indigenous Kenyans in industrial and commercial development effectively (ICDC, 1966:1).

The Development Finance Company of Kenya was another agency through which the government participated in the industrial sector. Established shortly before Independence its main role was to stimulate the flow of private investment, indigenous or foreign, by providing loans or share capital for large industrial ventures. However DFCK was faced by several constraints in that the Kenyan Government allocations of development finance institutions were virtually eliminated following a government policy to stop funding parastatals and this made the institution collapse with time without having done its role in the participation of industry in Kenya.

Industrial Development Bank, another financial institution established in 1973 to further industrial and economic development by promoting, establishing, expanding and modernising of the medium and large scale industrial enterprises, including mining, agro industries, engineering, tourism and transport and shipping. But due to the balance of payments problems in 1980s, the government's role as the chief financier declined forcing IDB to look for alternative sources of finance.

Kenya industrial estates was established in 1967 so as to encourage entry of indigenous firms into the manufacturing industry. This was also formed as a supportive institution to extend assistance by a way of offering technical and financial support to indigenous firms ranging from micro enterprises commonly referred to as Jua Kali artisans to modern scale industries. However despite the effort made by KIE, its perceived role to promote industrial development was not been achieved. Although still in existence operations of KIE are still faced by many constraints, finance being one of them lack of adequate capacity to offer effective technological training and supervision and the lack of enough working capital required for KIE's recurrent expenditure given the reduced financial support from the government as well as from donors and international funding agencies.

The Kenya Bureau of Standards (KEBS) established in 1974 to promote and make manufactured goods competitive in both the local and external markets by raising quality, was a regulatory body mandated to deal with strengthening of manufactured goods and services through the application of standards and by providing technical advice on quality management in Kenya. Nevertheless, despite the achievements made so far, there were still many problems facing KEBS. Inadequate funding to facilitate training, dissemination of information by a way of exhibiting in show grounds and others such as trade exhibitions, seminars and symposia to educate the manufacturers as well as consumers on standardization work and increase their awareness. There was extremely low patronisation by manufacturers blaming it on lack of capacity such as recent metrology techniques coupled with few skills available in terms of professionals required.

Kenya Industrial Research and Development Institute was established in 1979 to promote the national industrial innovation process through the development of a sufficient national capacity in disembodied and embodied industrial technologies for the attainment of self-sustaining industrialisation process. However internal constraints have hindered KIRDI from achieving its full potential. The unidirectional Staff mobility running from KIRDI to the private sector or universities makes retention of trained staff difficult. The effect of these is that the productivity of the institute is reduced in terms of research conducted or services offered to the industry. With the activities of KIRDI funded by the government, it is obvious that this funding may not be enough as this is usually the case with the institutes funded by the Government. Due to lack of working capital, it becomes difficult to purchase adequate machinery and facilities for use in the laboratories or stock and maintain library.

All these institutions initially established to help in Kenya's industrialisation, were somewhat biased towards foreign owned companies and these made local industries uncompetitive with the other foreign owned industries.

CHAPTER FOUR

STUDY RESULTS

4.1 Introduction

This section of the research study examines the various responses to the questions that were posed to the targeted population with regards to the research study.

4.2 Response to Questions

Kenya's current industrialisation policies is the National Industrialization Policy framework which recognises that Kenya is primarily an agricultural based economy with fairly skilled human resource base and strategically located to serve as a regional industrial hub and that the country is also endowed with natural resources that can be tapped through value addition for the benefit of the whole country.

The policy is intended to provide the road map for development of the industrial sector which addresses issues affecting the industrial sector by including broad-based strategies that would provide the sector with meaningful opportunities to realize its full potential. The policy also provides a broad framework within which all stakeholders, including the public sector, private sector, and civil society and development partners will contribute to industrial development. An implementation mechanism is inbuilt in this policy. The priority sector indicated in these policies includes Agro-processing, Agro-machinery, Electrical and Electronics and Information Communication Technology.

Through the National Industrialisation Policy Framework, there has been the development of Micro and Small Enterprises (MSEs) which are playing a vital role as it provides opportunities for 74% of the total employed. Development in this sector is anchored on the Sessional Paper No. 2 of 2005 on Development of MSEs for Wealth and Employment Creation for Poverty Reduction.

According to the research findings, respondents believed that Import Substitution Industrialization did not succeed in Kenya like in other western countries because in Kenya it reduced domestic competition, and shifted incentives in favor of the domestic market and against export production. It also distorted incentives between manufacturing imports and exports, and implicitly played out as a strong subsidy for manufacturing activities at the expense of other sectors. The inward looking nature of ISI also undermined the competitiveness of Kenyan products in the export markets. Furthermore, the ISI laid little emphasis on the production of intermediate and capital goods, so that the expansion of manufacturing precipitated a rapid increase in demand for imports of intermediate and capital goods by an increasing group of manufacturers of consumer goods. An over-valued exchange rate made imported capital goods relatively cheap, further reducing the incentive for domestic production. It also discouraged technological adaptation, research and development.

Unlike the newly industrializing countries, which industrialized under protected domestic markets, Kenya is attempting to achieve the same result with a liberalized market. In addition, whereas the current newly industrializing countries industrialised in high growth regions, Kenya is attempting to industrialise in a region with a tradition of low growth.

Also Kenya's Import Substitution Industries did not transfer technology to the domestic economy in any significant way mainly because Kenyans did not occupy managerial positions in Multinational Corporations and also because personnel were trained to implement decisions already made by Multinational Corporation headquarter thereby leaving little scope for employee's initiative. There was also the issue that during the ISI period emphasis was more on setting up industries rather than on building dynamic capabilities to allow firms to be competitive and purse export markets.

Under Import Substitution Industrialization there was the commercialization of the economy which created the basis for consumer demand for manufactures; indeed, it was also in this period that a change in the domestic agenda with greater emphasis on redistributing the benefits of economic growth, equality and poverty reduction was introduced. The growth of agricultural production also augmented incomes and stimulated the purchasing power of local consumers. That is, industrialization would raise productivity in agriculture by increasing the demand for agricultural produce and making available tools and equipment needed to improve agricultural techniques. The spread effects induced by industrial expansion would affect other parts of the economy. New factories would not only need labor, but also machinery, raw materials, infrastructure, transport and communication.

The Ministry of Industrialization and enterprise development has been exploring new horizons for attracting foreign direct investment into the country by promoting regional and global market access to Kenya's products and services in order to enhance equity and open up greater wealth creation opportunities to its citizens.

On promoting local industries, the Ministry is working with county governments to set up industrial parks for Jua Kali artisans and to formalize the sector in order to boost access to credit. By doing so the Ministry hopes to make counties the base for industrial growth and execute various initiatives among them is to rebrand the Jua Kali name in a bid to dignify the profession and accommodate innovations from institutions of higher learning.

In the first phase, the Ministry of Industrialisation will selectively encourage labour-intensive, resource-based and light manufacturing industries, where the country enjoys comparative advantage. To be targeted in this phase are primarily small-scale industries that use locally available raw materials and simple labour–intensive technologies and are therefore capable of generating employment. Examples are agro-based industries like: textiles; horticultural processing; skins, hides and leather; tea, coffee and sugar processing; and building and construction, such as brick manufacturing.

The ministry’s mandate is to provide a policy framework and an enabling environment for industrialisation and enterprise development. The ministry has a strategic plan the MIED (2013-2017) whose foundation is to transform Kenya into a middle income industrialising economy. The main goal of the plan is to accelerate the momentum of growth and employment creation in the sector by facilitating and supporting manufacturing and other enterprises in order to improve their efficiency, build up their capital and venture into manufacturing.

Therefore the Ministry of Industrialisation and Enterprise Development role is laid down in its objective to Kenya’s industrialisation by accelerating and sustaining the momentum of industrial growth, mobilise foreign and local investments into the sector, contribute to the envisaged 10% growth in GDP per annum and contribute significantly to employment creation.

Lack of a clearly defined National Industrialization policy has negatively affected the industrialization process in Kenya. The problem has been compounded by the existence of numerous laws, a weak legal framework and overlapping ministerial mandates, which has culminated into uncoordinated and slow industrialization in Kenya. This has led to a scenario where unemployment outstrips wealth creation; resulting to low demand and rapid growth of mitumba business.

Stiff competition in that many local industries are struggling to compete with the many industries and especially the foreign industries that produce similar goods to the local ones and which are cheaper. For example the textile industry which faces competition from mitumba.

Preference of imported good over local goods. Most Kenyans think that goods produced in the country are normally of inferior quality and therefore they prefer to buy imported goods.

Inadequate raw materials in that many industries are experiencing shortages in raw material in Kenya. For instance the lack of coal and iron has hindered the growth of heavy industries and the inadequate supply of cotton has led to the closure of many textile industries.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS OF THE STUDY

5.0 Introduction

This chapter discusses the summary, recommendations and the conclusions of the research study.

5.1 Summary

Post independent Kenya inherited a policy framework for industrial development from the colonial era, notably the use of protectionist, so as to stimulate local industrial development. This had a profound influence in the direction that development policy in Kenya took and also established a framework for industrial development.

The Import Substitution Industrialisation policies that were adopted in Kenya to some extent developed an industrial sector as was exemplified by the fact that during that period of intensive Import Substitution, the manufacturing sector grew with a constant increase in its share in Gross National Product and therefore there was the reduction in the dependence on primary production.

However ISI failed due to external factors beyond the control of Kenya's policy makers. For instance the oil crisis of 1973 which resulted in the escalation of cost of production and exerted pressure on the balance of payments with adverse effects on the availability of imported raw materials and equipment. Therefore due to an absence of a well-articulated industrial policy, few measures were implemented to move the economy to the next stage of the strategy which would have facilitated in the production of manufactured exports.

The economic problems that faced Kenya made the government change the industrial strategy from ISI to an export-led industrialisation. These were evident from the development plans and policy documents published during the late 1970s and early 1980s. The fourth development plan (1979-1984) for instance advocated for an open strategy for the industrial sector and which outlined policies designed to create an enabling environment for industry through increased reliance on market based incentives and less regulatory structures. However despite the need to promote exports, there was lack of commitment in the implementation of the recommended measures and this was attributed to policy constraints facing policy makers. This was the same case with ISI whereby lack of commitment and policy's that were in favour of the domestic market led to its failure.

5.2 Conclusions

Policy responses can be categorised into two: preventive and curative. The industrialisation interventions in Kenya appear to have mostly been curative in nature. In this case, the policies that were implemented after independence and which attempted to identify the situation at that time tried to deal with the problem of industrialisation. Therefore there is need for Kenya to shift the emphasis from curative to preventive interventions. In this case, focus should be on analysing and understanding the determinants of industrialisation in the country and devising strategies to deal with it. This makes it imperative in that the challenge facing industrialisation in the country is broken down into its main causes and specific strategies designed and implemented. This will ensure proper and effective policy targeting and response.

Also what sets developing countries apart from the developed countries was the duration of ISI that they took in their countries. Most of the really successful late-comers went through a brief transitionary of ISI phase before embarking on an outward-oriented trade strategy. The socio-economic context inherited at Independence had a profound influence on the direction that development policy took. The colonial period left the post-independence state with a massive developmental deficit to fill. More significantly, it saddled the Kenyan government with a disquieting unemployment situation. It was the search for a panacea to this problem that precipitated the radicalization of policy and the new emphasis upon forced industrialization. However, the intensification of this process in the context of economic crisis was a product of the dynamics of independence.

The experience with ISI in Kenya suggested that an industrialization programme that focuses exclusively on the domestic market and does not have an export promotion component is likely to run out of steam. Small size of domestic market in most African countries cannot sustain an industrialization programme without access to external markets and external markets provide opportunity to expand production, reap the benefits of scale of economies and provide access to foreign exchange.

Technology and innovation are important in building the capabilities of domestic firms and preparing them to compete in export markets for medium and high technological manufactures. Not much attention was paid to the building of technological capabilities to produce medium and high technology goods and one needs to establish and fund institutions for quality standards and testing, research and development.

Therefore ISI did to some extent develop an industrial sector as was exemplified by the fact that during the period of intensive Import Substitution the manufacturing sector grew with a constant increase in its share in GDP. However this industrial growth was not self-sustained and this was due to the fact that the beneficiaries of industries in Kenya were multinational corporations who remitted most of their profits abroad.

5.3 Recommendations

Kenya's past has witnessed development of national and sectoral policies aimed at facilitating industrialisation. However, while some of the policies have been noble, more often than not, they have not been effectively implemented. In situations where policies have been implemented, not much monitoring and evaluation has been undertaken to assess the achievement of outcomes, identify the strategies that may have worked, isolate the non-viable strategies and learn from the possible mistakes.

It is hence, critical that for effectiveness, Kenya should put a little more emphasis on implementation of the identified industrialisation promotion policies, and develop a framework for monitoring, evaluation and learning that incorporates both state and non-state stakeholders. Further, it would be crucial for the country to develop and implement a mechanism or framework to coordinate government and stakeholder interventions and exploit synergies towards industrialisation. At the same time, the linkage between policy makers, universities, research institutions and industries should be strengthened to promote relevance of research, trigger uptake of research outputs for improved product development and organizational competitiveness.

There is a strong need for effective nurturing and promotion of productivity and organizational competitiveness at all levels of the Kenyan economy (national, sectoral and individual). To facilitate this, the government should, in collaboration with the social partners, development partners and other stakeholders, strengthen the policy, legal and institutional frameworks of the Ministry of industrialisation so as to undertake the task of productivity promotion and management.

Along the same lines, a national productivity drive should be established. This should enlist participation of government, employers, workers, and all other stakeholders. A specific month and week should be designated annually for the drive. During this time, the concept of productivity and productivity improvement should be popularised. To recognise organizational and individual productivity improvement initiatives, an award scheme may also be established and implemented.

The link between agricultural and industrial sectors should also be strengthened by creating incentives for more domestic processing and product finalisation activities. This in turn requires incentives for moving further up the value chains of different agricultural systems in order to optimise the employment and wealth potential of different value adding nodes. In that process, it is crucial to put mechanisms in place for the long term financing of agro-processing activities and other activities that make use of domestically available resources. The link between agriculture and industry further holds the key to addressing regional inequalities in Kenya. Many of the processing activities can be undertaken in the regions where primary production takes place, to provide employment and value addition activities to the local people.

Enhanced industrialisation is seen as achievable through the adoption of an integrated strategy in which market-driven development is combined with careful capacity building and strengthening of the institutional framework.

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APPENDIX I

Table 3.2 Wage Employment by Industry from 1972-1977

Manufacture	**1972**	**1973**	**1974**	**1975**	**1976**	**1977**
Slaughtering, preparing and preserving of meat	2120	2044	2079	1931	1,991	2234
Dairy Products	1657	1857	1902	2001	2444	2446
Canning and preserving of fruits and vegetables	1409	2157	2212	2822	2794	2677
Vegetable Oil	502	561	675	809	569	642
Grain mill products	2370	2303	2336	2557	2759	43
Bakery Products, Sugar factories	4748	4669	5867	5553	5403	6659
Cocoa, Chocolate and Sugar	236	284	193	302	298	292
Food products	2370	3413	4071	3897	6573	7779
Spirits, beer, tobacco and carbonated water	4193	4233	4656	4554	5519	5720
Spinning, weaving and finishing textiles	14117	16221	17586	17755	19227	20700
Leather and footwear	1534	1925	2094	2049	2093	2230
Sawmills, planning and wood mills	6036	6242	7356	7506	7612	6968
Furniture ,Pulp and Paper	4472	5614	5819	5886	6309	6524

Printing, publishing and allied industries	3920	4057	4389	4351	4508	4032
Industrial Chemicals and Fertilizers	787	956	919	875	879	1470
Wattle bark processing	579	570	444	514	463	-
Pyrethrum extraction	472	518	481	521	566	614
Manufacture of chemical	2453	2830	3327	3167	3919	4877
Petroleum refineries	248	288	282	293	289	291
Non-metallic Mineral	5016	5030	6337	6839	6870	8070
Basic metal industries	-	853	1088	938	1,118	1340
Cutlery, hand tools and hardware	-	270	485	214	329	407
Furniture and Fixtures	1,340	1316	1098	1109	1207	1356
Structural Metal	7653	8152	5306	8501	9204	10230
Railroad Equipment	12449	14015	12540	11986	1207	
Motor Vehicles and Motor Bikes	1354	1532	1944	1381	1198	1782
Repair of aircraft	1243	1134	1212	1158	1229	800
Scientific equipment, photographic and optical	30	45	46	42	25	175
Other Manufacturing	1525	1064	1593	1220	1364	1383
Total	84804	94453	101332	100731	108776	117979

Source (Statistical Abstract 1980:236)

APPENDIX II

QUESTIONNAIRE

Appendix 1: Interview guide for the Ministry of Industrialization and Enterprise Development

Topic of research: Effects of Import Substitution Trade Policies on Kenya's industrialization process since independence

Introduction:

Name: Ireri Stellamarie Wanja

Institution: University of Nairobi, Department of Political Science and Public Administration

Aim of the Interview: To obtain valuable data from questions answered on the experiences that Kenya's industrialization had under the Import Substitution Industrialization (ISI) after independence with a view of having a better understanding of the role it played in Kenya's industrialization process to date.

Questions:

1. What are some of Kenya's current industrialisation policies?

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2. How have the above policies in Q 1 above brought about industrial growth in the country?

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3. Why did Import Substitution Industrialisation (ISI) succeed in the western countries and not in Kenya?

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4. To what extent did the manufacturing sector in Kenya under ISI contribute to the country's economic gains?

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5. What role has your organization played in ensuring that Kenya's industrialization does not stagnate?

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6. How will your ministry enhance Kenya's industrial sector productivity and competitiveness?

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7. What role has your organisation played in ensuring that Kenya's industrialisation process does not stagnate?

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8. What are the challenges that your organisation is facing in attaining an industrialised economy in Kenya?

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