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Foreign Development Assistance in Kenya's Manufacturing Sector: In the Interest of Development Partners or For Mutual benefit?

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Abstract: *This article delves into the role of foreign development assistance in Kenya's manufacturing sector, analyzing motivations, outcomes, and mutual gains. Against the backdrop of historical financing limitations in African countries' manufacturing sector, development aid has emerged as a pivotal instrument, addressing the limited domestic resources for economic growth. Foreign development assistance on Kenya's manufacturing growth has had mixed outcomes. On one hand, it has enabled the construction of critical infrastructure and technology provision while on the other hand, it has fostered unintended repercussions. The promotion of competitive imports through foreign aid agreements and conditionality has triggered intense competition for local products, prompting the closure of local manufacturers unable to withstand foreign competition. Despite Kenya's strides, the manufacturing sector's potential remains untapped, as the nation relies predominantly on exporting primary resources and importing essential goods. The findings of this article reveal that foreign aid to Kenya's manufacturing sector is frequently aligned with development partners' national interests, facilitating technology, knowledge, and resource transfer. This article underscores the need for strategic global alliances that align with the interests of Kenyan manufacturers, thereby fostering sustainable economic advancement.*

Keywords: *Foreign development assistance, Development Partners, Kenya Manufacturing Sector, Development Partners interests, foreign assistance, Kenya Manufacturing assistance, Development Partners mutual benefits*

INTRODUCTION

African nations have continued to confront fiscal limitations impeding the advancement of their manufacturing sectors. The deficiency in domestic savings has prompted a reliance on foreign capital, crucial for fostering manufacturing growth in these economies. Development aid has emerged as a pivotal instrument driving growth across Africa, countering the shortfall of

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domestic resources to sustain economic activities (Ndikumana, 2022). At the core of foreign aid's role in the industrial sector lies the pivotal issue of capital, an essential ingredient for establishing a robust industrial foundation within a nation. The existing body of literature concerning industrial growth underscores the intrinsic nexus between capital accumulation and the process of industrialization (Kemp, 2014; Oqubay, 2015; Page, 2014).
The industrialization journey in Africa has been significantly aided by bilateral state interventions and various multilateral institutions. Development aid allocation has facilitated the creation of critical infrastructure like roads, ports, and power plants, fostering a stable and efficient environment conducive to industrial expansion. Furthermore, funding educational initiatives has fostered the cultivation of a skilled workforce vital for the industrialization process. Technical assistance initiatives, supported by development aid, have empowered developing nations to design and implement industrial policies that foster sustainable industrial growth(Kemp, 2014).

In the 21st century, Kenya's trajectory has been marked by substantial economic growth, attaining an average annual GDP growth rate of 4.81 percent from 2004 to 2022 (World Economics, 2023). Despite its lack of significant natural resources, Kenya ranks as the seventh-largest economy in Africa and serves as a regional leader in East Africa. Agriculture, encompassing critical sectors like coffee and tea cultivation, remains a linchpin, contributing around 22 percent to the nation's economy. Closely trailing is the manufacturing sector, accounting for approximately 11 percent of the GDP (Trading Economics, 2022).However, the growth of Kenya's manufacturing sphere has lagged behind other sectors like agriculture and services (Ngui et al., 2016). The sector contends with challenges in attaining favorable factor productivity growth rates due to an array of hindrances obstructing industrial development. These obstacles encompass limited access to financing, inadequate infrastructure, and inconsistent policies and bureaucratic processes, collectively leading to a demanding business environment (Ngui et al., 2016; Were, 2016).

Exploring the role of foreign development assistance in Kenya's manufacturing sector can provide valuable insights into the dynamics of international partnerships and their impact on the manufacturing sector. This article looks into the role and impact of foreign development assistance in Kenya’s manufacturing sector.The article employed a mixed research design that integrated both qualitative and quantitative data sources. This approach encompassed qualitative information garnered from interviews involving four pivotal stakeholder groups in Kenya—government officials, manufacturers, donor agencies, and private sector representatives. To support this primary qualitative data, secondary data was also drawn from national and international databases.An assessment of the role of foreign aid in Kenya’s manufacturing history is covered below, before looking at the controversies and issues arising relating to the place of foreign aid in enabling manufacturing in the country.

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FOREIGN DEVELOPMENT ASSISTANCE IN KENYA'S MANUFACTURING SECTOR

This section looks into the foreign development assistance in Kenya’s manufacturing: in the interest of development partners or for mutual benefit? By addressing the major question of concern, the paper covers the following sections foreign aid to Kenya’s manufacturing sector: a historical overview, aid for trade in Kenya’s manufacturing in the 21st century, and in the interest of donors or for mutual benefit?

Foreign Aid to Kenya’s Manufacturing Sector: a Historical Overview

Like many African countries, early 20th Century manufacturing in colonial Kenya was dominated by the non-African populations of European settlers, Asian and foreign multinationals (Gachino, 2009). In the East African region, Kenya was the dominant producer of manufactured goods with the European settlers setting up industries through the support of development aid from the British Empire. The native Kenyans served as laborers in industrial factories and as a market for the goods produced. When Kenya gained independence in 1963, it had an economy that was created to meet the standards and needs of the British settlers and foreign markets. As fairly sophisticated as this system was, the newly established Kenyan government was not able to sustain the manufacturing growth in the immediate years of independence(Kamau & McCormick, 2011). The manufacturing sector in this era was fostered by policies to attract foreign capital and investment while targeting the needs of foreign markets. The post-independent government was therefore keen on creating a domestic manufacturing base that catered to the needs of Kenyan citizens while supporting their engagement in manufacturing enterprises.

It was against this backdrop that Kenya began to receive development aid to improve its economic condition post-independence. The British government was the first aid donor to provide development financing to Kenya after independence. Other donor countries, included the United States, France, Japan, and Germany. Foreign aid in the early years to the manufacturing sector was directed at building infrastructure, supporting the construction of factories, and offering technical assistance as the government put in place policies and regulations to support manufacturing. Kenyan scholars in this period noted that the industrial policies adopted after independence bred monopolies as foreign aid was used as a means for foreign dominant powers to continue their neocolonial interests in Kenya. The largest beneficiaries of foreign aid to Kenya were the multinational foreign investment firms who got access to local and regional markets as a result of bilateral agreements between Kenya and their mother countries (Coughlin & Ikiara, 1988). Existing local enterprises were often destroyed by the competition of these foreign institutions.

From 1964 to 1973 the manufacturing sector's share of GDP increased only marginally contributing to 10 percent of GDP (Chege et al., 2014). However, compared to other countries in the region, Kenya continued to be a dominant industrial player. The manufacturing output of Kenya in this initial decade grew faster than other industrial sectors in sub-Saharan Africa during

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the 1960s- 1970s. This period led to the establishment of industrial sectors such as paper, food processing, textile & garment, and leather tanning & footwear (Kinuthia, 2013). Kenya implemented an Import Substitution Policy (ISI)after gaining independence in 1963. Driven by the desire to be self-sufficient from imports of manufactured goods, the post-independence government was keen to establish a local manufacturing base. The policy aimed to promote economic development by reducing the country's dependence on imported goods and encouraging the growth of local industries. The ISI policy supported the increase of tariffs on imports to make them costlier than locally produced goods, implementing import licensing, restricting foreign currency acquisition for imports, and offering subsidies and incentives such as tax holidays and low-interest loans (Ngui et al., 2016).

The implementation of the import substitution policy had both positive and negative effects on Kenya’s industrial sector. On the positive side, it led to the growth of local industries and increased employment opportunities. Industries established from the 1960s to 1990s include Rivatex, Ken Knit, Kenya Canners, Del Monte, Kakuzi, East African Pharmaceuticals, and East African Portland Cement. However, the ISI policy equally had negative effects, including the creation of inefficiencies in domestic industries, higher prices for consumers due to the protection of local industries, and limited access to foreign goods and technology. The model proved to be unsustainable, solely focusing on the domestic market, and caused major problems with the balance of payments as the government ended up relying heavily on imported materials for industrial production(Were, 2016). The problem of limited technical skills in the Kenyan population and the collapse of the EAC in 1977 also greatly contributed to the failure of this system (Ngui et al., 2016). Despite the challenges of import substitution, the Kenyan government continued to hold on to this system implementing limited reforms. The manufacturing sector in Kenya appeared competitive initially, but a closer examination exposed flaws in an unsustainable system. Weak institutional structures and state-led initiatives hindered efficiency and private investment. The focus on ISI limited global competitiveness and economies of scale, while protectionist policies stifled innovation. Additionally, largely owned multinational industries lacked linkages to the broader economy, limiting overall manufacturing growth in small and medium enterprises. (Chege et al., 2014).

In the 1980s, Kenya was encouraged by the Bretton Wood institutions to adopt the Structural Adjustment Programs (SAPs) as part of the conditionalities to receive development aid as it worked on re-stabilizing the economy after the 1970s oil price shocks (Nzau, 2010). The market-oriented policies, called for a reduction of government spending, increasing revenue collection, tightening monetary policy, privatizing some state corporations, and the adoption of an open economy reducing barriers to international trade. These policies sought to remove the ‘Anti Export Bias’ that was encouraged in the ISI phase leading to the removal of the restrictive import licenses and tariffs(Schmidt, 2020). The Kenyan economy became liberalized and was gradually opened to external markets. These policy recommendations formed the basis of the economic reforms that Kenya implemented from the 1980s to the 2000s.

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Although the programs aimed to foster economic growth and development, they resulted in significant social and economic repercussions. The policies caused a decrease in government expenditure on vital social services like healthcare and education, adversely affecting the most marginalized segments of the population (Kalu, 2018). The impact of the SAP conditionalities on manufacturing in Kenya was mixed. On the one hand, SAPs led to the closure of many manufacturing enterprises and the opening up of the economy to foreign competition. This resulted in a significant decline in the output and employment in the manufacturing sector. A renowned Kenyan economic development expert who worked in the sector during this period noted that the opening up of the economy resulted in the shutdown of domestic manufacturing companies as inexpensive imports flooded the market. Numerous local companies faced difficulties in competing with more affordable imports, leading to decreased market share and profitability.The few export-driven industries experienced disruptions as changing international trade dynamics and consumer preferences resulted in reduced orders and the closure of businesses that couldn't adjust.

On the other hand, some industries, such as those in the textile sector, were able to restructure and become more competitive as a result of the SAPs. The removal of import controls and the depreciation of the Kenyan shilling made it cheaper to import raw materials, leading to an increase in textile product exports (Asongu & Odhiambo, 2019).Garrison Ikiara, a Kenyan economist and researcher, emphasizes the significance of Structural Adjustment Programs (SAPs) in Kenya's economic recovery as a result of the impact of the 1970s oil crisis and mismanagement of funds by previous political regimes. Ikiara credits the governance and institutional reform conditions imposed by Western donors for effectively addressing unsustainable government spending and corruption, leading to a more conducive business environment.

This article notes that the impact of SAPs on manufacturing in Kenya was largely negative in the short term, with many firms closing down and significant job losses. Foreign developmental aid taken up from the 1980s to the post-Cold War era had a small impact on the manufacturing sector with the share of GDP coming from manufacturing contributing to an average of 13% between 1990 and 1995 (Chege et al., 2014). However, in the long run, the Kenyan manufacturing sector has been able to restructure and become more competitive, leading to increased exports and growth in the sector (Gachino, 2014).

Aid for Trade in Kenya's Manufacturing in the 21st Century

In the 21st century, foreign aid has continued to be a dominant feature in supporting the manufacturing sector. The donor community in Kenya has in recent decades begun to adopt the global development trend of supporting countries through the international initiative commonly known as 'Aid for Trade'. It is a type of development aid that aims to build the economic capacity of countries by improving their trade-related infrastructure, policies, and regulations (Kalu, 2018). For Kenya, this renewed focus on supporting enterprise has resulted in more foreign aid financing being directed to the manufacturing sector. With the liberalization of the

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Kenya economy, the government has largely taken a step back from directly participating in manufacturing activities holding on to a few government-run manufacturing firms that were established in the ISI era. These government-owned manufacturing firms include Chemelil Sugar and Rivatex Limited. These government-owned manufacturing firms, although few have received grants and concessional loans through bilateral and multilateral donor support. In 2016, Rivatex textile manufacturing firm received a Sh. 3 billion concessional loan from the Indian government to support the upgrading of machinery and operations (Lubanga, 2020). The private sector consisting of local and foreign manufacturing businesses has equally received financial support from a variety of donors in the country. As a whole, the largest sum of foreign aid financing in Kenya has not gone to supporting manufacturing firms directly but has been directed to supporting the enablers of manufacturing which include improving transportation networks, building new power plants, and upgrading water and sanitation systems. There is a greater focus on foreign donors collaborating with the government and the private sector to facilitate the establishment of a stronger industrial base.

The emergence of foreign aid from newly industrialized states to Kenya's manufacturing sector has caused a notable transformation in the landscape of aid and development. Countries like China, India, Israel, Brazil, and Turkey have become prominent donors, engaging in South-South collaborations to strengthen diplomatic ties. Unlike traditional donor nations, these rising powers prioritize supporting development projects in the productive sector. China, in particular, takes the lead by offering concessional loans, grants, and technical assistance. This increase in aid from emerging powers has led to a rise in foreign investment enterprises establishing themselves in Kenya's manufacturing sector. As pointed out by Hyseon Na, this has resulted in the diversification of manufactured goods, reducing reliance on exports of non-processed agro-products like tea and coffee. Instead, investments in sectors such as textiles, leather, and motor vehicle assembly have emerged, causing a significant shift in the country's manufacturing landscape (Na, 2016). While these developments bring potential benefits in terms of industrial diversification and growth, concerns have been raised by domestic manufacturing firms. Unfair competition arises as foreign manufacturing firms, benefitting from aid and other incentives, enter the Kenyan market and directly compete with local firms. The monopolistic tendencies exhibited by some foreign firms are concerning, as they displace local production firms and gain control in certain sectors.

Despite receiving foreign aid aimed at supporting Kenya's manufacturing sector, this article noted that the governance and institutional frameworks within the country have been major constraints, leading to poor utilization of foreign financing. A majority of the respondents to the interviews noted that high levels of corruption have resulted in the misappropriation of foreign capital, while fiscal mismanagement and over-borrowing have led to a debt crisis, burdening the manufacturing sector with a high tax regime (Kodongo, 2022). The debt crisis and the government's revenue generation necessities have driven the implementation of a demanding tax system in Kenya, imposing significant pressure on the private sector, including manufacturing companies. This tax environment has diminished the profit margins of local manufacturers, hampering their ability to invest in the sector. As a consequence, domestic manufacturing firms

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are facing difficulties in staying competitive in the Kenyan market, resulting in business closures and a decline in the overall size of the manufacturing sector. These challenges have negatively impacted the potential benefits of foreign aid on Kenya's industrial development.

In the Interest of Donors or for Mutual Benefit?

Although the Kenyan government and a few businesses have benefited from foreign aid to the manufacturing sector, this article notes that the distribution of aid to the sector is largely based on the interest of donors while passively taking into consideration the manufacturing agenda of the country. Indeed structures exist for donor agencies to consult with the Kenyan government to harmonize goals and objectives, however, the decisions eventually taken by donor agencies will be determined by the needs of their main constituents who are their citizens.

The decision by donors to focus on one area of interest in the manufacturing sector compared to another is dependent on what will lead to the greatest return for the donor country. For example, the Japanese Development Agency (JICA) has supported the construction and establishment of Special Economic Zones (SEZ) and Export Processing Zones (EPZs)(JICA, 2022). These industrial hubs have encouraged foreign investors including Japanese investors to establish manufacturing firms at a low cost enabling them to export their goods with minimal to no tariff charges. In the same light, foreign aid to manufacturing cannot be directed to sectors that may have direct competition with donor countries' businesses. For example, the US development agency cannot fund sectors like steel manufacturing because there is a risk that these foreign firms may end up affecting American manufacturers negatively. While seemingly acknowledging the recipient country's needs, this article's findings demonstrate that aid initiatives are strategically designed to align with sectors that simultaneously yield advantages for the contributing partners. This strategic alignment often facilitates the transfer of knowledge, technology, and resources, affording development partners increased market access and potential economic advantages. Consequently, while responding to the recipient's requirements, the overriding objective remains to fulfill the priorities and interests of the donor nation.

Foreign aid in Kenya’s manufacturing has been linked to the promotion of inequality where a few businesses continue to benefit from the donor aid. A 2011 Kenyan study by Gerald Holtham et al. shows that aid funds have to a great extent been linked to inequality in the recipient country. The study notes that the structure of the aid system generally favors those within a society that already have a mix of opportunities that enable them to benefit from the aid(Holtham & Hazelwood, 2010). A majority of the manufacturers interviewed for this article noted that the acquisition of some donor-related economic opportunities requires one to have already established existing entrepreneurial skills that they can prove for the acquisition of donor support. This eventually leads to only a few individuals benefiting from the aid. The influence of foreign development assistance has yielded a multifaceted outcome for the progression and transformation of Kenya's manufacturing domain. On one hand, it has served as a pivotal enabler by furnishing essential infrastructure and technology – pivotal components in nurturing a robust

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manufacturing foundation. On the other hand, the effects of aid have also given rise to unintended ramifications. The active promotion of competitively priced imported goods from the markets of development partners has cultivated substantial competition for locally manufactured products while promoting inequality among businesses. Unfortunately, this dynamic has culminated in the closure of indigenous manufacturing enterprises that were unable to withstand the formidable challenge posed by these dynamics.

CONCLUSION

In conclusion, the motivations of development partners often intertwine with their national objectives, thus shaping the contours of aid projects in the manufacturing sector in Kenya. Although foreign assistance has positively contributed to Kenya's manufacturing realm through the infusion of technology and infrastructure, the sector has concurrently grappled with challenges due to import-oriented competition supported by foreign aid conditionality. As Kenya navigates this landscape, it becomes imperative to engage in strategic alliances that align the interests of all stakeholders, thereby fostering a harmonized and sustainable trajectory for the manufacturing sector and the broader national development agenda.

This article recommends that Kenyan policymakers should diversify their sources of funding beyond relying solely on foreign development assistance to reduce their aid dependency. They should actively promote domestic savings and attract foreign direct investment as viable alternatives. Moreover, there is an urgent need to empower local entrepreneurs and enhance their competitiveness against foreign counterparts within the manufacturing sector. This involves providing tailored support for the adoption of technology, fostering innovation, and promoting skill development. A well-crafted policy framework is essential to create a balanced playing field that safeguards local industries while simultaneously promoting an open trade system for the importation of foreign goods. Ultimately, this approach can pave the way for sustainable economic progress.

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