Following recent rebasing of its economy, Kenya is now classified as a lower middle-income country. With a 2013 GDP of US$53.4 billion and a per capita income of US$1,246, the country is ranked the ninth largest economy in Africa and the fourth in Sub-Saharan Africa (SSA). As it stands now, the Kenyan economy is the dominant economy in the East African Community (EAC) and the primary source of foreign direct investment (FDI) for some of the countries of the region. The country has a youthful population and is well positioned to reap the population dividend.

In addition, the country has recently discovered oil and it is likely to be an oil exporter in the near future, joining Uganda and South Sudan. Even without the oil discovery, the Kenya economy stands at a strategic location in the Eastern Africa region. It serves five landlocked countries that are relatively resource-rich (Ethiopia, South Sudan, Uganda,
Rwanda, and Burundi). So its relative comparative and locational advantages lie in improving port facilities, road and railway networks, and transit airports as trade routes for these five countries. Even more significant has been the strengthening of the institutions of governance through the 2010 enactment of a progressive constitution that has radically altered the previous dominance of the executive. At the core of the new constitutional dispensation is devolution of decision-making powers to forty-seven county governments. All these factors augur well for continued strong economic performance.

This study seeks to analyze the drivers of economic growth both in the past and the more recent period and to evaluate the impact of economic growth on labor market prospects, the population structure, and growth. We also review opportunities and pitfalls that are likely to influence the country's growth trajectory. Initially, we start with a background of Kenya's economy and some important policy and political developments that have a bearing on economic performance. Next, the study presents a discussion of the country's population growth, structure, transition, and demographic dividend prospects. The interest here is primarily on those aspects of the population that have a bearing on economic performance and, specifically, on the labor markets.

We also look at Kenya's labor market, with a focus on the structure of employment and the growth–employment dynamics. We discuss the distribution of employment by industry and, also, by formal and informal sectors. We then discuss some aspects of labor supply side, including wage earnings, labor productivity, and returns on human capital. We conclude that examination with some evidence of the growth–employment nexus. Following that, we discuss some of the emerging challenges and opportunities to growth and employment and, finally, provide conclusions that tie the study together to show why Kenya qualifies to be an African Lion, but with immense challenges to overcome.
KENYA’S GROWTH PROFILE

This section explains Kenya’s economic growth performance since 2000, updating an earlier study that covered the period from the 1960s to the 1990s (Mwega and Ndung’u 2008). This earlier study showed that the good economic performance in the 1960s and early 1970s was not sustained in the 1980s and 1990s. The latter period was characterized by persistently low growth and limited economic transformation, despite the fact that the country maintained a large measure of political stability and pursued a fairly consistent development strategy. In the 1960s, growth averaged 5.7 percent, accelerating in the 1970s to 7.2 percent. It declined in the 1980s to 4.2 percent, and in the 1990s fell to 2.2 percent (World Bank 2015).

In analyzing the persistent growth slowdown that got under way in Kenya around the 1980s, a shortlist of plausible determinants includes the global recession, commodity price decline, delayed structural adjustment policies, political succession in the country, as well as other, slow moving candidates such as institutional quality and distributional politics (O’Connell 2008). The country also experienced several negative shocks that undermined growth and contributed to the weak performance. Measures to reduce Kenya’s susceptibility to exogenous shocks, hence, are necessary for improved economic growth (World Bank 2013). However, the scope for untangling the contributions of a large number of potentially relevant determinants is limited in a country case study (O’Connell 2008). For this reason, we focus on a few factors that will help explain the current period.

Kenya’s Economic Performance since 2000

In explaining Kenya’s economic performance since 2000, we focus on three dimensions: first, the role of political economy; second, the macro-growth story that sheds light on how much of Kenya’s experience is explicable in terms of growth regressions; and finally, the role of markets in explaining Kenya’s growth process.

Since the early 2000s (figure 4-1), the economy has experienced some recovery consistent with the Africa Rising narrative of resurgent
economic growth in the region. The rapid growth in Africa has been attributed to a whole range of factors (Robertson 2013): better government finances and fiscal policies reflected in reduced debt and general government expenditures ratios; booming commodity exports, especially to China, although the region runs a trade deficit with the country; increased FDI; new discoveries of oil and other minerals; the increased role of telecoms; ease of doing business reforms; increased investment in education; and democratization of the continent. Some of these factors have also applied to Kenya, especially the rapid expansion in telecommunication and financial services, although the country started from dismally low growth rates.

**Political Economy of Kenya’s Growth Process**

In 2000, the economy recorded an all-time low growth rate of 0.6 percent, increasing to 3.8 percent in 2001 but declining to 0.5 percent in 2002. Following a peaceful change of government in December 2002 from
the Kenya African National Union (KANU), which had ruled the country since independence, to the National Rainbow Coalition (NARC) under Mwai Kibaki, the growth rate accelerated. The economy expanded steadily from 2.9 percent in 2003 to 5.1 percent in 2004, 5.9 percent in 2005, and 6.3 percent in 2006, to reach a peak of 7.1 percent in 2007, the highest in over two decades and the only episode of five-year growth acceleration in Kenya’s independence history (World Bank 2014). The good economic performance was bolstered by the implementation of bold economic and structural reforms under the Economic Recovery Strategy (ERS) and a favorable external environment. The ERS was a five-year blueprint prepared to address Kenya’s macroeconomic vulnerabilities and structural weaknesses.

The Kibaki government put in place economic policy and governance reforms that enhanced economic performance. The average World Bank Country Policy and Institutional Assessment (CPIA), published since 2005, which rates twenty aspects of governance and policies, for example, generally improved over the study period. It improved in 2005–06 (from 3.52 to 3.58); declined in 2007–08 (to 3.55 and 3.52, respectively) as a result of the post-election violence, drought, and the global financial crisis; and improved in 2009–13 (from 3.67 to 3.80). In the absence of poverty measurements, the World Bank (2014) estimates that poverty declined from 46 percent in 2006 to around 42 percent by 2013.

Despite the relatively good performance, the failure to develop an inclusive political agenda widened divisions in the country. The coalition of parties that formed NARC splintered after only three years, following disagreements over proposed constitutional reforms (Collier and others 2010). The subsequent 2007 elections were followed by a serious outbreak of ethnic violence, significantly disrupting the economy. About 1,300 people were killed and nearly 600,000 displaced. A group of eminent persons, led by former United Nations secretary-general, Kofi Annan, brokered a peaceful solution to the political stalemate, leading to a power-sharing agreement between Mwai Kibaki and Raila Odinga.

The events that followed the 2007 general election left a difficult legacy by exacerbating inter-ethnic mistrust and lack of confidence in
the rule of law, which can be expected to have detrimental economic effects. Collier and others, therefore, recommend revamping efforts at building supervisory institutions, such as the electoral commission and judiciary, in which the country’s citizens can have confidence. The efforts in strengthening the institutions in the country since the promulgation of the new constitution in 2010 led, in part, to a peaceful change of government in March 2013.

In 2008, the growth rate declined to 0.23 percent as a result of the post-election violence, drought in the country, and the global financial crisis, eroding the achievements of the previous half-decade. Following countercyclical demand management policies and favorable weather conditions that improved agricultural performance, growth subsequently picked up, to 3.31 percent in 2009 and to 8.41 percent in 2010. As a result of a surge in global food and oil prices and a drought in the country, growth declined to 6.12 percent in 2011, to 4.45 percent in 2012, to 5.74 percent in 2013, and 5.30 percent in 2014. With an average economic growth of only 4.37 percent over 2000–14, not very significantly above the population growth rate of 2.7 percent, the country continued to operate below its potential. This growth was lower than the average for Sub-Saharan Africa (4.88 percent).

**Macro-Growth Performance**

The Kenya story is one of missed opportunities. Kenya, for example, did not exploit globalization to increase manufactured exports, given its coastal location, relatively cheap labor, and basically market-friendly orientation. The share of manufactured exports in manufacturing output has historically remained quite low (at less than 15 percent). While the economy was liberalized in the 1980s and 1990s, the trade liberalization policies were not credible and were subject to frequent reversals. Manufactured exports were also subject to serious supply constraints, such as unavailability and/or high cost of credit and foreign exchange, infrastructural deficiencies, and an adverse regulatory framework, increasing transaction costs and undermining the country’s competitiveness. This makes it difficult to overcome the threshold of cost-competitiveness to sell in the global market arising from the Asian countries’ agglomeration economies (Collier and O’Connell 2008). There is agreement that
manufactured exports are mainly constrained by high transaction costs, not endowments, at least in the medium term. The poor performance has not been confined to manufactured exports only, but encompasses exports in general.

What differentiates Kenya from peer countries, in particular those outside the East Africa region, is the clogged “exports engine” (World Bank 2014). Exports of goods, as percent of GDP, have been declining since the mid-2000s, from 21.7 percent in 2006–10 to 18.9 percent in 2011–14, while imports of goods have been increasing. In contrast, services exports have been expanding, but not enough to offset the widening gap between exports and imports of goods. Kenya has, in the last decade, therefore, experienced a large increase in the current account deficit. The current account recorded an average deficit of 1.75 percent of GDP in 2006, generally widening in subsequent years. By 2012, the deficit had risen to an average of 10.6 percent of GDP, and by July 2015 to 10.8 percent of GDP, mainly due to increased imports in the context of a stagnant export sector. Imports of machinery and other equipment have, however, continued to account for a higher proportion (about one quarter) of the import bill. These are essential for enhancing future productive capacity of the economy.

The high overall current account deficit is mainly financed by short-term net capital inflows. This is a major source of potential vulnerability for the economy and for financial stability. The easy reversibility of these inflows increases the risk of a “sudden stop” or a reversal as a shift in market sentiments creates a flight away from domestic assets (O’Connell and others 2010).

The growth literature, however, takes cognizance that economic growth is a multi-faceted process and that the rapid economic growth in East Asia from the 1960s to 1990s is attributable to a wide range of factors. Rapid economic growth requires the positive interaction of multiple factors, such as the “prevalence of primary education, agricultural development, macroeconomic stability, the role of public policies, the existence of regional dynamism, and so on” (Kurihara and Yamagata 2003, p. 6). Achieving rapid growth and shared prosperity requires continued action on multiple fronts. Improving on the key determinants to growth necessitates not only enactment of legislation, but also its
enforcement; more public investment and better execution of capital projects; greater political and economic stability; and improved governance (World Bank 2014).

The rate of investment is one of the most important influences on economic growth in Kenya. As seen in figure 4-2, there is close correlation between growth and the gross capital formation ratio (0.3), with causality running from the investment ratio to growth.\(^4\) Since 2000, there was a general increase in the investment ratio, from 17.4 percent in 2000 to 21.3 percent in 2014. These are, however, relatively low investment rates, driven by low private and public saving rates, as well as low foreign direct investment. Savings, for example, did not keep up with investment. The gaps increased from near zero to a deficit equivalent to 8.9 percent of GDP in 2011 (World Bank 2013). An obvious policy implication is that macroeconomic policies should be geared toward stimulating more private and public investment rates (World Bank 2013). The Second Medium Term Plan of Vision 2030 sets ambitious targets for augmenting public and private investment. To this end, it envisages an increase in the investment rate to 31 percent of GDP by 2018, an ambitious 11 percent increase from the 2013 level. While foreign

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**FIGURE 4-2. GDP Growth Rate and Gross Capital Formation/GDP Ratio, 1964–2014**

savings can finance some of the investment, the stated target cannot be achieved in a sustainable manner without higher national savings.

**Role of Markets in the Growth Process**

Markets are crucial for providing the incentive structure of the economy and shaping the direction of economic change toward growth, stagnation, or decline. Markets and their accessibility are important for inclusive growth. It is difficult to map out specific policies for each of the markets in Kenya, but the general trend was that major controls were introduced in the 1960s and 1970s and dismantled in the 1980s and 1990s. From being largely syndrome free in the 1960s, regulatory syndromes of soft (mild) controls were introduced in the 1970s, which persisted into the 1980s (Collier and O'Connell 2008). These controls acted as an easier response in controlling balance of payments and inflationary pressures in the economy. However, the 1980s and 1990s are characterized by economic reforms to aid markets to work better: structural adjustment policies. There were also parastatal and civil service reforms. Whereas market reforms started in the 1980s with a slow pace and then accelerated in the 1990s, institutional reforms were a phenomenon of the 1990s.

By the new millennium, therefore, most of the markets were fully liberalized, although, more recently, in December 2010, price controls were re-introduced in the oil industry. As well, legislation that allows the government to determine and gazette price controls on essential commodities like maize flour, kerosene, and cooking oil was passed by parliament. In other areas, liberalization has continued. Privatization of state corporations like the defunct Kenya Post and Telecommunications Company, for example, which resulted in East Africa’s most profitable company (Safaricom), has led to their revival because of massive private investment. But removing controls does not guarantee rapid economic growth (Collier and O’Connell 2008). First, there are lags between reforms and private investment. Second, agglomeration economies by Asian countries make it difficult for African countries to break into international markets for manufactures and services. Third, success requires “big push“ actions by the state, such as the provision of physical and social infrastructure.
To summarize, there are various lessons to be learned reviewing Kenya’s growth experience over the past decade. While the economy has become fairly dynamic and innovative, the economic outcomes have not been transformative. Agriculture remains the mainstay of the economy and three quarters of the population continue to live in rural areas. Manufacturing has been disappointing, and service industries, such as finance or communications, account for only a marginal share of employment. Kenya’s modest growth performance is not surprising when the country is benchmarked against the most important determinants of growth (World Bank 2014). Countries at similar levels of development typically have greater macro-stability, higher urbanization, are more open, invest more, spend more on health, have better governance, and have more developed higher education system than Kenya.

Kenya’s challenges in enhancing its growth performance, as noted by Robertson (2013), include identifying competitive advantages; delivering the energy and transport infrastructure required to achieve the Vision 2030 development goals; enhancing investment in education to support rapid growth; and ensuring sustainable fiscal policy and a stable macroeconomic environment. Achieving the desired growth targets, therefore, entails improvements simultaneously on two fronts: increased physical and human capital, and faster productivity growth.

THE PROMISING FUTURE

The rapid population growth in Kenya is a phenomenon of the 1960s to the 1980s: its growth was on average above the real GDP per capita growth. But in the decades that followed, it is the age cohort analysis that has been amenable to interesting policy debate and presents an opportunity for a promising future. Four outcomes have been observed in the Kenyan analysis: first, Kenya has witnessed a youth bulge that has increased the labour force, we observe that 67.8 percent of the working age is comprised of youth. Second, urbanization in Kenya has increased over time, it stands at 25.2 percent and is projected to increase to over 32 percent by 2030. Third, the analysis does show that Kenya is reaping the demographic dividend. Finally, a combination of the above three
factors strengthen the outcome of an emerging middle class in Kenya. This is a class of innovators and investors who have taken advantage of digital financial services to build savings and accumulate capital. It is a class that presents opportunities for social, economic transformation and growth in Kenya.

Kenya’s Population Structure, Transition, and Demographic Dividend

Kenya has been disadvantaged by a more rapid population growth (Mwega and Ndung’u 2008). Up to the 1980s, Kenya had one of the most rapid population growth rates in the world. Population growth rate increased from 3 percent in the 1960s to 4 percent in the 1970s and 1980s, whereas that of Highly Performing East Asian Economies (HPAEs) declined from 3 percent in early 1960s to 2 percent thereafter. In the 1990s, the average population growth rate was 2.9 percent, declining to about 2.7 percent in the new millennium.

World Bank statistics show an increasing trend in population age ranges 0–14 years, 15–34 years, and 35–64 years since 1960, while the population age sixty-five years and above has stagnated. The population aged 0–14 years continues to remain higher than the other age groups, followed by the youth population (ages 15–34 years) and those age 35–64 years. This trend indicates that Kenya is likely to experience a youth bulge as more of those age 0–14 years move into the youth age group. In 2014, the population age 0–14 years stood at 19.1 million, while the 15–34 years group stood at about 16.1 million. The population group age 35–64 years stood at about 8.9 million. On the other hand, the population age sixty-five years and above has remained at below 3 percent of the total population since 1981, with the 2014 figure being 1.2 million.

Kenya has also experienced a steady rise in urbanization. In 1950, the share of urban (rural) population was 5.5 percent (94.41 percent). In 2014, urban population was estimated at 25.2 percent of the total population. So urbanization has steadily increased in Kenya. It is projected that by 2030 the urban population will be at 32.83 percent, while the rural population will have declined to 67.17 percent of the total
population due to rural–urban migration resulting from the pull factors in urban areas (quality of life and economic opportunities in urban areas, among others). The trend reveals that while, indeed, urbanization will continue at a steady rate, rural areas will remain home to the vast majority of the population for the foreseeable future.

An important feature of the population structure that relates to labor markets outcomes is the relative size of the youth population to that of the total working-age population (ages 15–64). The United Nations defines youth as a person between the ages of 15 and 24 years, while in Kenya, youth is defined as a person between 15 and 35 years old, according to the Kenya National Youth Policy (Republic of Kenya 2006). The youth population has constituted more than half of the working-age population in Kenya since 1950; in 1950, the youth population comprised 57.5 percent of the working-age population. The share of the youth population increased steadily over time, reaching a peak of 67.7 percent of the working-age population in 2002. Since 2006, the ratio of the youth population to the working-age population has been declining. In 2014, the share of the youth population to the working-age population stood at 64.2 percent and is projected to decline gradually to 59.0 percent in 2030. The youth population can be disaggregated into two cohorts; that is, those who are age 15–24 years (most of whom are still in school and are considered inactive in the labor market) and those age 25–34 years (most of whom have completed school and are employed or actively looking for jobs). Figure 4-3 presents the trend and projections for these cohorts of youth population in the country.

Figure 4-3 shows that the population of youth age 15–24 years has been higher than that of those age 25–34 years since 1950, and this is projected to continue toward 2050. In 2014, the share of the youth population age 15–24 years was 35.2 percent of the working-age population, while the share of the youth population age 25–34 years was 29.1 percent of the working-age population. The share of both cohorts of youth population in the working-age population has been declining since 2006 and is projected to decline further as we move to 2050. This decline is expected to reduce the youth dependency ratio as more of the working-age population will be composed of those aged between 35–64 years as we move to 2050. The fact that the working-age popula-
tion is not homogeneous is important to note in developing policies to ensure that most of them are actively involved in the labor market activities in one way or another.

The second feature of the population structure, related to the labor market, is the share of working-age population (ages 15–64) to the dependent population (ages 0–14 and above sixty-four). In 1950, the dependent population was 2.7 million. In 2014, the dependent population was estimated at 20.4 million (44.75 percent of the total population), while the working population was 25.2 million (55.25 percent of the total population). Figure 4-4 shows the trends in the working-age population and the dependent population in Kenya.

From 1960, the dependent population was slightly higher than the working-age population until 1994, when the working-age population overtook the dependent population. The figure indicates that, since 1994, the working-age population has been growing faster than the dependent population, and this trend is projected to continue into the next decades. As noted, the population age 0–14 years continues to

remain higher than the other age groups, followed by the youth population (ages 15–34 years) and those age 35–64 years. As more of those age 0–14 years move into the youth age group, the working-age population in the country is expected to continue expanding, leading to further decline in dependent population and a larger working-age population that would accumulate savings and increase investment in the economy.

It is also worth noting that Kenya has witnessed declining fertility rates, from eight births per woman in the 1960s to seven births per woman in the 1980s and, finally, to 4.4 births per woman in 2013. In 2014, Kenya had 46 percent contraceptive prevalence rate (all methods) and a fertility rate of 4.6 children per woman (Republic of Kenya 2014). The crude mortality rate has also declined from twenty per 1,000 people in 1960 to eight per 1,000 people in 2013. Consequently, the life expectancy has improved from 46.4 years in 1960 to 61.7 years in 2013. With the increase in the share of the working-age population, which
Kenya

has accelerated since 1993 from 49.8 percent of the total population to 55.1 percent in 2013, these trends indicate that demographic transition has taken effect in Kenya. This sets the country on the path to realization of demographic dividend, if other contributing factors are adequately provided for. Bloom and Canning (2008) observe that, as the dependency ratio falls, opportunities for economic growth tend to rise, creating a demographic dividend.

A demographic dividend is a temporary opportunity for faster economic growth that begins when fertility rates decline, leading to a larger proportion of working-age population compared to young and retired dependent population (Republic of Kenya 2014). Bloom and others (2014) note that factors that can facilitate the reaping of demographic dividend for a country include integrated family planning, education, and economic development policies. From Bloom and others (2014), the emphasis is that, for a demographic dividend to be realized, there should be a decline in birth rates and mortality rates, followed by an increase in labor supply. This seems to describe what Kenya has gone through. The increase in labor supply must then find a macroeconomic setting that will absorb this labor force (Gribble and Bremner 2012). With a low share of dependent population, the larger working-age population would be able to save and invest more in the economy. At the same time, they are able to produce more per work, hence boosting the national income per capita.

Computation of the demographic dividend focuses on the relative changes of the dependent and working-age populations. Based on the data of the working-age and dependent populations, the support ratio is obtained by dividing the dependent population by the working-age population. The support ratio shows the average number of dependents per worker. Figure 4-5 presents the prospects of Kenya’s earning demographic dividend, to which the change in support ratio is a key contributing factor.

Figure 4-5 shows that the change in support ratio has been positive but declining from 1960 to early 1980s, when it became negative. Since then, the change in support ratio has remained negative, with a negative change of about 0.6 percent in 2011, 0.3 percent in 2012, and 0.4 percent in 2013. The consistent negative change in support ratio implies that the dependence on the working population in the country is
Declining. With less dependence, the working-age population is able to save and invest more in the economy, hence creating opportunities for economic growth.

Lee and Mason (2006) and Bloom and others (2003; 2007) acknowledge the fact that demographic transitions do not in themselves guarantee a demographic dividend unless there is a quality institutional environment to enhance the productivity of the working-age population. Kenya has made positive steps in strengthening its institutions since the promulgation of the new constitution in 2010. Significant steps have been made in reforms in the public service, the police, the judiciary, the electoral system, and in devolving power. The CPIA public sector management and institutions cluster average (1 = low to 6 = high) for Kenya has averaged at 3.58 since 2005, improving to 3.80 in 2014. Though more still has to be done, Kenya can be said to be on the right path in strengthening its institutional quality, a move that will enhance the chances of the country realizing the demographic dividend even before the year 2050.
The sustained increase in the GDP per capita since 2008, after the post-election violence shock, is an indication that the prospects of Kenya reaping demographic dividend by 2050 is real with improved political and economic framework. A demographic dividend model (DemDiv), developed by the USAID-funded Health Policy Project (HPP), predicts that Kenya will benefit from demographic dividend by 2050 if the institutional qualities are ensured. The DemDiv model integrates key elements needed for Kenya to achieve a demographic dividend that include family planning, education, and economic policies, especially on financial efficiency, ICT use, imports, labor flexibility, and public institutions. The DemDiv model presents a base scenario with no investment in family planning and a combined scenario of investments in family planning, education, and economic policies. In the base scenario, with no investments in family planning, the fertility rate would be the same in 2050 as it is today, more than four children per woman. Kenya’s age structure would remain very young and be dominated by dependents. In contrast, the combined scenario, which includes increased use of family planning, produces a youth bulge, which moves into the working-age years in 2050. An increase in a healthy, educated, and productive working-age population will put Kenya on the path to realization of a demographic dividend (Republic of Kenya 2014).

Another notable feature of Kenya’s working-age population that should be factored in the growth debate is the emerging middle class population and its role in driving economic growth in the country. According to the African Development Bank, the middle class are those who spend between US$2 (approximately 200 Kenyan shilling [Ksh]) and US$20 (approximately Ksh2,000) a day or earn an annual income exceeding US$3,900 (approximately Ksh390,000). In 2011, the middle class in East Africa was estimated to be about 29.3 million, representing an average of 22.6 percent of the population: 44.9 percent of Kenya’s population, 18.7 percent in Uganda, 12.1 percent in Tanzania, 7.7 percent in Rwanda, and 5.3 percent in Burundi (AfDB 2011).

The emergence of the middle class presents an opportunity for social and economic growth in Kenya, since the middle class has been argued to play a key role as a conduit for advancing social progress, an agent of change for institutional reforms, a catalyst for the realization of
inclusive growth, innovation, and entrepreneurial drive (Ncube and Shimeles 2012). The rise in the middle class population in Kenya has boosted the purchasing power in the country, leading to the thriving of the wholesale and retail sector (evidenced by the growing shopping mall culture) in the country. Additionally, the rise in the middle class population has led to an increase in demand for housing, giving rise to the boom in the housing market. It has also contributed to growth and innovation in the financial sector that finances the increased consumption by the middle class population. Moreover, the growing middle class is increasingly appealing to both domestic and foreign investors, thereby presenting Kenya with an opportunity for wealth creation and increased investment in the country.

**The Labor Market, Employment, and Growth**

In this section, we focus on some important aspects of the Kenyan labor market. We note that analysis of the Kenyan labor market is severely constrained by the paucity of data necessary to fully capture and analyze the dynamics of the labor market and, especially, the link between economic growth, employment, and poverty reduction. Nevertheless, the available data reveals some key features of the labor market and points to some specific policy proposals.

**Labor Market Structure, Employment, and Wages**

To provide a broad picture of Kenya’s labor market, we start by looking at the trend of total employment and sectoral distribution of wage employment, as shown in table 4-1 and figure 4-6, respectively. The Kenyan work force is categorized into the modern (or formal) sector, the informal sector, and the small-scale agriculture and pastoralist sector. This section focuses mainly on the modern (formal) sector alongside the informal sector employment in view of the challenges of availability of data on small-scale agriculture and pastoralist sector. Table 4-1 shows that in 1985 total employment, excluding employment in small-scale agriculture and pastoralist activities, was estimated at 146,200 persons. Out of this, 80.33 percent were in wage employment. The self-employed and unpaid family workers were about 2.26 percent,
Over the period under review, wage employment grew by an annual average of 2.5 percent, self-employment and unpaid family workers grew by an annual average of 3.7 percent, while informal employment grew by an annual average of 11.6 percent. Over the same period, the share of wage employment declined to 16.56 percent in 2014, and that of self-employment and unpaid family workers declined to 0.72 percent of the total employment in the same year. On the other hand, the share of estimated informal employment increased from 17.41 percent in 1985 to 82.73 percent in 2014. Informal employment increased from 1989 into the 1990s, surpassing the wage employment in 1994. Since then, the composition of employment in Kenya has progressively tilted toward informal employment. Generally, since 1985, the trend in informal employment has defined the overall trend in growth of total employment.

### TABLE 4-1. Shares of Kenya’s Total Employment, 1985–2014

<table>
<thead>
<tr>
<th>Year</th>
<th>Wage employment</th>
<th>Self-employment and unpaid family workers</th>
<th>Estimated informal employment</th>
<th>Total employment (number)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>80.33</td>
<td>2.26</td>
<td>17.41</td>
<td>146,200</td>
</tr>
<tr>
<td>1988</td>
<td>77.47</td>
<td>2.54</td>
<td>20</td>
<td>173,140</td>
</tr>
<tr>
<td>1991</td>
<td>56.38</td>
<td>2.04</td>
<td>41.58</td>
<td>255,710</td>
</tr>
<tr>
<td>1994</td>
<td>44.86</td>
<td>1.74</td>
<td>53.41</td>
<td>335,620</td>
</tr>
<tr>
<td>1997</td>
<td>35.06</td>
<td>1.36</td>
<td>63.57</td>
<td>469,840</td>
</tr>
<tr>
<td>2000</td>
<td>28.68</td>
<td>1.1</td>
<td>70.22</td>
<td>591,160</td>
</tr>
<tr>
<td>2003</td>
<td>23.53</td>
<td>0.9</td>
<td>75.57</td>
<td>733,940</td>
</tr>
<tr>
<td>2006</td>
<td>20.66</td>
<td>0.75</td>
<td>78.6</td>
<td>899,340</td>
</tr>
<tr>
<td>2009</td>
<td>19.13</td>
<td>0.65</td>
<td>80.23</td>
<td>1,045,650</td>
</tr>
<tr>
<td>2012</td>
<td>16.87</td>
<td>0.6</td>
<td>82.53</td>
<td>1,278,110</td>
</tr>
<tr>
<td>2013</td>
<td>16.89</td>
<td>0.62</td>
<td>82.49</td>
<td>1,351,700</td>
</tr>
<tr>
<td>2014</td>
<td>16.56</td>
<td>0.72</td>
<td>82.73</td>
<td>1,431,670</td>
</tr>
<tr>
<td>For the period</td>
<td>169,582</td>
<td>6,179</td>
<td>463,036</td>
<td></td>
</tr>
<tr>
<td>1985–2014</td>
<td>(26.55%)</td>
<td>(0.97%)</td>
<td>(72.49%)</td>
<td></td>
</tr>
</tbody>
</table>

employment in the country. This increased rate of growth of informal employment can be attributed to a multi-dimensional matrix of reasons. These reasons include but are not limited to the government promotion of the informal sector and better informal sector data capture (Omolo 2010); limited capital, which hinders small entrepreneurs from venturing into large formal firms; the relatively high cost of doing business, which pushes employers to cut on labor costs (such as social contributions) through informal employment; and occasional freezes and/or rationalization of government employment, pushing labor to the informal sector.

The informal sector, commonly referred to as the *jua kali* sector, therefore, currently dominates and plays a critical role in the labor market in Kenya. Over the years, the sector has expanded into activities of manufacturing, transport and information, communication, and technology (Republic of Kenya 2003). However, there has been a lot of debate on the quality of employment in the informal sector. Additionally, Kenya’s informal sector enterprises tend to remain small with limited labor absorption capacity. A look at the informal sector units in the period reviewed shows an increasing number of informal business units rather than expansion of existing units. This could be as a result of increased self-employment in the sector, an indication that the sector has not been dynamic enough to absorb the excess labor in the country. This suggests that focus should be on how to make the informal sector more dynamic while, at the same time, seeking to make it easier to do business in the formal sector. Bigsten and Wambugu (2010) argue that the formal sector employment expansion, on the other hand, has been constrained by the inability of the country to achieve rapid capital accumulation to improve on the capital–labor ratio and the labor market regulations that have tended to increase labor costs relative to productivity in the sector. They noted that the increase in informal sector firms leading to the employment expansion in the sector is mainly made possible by the limited capital requirements for new jobs in the sector.

In the modern sector employment, a notable feature has been the increasing number of casual workers as compared to regular employment workers. Casual workers are individuals whose terms of engagement provide for payment at the end of each day and who are not
engaged for a period longer than twenty-four hours at a time (Republic of Kenya 2007). This category of workers enjoys the same rights as other employees to a large extent, but may be excluded from certain crucial benefits, such as leave entitlement, medical coverage, and pension contributions. Most employers in Kenya, including the public sector, have resorted to the increasing use of casual, temporary, part-time, contract, subcontracted, and outsourced workforces to reduce labor costs, achieve more flexibility in management, and exert greater levels of control over labor (Omolo 2010). According to a report by the International Labor Organization (ILO 2013), regular employment grew by only 7.0 percent between 2003 and 2011, while casual employment grew by 87 percent over the same period. Additionally, the proportion of casual formal jobs increased from 20 percent in 2003 to 30 percent in 2011 (Republic of Kenya 2014).

Until the end of 1980s, expansion of employment in the modern sector of the economy was largely attributed to the absorption of employees into the public sector. However, in 1994, there was a turnaround in this trend with employment in the private sector expanding faster than that in the public sector. The share of the private sector in wage employment has been on the rise since 1991, dominating wage labor progressively, to stand at 70.4 percent of wage employment in 2014. On the other hand, the share of the public sector in wage employment has declined from 49.6 percent in 1991 to 29.6 percent in 2014. A comparison of the wage earnings in the public and private sector is presented in table 4-2, which shows the real average annual earnings per employee in selected sectors in the Kenyan economy.

As is evident, there is a wide variation in earnings across sectors, with workers in financial and insurance activities earning the highest and those in agriculture, forestry, and fishing sectors earning the lowest. In essence, workers in agriculture, forestry, and fishing, mainly rural workers, have low earnings, hence dominate the bracket of the working poor. Furthermore, the gap between public and private sector earning varies widely within the sectors. Earnings in the public sector are relatively higher than in the private sector for most of the selected sectors, as evidenced by the percentage divergence in table 4-2. The sectors of specific concern are the wholesale and retail trade sector and the
In the wholesale and retail sector, private sector employees’ real average earning is approximately a third of their counterparts in the public sector. In the education sector, private sector employees’ real average earning is slightly more than twice that of their public sector employees.

These wage inequalities explain the frequent agitation for wage adjustments by trade unions, such as Kenya National Union of Teachers (KNUT), which has seen the public wage bill spiral in the last two decades. The high wage bill in the public sector has turned out to be a constraint to economic growth, as it tends to crowd out resources available for development expenditure in the country. A study commissioned by the Salaries and Remuneration Commission (SRC) and carried out by the Kenya Institute for Public Policy Research and Analysis (KIPPRA) found that, generally, the public sector pays slightly higher than the private sector when comparing basic salary and allowances. However, the private sector pays a higher basic salary. The study also found

### TABLE 4-2. Estimated Real Average Wage Earnings Per Employee, Kenya, 2014

KSh per annum, unless otherwise noted

<table>
<thead>
<tr>
<th>Sector</th>
<th>Private sector</th>
<th>Public sector</th>
<th>Divergence (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry, and fishing</td>
<td>153,904</td>
<td>217,789.60</td>
<td>70.7</td>
</tr>
<tr>
<td>Mining and quarrying</td>
<td>229,400</td>
<td>205,021.70</td>
<td>112</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>233,304</td>
<td>472,230.60</td>
<td>49.4</td>
</tr>
<tr>
<td>Electricity, gas, steam, and air conditioning supply</td>
<td>831,991</td>
<td>747,447.10</td>
<td>111.3</td>
</tr>
<tr>
<td>Construction</td>
<td>366,160</td>
<td>365,919.60</td>
<td>100.1</td>
</tr>
<tr>
<td>Wholesale and retail trade</td>
<td>346,494</td>
<td>1,042,822.50</td>
<td>33.2</td>
</tr>
<tr>
<td>Transportation and storage</td>
<td>702,651</td>
<td>819,062.60</td>
<td>85.8</td>
</tr>
<tr>
<td>Financial and insurance activities</td>
<td>1,005,456</td>
<td>950,288.80</td>
<td>105.6</td>
</tr>
<tr>
<td>Education</td>
<td>553,722</td>
<td>270,131.30</td>
<td>205</td>
</tr>
<tr>
<td>Human health and social work activities</td>
<td>436,270</td>
<td>600,710.20</td>
<td>72.6</td>
</tr>
<tr>
<td>Arts, entertainment, and recreation</td>
<td>353,746</td>
<td>424,133.10</td>
<td>83.4</td>
</tr>
<tr>
<td>Information and communication</td>
<td>498,375</td>
<td>410,726.60</td>
<td>121.3</td>
</tr>
</tbody>
</table>

that there is a large vertical wage inequality in both the public and private sectors between the lowest and highest cadres (KIPPRA 2013). The wage differentials between the public and private sectors indicate that there are barriers to mobility of labor between the sectors and that the Kenyan labor market is not efficient in allocation of labor.

_Labor Productivity and Human Capital Returns_

In this section, we focus on labor productivity and human capital returns. Labor productivity measures the amount of real GDP produced by an hour of labor. In Kenya, labor is the abundant factor of production for the various economic activities. Labor productivity growth is important in measuring the efficiency of labor and in signaling an improvement in the standard of living in the country. Figure 4-6 shows productivity in terms of GDP per person employed (for the period 1980–2012) converted to 1990 constant international dollars using Purchasing Power Parity (PPP) rates and agriculture value added per worker in constant 2005 dollars (for the period 1980–2014). Agriculture value added per worker is a measure of agricultural productivity. In the analysis, agriculture is comprised of value added from forestry, cultivation of crops,
hunting, fishing, and livestock production. Since agriculture is the dominant sector of the Kenyan economy, agricultural productivity provides a good estimate of the labor productivity in the country.

In the period under review, GDP per person employed has experienced a sluggish, inconsistent growth, dropping from 2,810 in 1980 to a low of 2,615 in 2000, then rising to 3,134 in 2012. Since 2008, GDP per person employed has been on a consistent upward trend, an indication of growth in labor productivity in the economy. On the other hand, agricultural productivity has been quite erratic over the period under review, dropping inconsistently from a high of 429.5 in 1983 to a low of 331 in 1997. Since 2009, agricultural productivity has consistently grown from 347.5 to 395.8 in 2014. The trends of GDP per person and agricultural productivity in recent years are an indication of growing labor productivity in the country. This is essential for enhancing economic growth of the country.

The growth in labor productivity in the country comes partly as a consequence of the improvement in education attainment since independence. Barro and Lee (2010) show that educational attainments (average years of schooling) in Kenya increased significantly, from 0.3 years in 1960 to about 4.4 years in 2000, then to 6.5 years in 2010. This was mainly driven by attainments in primary education (47.8 percent) when compared to secondary education (7.9 percent) and tertiary education (2.8 percent), due to the introduction of free primary education in 2003. Tertiary education has also expanded rapidly in the last two decades, mainly driven by demographic pressures as well as pressures from the high subsidization of primary and secondary education, the upgrading of colleges to universities, and the introduction of what is referred to as “parallel programs,” where students pay tuition for part-time or distance learning programs (World Bank 2014). These trends suggest an improvement in the supply of quality labor that has positive effects on growth.

Information on the human capital returns is scarce. Kimenyi and others (2006) use data from the 1994 Welfare Monitoring Survey (WMS) to estimate human capital returns for workers with different levels of education using the Mincer (1974) earnings function. The sample used in the study includes only individuals in the working-age group 15–65
years who are full-time employees. The sample size consisted of 6,140 observations covering individuals both in the rural (4,878) and urban (1,262) areas.

Table 4-3 shows private returns to education for different levels of education by region and gender categories determined by Kimenyi and others (2006). The results reveal large differences in returns between levels of education, with the largest difference in returns observed between primary and secondary education. The human capital return for those who have completed primary schooling was estimated at 7.7 percent, while the return for those with secondary schooling was estimated at 23.4 percent. The human capital returns for those with secondary education are about thrice the returns of those with primary schooling. This has influenced the education policies in the country, as evidenced by the increased allocation for development of secondary schools to improve on their enrollment rates and the current push to review the education system. The results also indicate that returns to education are greater for females than for males. For example, the return for females with primary education was 13.2 percent compared to 4.4 percent for males. Human capital returns to females with secondary education were estimated at 36.3 percent, while returns to males were

<table>
<thead>
<tr>
<th>Completion</th>
<th>Completed primary</th>
<th>Completed secondary</th>
<th>College</th>
<th>University</th>
</tr>
</thead>
<tbody>
<tr>
<td>National</td>
<td>7.7</td>
<td>23.4</td>
<td>23.6</td>
<td>25.1</td>
</tr>
<tr>
<td>Urban</td>
<td>9.3</td>
<td>34.4</td>
<td>26.2</td>
<td>34.8</td>
</tr>
<tr>
<td>Rural</td>
<td>7.8</td>
<td>21</td>
<td>22.4</td>
<td>14.2</td>
</tr>
<tr>
<td>All Males</td>
<td>4.4</td>
<td>21.2</td>
<td>12.8</td>
<td>23.3</td>
</tr>
<tr>
<td>Urban</td>
<td>6.1</td>
<td>25.6</td>
<td>17.9</td>
<td>30.7</td>
</tr>
<tr>
<td>Rural</td>
<td>4.2</td>
<td>20.2</td>
<td>12.4</td>
<td>12.6</td>
</tr>
<tr>
<td>All Females</td>
<td>13.2</td>
<td>36.3</td>
<td>43.5</td>
<td>62.5</td>
</tr>
<tr>
<td>Urban</td>
<td>6.2</td>
<td>44.9</td>
<td>28</td>
<td>66</td>
</tr>
<tr>
<td>Rural</td>
<td>16</td>
<td>30.3</td>
<td>51.5</td>
<td>18.6</td>
</tr>
</tbody>
</table>

Source: Adapted from Kimenyi and others (2006).
21.2 percent. This informs the increased focus on girl-child education as the government endeavors to provide an equal opportunity for all children to access basic education and to increase enrollment rates, especially for girls in secondary schools and institutions of higher learning. Additionally, the returns for urban workers were found to be higher, except for the case of females with primary education, where returns are higher for those in rural areas. The rising productivity since 2009 and the results for returns on human capital indicate an improvement in the efficiency of labor in the country. With the improvements in labor quality and efficiency, additional capital accumulation will propel the country to a rapid economic growth path.

**Growth and Employment**

We have outlined Kenya’s growth profile and recent performance. One important question is whether growth has been effective in creating employment. In this section, we provide evidence on the relationship between growth and employment. As noted previously, this analysis is severely hampered by the lack of accurate and updated data; hence, we rely on available data and anecdotal evidence to draw some conclusions. Policies aimed at generating employment opportunities in Kenya have consistently promoted economic growth as the panacea to employment creation in the country. The relationship between economic growth and employment is estimated using a simple employment elasticity (which is a measure of the percentage change in employment associated with a one percent change in economic growth). The employment elasticity summarizes the ability of a country’s economy to generate employment opportunities for its population as its economy grows, and can also provide an insight into trends in labor productivity in the country. According to ILO (2009), employment elasticity for Kenya has been generally higher than that for the world and also for Sub-Saharan Africa. Nevertheless, employment elasticity varies greatly over different periods, with the highest elasticity of 1.77 recorded for the period 1996–2000, when the growth rate was low (~1.6 percent). The lowest employment elasticity, 0.5, was recorded during the period 2004–08, when the economic growth rate was high at 5.3 percent. Thus, in the latter high-growth period, employment response was weak.
This has been explained by the fact that growth in this period was driven by efficiency gains.

It is evident from figure 4-7 that employment elasticity for Kenya has been erratic, especially in the late 1980s and early 1990s, after which it stabilized between 1993 and 1998, before declining to a low of −4.7 in the year 2000. It then rose again to 5.4 in 2002. Since then, Kenya’s employment elasticity has stagnated, ranging between 0.5 and 1.6. In 2014, the employment elasticity was at 0.56. This means that a 1 percent increase in the country’s GDP would trigger a 0.56 percent increase in employment in the economy. The decline in employment elasticity since 2009 shows the declining responsiveness of Kenya’s employment to growth in GDP as more labor is pushed into the informal sector. From the analysis earlier, the informal sector is a reservoir of self-employed, unemployed, and underemployed, and so may have a weak relationship to economic growth.

Figure 4-7 also shows that the growth in total employment in the country has closely tracked the economic growth in the country from 2004 to 2014. The GDP growth witnessed between the years 2003–2007

FIGURE 4-7. Growth-Employment Elasticity

can be related to the strategies employed by the government as per the Sessional Paper of 2003 on Economic Recovery for Employment and Wealth Creation (Republic of Kenya 2003), but the growth experienced up to 2007 was related to the efficiency gains in the economy. However, the unemployment rates still remain high in the country. The employment and GDP growth dynamics indicate that the nexus between economic growth and reduction of unemployment in the country is weak. This can be explained by the fact that labor force growth (mainly attributed to increase in working population and increased labor participation) in the country outpaces employment growth, leading to an increase in unemployment despite the positive economic growth witnessed in most of the years in the period under review (which averaged 3.87 percent in the period 1986–2014 and 5.45 percent in the period 2003–07, which had the highest growth episode). However, economic growth seems to be a key factor in generating wage employment in the country. The growth in wage employment tracks GDP growth closely. However, there is no clear pattern in the relationship between GDP growth and growth in informal sector employment or growth in self-employment and unpaid family workers.

EMERGING OPPORTUNITIES AND PITFALLS TO ECONOMIC GROWTH AND EMPLOYMENT

As discussed, Kenya has recorded robust growth over the last decade and is expected to sustain growth rates above 5 percent in the next few years. However, the growth achieved so far is still below what is necessary to achieve the targets set in the country’s Vision 2030 to make Kenya an upper-middle country by 2030. But there are many opportunities the country can exploit to maintain and raise its growth performance. An important one is to take advantage of being a regional financial hub and having a set of port and airport facilities and an efficient road and railway networks that would serve the landlocked countries and generate economic rents and employment. As the largest economy in the East Africa community, Kenya stands to gain from removal of barriers to trade. Advancement with the trilateral agreement between Southern
Africa Development Community (SADC), East African Community (EAC), and Common Market for Eastern and Southern Africa (COMESA) is bound to boost opportunities for trade and enhance economic growth in the entire region, including Kenya. Kenya has also diversified her commercial relationships to a wide array of partners, especially in Asia and, increasingly, in the Middle East. These new relationships offer new opportunities to boost economic growth through expanded trade and investment and also other dimensions of development cooperation.

Kenya has embarked on the implementation of an ambitious new constitution, the Constitution of Kenya 2010. The key aspect of this constitution is devolution, which has resulted in the creation of forty-seven constituent county governments. The devolution process is a significant shift from the previous system, where power was concentrated with the central government. Devolution is particularly important because it provides for individual counties to deliver specific services and to design policies to promote growth. The counties have different resource endowments that can be used once devolved policies and resources are efficiently employed but, also, those disadvantaged by resource endowments have a compensatory mechanism in line with shared growth. If well implemented, devolution holds the potential to significantly support growth. Each county has different resource endowments, so policies and the provision of services closer to the populace will spur economic vibrancy at the periphery.

Kenya has also discovered new natural resources, with oil being the most important. The exploitation and possible exportation of oil by Kenya is expected to support the country’s transformation process by reducing the cost of energy and stimulating manufacturing of petrochemicals, plastics, and related products. These are expected to drive economic growth and generate more employment opportunities in the country.

The large youthful population in the country presents the country with an opportunity to accelerate its growth. There is an increasing number of educated youth, and this group has been active in various mobile phone-based financial services innovations that have created job opportunities. With a supportive environment, Kenyan youth hold great potential for economic growth. Coupled with the growth in youth
population, the emerging middle class in Kenya forms a large market, a
group of innovators, investors, consumers, and early adapters. The middle
class population prefers and preserves stable policy and political environ-
ment. They have everything to lose with violence and civil wars, hence are major contributors in creating a supportive environment and
market that drive investment and employment creation in the country.

However, the country also faces serious pitfalls that present real risks
to growth potential. A serious challenge to economic growth in the
long run pertains to the limited transformation of the economy. Although
there have been important shifts in terms of sectoral contribution from
agriculture to services, the economy has undergone only limited trans-
formation. In agriculture, which is the primary source of livelihood for
the vast majority of the population, productivity remains low, and most
subsectors are characterized by traditional production methods. Like-
wise, productivity in manufacturing is low, and the growth in this sec-
tor has been stunted. The share of manufacturing output to GDP has
remained relatively flat. The expectation given the resource endow-
ment pattern in Kenya was that agri-industries would transform agri-
cultural production downstream and expand the manufacturing sector
and product demand upstream. The failure to transform the economy
is a major threat to economic growth and job creation.

The fragile democracy in Kenya is also a challenge to sustained eco-
nomic growth in the country. The sporadic ethnic violence observed
during elections has been a major concern, and private investors seem
to have adopted a waiting option, driven by election cycles. This is the
pattern that was observed in most ethnically heterogeneous constitu-
cencies in 1992, 1997, 2002, and even in 2007 general elections (see
Kimenyi and Ndung’u 2005). This can only be resolved by strong institu-
tions of governance and obedience to the rule of law. Other risk factors
include the emerging terrorist attacks by the Al-Shaабab group based
in Somalia, which has adversely impacted the country’s economy and
directly affected the tourist sector. The youth bulge could also easily
turn out to be a curse instead of a blessing if not enough jobs are created
for the increased youth population. Likewise, poverty and inequality
and, more so, inequality at the regional levels remain high and pose
threats not only to sustained growth but also to stability. Empirical evi-
idence has shown that inequality can choke a growth momentum. In addition, internal institutional weaknesses and governance challenges threaten the gains of the new constitution. These and other risk factors are of concern to the country’s ability to sustain growth and retain its position as a dominant economy.

CONCLUSIONS

The objective of this study was to analyze the recent drivers of economic growth in Kenya and to evaluate the impact of growth on labor market prospects, as well as population growth dynamics. This is in recognition that Kenya, as the ninth largest economy in Africa and the fourth largest in Sub-Saharan Africa, presents some lessons that can boost its capacity and take advantage of its location and policy environment to drive growth in the region. We advance from Mwega and Ndung’u (2008), but also review the challenges as well as the opportunities that are likely to influence the country’s growth trajectory. We have provided a background to Kenya’s economy and some important policy and political developments that have a bearing on economic performance. The discussion and analysis dwell on the macroeconomic performance and the role of political economy and markets in Kenya’s growth process. The most important conclusion to be drawn here, to relate it to the micro-analysis, is one of institutional and policy failures. The study then focuses on the country’s population growth, its structure and transition, and the prospects of reaping the demographic dividend. The interest here was primarily on those aspects of the population that have a bearing on economic performance and, specifically, on the labor markets. We focus on the working-age and youth populations, and the implication for population dividend, in addition to analyzing the trends in urbanization and the implication for economic growth.

The analyses of Kenya’s population trends reveal a high rate of population growth, though the rate of population growth is expected to continue on a downward trend. Urbanization is expected to continue at a steady rate, even though the vast majority of the population will remain in rural areas. Increased urbanization and expanding cities has
been shown to increase economic growth if accompanied with enhanced infrastructural development and decongestion of the urban areas. The demographic transitions experienced over the years in the country put Kenya on the path to reaping demographic dividend. If measures are put in place to enhance institutional quality and provide productive employment opportunities to the large working population, Kenya is likely to realize her demographic dividend even before 2050. The emergence of the middle class in the country, which is driving innovations in the country, is also increasingly appealing to investors, hence presents an opportunity for economic and social–political growth through advancement of social progress, realization of inclusive growth, innovation, and entrepreneurial drive.

The Kenyan labor market is dominated by the informal sector employment, which has been rising since the early 1990s. On the other hand, employment in the modern (or formal) sector has remained stagnant over the period. In view of the insufficient capital accumulation in the country, labor tends to move into the informal and self-employment sectors, which require limited capital as compared to the capital-intensive modern sector and capital-intensive agricultural activities. To enhance long-term growth prospects, the rapid growth in labor supply should be accompanied with rapid growth in capital accumulation. Labor market growth and dominance of informal employment has reduced the capacity of the economy to deliver quality employment and output growth via productivity. Over the years, there has been an increase in the number of informal units rather than expansion of the existing ones. The private sector is best positioned to drive labor demand in the future, having increasingly dominated the provision of employment opportunities over the public sector. Therefore, continued implementation of measures to boost private sector investments should be highly encouraged.

Earnings across the various sectors of the economy and even within the sectors (between public sector employees and private sector employees) were found to vary. This reflects barriers to mobility of labor between the informal and formal labor market, resulting in labor with similar skills being rewarded differently in the two markets. This is an indication that the different segments of the labor market in Kenya are not fully integrated and are less efficient, since labor mobility is impor-
tant in ensuring efficient allocation of the labor force in the market. The rising productivity since 2009 and the results related to returns on human capital indicate an improvement in the efficiency of labor in the country. With the improvement in labor efficiency, additional capital accumulation will propel the country to a rapid economic growth path.

Growth-employment elasticity has slightly declined in recent years. However, growth in wage employment and, by extension, growth in total employment has tracked GDP growth closely since 2004. On the other hand, there has been no clear pattern in the relationship between GDP growth and growth in informal sector employment or growth in self-employment and unpaid family workers. This affirms the fact that the key to growth in formal sector employment is capital deepening, which is fundamental for economic growth.

Finally, it is the middle class that seems to drive the economy. A developing country with a large middle class is likely to enjoy peace, stability, and increased private investments that will drive overall growth. That is where the Kenyan economy is at the moment.

**NOTES**

1. In 2014, Kenya had an average score of 3.76, above Africa’s average of 3.20.
2. Recent growth rates have been revised as a result of the rebasing of the economy in September 2014. This involved revisions in sector classifications and the base year to 2009. Rebasing increased the GDP by 25 percent in 2013 so that indicators such as the Debt/GDP, current account balance/GDP, and fiscal deficit/GDP improved (Central Bank of Kenya, Monetary Policy Statement, October 2014).
3. According to a Central Bank of Kenya (CBK) estimate, excluding heavy machinery and industrial equipment would reduce the current account deficit to a sustainable 4.2 percent of GDP in the year to July 2014.
4. This is based on our own analysis. Only at six lags is there a two-way causality between growth and gross capital formation.
5. “Syndrome free” refers to a situation where a country avoids four broad anti-growth regimes: 1) severe controls or regulations that distort production activities and reward rent-seeking behavior; 2) ethno-regional redistribution that compromises efficiency in order to generate resource transfers to sub-national political interests; 3) inter-temporal redistributions that aggressively
transfer resources from the future to the present, especially in resource-rich countries; and 4) state breakdown characterized by civil war or intense political instability during which the government fails to provide security or to project a coherent influence in a substantial portion of the country.

6. The public sector management and institutions cluster includes property rights and rule-based governance, quality of budgetary and financial management, efficiency of revenue mobilization, quality of public administration, and transparency, accountability, and corruption in the public sector.

REFERENCES


