Inclusive Growth and Structural Transformation Pillar Strategy

1. Introduction

Kenya has recorded a robust average annual economic growth of 5.9% during the period 2010-17 and GDP is forecast to grow by over 6% in the medium term.[1] The Human Development Index improved from 0.468 in 1990 to 0.590 in 2017 an increase of 26.1%. Although progress on social indicators has been significant, more effort is required to achieve the Sustainable Development Goals (SDGs).[2]

Poverty remains high despite a decline in the poverty rate from 46.6% in 2005/06 to 36.1%[3] in 2015/16.[4] Poverty rates remain above 70% in remote, arid and sparsely populated north-eastern parts of Kenya.[5] Poverty is also feminized. The latest Kenya Integrated Household Survey (KIHBS) results show that 30.2% of female headed households are poor compared to 26.0% of their male counterparts.[6]

Income inequality levels have not decreased significantly in recent years. Kenya's Gini coefficient of 44.5 is above the 2013 sub-Saharan African average of 43.8.[7] Nationally, more than half (59.4 per cent) of total expenditure is controlled by top quintile (Q5) while the bottom quintile (Q1) controls the least share of 3.6 per cent.[8] While increased poverty in urban areas is attributable to the lack of employment opportunities, inequitable access to public goods between rural and urban populations also informs income disparities.[9] Notably, a wide urban-rural gap exists in access to education, electricity, water and sanitation, health and housing services, which exacerbates inequalities[10] and leaves a significant proportion of the population behind

The Kenya National Bureau of Statistics (KNBS) estimates that unemployment stands at 19.2% amongst youth aged 20 – 24 years with female constituting 64% of the unemployed [11]; as such, there is pressure for job creation and skills match in the labour market. The formal sector currently generates 20% of the jobs required to absorb the labour force which is growing at 2.9% per annum.

Slow structural transformation in production and labour markets has resulted in most workers being confined to low earning jobs or the informal sector and is another underlying cause of poverty. The Medium-Term Plan II (MTP II) 2013-2017 projected the creation of about 1 million jobs per year between 2013 and 2017. Data from the MTP II midterm review (2017) show, however, that between 2014 and 2015, the number of new jobs was estimated at only 799,700 and 841,600, respectively. Furthermore,

[1] Medium-term Expenditure Framework, 2017.
[2] Kenya Voluntary National Report, 2017.
[3] Using the US$1.90 2011 PPP, the poverty rate declined from 43.6% in 2005/06 to 35.6% in 2015/16 (World Bank, 2018).
[4] Using the monthly adult equivalent total consumption expenditure per person below KSh 3,252 in rural and peri-urban areas and below KSh 5,995 in core-urban areas as national poverty lines (KNBS, 2018. Kenya Integrated Household Budget Survey (KIHBS), 2015/16).
[5] *ibid*.
[6] The female labour participation rate (75.9 percent) is lower than the male labour participation rate (79.2 percent) (KNBS, 2018. Labour Force Basic Report, 2018)
[7] KIHBS 2015/15 and World Bank, 2016.
[8] KIHBS 2015/2016.
[9] World Bank, 2014.
[10] Oxford Poverty and Human Development Initiative, 2017.
[11] *ibid*.

bout 83% of these were in the informal sector,[12] which is characterized by low labour productivity and earnings, poor job security and no social protection. The number of jobs in the informal sector is growing faster than in the formal sector, rising by about 4 million compared to 60,000 since 2009, while the share of the formal economy in total employment shrunk to 17% from 19%.[13] The formal sector, which generates around 20% of the jobs required to absorb the labour force, is growing at about 2.9% per annum. With unemployment at 21.8% among youth aged 18 to 24,[14] there is pressure to spur growth in the formal employment sector to sustain a middle-income growth trajectory including in the productive sectors through employment creation and catalytic structural economic transformation.

In line with the Strategic Plan Signature Solution 1, keeping people out of poverty, and Sustainable Development Goal 1 and 8[15], the programme will support capacity development across the government for inclusive growth, gender-sensitive and evidence-based policies, particularly in the Arid and Semi-Arid Lands (ASALs). In partnership with the World Bank (WB), African Development Bank (AfDB), Kenya National Bureau of Statistics (KNBS), county governments, civil society and the private sector, the programme will support initiatives on macroeconomic and poverty analysis for inclusive growth policy formulation and implementation for structural transformation, gender and extractives; support monitoring of the Sustainable Development Goals (SDGs) "big data" gaps, including the 2019 National Population and Housing Census; and poverty reduction interventions.

To complement enabling actions in infrastructure, public sector reforms and innovative financing mechanisms, in line with SDG 9, UNDP will focus on structural economic transformation for job creation through policy advisory support to increase the economic share of the manufacturing, extractives and mineral resources, industrial and exporting sectors. The programme will deliver livelihoods interventions for increased productivity, income generation and rural development and improve stakeholder capacities to access entrepreneurship opportunities, particularly for young men, women and persons living with disability. Through the *Biashara* (Business) Centres, innovative technologies will be deployed, particularly for female-headed households, to address the gendered dimensions of poverty and add value, strengthen quality standards and improve access to markets, in collaboration with the Food and Agriculture Organization (FAO), International Labour Organization (ILO), United Nations Children's Fund (UNICEF), UN-Women, civil society organizations, the private sector and county governments, in line with SDG 8. The programme will address youth unemployment through scalable pilot fruit agro-processing value chains in Tana River and Taita Taveta Counties and with the private sector for leather production in Turkana County.

2. Theory of Change

The overall policy objective of the inclusive growth and structural transformation pillar is to achieve inclusive and sustainable growth in Kenya. This objective is an acknowledgement that current patterns of economic growth have not been capable of the transformative change required to reduce poverty, inequalities and generate employment in Kenya.[16] It is a recognition of the fact that, without fundamental

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[12] *ibid*.
[13] Kenya National Bureau of Statistics, 2017.
[14] World Bank, 2017
15 Promote sustained, inclusive, and sustainable growth, full and productive employment and decent work for all.
16 Slow structural transformation in production and labour markets has resulted in most workers being confined to low earning jobs or the informal sector and is another underlying cause of poverty. The Medium-Term Plan II (MTP II) 2013-2017 projected the creation of about 1 million jobs per year between

changes in the structure and pattern of growth, rising inequalities and exclusion may well prevail and, unless systems that build resilience to protect the economy and Kenyan society against crises are forthcoming, most vulnerable households may slide right back into poverty and, without sustaining the environment, economic growth itself may be compromised.

Achieving inclusive and sustainable growth, however, is no easy task. There are trade-offs between different policy objectives and these should be identified at the outset in national development plans and strategies.

The evidence and trends point to three broad policy priorities:

- Integrated Planning for Inclusive and Sustainable Growth:

The need to recalibrate economic growth structures and patterns such that they are diversified and broad-based and to focus on boosting domestic demand to create productive and decent employment while preserving and promoting environmental sustainability. The evidence shows that in Kenya, economic growth has not necessarily been accompanied by reductions in income inequality and extreme poverty.[17] This is the distributional bias of growth that needs to be addressed if Kenya is to adopt a more inclusive growth pathway. Activities for integrated planning for inclusive and sustainable growth include establishing evidence-based analysis for national plans, promoting economic diversification and sustainable growth pathways and promoting environmentally sustainable natural resource management.

- Supporting Employment Creation, Decent Work, and Redistributive Programmes to Address Poverty, Inequality and Exclusion:

Economic growth can reduce inequality and extreme poverty only if its benefits are shared widely across the population. Employment represents an extremely important channel through which the income generated by growth is distributed. So, an inclusive and sustainable growth strategy must prioritize a pattern of growth that creates a sufficient number of jobs to secure productive employment for the majority of the workforce; the employment created needs to provide sufficient income, security and stability to workers (decent work); and employment needs to be accessible to all groups within a population.

It is important to address the inequality of opportunities that consistently excludes specific groups, including women, ethnic and racial minorities, among others, from the gains of development. Persistent inequality between different segments of a population can entrench discriminatory practices and cultural biases that fuel social exclusion. Thus, policy measures must address the inequality of outcomes and opportunities in tandem.

Activities for facilitating the creation of productive employment, including in firms and sectors promoting environmentally sustainable practices, include: supporting work and employment sectors to better address poverty, inequality and exclusion; promoting decent work; removing barriers to access to labour market opportunities; improving working conditions, particularly for the poor; and scaling up redistributive programmes, especially support to social protection systems.

2013 and 2017. Data from the MTP II midterm review (2017) show, however, that between 2014 and 2015, the number of new jobs was estimated at only 799,700 and 841,600, respectively.

[17] Income inequality levels have not decreased significantly in recent years. Kenya's Gini coefficient of 44.5 is above the 2013 sub-Saharan African average of 43.8. Poverty has declined at a slow rate of an annualised rate of 1.8% between 2005 and 2015.

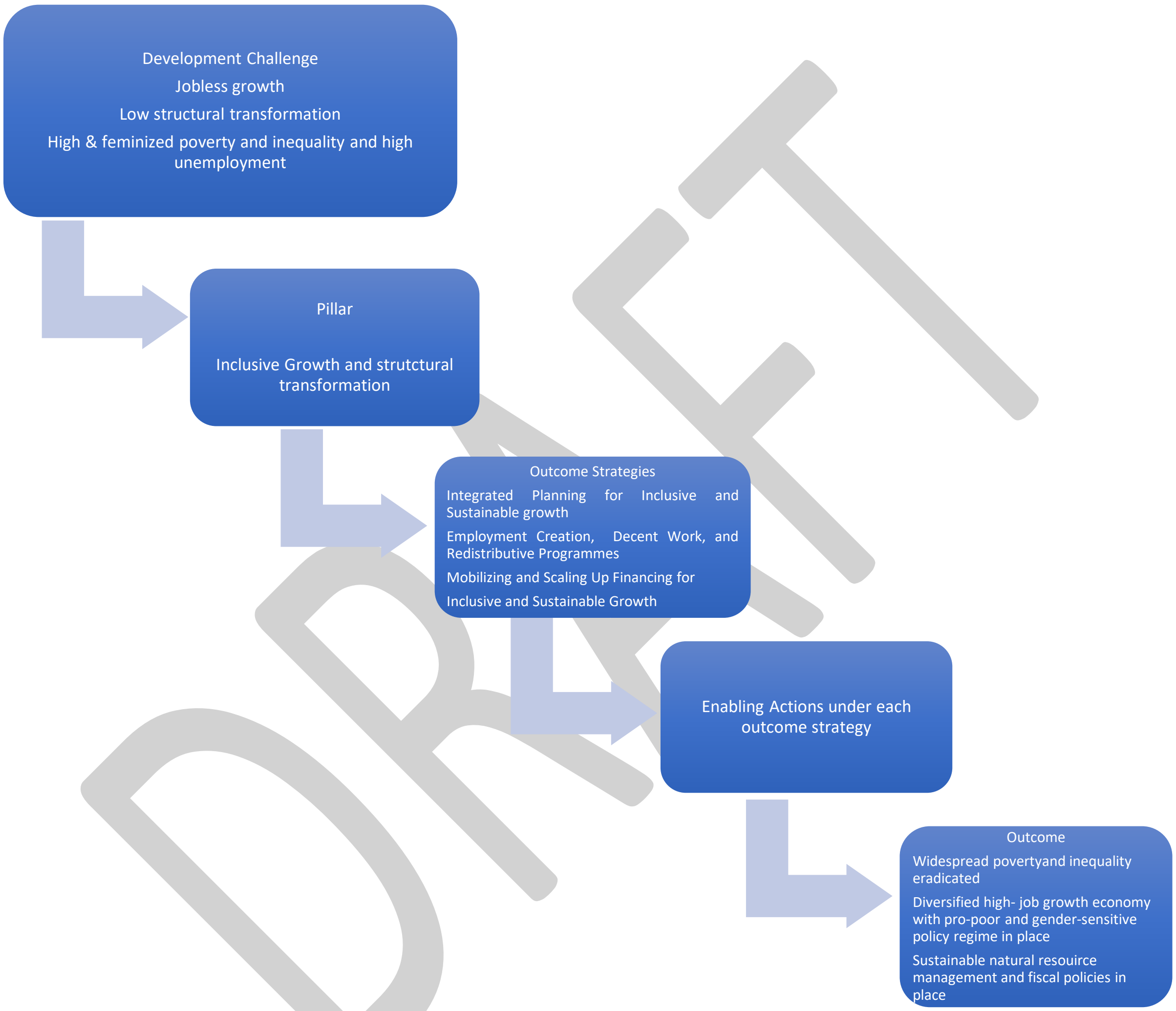
- Mobilizing and Scaling Up Financing for Enabling Transition to Inclusive and Sustainable Growth

Expanding fiscal space is a key challenge in Kenya in light of the high public debt. In this context, three issues are particularly important: first, the need to adopt a progressive tax regime so that the cost of financing development does not fall disproportionately on those that public policy is trying to assist; second, reforms to improve the efficiency of tax collection systems and expenditures; and third, to prevent tax evasion (curb illicit financial flows) and tax avoidance by domestic and foreign companies and high-worth individuals. In light of the recent discovery of oil and natural gas in Kenya, implementing a fiscal regime to sustainable managing resource revenues is key as tax incentives in the extractives sector can result in large revenue losses when rent-sharing agreements are negotiated in a way that leads to highly favourable terms for investors at the expense of lower public revenues. Sustainable management of extractive sector for human development will require capacity to manage boom time revenues more prudently.

Activities to mobilize and scale up financing include promoting fiscal policy consistent with inclusive and sustainable growth objectives; promoting domestic resource mobilization and efficiency in public; and promoting the adoption of innovative financing mechanisms for environmental sustainability and clean energy.

See **Diagrammatic Representation of the Inclusive Growth and Structural Transformation Pillar TOC below;**

Diagrammatic Representation of the Inclusive Growth and Structural Transformation Pillar TOC[18]



[18] a) Evidence base analysis for national plans; b) Economic diversification; and c) Sustainable natural resource management (Integrated Planning for Inclusive and Sustainable Growth)
a) Productive employment; b) Decent work; c) Remove barriers to labour markets; and d) Redistributive programmes (Supporting Employment Creation, Decent Work, and Redistributive Programmes to Address Poverty, Inequality and Exclusion)
a) Fiscal policy; b) Domestic resource mobilization; and c) Innovative financing mechanism (Mobilizing and Scaling Up Financing for Enabling Transition to Inclusive and Sustainable Growth)

3. Proposed Approach

The Inclusive Economic Growth and Structural Transformation Pillar Strategy is based on a theory of change which argues that improving economic policy frameworks, diversifying the economy and strengthening capacities of institutions, enterprises and individuals will minimize economic exclusion and marginalization of the poor, and make available opportunities for decent and productive employment for target groups. The approach will be holistic and informed by UNDP's global, regional and national experiences. It will include a combination of upstream and downstream interventions, where research and pilots will inform planning and policy making and where enhanced institutional capacities will contribute to improved implementation of plans and policies on the ground. Key elements of the strategy include strengthening national capacities for pro-poor planning and policy making, promoting sustainable management of natural resources in particular extractives, enhancing productive capacities and inclusive and sustainable business practices. The strategy will respond to the reinforcing links between poverty reduction, environmental management and gender will be mainstreamed in the interventions.

Upstream interventions will focus on the following:

1) Support to national development planning and policy reforms to transform productive capacities and extend greater protection to the poor and at-risk groups from major natural and economic shocks.
2) Support to planning at national and county levels to help connect national and county priorities with action on the ground.
3) Support to collect, store, analyse and report on sex disaggregated, quality socio-economic data which will inform planning and policy making at national and county level.
4) Support development debates and actions at all levels that prioritise poverty, inequality and exclusion (NHDRs, SDG Reports and other knowledge products)

Downstream interventions will focus on the following:

1) Pilots on extractive resources governance, sustainable livelihood options and the economic empowerment of rural women.
2) Support to youth and women led small and medium size enterprises (SMEs).
3) Developing agribusiness value chains for small holder farmers/producers and rural enterprises as well as enhancing value addition.
4) Linking social welfare with climate change projects

4. Linkages with other pillars:

The Inclusive Economic Growth and Structural Transformation pillar has very close linkages with the Governance, Peace and Security (GPS) pillar and the Environmental Sustainability, Climate Change and Resilience pillar. The three pillars will be working in tandem and at every given opportunity and to the extent possible work across practices to ensure efficiency and better use of available resources. Key areas of collaboration between the Inclusive Growth and the GPS pillar include efforts to promote effectiveness, devolution, transparency, accountability, and inclusion. Possible entry points are support to the SDGs implementation and policy coherence, advancing the ten principles under the UN Global Compact and the endeavours to develop trade and promote growth of local enterprises and better management of the extractives. Hence efforts will be made to work together at the upstream level to ensure common and joint approach to issues that are similar and/or complement each other.

The Environmental Sustainability, Climate Change /Resilience pillar are closely entwined with the Inclusive Economic Growth and Structural Transformation pillar downstream interventions. Capacities that are to be developed to enable individuals and local enterprises to sustainably develop natural resource-based industry to create jobs, markets for local products and new partnerships for business are very much dependent on sound environmental conservation and ability to adapt to and mitigate effects of climate change. Therefore, in all the interventions to be undertaken under these three pillars, there are synergies to draw upon and collaboration that should be enhanced to achieve optimal results especially in the geographical areas where there will be interventions from either of the two or all the three pillars.

Proposed Interventions

Recalibrating national growth strategies to be broad-based, economically diverse and oriented towards domestic demand will be fundamental to changing growth patterns. At the same time, addressing jobless growth is critical to structural transformation. This is because having little job creation, many low-income households have ended up in low-productivity sectors with inadequate earnings, lacking job security or safe working conditions. At the same time, women workers tend to predominate in the bottom tiers, occupying the lowest-paid jobs, piece-rate subcontracted work and other insecure forms of self-employment.

Transitioning to inclusive and sustainable growth requires significantly scaled-up resources. It will require the best possible use of available resources, including official development assistance (ODA), remittances, philanthropy and South-South flows. The proposed interventions include;

Integrated Planning for Inclusive and Sustainable Growth

1. Establish Evidence Base for National and County Plans to achieve Inclusive and Sustainable Growth: This will entail supporting national and county specific diagnostics on distributional and poverty impacts of growth and associated policies, including trade and macroeconomic policies. It will also include support to policy analysis on trade-offs between current growth strategies and adoption of sustainable growth frameworks.
2. Promote Economic Diversification and Sustainable Growth Pathways**:** Support policy analysis on economic and export diversification in the context of manufacturing strategy and structural reforms. In addition, it will support development and application of social and environmental standards to assess potential social and environmental risks of specific policies and programmes.
3. Promote Sustainable Natural Resource Management and Access to Affordable Clean Energy**:** Support sustainable agricultural practices that minimize environmental impacts, including deforestation, losses to biodiversity and nutrient run-offs into water bodies. Other aspects under this component will be promoting adoption of green technologies to reduce or to eliminate the use and generation of hazardous substances and innovations for products whose methods of production have the smallest possible impact on the environment.

Supporting Employment Creation, Decent Work, and Redistributive Programmes to Address Poverty, Inequality and Exclusion

1. Facilitate Creation of Productive Employment, including in Firms and Sectors Promoting Environmentally Sustainable Practices: The strategy will support labour market reforms that promote job creation in sustainable agriculture, higher value-added manufacturing, blue economy among other sectors. In addition, enterprise development especially for firms producing for domestic markets will be supported. Other areas include promoting productive employment opportunities specifically for youth and women, among other disadvantaged groups, in the labour market. It will also entail promoting job creation in biodiversity-friendly firms, eco-tourism and sustainable harvesting and for sustainable management of ecosystems.
2. Promote Decent Work: Support policy reforms that protect the rights of workers in terms of the safety and security of working conditions, especially in the informal sector, small and medium enterprises, export processing zones and jobs that currently fall outside legislative purview, such as domestic work. Advocate for basic income policies for the working poor and the enforcement of minimum wage laws.
3. Remove Access Barriers to Labour Market Opportunities: The strategy will establish partnerships with the private sector to facilitate productive employment of specific vulnerable groups, including women. Support legal reforms to increase access of disadvantaged groups to livelihoods through employment, credit and property. Work with civil society organizations, the media and policymakers to address social norms and societal perceptions that reproduce unequal opportunities and preclude the inclusion of specific groups from accessing employment and income opportunities.

Mobilizing and Scaling Up Financing for Enabling Transition to Inclusive and Sustainable Growth

1. Promote Fiscal Policy consistent with Inclusive and Sustainable Growth Objectives: This will entail ssupporting fiscal space assessments and public expenditure reviews to identify poverty and distributional impacts of fiscal policy. It will also support participatory public expenditure reviews such as social audits and citizen report cards to improve efficiency and accountability of public expenditure.
2. Strengthen Domestic Resource Mobilization: Support development of progressive tax regimes including development of national legislative and regulatory frameworks to curb tax evasion and tax avoidance by national and foreign firms and high net-worth individuals. The strategy will also support strengthening of county capacities for management of revenues arising from natural resources.
3. Promote Adoption of Innovative Financing Mechanisms for Environmental Sustainability and Clean Energy: The strategy will support development of payment systems for environmental services, including environmental funds; fees related to use of natural resources such as charges related to toxic waste, dumping of pesticides and fertilizers, among others. The strategy will also support community-level arrangements for common pool resources.

5. Partnerships:

The Inclusive Economic Growth and Structural Transformation pillar cut across many sectors such as agriculture, forestry, industry, trade, tourism, extractives and others like services and technology. The successful implementation of the strategy and the projects therefore require support from various partners including government, development partners, philanthropic organizations, privates' sector and civil society. The Government partners at national and county level will continue to play a key role in the implementation and monitoring of projects and strengthening their capacity for planning and policy making as an important element of the proposed approach. Partnerships will also be sought from the private sector, such as banks and telecom companies, in piloting innovative solutions to improve poor rural women and youth access to finance, technology and information. Partnerships with research institutions will be further strengthened to ensure high quality data/evidence for programming, planning and policy making. CSOs will continue to play a key role in the implementation of downstream interventions and will be actively engaged in consultations on development issues and in ensuring enhanced participation and involvement of beneficiaries in project implementation. Donors and foundations will play a key role in the successful implementation of the strategy in terms of providing financial as well as technical support.

6. Indicative Budget and Potential donors

In order to accomplish all the interventions envisaged and achieve intended outputs under this pillar, will need a about USD 43.5 million as shown in the Table 1. The expectation is development partners will join will collaborate with UNDP to make the projects implementable by ensuring they are financially well resourced.

Table 1: Estimated Resource Requirement

S/N	**Proposed Project Title**	**Expected Outputs**	**Indicative Budget ‘000 USD**	**Potential donors**
Integrated Planning for Inclusive and Sustainable Growth				
01	Establish Evidence Base for National and County Plans to achieve Inclusive and Sustainable Growth		5,000	
02	Promote Economic Diversification and Sustainable Growth Pathways		5,000	
03	Promote Sustainable Natural Resource Management and Access to Affordable Clean Energy		2,000	
04	Promoting women’s economic empowerment		5,000	
Supporting Employment Creation, Decent Work, and Redistributive Programmes to Address Poverty, Inequality and Exclusion				
04	Facilitate Creation of Productive Employment, including in Firms and Sectors Promoting Environmentally Sustainable Practices		3,000	
05	Promote Decent Work		2,500	
06	Remove Access Barriers to Labour Market Opportunities		5,000	
Mobilizing and Scaling Up Financing for Enabling Transition to Inclusive and Sustainable Growth				
07	Promote Fiscal Policy consistent with Inclusive and Sustainable Growth Objectives		3,000	

08	Strengthen Domestic Resource Mobilization (national and county)		5,000	
09	Capacity development for Partnerships and integration of smallholder farmers in value chains		5,000	
10	Value Chains Development for selected high value products		3,000	
		Total	**43,500**	

***7. Sustainability and exit plan**:*

UNDP will work with national Implementing Partners (IPs) and Responsible Parties (RPs) in the implementation of the projects using the National Implementation Modality. The aim is to ensure there is ownership of the projects by the IPs and RPs and thus sustainability of the activities after the projects come to an end. Capacities of IPs and RPs will be built so that they can effectively mainstream project activities in plans, budgets and regular functions. To ensure the sustainability of the interventions, UNDP will also empower and build the capacity of beneficiaries to promote and defend their freedoms and hold the government accountable for the same. Where Government frameworks and systems already exists, such as the Productive Social Safety Nets, UNDP will support the strengthening of existing structures instead of creating parallel systems and stand-alone projects.

As part of the exit plan, project activities will be planned such that over life period of each project, the project will progressively pass on to IPs and RPs more of the in-project's activities, and ensure they are incorporated in the IPs/RPs plans and budgets.

8. Monitoring and Evaluation

A robust M&E framework will be developed to track progress on this pillar and to demonstrate how it will contribute to the wider Country Programme Document in conjunction with the other pillars. Clear indicators will be set and where critical information is not available baseline studies will be conducted to obtain the required data and information.