

# KENYA POVERTY AND EQUITY ASSESSMENT 2023

# FROM POVERTY TO PROSPERITY: MAKING GROWTH MORE INCLUSIVE

## EXECUTIVE SUMMARY



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- Woman selling fruits and vegetables at Ngong market, Nairobi, Kenya. Sambrian Mbaabu / World Bank.
- Camel market in Wajir town, Kenya. Tintseh / World Bank.
- Container depot at the port of Mombasa, Kenya. Sambrian Mbaabu / World Bank.
- View of Nairobi city from the rooftop of the Kenyatta International Conference Centre. Precious Zikhali / World Bank.

##### ***Back cover***

- Farmers harvest their crops near Kisumu, Kenya. Peter Kapuscinski / World Bank.

This Executive Summary was edited by Peter Milne. Design by Robert Waiharo.

**KENYA POVERTY AND EQUITY ASSESSMENT 2023**

# **FROM POVERTY TO PROSPERITY: MAKING GROWTH MORE INCLUSIVE**

## **EXECUTIVE SUMMARY**

**December 2023**

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## ABBREVIATIONS

AfCFTA	Africa Continental Free Trade Agreement
ASAL	Arid and Semi-Arid Lands
BAU	Business as Usual
BETA	Bottom-up Economic Transformation Agenda
CBK	Central Bank of Kenya
CCDR	Country Climate and Development Report
CEM	Country Economic Memorandum
CIDPs	County Integrated Development Plans
CSA	Climate-Smart Agriculture
D-Index	Dissimilarity Index
EAC	East African Community
FDI	Foreign Direct Investment
FLID	Famer Led Irrigation Development
GCP	Gross County Product
GDP	Gross Domestic Product
GoK	Government of Kenya
HOI	Human Opportunity Index
HSNP	Hunger Safety Net Program
ICT	Information and Communication Technologies
IMF	International Monetary Fund
JD	Jobs Diagnostic
KCHS	Kenya Continuous Household Survey
KIHBS	Kenya Integrated Household Budget Survey
KNBS	Kenya National Bureau of Statistics
KPEA	Kenya Poverty and Equity Assessment
LFP	Labor Force Participation
LMIC	Lower Middle-Income Country
MSME	Micro, Small and Medium Enterprise
MTP IV	The fourth medium-term plan
NDVI	Normalized Difference Vegetation Index
OLS	Ordinary Least Squares regression
OSS	One-Stop-Shop
PAYE	Pay as You Earn
RRPS	Rapid Response Phone Survey
SSA	Sub-Saharan Africa
TFP	Total Factor Productivity
TIMPs	Technologies, Innovations, and Management Practices
UMIC	Upper Middle-Income Country
US\$	United States Dollar
VAT	Value-Added Tax
WTO	World Trade Organization



## EXECUTIVE SUMMARY

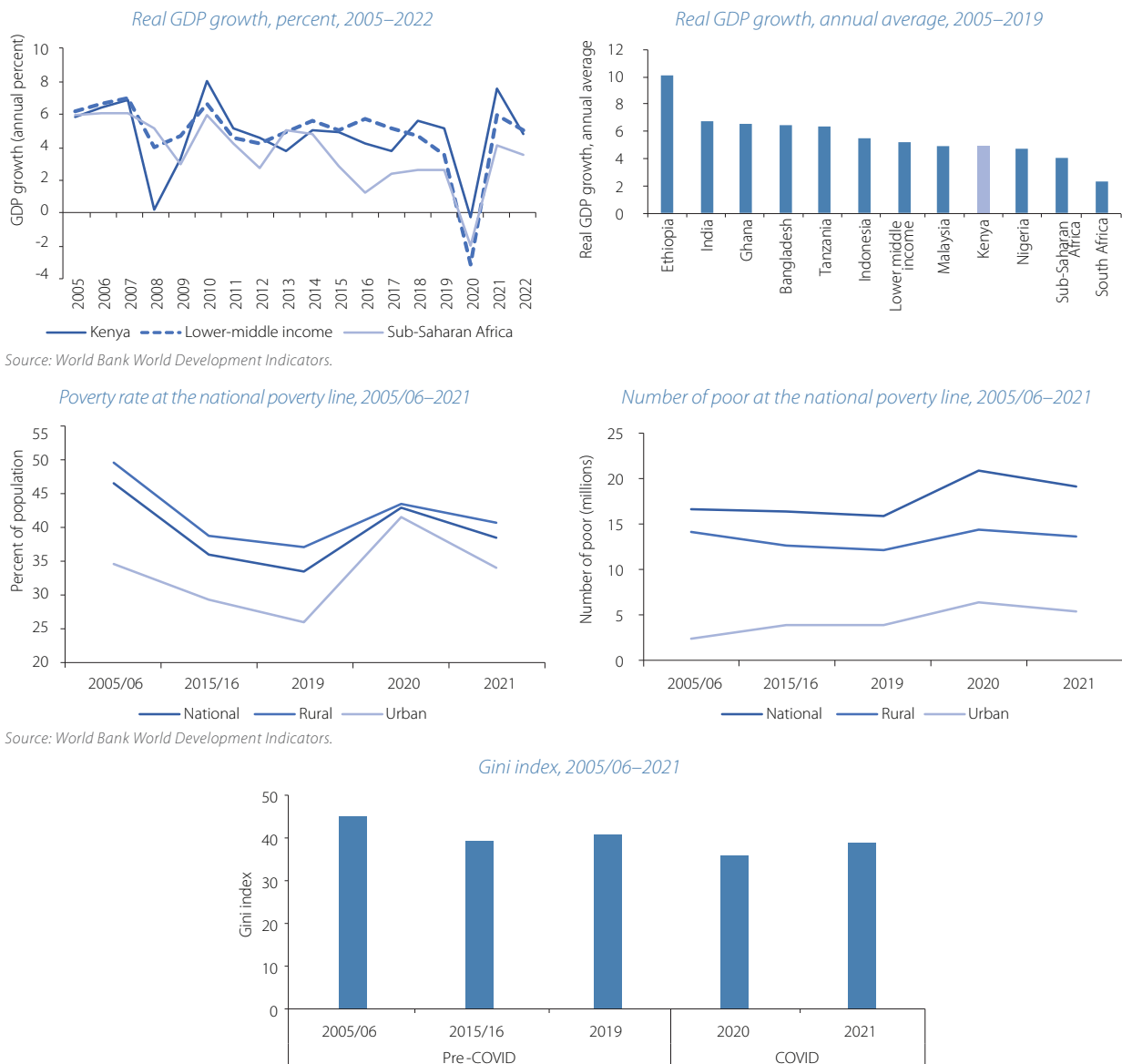
## EXECUTIVE SUMMARY

### A. Poverty had been declining before COVID-19; however, the pace of poverty reduction was already starting to slow

Kenya is a leading economy in East Africa thanks to several market-oriented reforms that, together with favorable regional and global conditions, propelled the economy to middle-income country status in 2014. The country's robust economic growth over the past decade has outperformed its Sub-Saharan Africa (SSA) peers (Figure 1). Although, the COVID-19

pandemic led to real gross domestic product (GDP) contracting by 0.3 percent in 2020, the economy staged a remarkable recovery from the pandemic, growing by 7.6 percent in 2021, supported by rebounds in industry and, especially, services. The services sector is increasingly becoming an engine of economic growth in Kenya. In the decade to 2021, services activity drove about 70 percent of the total increase in economic output and, of the 10 fastest-growing sectors from 2012 to 2021, all except construction were services.

Figure 1: Recent trends in economic growth, poverty and inequality



Source: Based on the Kenya Integrated Household Budget Survey (KIHBS) and Kenya Continuous Household Survey (KCHS).

Note: The report uses official national poverty lines produced by the Kenya National Bureau of Statistics (KNBS). Poverty is measured at the national poverty line of Ksh 3,947 and Ksh 7,193 per month per person (in adult equivalent terms) for rural and urban areas, respectively, in 2021 prices.

The Gini index is a measure of inequality and in this report, it is based on the distribution of consumption expenditure. It ranges from 0 to 100, with higher values indicating greater inequality.

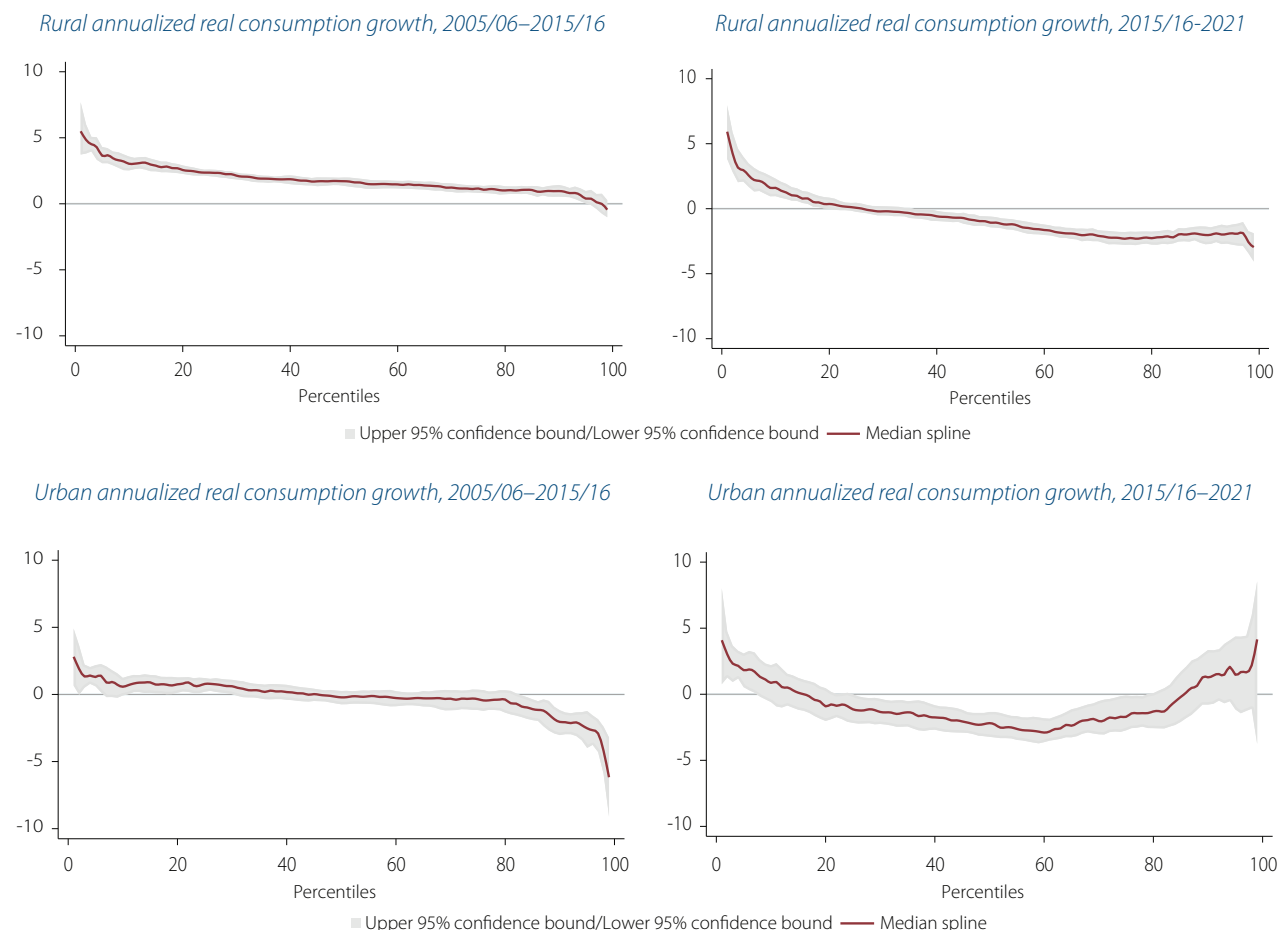
Historically, Kenya has been successful in translating economic growth into poverty reduction, with poverty declining before the pandemic. In 2019, almost one-third of Kenyans (33.6 percent) were living below the national poverty line, a 13.1-percentage-point decline from 46.7 percent in 2005/06 (Figure 1). This translated into a decline in the number of poor individuals. In rural areas, poverty declined from 49.7 to 37.0 percent. In comparison, the urban poverty rate fell from 34.5 to 26.0 percent.

**The sharpest gains in poverty reduction occurred prior to 2015/16, driven by progress in rural areas.** Between 2005/06 and 2015/16, the poverty rate declined by 10.5 percentage points from 46.7 to 36.1 percent, translating to an average annual reduction of 1.1 percentage points. This coincided with a period of robust GDP per capita growth of 2.05 percent, along with strong growth in private consumption. Poorer rural households benefited more from growth during this

period. In rural areas, the consumption of the bottom 40 percent grew at an annualized rate of 2.5 percent per year between 2005/06 and 2015/16, compared with 1.3 percent per year for the total population and 0.7 percent per year in urban areas. Nationally, growth was pro-poor from 2005/06 to 2015/16, with the poorest households experiencing the largest improvements in welfare (Figure 2). In urban areas, growth was pro-poor, but this was from a much lower level. Consistent with this, rural areas accounted for most of the poverty reduction during this period. The rural poverty rate fell from 49.7 to 38.8 percent, translating to an average annual reduction of 1.1 percent. This was twice the rate of the reduction seen in urban areas, where the poverty rate declined from 34.5 to 29.4 percent in 2015/16.

**This trend was reversed after 2015/16, with the consumption of poorer households growing more slowly.** From 2015/16 to 2021<sup>1</sup>—a period that coincides with the COVID-19 pandemic—average consumption

**Figure 2: Annualized real consumption growth, 2005/06–2021**



Source: Based on KIHBS and KCHS surveys.

<sup>1</sup> Due to the quality of the consumption data collected for the 2019 household survey the aggregate was imputed. The imputation process relies on past consumption data and has not been used to measure growth incidence, which requires each percentile of the imputed distribution.



growth was much lower for all percentiles. While rural consumption growth was positive for the bottom quintile, the rest of the distribution experienced a decline in consumption. Urban households over the same period experienced a similar trend as consumption growth for the poorest households but, unlike their rural counterparts, the richest quintile of urban households also experienced consumption growth (Figure 2). Even before the pandemic, poverty reduction had started to slow. When improvements in rural welfare, which drove the national reduction in poverty from 2005 and 2015, stagnated, poverty reduction also slowed. In the period 2015–2019, the pace of poverty reduction almost halved, slowing to an annual reduction of 0.6 of a percentage point. The poverty rate fell from 36.1 percent in 2015/2016 to 33.6 percent in 2019. This was consistent with the slowing of rural poverty reduction: the rural poverty rate declined by an annual average of 0.4 of a percentage point to 37.0 percent, while the urban poverty rate declined by an annual average of 0.8 of a percentage point to 26.0 percent. This declining pace of poverty reduction in rural areas, coupled with a higher initial poverty level, means that poverty has remained higher in rural areas.

**The pandemic temporarily set back the progress that had been made, hitting urban areas harder.** At the national level, the poverty rate increased by 9.3 percentage points between 2019 and 2020, from 33.6 to 42.9 percent. This was largely driven by an increase in urban poverty of 15.7 percentage points from 26.0 to 41.7 percent. In rural areas, the poverty rate increased by 6.5 percentage points from 37.0 to 43.5 percent. Not only did poverty increase between 2019 and 2020, but the number of poor individuals also rose. Nationally, the increase was about 5.1 million; 2.6 million in urban areas and 2.4 million in rural areas. Although there was some recovery in 2021, the poverty rate remained above pre-pandemic levels, at 37.3 percent. Overall, the pandemic transformed relatively large positive growth for the period into negative growth for the bottom 40 percent and the total population. The slow recovery also reflects the compounded impacts of the ongoing shocks, including the long drought in arid and semi-arid areas, and rising inflation.

**The role of the shift of people between rural and urban areas in poverty reduction is limited.** The decomposition of poverty reduction by “between-rural/urban areas” and “within each rural or urban area” shows that the within-area poverty reduction explains most of the total poverty reduction, with only a limited role for the population shift effect of migration between the two areas. This pattern holds for both pre- and post-COVID-19 periods. Between 2015/16 and 2019, within-area consumption growth accounted for nearly all the decline in poverty. Analyzing 2015/16 to 2021, a period that includes the COVID-19 shock, demonstrates that the increase in poverty was due to a decrease in household consumption within rural and urban areas.

**While poverty remains a rural phenomenon, there is a smaller rural-urban difference in the depth of poverty.** The poverty gap, which measures the consumption shortfall of the poor as a percentage of the absolute poverty line, fell between 2005 and 2019. Unlike the other poverty measures though, there is a smaller rural-urban difference in the poverty gap. In 2019, this stood at 10.9 percent for rural areas and 7.7 percent in urban areas. This implies that, although there are fewer poor people in urban areas, the depth of poverty tends to be similar. The same applies to inequality among the poor, captured via the squared poverty gap, which captures the severity of poverty by placing greater weight on individuals further below the poverty line.

**Inequality in consumption expenditure dropped from the onset of the pandemic, due to the large decline in consumption of richer households.** However, the economic recovery in 2021 resulted in an increase in inequality toward pre-pandemic levels. Driven by strong growth among the bottom 40 percent of rural households, the Gini index—a measure of inequality—declined from 45.0 in 2005/06 to 40.7 in 2015/16. The Gini index increased slightly in 2019 due to slower growth among the poorest households in rural and urban areas. The sharp drop in the welfare of richer urban households was associated with a fall in the Gini index from 40.7 to 35.8 in 2020, but it then increased to 38.7 in 2021 following the economic recovery. In absolute terms, inequality is highest in urban and non-ASAL areas.

Despite progress in growing the economy and reducing poverty, comparison to peers suggests there is scope to do more given the country's income status. Although growth has been robust in Kenya, including in recent years, it lags some other fast-growing comparator countries, such as Bangladesh and India which are also both Lower-Middle Income Countries (LMICs). Between 2005 and 2019, Kenya achieved an average annual GDP growth rate of 4.9 percent, lower than the average for LMICs. Despite progress in reducing poverty, poverty remained high relative to LMIC standards. In 2021, at 36.1 percent, Kenya's international poverty rate<sup>2</sup> was almost four times the average for LMICs, at 10.9 percent.

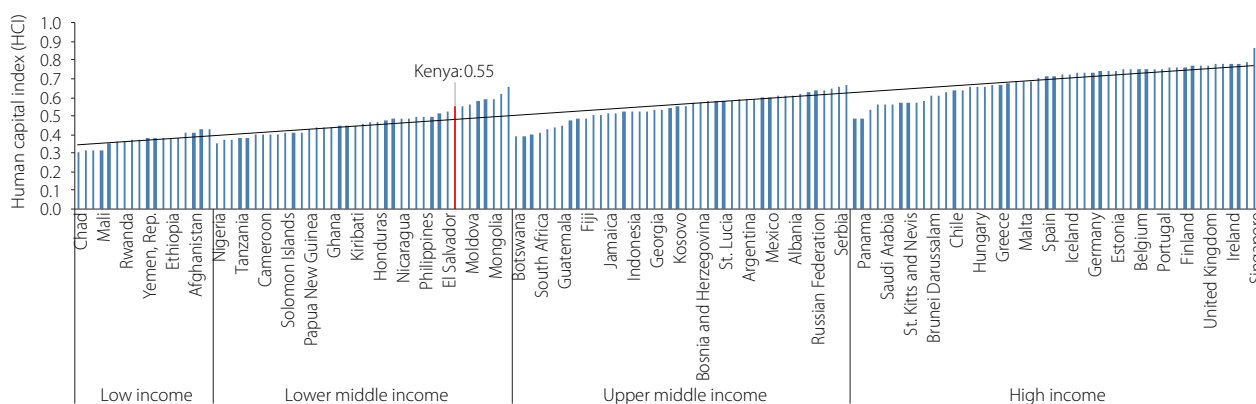
**Nonmonetary indicators of welfare had also improved before the pandemic**

The country has made noteworthy progress in human capital development and expanding access to basic services—investments that are fundamental for inclusive growth. Today, Kenya has the highest Human Capital Index (HCI)<sup>3</sup> score in mainland SSA, thanks to the Government's efforts to reduce malnourishment, increase access to education, expand access to health care, and expand social protection programs. At 0.55 in 2020, Kenya's overall HCI score<sup>4</sup> is higher than the 0.40 average for SSA, and only slightly below the upper middle-income country (UMIC) average of 0.56.

Expanding access to health care has resulted in significantly improved health outcomes and this has contributed to human capital achievements. For instance, the under-5 mortality rate in Kenya decreased from 74 deaths per 1,000 live births in 2008/09 to 41 deaths per 1,000 live births in 2022, significantly lower compared with its peers (Figure 4). Maternal mortality has also declined, owing to pregnant women having access to health services during their pregnancy and delivery, with almost all births being delivered by a skilled health provider. The HIV prevalence rate has also decreased.

Fewer households have children not in school and secondary school enrolment has significantly improved. The proportion of households with a primary school-aged child not attending school declined from 17 percent in 2005 to 5 percent in 2021, thanks to the GoK's efforts in the provision of free primary education. The introduction of the Universal Access to Basic Education policy led to large gains in secondary school enrolment, coinciding with an increase of secondary enrollment from 18 percent in 2005 to 41 percent in 2021. There is no national gender gap in net enrolment rates: the net enrolment rates for male and female students at different levels of education are similar, suggesting equal opportunities to access education. Even in arid counties, the gender gap has been closed, although primary enrolment rates remain low.

**Figure 3: Human Capital Index, 2020**



Source: Based on World Bank HCI data and World Development Indicators (WDI).

<sup>2</sup> Measured at the international poverty line of US\$2.15 per person per day (in 2017 PPPs).

<sup>3</sup> The Human Capital Index (HCI) summarizes the amount of human capital that a child born today can anticipate acquiring by age 18, accounting for the risks of poor health and poor education that prevail in the country she or he lives. The index assesses countries across five components (health, education, survival, quality of learning, and adult survival).

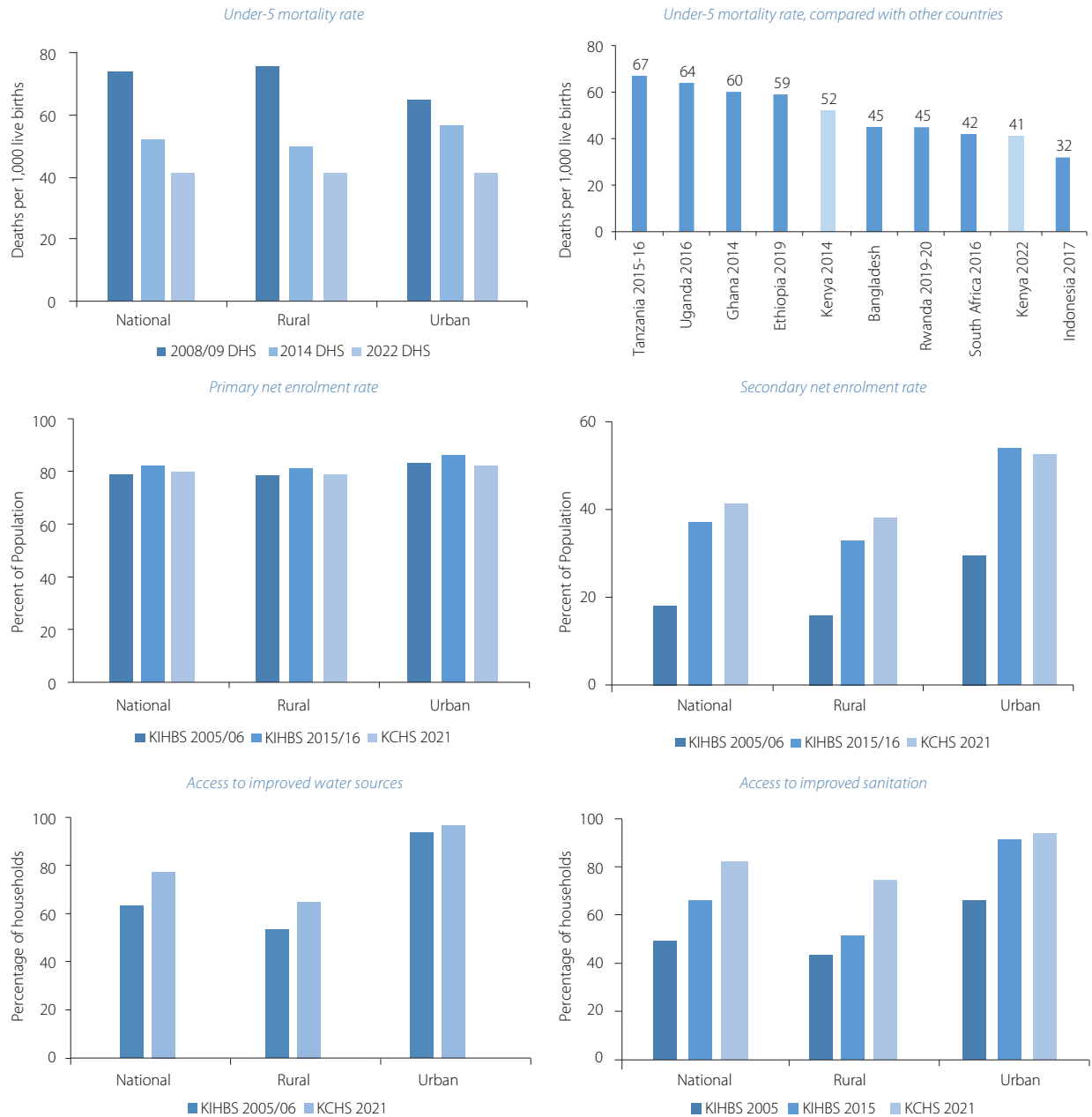
<sup>4</sup> This means Kenya children born today would be 55 percent as productive when adults as they could have been if they had had a complete education and full health.

Access to basic services has improved and, for some services, the rural-urban gap, as well as the gap between the poor and rich, has narrowed. For instance, the share of households using improved water sources and improved sanitation has increased. Access to electricity has improved considerably in urban areas, although it remains highly limited in rural areas.

## B. Progress is not being equally shared...

The north and northeast regions of the country, where arid areas are concentrated, are characterized by poverty rates that are persistently higher than the rest of the country (Figure 5). Counties in these areas are historically underdeveloped and have seen little progress in poverty reduction. Kenya's northern-most county, Turkana, has the highest poverty rate. Even

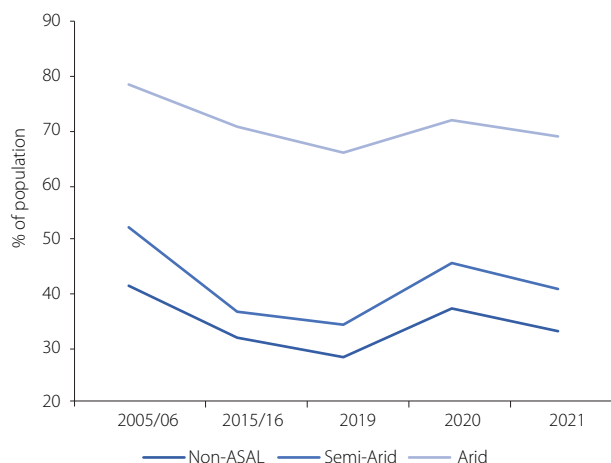
Figure 4: Nonmonetary dimensions of welfare



Source: Based on KIHBS and KCHS surveys.

**Figure 5: Spatial disparities in monetary poverty persist**

*Poverty rate by ASAL classification, 2005/06–2021*

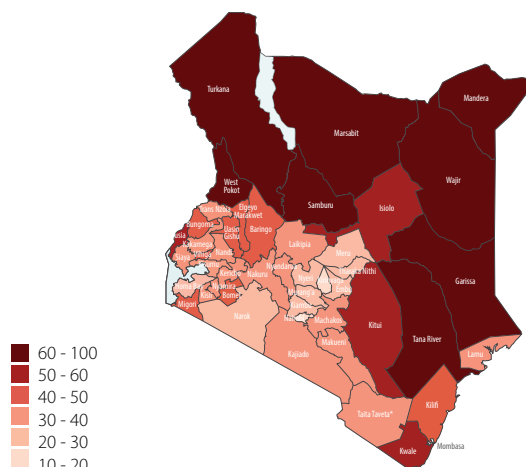


Source: Based on KIHBS and KCHS surveys and KNBS Poverty Report.  
Note: ASAL refers to Arid and Semi-Arid areas combined.

accounting for other household-level characteristics, households in arid areas have a significant and larger likelihood of being poor compared with households in non-arid areas. Larger households, households with a head with lower education levels, and households in arid areas, as well as households with children, are all associated with higher poverty rates. Refugees are a particularly vulnerable group, facing high food insecurity and limited employment opportunities. Their labor force participation is particularly constrained by a lack of official work permits, affecting their ability to be self-reliant.

**Significant disparities in access to basic services remain, based on location and income.** Arid counties in the north and northeastern parts of the country lag behind (Figure 6): they have significantly lower Human Capital Index (HCI) scores and economic activity, which is reflected in lower gross county product (GCP) per capita. For example, these counties persistently have the lowest incidence of live births delivered by a skilled provider, and continue to lag around 30 percentage points behind the national average in primary school enrolment, and also lag behind in those transitioning to secondary school. The poor also tend to be left behind (Figure 7): HCI scores are lowest among the poor. Children from households in lowest wealth quintile are less likely to have been fully immunized, posing significant health risks to children and increasing the possibility of mortality. Experience from around the globe shows

*Poverty rate by county, (percentage), 2021*

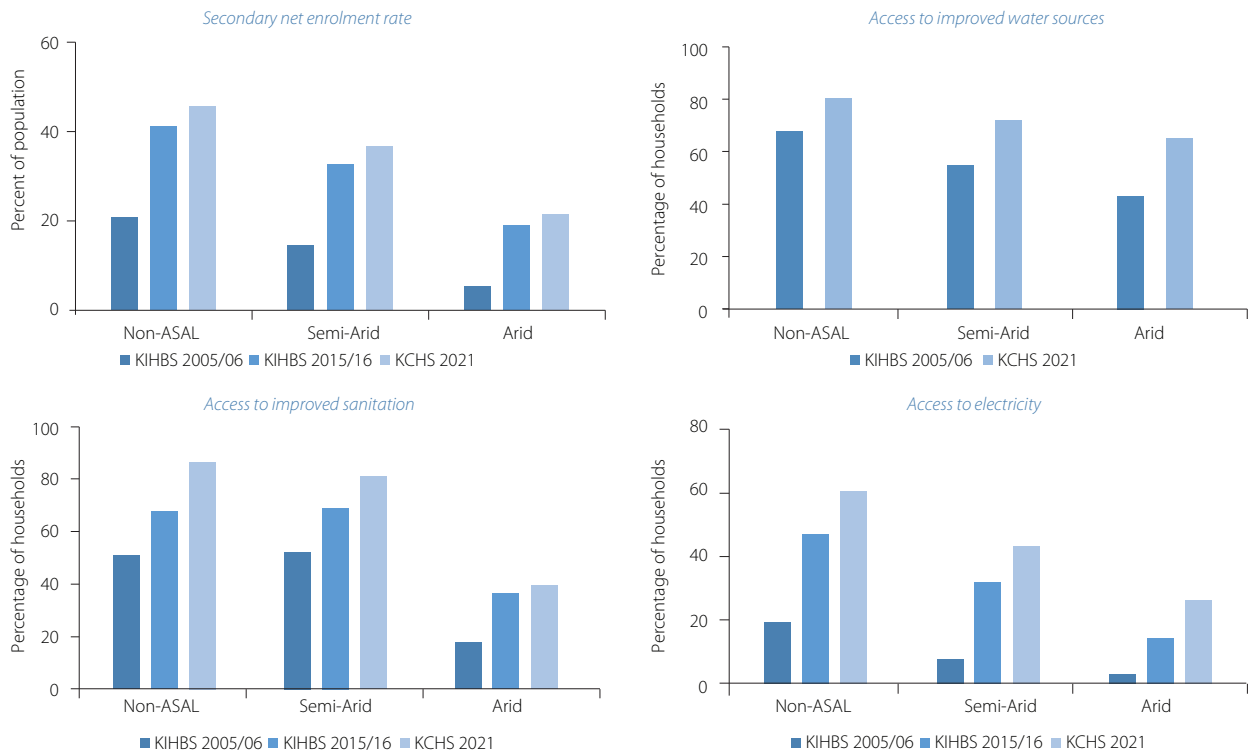


that such unequal opportunities hold back a country's growth potential. Concerted effort is therefore needed to address spatial disparities and ensure that progress is equally shared across the population.

**C. ...and as a result, growth is not sufficiently translating into poverty reduction**

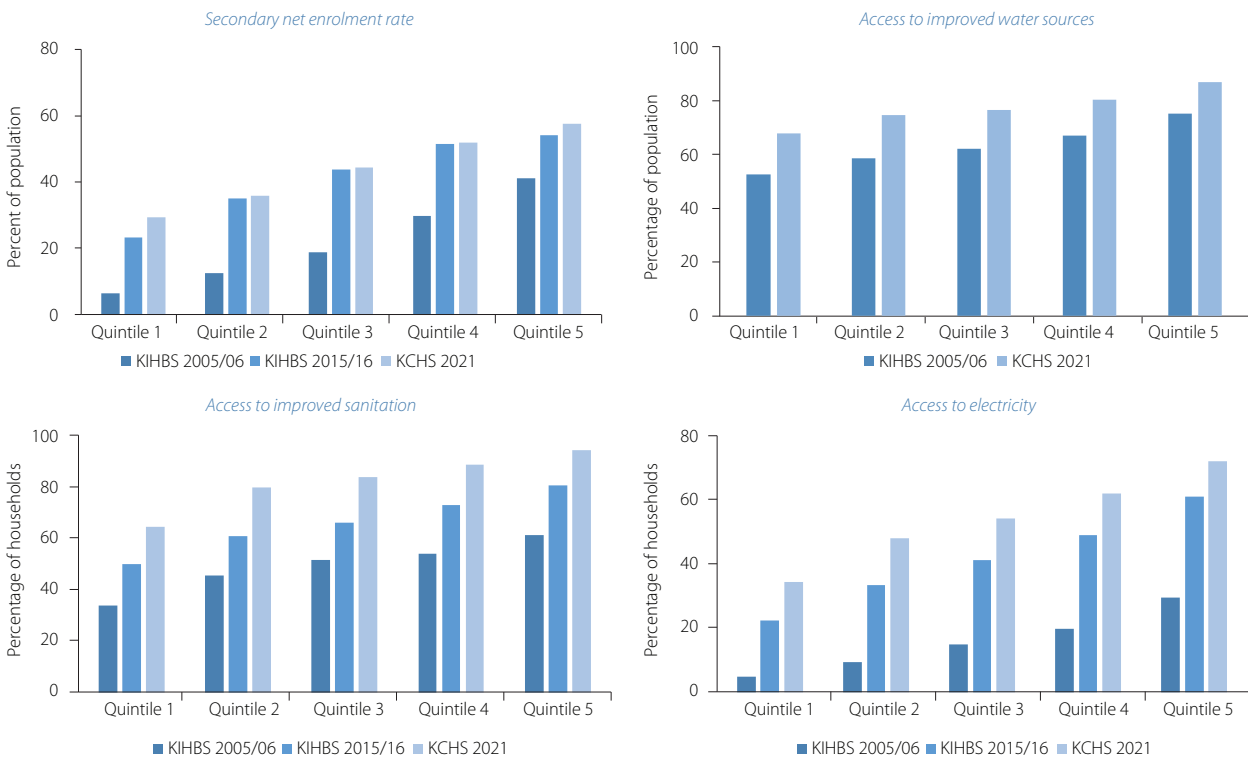
Recent periods of strong economic growth have not resulted in equally strong poverty reduction; rather, the pace of poverty reduction has slowed over time. An average annual poverty reduction of 1.1 percentage points was recorded between 2005 and 2015, with the poverty headcount falling from 46.7 to 36.1 percent. This coincided with a period of robust average annual GDP per capita growth of 2.05 percent, along with strong growth in private consumption, especially among poorer rural households. During this period, a 1-percent increase in per capita GDP resulted in a 1-percent reduction in the poverty rate. However, between 2015 and 2019, the pace of poverty reduction slowed to an average annual reduction of 0.6 of a percentage point, resulting in a poverty rate of 33.6 percent in 2019. This slowdown in poverty reduction coincided with an increase in the annualized rate of GDP per capita growth to 2.28 percent during the period 2015–2019. The pandemic reversed the modest gains in poverty reduction: the poverty rate increased to 42 percent in 2020 and partially recovered to 38.6 percent in 2021, remaining above the pre-pandemic level.

**Figure 6: Spatial disparities in nonmonetary dimensions of welfare also remain**



Source: Based on KIHBS and KCHS surveys.  
 Note: ASAL refers to Arid and Semi-Arid areas combined.

**Figure 7: There are also disparities in nonmonetary dimensions of welfare based income**



Source: Based on KIHBS and KCHS surveys.  
 Note: Quintiles refer to quintiles of consumption. Quintile 1 is the poorest quintile and Quintile 5 is the richest quintile in the survey.

### *Factors contributing to growth becoming less inclusive*

The services sector is increasingly becoming the engine of growth, but the returns for skilled workers are likely to be higher than those for low-skilled workers. In the past, increased agricultural production associated with favorable rains has led to increased incomes among poorer rural households and, subsequently, supported poverty reduction. However, consumption growth of the poor over the 2015/16–2019 period slowed after 2016, consistent with the growing incidence of climate shocks. This has coincided with the movement of labor out of the agriculture sector and into services over the past decade. Today, the services sector contributes the largest share of value added, driven by growth in knowledge-intensive “global innovator” services, such as information and communication technologies (ICT), technical services, professional services and financial services. In terms of job creation, however, a large part of job creation in the services sectors has been in lower-skilled services subsectors, such as retail and personal services, subsectors that have limited potential to boost incomes of those at the bottom. The returns for skilled workers in services is therefore likely to be higher than those for unskilled and low-skilled workers. Thus, the rising importance of the services sector likely also contributes to the weakening relationship between aggregate growth and poverty reduction.

Creation of paid jobs has been limited and, as a result, most of the poor remain engaged in self-employment or agriculture, activities where productivity and earnings are dependent upon the availability of assets that the poor have fewer of. The poor participate less in the non-subsistence labor force, and the difference in the labor force participation rate between poor and non-poor individuals has widened over the past 15 years, particularly in rural areas. The youth and women, particularly in arid areas, participate less in the non-subsistence work activities than other groups, driven by lack of suitable jobs in the area linked to low non-farm diversification and, for women, family responsibilities. Poor individuals and those living in rural areas continue to rely on agriculture and low-productivity services subsectors for employment. In sum, the poor face twin challenges in the job market: fewer household members work outside of subsistence activities and they are mostly engaged in low-productivity sectors.

**The growing incidence of shocks, especially extreme weather shocks, amid limited resilience among the poor, amplifies the negative effect of shocks on household welfare.** Households are often exposed to multiple shocks. For instance, alongside the recent drought, evidence shows that almost all households reported increased food prices in 2022 or the first half of 2023. Furthermore, climate shocks pose a huge



Photo: ©Sambrian Mbaabu/World Bank

developmental challenge, as they are associated with an increase in monetary and non-monetary poverty. Climate shocks have a strong spatial dimension, as they are more likely to affect poor regions in the north and northeast—specifically, arid and semi-arid lands (ASAL) areas—where poverty is already high. In addition, climate change is forecast to have the largest negative impact on poverty in the poorest parts of the country. The poor have limited strategies to cope with shocks, rendering them less resilient to these shocks. While gains have been made in poverty reduction, there is widespread potential for people to fall below the poverty line in the event of a shock. This was demonstrated by the pandemic, which led to a significant rise in poverty driven by a large increase in urban areas. While recovery from the pandemic had begun in 2021, the poor’s consumption was slower to recover and, as a result, poverty levels remain above pre-pandemic levels.

**Inequality of both outcomes and opportunity dampens the translation of economy-wide growth to income growth of the poor, acting as a brake on poverty reduction.** This slowdown in the growth-poverty relationship is partly due to enduring inequalities that result in poverty being increasingly concentrated in arid and drought-prone parts of the country. For example, while opportunities for good quality education and lifelong learning are important to access better jobs, children from poor households do not have these opportunities. Inequality of opportunity undermines access to services for children from poor households, particularly in ASAL areas of the country. While there is relatively low inequality in access to primary school attendance, with Kenya achieving near universal coverage in this respect, secondary school attendance is much more dependent on the circumstances of the child. The transition from primary to secondary school, especially among rural, arid, and poor households, is a significant challenge. The pandemic exacerbated inequality of opportunities, particularly eroding human capital in children from poorer households. Location (rural vs

urban), education of the household head, and poverty are the main drivers of inequality of opportunities of basic services. The good news is that there is evidence of intergenerational mobility: children are achieving higher levels of education than their parents.

**Fiscal policy could be used more effectively to support poverty reduction and boost equity.** Fiscal policy is an important instrument to equalize opportunities and reduce poverty, and could offset some of the forces that weaken the growth-poverty reduction relationship. However, although Kenya’s fiscal system reduces income disparities, it is less effective in poverty reduction due to a combination of factors related to tax and social spending design. A positive feature is that education and health spending is pro-poor and thus supports the poor’s human capital acquisition—important for an economy creating opportunities in the services sector.

#### **D. Looking ahead, an inclusive growth strategy is needed**

**Kenya’s economic growth has the potential to pull millions more out of poverty, even in challenging economic contexts; an inclusive growth strategy that boosts economic opportunity and productivity among the poorest, while maintaining focus on longer-term development objectives, will help realize that potential.** The recent slowdown in the pace of poverty reduction underpinned by inequality of opportunity, periodic shocks, and weak job creation all point to the need for an inclusive growth strategy that brings widespread growth in people’s disposable income. More disposable income in the hands of more people, especially among those who are at the bottom of the income distribution, will not only translate into higher tax revenues and greater fiscal space but also support vibrant domestic demand and a strong private sector. An inclusive growth strategy will accelerate poverty reduction and equalize opportunities through smart economic policies, and efficient and equity-enhancing public spending that enable the poor to better utilize their productive capacity.

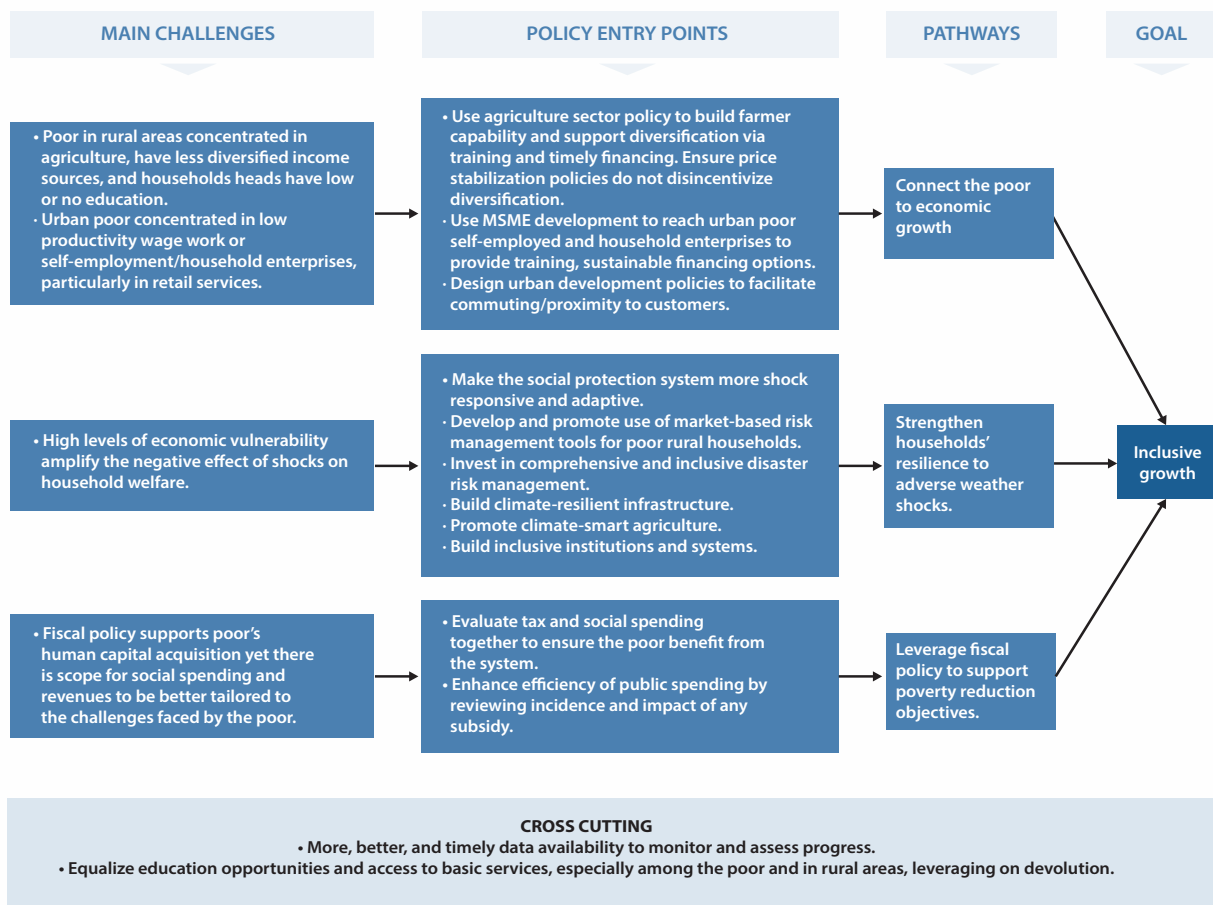
Three broad policy pathways can help Kenya make growth more inclusive and accelerate poverty reduction, building on past success. This encompasses: (i) connecting the poor to economic growth; (ii) strengthening households' resilience to shocks, particularly adverse weather shocks, given their growing incidence and the importance of agriculture as an important sector from an inclusion perspective; and (iii) leveraging fiscal policy to support poverty reduction objectives. More, better, and timely data availability will also be key to monitor and assess progress. In addition, connecting the poor to economic growth requires addressing the challenge of low education and skills among workers, especially workers who are poor and those in rural areas, as well as youth and women, along with improving access to productive jobs, and capital.

### Connect the poor to economic growth

*Use agriculture sector policy to build productive capacity of rural poor households to grow and diversify their income sources*

Kenya uses input support policies and price controls to support smallholder farmers' incomes and maintain affordability of staples for the population at large. The price stabilization of staples, particularly maize, is implemented by the National Cereals and Produce Board (NCPB) (Government of Kenya 2019). These policies aim to raise agricultural output and ensure sufficient availability of affordable staples for Kenyans, while protecting smallholder farmers' incomes. While the elements of the strategy to raise agriculture sector output have evolved over time, incentivizing the adoption of inputs, particularly inorganic fertilizers, via subsidies has remained an important part both at the national and county levels. Keeping the market price of cereals attractive for producer households and affordable for consumers is also an important consideration for government. The rationale for price stabilization is that prices fluctuate as part of the expected functioning of agricultural markets across planting and harvesting seasons. Prices typically fall during harvest time, which can have an adverse effect on

Figure 8: Channels and policy entry points





the incomes of households that market their produce. Prices of staples are also affected by increasingly frequent rainfall variability, droughts in the Horn of Africa, and pests and diseases, and global shocks can hurt agricultural households' production and, in turn, worsen affordability of staples for consumers.

**It is unclear, however, to what extent these input-support and price-control policies are effective in raising incomes of poor rural households.**

Rural poverty remains high and past gains in rural poverty reduction have overlapped with favorable weather conditions. The livelihood strategies of poor households tend to be less diversified. While a small share of poor rural households run household enterprises that are engaged in trade, manufacturing (likely processing of agricultural produce) and transport, more than 50 percent of all poor households have employed members working only in agriculture. Studies have identified several sector-wide challenges that affect the ability of agricultural households to grow their incomes and also diversify investments in crops or non-farm activities.

- First, despite policy commitments, agriculture sector growth has fluctuated due to periodic shocks (rainfall, pests and diseases, input prices). These periodic shocks also affect rural households' incomes and their production decisions.
- Second, agricultural productivity is affected by limited physical infrastructure, continued reliance on rainfall, deteriorating soil conditions, fragmented land holdings, and high use of fertilizers in some parts of the country and low use in others (World Bank 2019; Mather and Jayne 2018; Duflo, Kremer, and Robinson 2011).
- Third, value addition in this sector remains low, which in turn limits rural households' income growth. Even though the sector is an important source of foreign exchange for Kenya via exports (coffee, tea, cut flowers), only 16 percent of the agricultural exports are processed, which limits the revenue potential of the sector (World Bank 2019).
- Fourth, balancing the functioning of the market and the role of the private sector with the GoK's objectives to maintain food price stability is

a challenge. Procurement programs aimed at stabilizing prices have been implemented in a way that influences normal market price developments, which affects the private sector's presence, and has been found to elevate intra-annual price volatility for maize and other staples (D'alessandro et al. 2015).

**Sector-wide and targeted policies for poor rural households must be tailored to the needs of agricultural households and those running rural non-farm enterprises.** These policies and interventions will build capabilities, provide access to finance, and connect households to the market.

- **Review the incentive effects of price stability policies, facilitating linking to markets.** Ensuring that the GoK's price stabilization follows a rules-based approach in keeping staples affordable will help poor smallholders—who tend to be either subsistence producers or net buyers—to switch to more profitable crops or activities (Jayne 2012). This will then facilitate agricultural households' connectivity to supermarket value chains (Barrett et al. 2022). The development of agricultural value chains and their linking to the value chains of supermarkets is an emerging opportunity for market-led growth.
- **Raise the marketable surplus of agricultural households.** More than 50 percent of the poorest households have employed members working only in agriculture. Poor agricultural households have limited assets for farming or livestock and poultry raising, and those that grow crops tend to specialize in maize and cereals. Households' limited assets also constrain their ability to diversify to non-farm work. Less-well-off agricultural households use fewer inputs, are less likely to have access to irrigation, and have low educational attainment. Moreover, production is risky due to pests/diseases, poor soil, unpredictable/shifting rainfall patterns and households self-insure by opting for less risky investments (D'alessandro et al. 2015). As a result, their marketable surplus is low. Sales to the Government are the smallest share of all marketed output and all households sell in local markets,

to brokers, or local traders. Prices of output are distorted by small production volumes that increase purchasers' transaction costs and the market power of local traders, who offer low farmgate prices (Bergquist and Dinerstein 2020). Moreover, farmers who purchase produce "buy high" and "sell low": cash-constrained smallholders are more likely to sell at harvest time (when prices fall) and purchase staples post-harvest (when prices tend to be higher) (Burke, Bergquist, and Miguel 2019).

- o **Shift away from input subsidies to farmers and toward removing market distortions, investing in key infrastructure, and research and development.** Swapping vouchers for inputs with vouchers for an equivalent amount of cash can also allow poor households to take efficient planting and investment decisions tailored to their asset endowments. Domestic fertilizer prices are subject to global conditions and the promotion of local (or within Africa) production of fertilizer potentially offers a less distortionary way to make this input affordable (Suri and Udry 2022).<sup>5</sup>
- o **Make loans available at harvest time.** An impact evaluation of group microloans to maize farmers offered via One Acre Fund (OAF) right after harvest season (tied to grain storage) in Bungoma county in the period 2013–2015 significantly raised revenues, and general equilibrium effects show that this intervention also stabilized seasonal price shifts (Burke, Bergquist, and Miguel 2019).
- o **Tackle trader market power.** Farmer organizations (FOs) are generally found to be effective in raising agricultural output. Evidence shows that using measures that encourage poor farmers to actually participate in FOs is critical for its success.
- o **Practical farmer training.** In-depth training has been found to be effective in building farmers' capability to adopt technology and use it to manage threats to production such as limited water. An impact evaluation in Niger found that a one-day training course on how

to build rainwater harvesting technology had a significant impact on the adoption of this technology and agricultural output (Aker and Jack 2021). Light-touch training for livestock, however, is found to have limited impact in Burkina Faso (Leight et al. 2021)

- **Boost earnings of rural non-farm enterprises.** Strengthening this segment is crucial for helping rural households diversify out of agriculture. Nearly 13 percent of those at the bottom of the distribution have non-farm enterprises. These enterprises are mainly solo enterprises with low input use and low productivity. Most enterprises are located in homes or local markets (only a few are in commercial locations). Human capital in these households is very low; 84 percent of households do not have any member with completed secondary education. Access to markets and customers is a commonly cited constraint. Most of these enterprises rely on their own source of funds for their financial needs. Three categories of interventions are needed, whether delivered by the Government or via private sector partners.
  - o **Business training tailored to the needs of the rural non-farm enterprises.** This will help overcome the constraints posed by low human capital. An example of an effective training program is the ILO's Get Ahead Program, which was found to be effective in raising profits (McKenzie and Puerto 2021).
  - o **Large loans or grants via microcredit or other financial services suited for rural solo enterprises.** Loans and grants of sufficiently large sizes can be effective in reducing reliance on own-source funding and raising earnings (Bandiera et al. 2022).
  - o **Linking these enterprises with other sectors in the economy.** A noteworthy share of these enterprises is in the transportation sector, which is promising for linkages with dynamic services subsectors and reaching urban consumers. Strong inter-sectoral linkages can spur productivity and income growth (Kenya CEM 2023).

<sup>5</sup> According to a source cited in Suri and Udry (2022), as of January 2021, there were only 135 fertilizer plants in Africa (outside of South Africa) and most were processing plants. Only 17 were manufacturing plants.

### *Use MSME development and urban development policies to raise productivity and earnings of urban poor workers*

The urban working poor will benefit from both economy-wide policies, as well as targeted initiatives that are tailored to their characteristics and enable them to connect to the urban growth centers. There are a number of challenges affecting micro- small, and medium enterprise (MSME) productivity and dynamics, and addressing these will benefit the working poor in urban areas. Most firms in Kenya are small and operate in the services sector (World Bank 2023a). Corresponding to this structure of the economy, most urban working poor are either self-employed, operating household enterprises, or employed in microenterprises (enterprises with fewer than 10 workers). Expansion of paid work opportunities in general will benefit the working poor in urban areas. However, targeted efforts are needed to raise the earnings of the self-employed and household enterprises—activities that are an important source of employment for the urban poor.

- **Expand paid work opportunities for the urban poor.** Economic policies and regulations that facilitate firms' growth and enable workers to locate in urban agglomerations will expand paid work opportunities for unskilled urban workers. While entry rates are high (compared with countries similar in economic structure to Kenya), firms' expansion (number of employees) is rather limited (World Bank 2023a). Together, these two factors result in limited paid work opportunities, particularly for unskilled and low-skilled workers.
  - o **Leveraging MSME policy.** The 2020 MSME policy recognizes several bottlenecks to development of these firms (Government of Kenya 2020). Drawing from firms' surveys, the policy identifies several obstacles, including access to affordable finance, market access, access to infrastructure, and the regulatory environment.
  - o **Leveraging urban development plans.** Aside from the provision of basic services (electricity, water) to firms, there is also a need for urban development policy to tackle within-city congestion that entails an arduous commute to retail and industrial establishments. Urban planning and transport infrastructure can be designed to enable workers to live closer to where the jobs are. Living far from where jobs are located is otherwise particularly costly for the poor (Nakamura and Avner 2018).
- o **Streamlining of registration and licensing procedures.** A well-noted point about the landscape of firms is that a vast majority operate informally, that is without business or tax registration. Many firms may, however, be registered at the local county level (paying license fees), even if not formally registered with the Kenya Revenue Authority (Cruz and Hernandez Uriz 2022).<sup>6</sup> Cross-county streamlining of licensing fees is an important effort that will reduce the cost of working across counties.
- **Boost earnings of household enterprises operated by poor households, with a particular focus on financial inclusion.** Household enterprises run by less-well-off urban households mostly have one employee and, as such, are not expected to expand in size. For these enterprises, MSME policy must focus on raising earnings and productivity by addressing key barriers, such as low human capital, fluctuations in earnings due to shocks (such as inflation in cost of inputs), and access to customers. A policy focus on affordable financing options can be particularly valuable for the self-employed, since most tend to rely on their own sources of financing. Fafchamps (1994) discusses how the self-employed and microenterprises might prefer to borrow from friends and family due to lower transaction costs and personal relationships that provide a better opportunity to enforce re-payments. On the side of financial institutions, the cost of lending to this segment via market-driven products is high, due to a number of factors including small loan sizes, lack of information about repayment abilities, and the high cost of using judicial systems in the case of default (again, due to the small loan sizes). In late 2022, the Government rolled out the Hustler's fund covering affordable personal financing (World

Bank 2023a). The Hustler’s fund will also provide business loans via mobile phones and via savings and credit cooperative societies (SACCOs), chamas,<sup>7</sup> and microfinance banks. While digital lending is prevalent in Kenya and some metrics suggest an uptick in the use of the lending products, it is unclear to what extent those enterprise activities at the bottom of the distribution were able to access “large” loan amounts. (Suri, Bharadwaj, and Jack 2021) show that Mshwari (a type of digital product offered by Safaricom) helped households cope with shocks. Importantly, they show that these loans are not used for business purposes.

- o Financial inclusion innovations beyond microfinance. There are some innovations in finance products that can be considered. These include supply-chain financing and asset-based microfinance. Testing the utilization and impact of these products will help fine tune the strategy to reach the goal of providing affordable finance to this segment.
- o Social protection. By law, self-employed are not required to contribute to social security. Promoting participation in schemes such as Haba Haba and Mbao could help the self-employed access social insurance (World Bank Blogs 2020).
- o Business training. Given the low levels of human capital of those operating household enterprises, the provision of business training will help overcome a key constraint to their productivity. Business training that teaches self-employed and household enterprise operators simple rules for managing their businesses can be effective in raising earnings (McKenzie et al. 2023). Training that focuses on addressing decision-making, such as personal initiative training, can also be effective. These types of training are commonly offered to microenterprises and additional steps may be needed to deliver these

to the self-employed and household enterprises.

- o Linking micro-retailers to supply chain of supermarkets and larger firms. Retail services cater to a wide range of consumers in urban areas. For the large number of household enterprises that are micro-retailers, becoming distributors for larger retailers can boost earnings. For participation in this type of links/supply-chains, it would be important to test different modalities of financing assets of micro-retailers (Cordaro et al. 2022).

### **Strengthen households’ resilience to adverse weather shocks**

**Tackling the challenge of climate change is critical to ensuring sustained high rates of economic growth, a prerequisite for inclusive growth.** The Kenya Country Climate and Development Report<sup>8</sup> (CCDR) (World Bank 2023b) shows that inaction (business-as-usual) could dampen real GDP by 1.25 to 2.4 percent by 2030 and 3.61 to 7.25 percent by 2050, compared to the baseline.<sup>9</sup> Adverse weather events, particularly droughts and flood, have become more frequent in Kenya, yet gaps in resilience and capacity to address them remain. Arid counties, despite having the highest baseline poverty rates, experience the largest forecasted negative poverty impact from climate change, regardless of the climate scenario. For Kenya to meet its growth aspiration in an inclusive and climate-resilient manner, the CCDR identified a key multisectoral action area of “delivering people centered resilience with climate-informed basic services and urbanization”. Building on this, this report underscores the importance of policy actions to reduce exposure and vulnerability of households, especially among poor and vulnerable households.<sup>10</sup> Poor and vulnerable households disproportionately depend on subsistence farming for their livelihoods and have limited financial means to cope with, and bounce back from, the impacts of shocks. Promoting physical, financial, and social resilience of poor

<sup>7</sup> A chama is an informal investment club where members contribute an agreed amount of money with the aim of helping each other grow economically and possibly achieve financial independence.

<sup>8</sup> The CCDR examines the impact of climate change on Kenya’s economy and identifies high impact intervention areas that would support climate positive development.

<sup>9</sup> Depending on the climate change scenario.

<sup>10</sup> The extent of exposure is determined by, among other factors, the presence of people; livelihoods; species or ecosystems; environmental functions, services, and resources; infrastructure; or economic, social, or cultural assets in places and settings that could be adversely affected. The extent of vulnerability is determined by the propensity or predisposition to be adversely affected. Vulnerability encompasses a variety of concepts and elements, including sensitivity or susceptibility to harm and lack of capacity to cope and adapt.

households against adverse weather shocks is therefore key to inclusive economic growth, as well as poverty and inequality reduction.<sup>11</sup> Strengthening resilience needs to reflect spatial differences to climate risk exposure and vulnerability. For instance, the poor in rural and arid areas are more vulnerable to increased flooding and drought, yet they are more likely to have no access to water supply, sanitation, and hygiene (WASH) services. The same applies for informal workers and MSMEs in urban areas. Improving access to WASH services is key to reducing exposure to the health consequences of extreme climate events and increased disease incidence. This helps to build and/or protect human capital, a key factor in equalizing access to economic opportunities.

### **Policy actions are needed to reduce exposure and vulnerability**

**A shock-responsive and adaptive social protection system in which the poor and vulnerable receive targeted and timely assistance after disasters is a critical tool for managing risks.** Building on the existing Inua Jamii system, Kenya can improve the coverage, timeliness, and adequacy of its social protection system. Ongoing efforts towards an enhanced single registry (ESR) would help provide a unified dataset of poor and vulnerable households

across the country and facilitate a quick and transparent identification of populations that are vulnerable to climate disasters and slow-onset climate change. The expansion of the Hunger Safety Net Program (HSNP) to additional ASAL counties will expand the coverage of the program. While fiscal constraints pose a challenge to expanding social protection in response to shocks, further improvements can be made through: (i) ensuring sufficient financial resources are available to allow the shock-responsive element to deliver timely assistance to poor and vulnerable households; (ii) increase the coverage for social assistance in a manner that ensures that the poorest are targeted first; and (iii) protect the real value of cash transfers through more frequent nominal increases. Other types of social assistance, such as digital public works, could also be considered to address short-term shocks and build job-relevant skills (World Bank, forthcoming).<sup>12</sup> In addition, Kenya's job programs could be improved not only by making sure they reach informal workers in urban areas, but also integrating climate considerations into these programs to help with job transitions caused by climate change. It is also important for climate considerations to be integrated into technical and vocational higher education to enable Kenya's youth to thrive in a climate-compatible economy.



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<sup>11</sup> Physical resilience helps to reduce risk and prevent disasters; financial resilience to minimize the financial impact of shocks; and social resilience helps households and society cope with shocks.

<sup>12</sup> World Bank, 2023. *Kenya Social Protection and Jobs Public Expenditure Review*.

**Financial resilience can be strengthened through leveraging risk management tools for poor rural households, and grassroots institutions.**<sup>13</sup> Different financial products, such as savings, credit, and insurance, can enhance resilience. Only 14 percent of those employed in Kenya are in formal employment and have access to social insurance. In addition, poor households have very limited access to formal financial services. Long-term savings schemes can be designed to attract informal sector workers (e.g., in schemes in Rwanda, China, India, and Colombia) by incorporating flexibility in saving and withdrawal, providing short-term benefits (by bundling services, such as maternity benefits), focusing on communication, and investing in partnerships with public and private sectors, and the civil society. Further innovations in rural finance can also be utilized, including credit, value-chain financing and remittance-based investment products. The development of weather risk management instruments, notably through weather index-based insurance, would be important.

**Invest in comprehensive and inclusive disaster risk management.** About 85 percent of Kenya's land area is classified as arid or semi-arid, which is largely suited for pastoral activities. Therefore, it is important to strengthen water and land management. As the poor often rely on rainfed agriculture, expanding and rehabilitating irrigation infrastructure where possible would be beneficial, while leveraging the farmer-led irrigation development (FLID) approach already being implemented. Improving irrigation services and operational and maintenance practices is also important. The CCDR argues that Kenya's binding constraint to managing climate variability is not an absolute water constraint; rather, it is the failure to harness water resources for productive uses. Improved water usage is important for enhancing resilience, and will require further investments in water storage, conveyance, irrigation, and water supply infrastructure as set out in the proposed National Irrigation Sector

Investment Plan and the National Water Sector Investment Plan, respectively. Measures to promote sustainable livestock grazing practices and sustainable land management practices can begin arresting widespread land degradation due to deforestation.

**The building of climate-resilient infrastructure will ensure all-year access to the road network and other infrastructure services to a large segment of the rural population, also reducing the cost of frequent maintenance.** The water supply and sanitation (WSS) sector is also widely affected by frequent flooding, causing frequent uptick of water-borne diseases due to contamination. Investing in water conservation, such as restoring watersheds, can improve water conservation. Further, rotational grazing, soil conservation, and agroforestry can all improve rangeland management. Building climate-resilient infrastructure needs to be underpinned by climate-informed planning. The engagement of urban residents can help ensure urban areas are not vulnerable to climate events, such as flooding and heat island effects, and do not suffer from increased congestion and expanding informal settlements.

**Developing and disseminating climate-smart agriculture (CSA)<sup>14</sup> technologies and services to farmers, prioritizing poorer regions and farmers, can enhance resilience.** An enabling environment for CSA is critical and can be achieved through incentive systems and safeguards,<sup>15</sup> including addressing inequalities and discrimination, particularly by gender. It is also important that farmers and community organizations have sufficient capacity to allow them to shift to new practices. Overall, fully integrating these climate-smart technologies in the Agricultural Sector Transformation and Growth Strategy will ensure sustainability. Sustainability can also be enhanced through a conducive environment for private sector leadership in developing and disseminating climate-smart technology, innovation, and management practices.

<sup>13</sup> Grassroots institutions includes institutions such as local savings and credit associations, church or other religious associations and extended family networks. Membership-based organizations with market-related functions can also significantly reduce risk, as in the case of farmers' organizations that increase the bargaining power of small rural producers and enable access to credit or provide quality assurance for access to a warehouse receipt system.

<sup>14</sup> This includes manure composting and application, improved pastures management, drought-tolerant crop varieties and other techniques mentioned on Kenya's CSA Country Profile (<https://climateknowledgeportal.worldbank.org/sites/default/files/2019-06/CSA%20KENYA%20NOV%2018%202015.pdf>)

<sup>15</sup> Examples include inclusive and fair tenure systems regulating access to land, water, forests, and other productive assets, protecting the entitlements of poor rural people, and facilitating fair and transparent transactions around these assets.

**Finally, the building of inclusive institutions and systems is important.** This can be achieved through: (i) developing and strengthening data and digital systems can support agricultural household resilience and climate adaptation planning, utilizing existing digital solutions and platforms; (ii) strengthening meteorological services, and ensuring poor households are able to access the information; (iii) increase the use of extension services to further develop the capacity of small-scale farmers; and (iv) strengthening community engagement and encouraging the uptake of digital solutions at the farm level.

### ***Leverage fiscal policy to support poverty reduction objectives***

**Fiscal policy is equalizing, but there is scope to make it more supportive of the poor.** Cash transfer programs such as hunger safety nets offer critical adaptive social protection and are effective in reaching less-well-off households. Any expansion of social assistance programs—fiscal space permitting—will not only help

strengthen households' resilience but also deepen the fiscal system's poverty reduction and redistributive impact, while balancing spatial disparities. An additional payoff to reviewing the size and coverage of select cash transfer programs is that they can help offset the incidence of VAT that falls on poorer households. Kenya's pro-poor education spending at the primary level offers an opportunity to continue to build human capital and the future productive capacity of children, particularly those from less-well-off households and counties that are more likely to use the public education system. Protecting this category of spending during reforms will be important to maintain the momentum on human capital and to invest in better quality learning outcomes. The incidence of input subsidies, such as vouchers for fertilizers, can also be reviewed for their redistributive and poverty impacts. As the Government balances multiple objectives, while implementing fiscal consolidation, close attention to these components will set the ground for inclusive growth.

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