THE EFFECTS OF IMPORT-SUBSTITUTION: THE CASE OF KENYA'S MANUFACTURING SECTOR

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ABSTRACT

This paper attempts to assess to what extent growth of the manufacturing sector in Kenya has contributed to a process of integrated and wide spread economic development.

There are three sections. The first reviews the general arguments of development theory to promote industrial development in the Third World countries.

The second section deals with the pros and cons of the 'import-substitution' policy, which was adopted to speed up growth of the manufacturing sector. The last section brings together relevant research findings concerning the effects of this policy on the structure of the manufacturing sector, employment creation, income distribution and the operations of multi-national firms in Kenya.

The conclusion is that the type of industrialization that occurred has not led to 'a structural transformation' of the Kenyan economy. Growth in the manufacturing sector, although fast in terms of output, has been growth within existing types of industries. Few 'forward- and backward linkages' were developed and the impact of the policy on employment creation and income distribution can hardly be viewed favourably. Resources have been concentrated on a small part of the economy and to a large extent have neglected others, in particular agriculture. Multinational firms in Kenya have been a hindrance to the establishment of an integrated, balanced type of economic development. Import-substitution did not lessen Kenya's external dependency, but merely changed its nature. Consequently, the policy was not effective in alleviating the balance of payments difficulties.

I. INTRODUCTION

After World War II, when concern with the Third World countries became widespread, most development economists agreed that growth in aggregate output should be the prime economic objective for these countries. During the 1950's, there was a consensus that poor countries were caught in the so-called 'low level equilibrium trap' i.e. the tendency of population growth to outpace growth in production, keeping the per capita income level unchanged in the long run. In order to escape this trap and reach the point of 'take off into self-sustained growth" (Rostow, 1953) various 'big spurt' theories were developed. These ranged from 'a critical minimum effort' (Leibenstein, 1957) and a 'big push' (Rosenstein-Rodan, 1957) to 'balanced growth' (Nurkse, 1955) and 'unbalanced growth' (Hirschman, 1958) versions. It is not surprising that many of the lessons, taught by western development economists were merely reflections of past development patterns in the now industrialized countries. Since rapid capital formation had played a crucial role there, it was assumed that the same would be true in the poor world and that capital accumulation could be realized in the industrial sector.

Furthermore, because productivity of labour is high in industry and low in agriculture (Lewis, 1954), it was generally agreed that economic development i.e. growth of national output, required the transfer of labour from the primary to the secondary and later to the service sector. Agriculture would be freed of a huge labour surplus, while more productive sectors of the economy would enable aggregate output to increase.

Moreover industrialization would raise productivity in agriculture by increasing the demand for agricultural produce and making available tools and equipment needed to improve agricultural techniques. The spread effects induced by industrial expansion would affect other parts of the economy. New factories would not only need labour, but also machinery, raw materials, infrastructure, transport, communication, etc. Some of these requirements in turn would stimulate domestic production (although in the beginning many items would have to be purchased abroad). Higher wages would increase demand for consumer goods

and further enhance domestic production. In short, what was supposed to get underway was the familiar multiplier-accelator mechanism, which would lead to cumulative expansion in all sectors of the economy. Industry was to fulfil the leading role.

Of course development theorists were aware of the obstacles which would inhibit development along these lines in poor countries. There would be difficulties in the supply of technical, managerial and administrative manpower; bottlenecks in the availability of materials and equipment and inadequacies in the provision of transport, power and communication systems. But, through conscious planning these problems might eventually be solved. Moreover industrialization would take place with the help of foreign investments and considerable aid funds which would close the foreign exchange gap.

There was also a more practical reason why industrialization was accorded such a high priority in development policies. The 'old colonial role' as exporters of primary commodities and providing a market for manufactured goods from the industrialized nations, proved to be detrimental to the poor countries. Export prices of primary commodities tended to fluctuate heavily and lagged behind prices of manufactured trade goods. There were also high protective tariffs against processed primary goods entering the rich countries. The combination of these factors called for the creation of an industrial base in the developing countries.

Before turning to Kenya's industrial development, two more remarks should be made. First concern for unequal income distribution effects, as a result of the advocated industrial policy, was almost absent. It was simply 'theorized away' with the argument that uneven income distribution was a sine qua non for capital formation and an inevitable outcome of development in the early stages of growth. Moreover, Kuznets (1955) demonstrated that a process of more equal income distribution would set in, once per capita income had crossed a certain threshold.

This 'trickle-down' effect which would lead to a widespread distribution of the fruits of development, and introduce more and more people into productive employment, was generally accepted as the long run solution to short term regional and sectoral problems of inequalities.

Secondly, as far as foreign investment and aid are concerned, little attention was paid to the inherent 'side effects' of massive

surplus transfers abroad and the intensification of import dependence caused by the implementation of modern (capital-intensive) production techniques.

II. IMPORT-SUBSTITUTION

In the 1950's and 60's many Third World countries attempted to create an industrial base through a policy of import-substitution, which meant that what had been formerly imported in consumer goods was produced locally instead. Arguments for this strategy included:

(1) The already established markets for the new industries;(2) Government protection of the 'infant' industries through bans on competitive imported goods and concessions on sales tax and customs duties on inputs (3) A reduction in the relative importance of foreign trade thus reducing vulnerability to externally induced fluctuations.

In many countries, including Kenya, this industrial strategy allowed for impressive growth of the industrial sector. However, as time went by, observers increasingly doubted the merits of this policy. Today it has become painfully clear that industrial growth alone is not able to alleviate the problems of mass poverty, income inequality, unemployment and regional imbalances. The disadvantages of import substitution can be summarized as follows:

a) Much of past industrial investment should be labeled 'easy stage' investment, that is in manufacturing consumer goods and in infrastructural improvements, sectors where capacity could easily be expanded. But since, formerly imported, consumer goods are bought by only a small, high-income, fraction of the population, the internal markets for these products soon turn out to be too small to justify large-scale production.

Hence further expansion in this direction is highly unlikely. Given the small size of the market, total demand can often be met by one or a few factories that enjoy heavy government protection against external competition. This leads to relatively high production costs, high prices and high monopolistic profits and contributes to a greater concentration of wealth.

b) Given the nature of the product-mix (Western oriented type of products), these industries are mainly owned, financed and managed by foreign companies, reinforcing dependence on external capital, skills and technology. Moreover, because imported equipment was made artificially cheap (through low or non-existent import duties and an overvalued exchange rate) it becomes attractive for companies to import their requirements rather than to obtain them from local suppliers. This not only aggravates the country's balance of payments, but also stimulates the use of capital-intensive techniques, which in turn has a detrimental effect on the amount of labour used in the production process. Capital-intensive technologies are in general inconsistent with widespread unemployment and rapid population growth.

c) A crital element in the 'chain reaction' set in motion by the import-substitution policy, is the weakness or even the absence of 'forward and backward linkages' between domestic sectors. Growth in one sector, with limited spread effects to the rest of the economy, contributes little to the objective of engaging more people in productive activities. Although it is true that the agricultural sector provides certain inputs for industry, the reverse supply linkages between industry and the agricultural sector have only developed to a limited extent. In fact, agriculture suffers from the policy of import substitution through an overvalued exchange rate, through monopoly pricing in the manufacturing sector and through surplus transfer to the manufacturing sector.

The urban 'informal' sector is also bound to suffer since modern firms (multinationals) compete with craft domestic fabricates, displacing artisans without offering sufficient new employment in the modern sector.

Given these constraints and the failure to spread productive activities and raise welfare in all regions of the underdeveloped countries, and also, because past industrialization shows signs of having reached its limits of 'easy stage growth', another type of industrialization, export promotion is being advocated. Underdeveloped countries should now concentrate on the expansion of those industries able to compete in international markets.

This implies that new demands of efficiency, quality and prices make themselves felt before successful access to the world markets

will be feasible. Not long ago such a strategy was successful in Japan and more recently in the so-called newly industrialized countries like Taiwan, South-Korea, Singapore, Mexico and Brazil. However, in the future it will be increasingly difficult for 'newcomers' to pursue such a policy, not only because it demands a complete restructuring of the economy and economic policies, but also because the rich countries, through tariffs, quota restrictions and other barriers, are inclined to protect their markets from exports of the Third World countries.

In the present context of economic crisis and rising unemployment in the rich countries, the development of the poor world through export promotion seems to offer few possibilities.

Given the inability of past industrialisation policies to bring about widespread development, 'new' suggestions have been put forward. Unified approach, integrated rural development, intermediate technology, informal sector and basic needs, and the New International Economic Order are the latest slogans in the international forums of development experts. Agriculture or rather the rural sector has been 'rediscovered'. All this simply reflects the growing awareness that past industrial strategies have failed to lead to increased welfare for the population as a whole. The debate has shifted from the merits of industrialization per se, to more practical (and policy) questions. How much industry, what type, with what techniques and for whom, employing what forms of organisation (private, foreign, statal or para-statal).

Having exploired some of the theoretical considerations involved in the industrialization issues, let us now turn to the case of Kenya. The main aim of the rest of the paper is to assess whether the industrial base, that has been established in Kenya, represents a source of strength or a source of distortions for Kenya's economic and social development.

The method applied is one of bringing together relevant findings of research on Kenya's industrial sector. Since these studies cover a wide range of interrelated topics, these findings are discussed under a number of headings relevant to the main question formulated above. The headings include:

a) The Kenyan industrialization process
b) Employment creation
c) Income distribution
d) Impact of multinational firm operations.

III. RESEARCH FINDINGS ON KENYA'S INDUSTRIAL SECTOR

a) The Kenyan Industrialization Process

Kenya's industrial development after political independence in December 1963 cannot be understood without taking into account its colonial history. With the arrival of the white settlers, Kenyan agriculture underwent a far reaching transformation. The settlers, in collaboration with the British colonial government, occupied millions of acres of the best agricultural land (the so-called White Highlands), and confined the African population to the 'Native Reserves'. Shortage of land and the imposed exclusion of Africans from growing certain[1] export crops resulted in a large pool of cheap labour for the European estate farms.

In 1912/13 African production accounted for at least 70 per cent of agricultural exports. By 1928 it had dropped to less than 20 per cent and in later years it further declined as the 'reserves' increasingly relapsed into subsistence farming to support their increasing populations. (C. Leys, 1975, p. 31).

The Asians were brought into Kenya, first to help construct the Mombasa-Lake Victoria railway and later to provide skilled services to the white colonialists. The Europeans generated income for themselves, exports and foreign exchange for the country and tax revenu for the colonial government by producing tea, coffee, sisal, beef, maize, wheat and sheep. Part of this income was channelled to the Asian traders and craftsmen and a (small) part to the African agricultural labourers, but most of the capital accumulated before 1945 was invested in 'merchant' activities (wholesale/retail and import/export firms) with only limited amount invested in agricultural processing. The few manufacturing industries established up to World War II were mainly for some basic processing of agricultural exports and the processing of food for the local European and Asian market. From 1945 on, a small import-substituting industrial sector developed. This was financed by British and local Asian capital.

One factor which induced British industry to enter direct manufacturing production in Kenya was the growing competition from non-British suppliers which threatened Britain's share in the Kenyan

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[1] Africans were allowed to cultivate only such export crops that would completement but not compete with settler production. These products included: tobacco, wattle, cashew-nuts and Irish potatoes. (N. Swainson, 1978, p. 361)

market. Import-substition became an official government policy when protective tariffs were introduced in 1958 to enable local and foreign capital to increase industrial production behind comfortable tariff walls. From the development theory point of view this process was to conform to the objectives set for the early stages of development: laying the foundations of an industrial base, reducing the excessive dependence on primary production and lessening import dependence in order to relieve the balance of payments.

At independence Kenya's industrial (2) sector accounted for a relatively small part of the total GDP. In 1956 this share was 15.8 per cent but it dropped to 13.0 per cent at independence in December 1963 (Table 1).

Table 1. Kenya's industrial sector, percentages of GDP, 1956 - 1964

Year	Mining and Quarrying	Manufacturing	Building and Construction	Electricity and water	Total
1956	0.7	9.4	4.8	0.9	15.8
1957	0.6	9.6	4.7	1.0	15.9
1958	0.6	9.9	4.0	1.1	15.6
1959	0.5	9.4	3.7	1.2	14.8
1960	0.5	9.6	3.5	1.2	14.8
1961	0.4	10.1	3.5	1.3	15.3
1962	0.3	9.4	2.8	1.4	13.9
1963	0.3	9.4	1.9	1.4	13.0
1964	0.3	10.2	1.6	1.2	13.3

Source: Statistical Abstract, 1966 and '69

Most of this reduction was attributable to a decline in building and construction as independence approached. After independence the industrial share in GDP steadily rose to about 19 per cent in 1976 (Development Plan 1979 - 1983, p. 84).

(2)The industrial sector is defined as including: mining and quarrying; manufacturing; building and construction; electricity and water.

As follows from Table 1, manufacturing is by far the most important industrial activity. Its share rose from 9.4 per cent of GDP in 1956 to 10.2 per cent in 1964, and further increased to 14.3 per cent in 1976. In absolute terms manufacturing output grew fast at a yearly average of 8 per cent between 1964 and 1972.

At independence the structure of Kenya's manufacturing sector reflected the policy of import-substitution. It also reflected the colonial inheritance of a very uneven distribution of income. As the I.L.O. 1972 report puts it:

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

Income data for enumerated employees reveal that in 1961 about 22,000 Europeans (4 per cent of total employment) earned one third of the total wage bill set at £ K90 million in that year. Average European earnings was 18 times the average African earnings. By 1970 the reduced number of European employees (14,000) still accounted for 18 per cent of the total wage bill, while average income for this group was still 12 times as high as the average income of the African employee. (Statistical Abstract, 1971, p. 187/196).

The very limited participation of Africans in manufacturing is also illustrated by the division of nominal company capital among different groups. The total nominal company capital of firms registered between 1946 - 1963, was £ K139 million, of which 68 per cent was European, 21 per cent Asian, 11 per cent partly European and partly Asian and less than 1 per cent African (J. Kamau, 1965, p. 10). Thus from the outset, manufacturing was geared to satisfy the material demands of the European and Asian communities and was never directed towards the needs of the African majority.

The main activities in the manufacturing sector were related to processing of primary products and last stage assembly production. Table 2 reveals that the so-called light consumer industries (3)

(3) We have somewhat arbitrarily divided the sector in three categories:
1. light consumer industries including industries 1 - 7;
2. intermediate industries including items 8 - 11 and
3. capital goods industries, items 12 and 13.

account for 65.3 per cent of total manufacturing whereas 'intermediate industries' constitute 25.6 per cent and 'capital goods' only 9 per cent. Food processing, beverages and tobacco alone contributed no less than 45 per cent to the total.

Table 2. Kenya's manufacturing sector at independence, 1963

Industry	Gross Production[a] K£'000
1. Food products	25,516
2. Beverages and tobacco	8,016
3. Textiles and clothing	3,769
4. Footwear	1,792
5. Wood and furniture	2,529
6. Paper and printing	5,623
7. Leather and rubber	1,096
8. Clay and glass	763
9. Basic chemicals and petroleum	10,570
10. Cement and other minerals	2,312
11. Metal products	5,276
12. Machinery and shipbuilding/repair	1,839
13. Railway rolling stock, motor vehicles	4,913
14. Miscellaneous	792
Total	74,806

[a]Gross production is defined as the value of sales plus the net increase in stocks of work in progress and finished goods.

Source: Statistical Abstract 1968, Table 88. Census of Industrial Production, 1963.

It is important to note the high percentage of imported inputs, used in the manufacturing sector. In 1963, 42.5 per cent of all inputs used, came from abroad. This indicates that manufacturing as a whole used few local resources (apart from agriculture). In some industries almost all basic materials were imported: soft drinks (90 per cent); footwear (85 per cent); paints (90 per cent); soap (67 per cent), metal products (90 per cent); rubber products (95 per cent) indicating

the last stage processing or assembly character of many industries (Seidman, 1972, p. 24).

From a development point of view two important conclusions could be drawn. First, much of the value added in industries found its origin not in Kenya but in the foreign, inputs supplying countries and second, due to the high import content, few 'forward and backward linkages' were developed during the initial industrialization.

How did the manufacturing sector develop after 1963? Table 3 shows the data for the year 1977. Although one should be cautious in comparing the Tables 2 and 3, because of changes in statistical coverage and re-classification of industries during the 1963-1977 period, two conclusions can be drawn.

Table 3. Kenya's Manufacturing sector, 1977

Industry	Gross Domestic Product[a]
	K£'000
1. Food products	68,267
2. Beverages and tobacco	25,000
3. Textiles and clothing	16,009
4. Leather and footwear	2,790
5. Wood and furniture	8,980
6. Paper and printing	17,757
7. Basic chemicals and petroleum	8,723
8. Rubber and plastics	10,020
9. Pottery and glass	1,082
10. Non metallic mineral products	9,307
11. Metal products	20,363
12. Machinery	9,461
13. Transport equipment	11,424
14. Miscellaneous	2,800
Total	211,983

[a]Gross Domestic Product is defined as the aggregate difference between output and input. It includes labour costs, interest payment, depreciation charges and net profit before tax.

Source: Statistical Abstract, 1979, Table 125. Census of Industrial Production, 1977.

Despite the fact that some growth in the period under observation could be described as 'illusory', resulting from the wider coverage of firms in the latter Census of Production, it is apparent that the manufacturing sector experienced fast growth. However, when considering the structure of the sector, it is clear that no significant shift has occurred from light consumer to intermediate and capital goods industries. The first category still accounted for 67.3 per cent of total manufacturing, intermediate industries for 23 per cent and the share of capital goods industries was 9.7 per cent. Food products and beverages and tobacco were still 43 per cent of the total.

Consequently, import substitution policy, in itself very successful in terms of growth has not basically transformed the structure of the manufacturing sector. Thus the picture has been of more growth along existing lines, instead of 'structural change'. A similar conclusion is drawn by Hazlewood (1979, p. 65).

As regards the 'foreign input' aspect of past growth,the role of foreign inputs, in terms of raw materials, intermediate goods, machinery and technology has increased. According to Jörgenson the past industrialization process was accompanied by increased imports of semi-processed raw materials, foreign machinery and technology, which more than offset the anticipated savings in imports of consumer goods. This leads him to conclude that "the Kenyan economy has become structurally more dependent since independence". (Jörgenson; 1975, p. 445). If this is true, then it is unlikely that the fast growth of Kenya's manufacturing sector also induced more use of local inputs and development of important forward- and backward linkages in the economy.

At this point, let us recall one of the disadvantages of import substitution policy set out earlier. It was argued that the policy could lead to an increase in the volume of imports since import substituting industries are to a great extent dependent on an inflow of intermediate products, machinery and spare parts.

Data relating to Kenya's trade pattern in the 60's indicate that a shift in such a direction has indeed occurred. Total overseas imports rose sharply from K£ 76.5 million in 1964 to K£183,6 million in 1971. Capital goods, including transport equipment which accounted for 32 per cent of total overseas imports in 1964, rose to 39 per cent in 1971. Semi manufactured goods and metals (imports for manufacturing and building)

increased from 15.3 per cent (1964) to 19.1 per cent in 1971 (V.Vinnai; 1973, p. 19).

Thus, the policy of import-substitution coincided with a continued rise in imports not only in absolute terms but also as a proportion of GDP. It contributed to severe constrains in the balance of payments and by 1971 caused the government to decide to effect a number of import control measures. In 1972 the share of (intermediate and capital) imports which stood as high as 52.3 per cent of total manufacturing output in 1971, decreased to 42.3 per cent. However, in 1974 increased again to 46.4 per cent (Development Plan 1979/83, p. 330). Apparently instead of easing the balance of payments deficit in Kenya (and in many other Latin American and Asian countries), import-substitution actually contributed to balance of payments difficulties.

Power (1972) outlined the dangers of this policy and its inherent protection of consumer goods industries. An expansion of last stage production of consumer goods could continue until import substitution has largely absorbed the domestic market. When the limits of this market are approached, industrial growth is likely to stagnate unless investment moves to intermediate and capital goods industries and/or manufactured goods move into the export market. However, it is just these types of industries that are penalized by the same system of protection since effective rates of protection (i.e. rate of protection of value added) are highest for consumer goods, lower for intermediate goods, still lower for capital goods and lowest for exports.

The required adjustment of the protection system, once domestic demand is fully met, will distress consumer good industries because it was this same protection system that allowed them to produce inefficiently and yet gain high profits at the same time. (4)

Thus the contradictory situation arises that the government which imposes import restrictions (to offset balance of payments difficulties) also tends to curb manufacturing growth (of consumer goods) since these are heavily dependent on imports of equipment, spare parts and materials.

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(4) For a theoretical framework of studying the effects of protection on the industrial sector see: M. Phelps & B. Wasow (1970). S. Lewis (1972) provided a study on the effects of protection on the balance of payments and the economy as a whole using an adapted "two-gap" Chenery and Strout macro-model. K. Kim (1973) provided an estimate of import substitution effects on domestic employment and foreign exchange savings using Kenya's 1967 input-output tables.

We have seen that in the second half of the seventies, Kenya's manufacturing sector continued to grow fast. However, it is also clear that there is 'little room' for further expansion of consumer goods industries. By 1977 imports of consumer goods had fallen to a mere 14 per cent of total imports while in 1964 they accounted for almost 30 per cent (Development Plan 1979 - 1983, p. 7). Consequently a move towards exporting industries is required but will be much more difficult if the theory described above, works.

Apart from the unfavorable effects on the balance of payments and the lack of a structural change within the manufacturing sector, import substitution had other negative effects. The Kenyan government is fully aware of these and has enumerated some of the negative effects of the policy in the 1974 - 78 Development Plan. These include: a sharp socio-economic cleavage, in which wages in the manufacturing sector increased to many times the average earnings of the workers in rural areas due to the following reasons:

i. Since machinery could be imported almost free of duty, manufacturing firms used it in preference to labour. Therefore, manufacturing became so capital-intensive that opportunities for employment were seriously limited.

ii. Because modern, capital-intensive manufacturing is most cheaply done by large companies, in many lines of activity one company was able to out-compete the rest and establish a monopoly.

iii. Partly because of monopolies and partly because of tariff protection, the companies were able to charge high prices and earn high profits, thus contributing to a greater concentration of wealth. They were able to drive handicraft competitors out of existence, thus promoting greater poverty for all the rest, and sharper social distinctions than before. (Development Plan, 1974 - 78 p. 27).

The plan also acknowledges: 'that a further distortion was the discouragement of producers of capital and semi-finished goods. Thus the manufacturing sector lacked depth. Only finished goods were produced and production was geared to foreign suppliers of machinery and raw materials' (p. 27).

In addition the plan states, rather optimistically: 'By contrast Kenya now hopes to develop an integrated manufacturing industry, with encouragement to production at all levels' (p. 27).

The next section provides some information on the employment and income distribution patterns that accompanied past rapid growth in manufacturing.

b) Employment Creation

In 1972 an I.L.O. team produced an important report which extensively discussed a wide range of issues all relevant to Kenya's pressing unemployment problem. According to this report, during 1964 - 70 output growth in the enumerated sector was about 8 per cent per annum, with an increase in employment of under 4 per cent per annum. There were about 645,000 wage and salaried employees in the modern sector in 1970 out of a total population of about 11 million in that year. This indicates a small fraction of the working age population (about 5.5 million in 1970) could be absorbed in the modern sector.

From 1972 to 1977, modern sector wage employment rose at an average of 4.7 per cent per annum bringing the total to 902,000 in 1977 (Economic Survey, 1977 and 1978). However, due to unfavourable external events (the oil crisis and the slow down in world economic growth) output growth during the same period was disappointingly low, averaging 5.5 per cent in the monetary sector.

Thus, despite low output growth, employment growth remained surprisingly high, approximating the growth rate of GDP. The public sector accounted for nearly half of the increase in employment. Specifically the increase in the teacher corps which added about 20 per cent to the total increase in the public sector employment.

In the 1972-77 period the manufacturing sector expanded at an average rate of 10 per cent per year (1972, constant prices) despite a significant slow down in 1975 following the oil crisis. The 1977 coffee boom accelerated domestic demand considerably so that the overall growth pattern turned out to be somewhat higher than the target set in the 1974-78 Development Plan. Employment in manufacturing rose from 84,800 in 1972 to 117,900 in 1977 which represents an average growth rate of 6.9 per cent (Statistical Abstract 1976). Although this is

a high figure, it should be remembered that wage employment in manufacturing accounts for only a small share of total modern sector employment (11.7 per cent in 1972 and 13 per cent in 1977) and that this sector still absorbs only a tiny part of Kenya's total labour force (less than 2 per cent). This is not to say that employment trends in this sector are unimportant, it only emphasises the overwhelming influence of the rural economy on the overall socio-economic performance.

Economists have noted that manufacturing employment fails to grow at approximately the same rate as industrial output. Usually this is explained by the existence of 'capital intensive production techniques' in the industrial sector, induced by artificial cheap capital (through capital investment allowance, accelarated depreciation allowances and refund of customs duty on capital goods imports) resulting in high capital-labour ratios. The main question here is, whether the demand for labour will show an increase once distortions in the relative factor prices have been corrected for. This in turn depends on the flexibility of choice in production techniques determining the scope for substitution between capital and labour in the production process. Thus the exent to which the capital-labour ratio can be altered, depends crucially on the value of the elasticity of substitution between the two production factors. Zero elasticity means no substitution is possible.

Studies of the Kenyan economy suggest an elasticity greater than zero (Harris and Todaro, 1969, J.K. Maitha, 1973, L.P. Mureithi, 1975). In most cases, in order to estimate substitution elasticity, a model including a production function of the CES (constant elasticity of substitution) type was employed.

However, it seems that results of econometric analysis should be handled with great caution. The type of available statistical data does not always coincide with the smooth presentation of variables in models. Aggregated data obscure production realities at the firm level, while underlying assumptions of the production function (for example homogeneous input factors) may lead to erroneous conclusions (5).

(5) See D. Morawetz, 1974. "Attempts to estimate substitution elasticities econometrically have yielded unsatisfactory results. Even slight variations in the period or concepts tend to produce drastically different estimates of elasticity" (p. 516).

Despite these problems Maitha (1973), after analysing Kenya's industrial development from 1963 to 66, concludes that "results indicate a significant relationship between factor prices in Kenyan industries with elasticities of substitution equal to or greater than unity. Slow growth of labour absorption can be attributed to capital labour substitution stemming from existing unbalances in the relative prices of capital and labour" (p. 49/50). Implicit in this reasoning is the assumption that there it a causal relationship between relative factor prices, the choice of techniques and the demand for labour. In an economy like that of Kenya however, where much of the technology is imported from developed countries, relative factor prices may play only a minor role in determining the technology used.

Apart from this, the widespread belief that there is a great gap between output growth and induced employment growth has been challenged by some writers. Weeks (1979) in his study of Kenya's large scale manufacturing sector, found that this gap is drastically reduced when (instead of output in current prices) the relevant time series deflated on real output is used. In that case a 1.4 per cent increase in output was associated with a 1.0% increase in employment, indicating that the demand for labour in large scale manufacturing is much more out-put responsive than previously thought.

Pack (1972) comes to similar conclusions. He conducted a series of interviews with Kenyan manufacturing firms and showed that by international standards, Kenyan firms are relatively labour intensive, and that increases in labour productivity were linked more to the use of excess capacity and improved organisation and training of labour than to increased capital labour ratio's (capital intensity).

Thus the assertion that employment growth lags far behind output growth and the belief that this is caused by high capital intensities appears to lack support when actual developments are taken into account. The figures for the 1972-1977 period (10 per cent real output growth per annum versus 7.0 per cent employment growth per annum) tend to support this conclusion. Employment growth seems to be far more output responsive than is usually thought.

c) Income Distribution

Although the manufacturing sector has absorbed more labour in the 1970's than is generally thought, (6) it is also true that this sector has not made a significant contribution towards alleviating the severe problems of unemployment and unequal income distribution.

It may be argued that manufacturing, or the industrial sector, because of its relative small size in the economy can never be expected to carry out a "structural transformation" (especially in the light of the high rate of population growth of 3.9% in the Kenyan case). Nevertheless it is relevant to ask what import-substitution and the resulting growth of manufactured output has done to the pattern of income distribution.

We may recall that the protection of domestic manufacturing (aimed at speeding up the expansion of industry) has had the effect of raising manufacturing prices and profits to the detriment of domestic consumers. While a small part of the additional income, generated in industry goes to hired labour, more goes to management and capital owners and another part goes to the government in the form of taxes.

To put it simply, much of the gains realized in the manufacturing sector, as a result of the distorted price structure (inherent in an import-substituting policy) can be interpreted into losses for other sectors of the economy, in particular agriculture.

(6) Also indirectly created jobs in other sectors of the economy: agriculture and forestry, transport, storage and communications, trade and other services and electricity and water.

Thus, import substitution policy has probably enhanced inequalities of income between agriculture and industry. The relative loss, suffered by farmers, can be measured by the evolution of the terms of trade between these two sectors. Available data suggest that in most years in the 1969 - 76 period, prices for farm products have risen more slowly than those of manufactured goods. This implies that farmers have subsidized industry during most of this period (Kaplinsky, 1978, p. 6 and Table 2). There was also a substantial net capital outflow from agriculture to industry which rose from K£ 50 million in 1964 to K£ 124 million in 1974. During the 1964-74 period over K£ 680 million was transferred out of agriculture (Sharpley, 1979, p. 560). The relevant question to raise is how these funds were used in the other sectors, particularly industry. Again here we touch upon the issue of industry's ability to create additional employment and to develop linkages with other sectors of the economy by using local resources. According to Sharpley the inflow of intermediate inputs (fertilizers, chemicals and seeds) and investment goods (farm equipment) was found to be extremely small (Sharpley, 1979, p. 569). Moreover if a substantial part of funds transferred to industry is used to finance new capital-intensive (foreign) firms and if considerable profits and dividends are transferred abroad, then the situation becomes highly suspicious. The large net capital outflow from agriculture has contributed to a widening of urban-rural imbalances and enhanced migration into urban areas. In addition to favouring the manufacturing sector, import substitution has probably also favoured profits over wages within that sector. Statistical data show that during the 1966-70 period, average real wages rose gradually until 1973, but dropped sharply between 1973 to 1976. The 1978 Economic Survey estimated that average real wages decreased by 11 per cent during that period and also suggested that 'wage earners in the lower income group have suffered a larger fall in their real wages than those in the middle and upper income groups' (p. 62) Profits, on the other hand, seem to have increased during this period, indicating a shift from wages to capital income. (Kaplinsky: 1978, Table 5, p. 11).

However these data should be interpreted with caution because many statistical and methodological problems are involved in assessing the pattern of income distribution. There are also levelling factors which should be mentioned. These include redistribution effects through remittances of migrant labour back to the countryside; redistribution within the extended family system and the provision of free or subsidized social services such as education and health by the government.

Past attempts to estimate overall income distribution in Kenya (I.L.O. 1972; Morrisson 1973 and Jones 1974) have yielded values of the gini coefficient (7) which is widely used as a measure of income inequality, in the region of 0.60. It is evident from these studies that Kenya's income distribution shows an extreme degree of inequality. Morrisson (1973) found that, in 1969, the poorest 50 per cent of the population received some 14 per cent of total income while 56 per cent accrued to the richest 10 per cent (8). A recent study on income distribution (Crawford and Thorbecke, 1978) found a gini coefficient between 0.50 and 0.55. It would be wrong to conclude from these figures, that income distribution in Kenya has improved, because differences in methods, such as different groupings of households, and different samples, make comparisons suspect. It seems unlikely that an import substitution policy which inherently favours the urban industrial sector leads to a less unequal distribution of income (9).

As to the geographical location of manufacturing, it seems that very little progress has been made in the dispersion of manufacturing activities. In 1967 Nairobi and the Coast Province (Mombasa) accounted for a disproportionate share of total value added in manufacturing of over 78 per cent. By 1976 this share had hardly changed, dropping

(7) For a discussion of methods to calculate this coefficient see O. Aseto, 1977.
(8) Figures taken from Killick, 1976, p. 12.
(9) According to Hazlewood (1978) too much emphasis is placed upon inequality. A more relevant question would be how absolute levels of income of the poor have changed overtime. He also criticizes international income comparisons and the I.L.O. 1972 income analysis. (p. 86 f.f.)

slightly to 74 per cent (Bigsten, 1977, p. 39).

After 1975, a policy of selective investment credit allowance was introduced, aimed at stimulating dispersion. However, Norcliffe (1977) argued that 'by and large the policy seems to have drifted with individual locational decisions being made on an ad hoc basis'. (p. 10)

d) Foreign Investment and Multi-national Firms.

Industrialization through import substitution means, local production of formerly imported goods, partly transnational, branded and standardised products. It is no wonder then, that foreign investment and multinational firms are heavily engaged in Kenya's industrial development. Since independence the Kenya Government has followed a generous open-door policy to foreign firms, providing very favourable terms. From 1966 onwards international capital poured into Kenya. Although fluctuating from year to year, it nevertheless represents a significant proportion of total investment- in some years as much as 20% of the capital formation by enterprises and non-profit institutions.

International capital has become dominant particularly in large-scale manufacturing. According to the 1967 Census of Industrial Production, predominantly or totally foreign-owned firms contributed 71 per cent of total value-added in Kenya's manufacturing sector. Langdon (1978), who surveyed 81 subsidiaries in 1972/73, valued the book value of direct foreign investment in Kenya at K£ 130 million in 1971/72, representing about 21 per cent of GNP. Langdon also confirmed the I.L.O. 1972 report finding that foreign capital was involved in about 60 per cent of manufacturing investment, (I.L.O, 1972, p. 442).

A recent study undertaken by Kanplinsky on the ownership of all large-scale manufacturing (and all tourist firms) (10) shows that between 1966 and 1976 foreign investment has remained important. However, some significant changes have occured during this period. The share of total issued capital, owned by foreign firms, declined from 59.3% in 1966 to 42% in 1976. This is a reflection of a selling-off of a minority stake of shareholdings to local firms, the growth of

(10) R. Kaplinsky, forthcoming. This research is a follow-up study of the National Christian Council of Kenya: "Who controls Industry in Kenya".

small indigenously-owned enterprises and the increasing role of parastatals in joint ventures with foreign capital (Kaplinsky, 1981, p. 443). Furthermore there has been a shift of foreign investment, formerly concentrated in the food, beverages, chemicals and rubber sectors to the textile, leather, paper and printing sectors.

However, according to Kaplinsky, these developments have not really challenged the control that multinational corporations (mnc's) have over a substantial part of Kenya's manufacturing sector (11).

In Kenya, mnc's are involved in a wide range of products, such as food processing, beverages and tobacco, petroleum refining and basic industrial chemicals, soap, paint, pharmaceuticals and other chemical products, leather and rubber products; cement and metal products (Langdon; 1978, p. 142).

Evidently the bulk of mnc's manufacturing activities is oriented towards consumer goods for the local market, rather than production for export markets.

Generally speaking, mnc's try to maximize accumulation of capital and profits at a global level. Their operations may diverge from the needs of national society and may also contradict national government policy goals. One of the implications of a large proportion of foreign investment in total Kenyan investment is the high potential of a large outflow of profits and dividends.

Unctad estimates show that in Kenya during 1964-70 inflow of new private long term capital almost equaled net outflow of investment income (Unctad, 1970).

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(11) The question whether or not local capital has succeeded in playing a successful role in 'the transition to industrial capitalism' has led to an animated discussion in the volumes of the "Review of African Political Economy", nos. 17,18 and 19; 1980.

As Stewart (1976, p. 87) points out, this situation illustrates:

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

The merits (and demerits) of foreign investment can be assessed in terms of the impact on several key economic factors: choice of production techniques, type of products, use and creation of employment, reinvestment of surplusses and profits, use of imported inputs and forward- and backward linkages within the host economy. In Kenya relatively little research has been done on these issues. The available findings however, tend to suggest that the ultimate impact on the overall Kenyan economy is unfavourable.

Kaplinsky (1978, p. 11) notes that the power of the mnc arises largely from their control over technology. A survey of several British mnc's in Kenya revealed that "parent corporations are anxious to control the generation of a new technology in their subsidiaries and that, particularly in the consumer and intermediate goods sectors, the subsidiairies are largely dependent upon parent companies for the generation (and choice) of new technology" (p. 11). However this does not necessarily mean that mnc's are using capital intensive techniques. Where comparison is made between local and foreign owned firms, the latter appear to use marginally more labour intensive techniques (Kaplinsky, 1978, p. 13).

It appears that mnc's are not much effected by market price competition due to the high levels of protection. In fact one of the main reasons making foreign firms eager to invest in developing countries including Kenya, is that they can exploit the existing imperfections in the factor and product market giving them a monopolistic advantage. This allows for high levels of surplus appropriation, in-

cluding high profits while operating below maximum capacity utilization. Hopcraft, among others, has set out the negative results of a heavily protected economy. Import bans or controls lead to distortions in the price structure, by increasing the domestic price of non-essential products (formerly imported). "The problem comes not with luxury items per se, but with irrational distortions that bias incentives toward inward-looking luxury goods production. The bias is simultaneously toward import-intensive, capital-intensive lines, and away from internationally efficient, exportable lines". (Hopcraft, 1972, p.6). Mnc's also tend to add little value-added while producing in Kenya. Both Langdon and Kaplinsky found evidence that mnc subsidiaries, operating in Kenya, mainly assemble, mix and package imported inputs. Thus most value-added has already been realized abroad in parent firms.

Backward linkages are few since 98% of import-substituting firms imported over 70% of their machinery and nearly 70% of these firms imported 70% of their raw materials (Langdon, 1975).

Large mnc's also successfully gain protection privileges in bargaining with government institutions. According to Langdon (1978) and Hopcraft (forthcoming) a cooperative symbiosis develops between mnc's and the dominant African class, sharing the benefits which accentuates the inequalities within Kenyan society (Langdon, 1978, p. 198).

Another effect of mnc's operations is the tendency to change consumer taste in the host country towards the particular branded products which they produce at home. This redefiniton of consumer needs (e.g. the translation of thirst into the need for a Coke) often accompanied by mass advertising, may threaten small scale indigenous entrepreneurs and force them to produce simular branded, standardised articles. The majority of these 'informal sector' firms will not be able to make such a shift and will be forced out of business. Evidence for this is provided by Langdon in his 1973 survey of 32 African shoe manufacturers in Machakos district, his

'soap case study' (Langdon, 1975) and by the 'maize flour study' (Stewart, 1979). Eglin (1978) found that local entrepreneurs, mostly Kenyan Asians, unable to compete with foreign firms in the import substituting consumer industries, have made "a significant number of investments in the production of intermediate and capital goods" (Eglin, p. 132).

However Kaplinsky questions the conclusion that indigenous entrepreneurs have been forced out of the market by mnc's activities. He cites Swainson (1976) who found that African-owned shoe firms had expanded considerably and had begun to compete with some success with the established mnc operating in that sector (Kaplinsky, 1978, p. 15).

Other negative effects of mnc's operations can also be mentioned. The western-type of products of mnc's require the importation of 'sophisticated inputs' (which parent companies are only too glad to provide) and this 'tends to block off many potential linkages to any integrated national economy" (Godfrey and Langdon, 1976, p.50).

Mnc's, furthermore tend to contribute to 'a polarisation of the national labour market' by paying relatively high wages and salaries to their labourers and managerial staff. High salary levels abroad, in particular for managers and directors, are passed on to Kenyan managers and directors in the subsidiaries and "acted through the market mechanism on other higher-level salaries in the public and private sector" (Godfrey and Langdon, 1976, p. 51).

Altogether, it seems unlikely that multinational corporations are contributing to the process of genuine industrial development in Kenya. But as Kaplinsky (1978 p. 20) remarked:

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

IV. CONCLUSION

The aim of this paper was to bring together research findings to answer the important question whether or not the type of industrial development in Kenya has contributed to the establishment of an integrated economy aimed at raising productivity and higher standards of living for the entire population.

Drawing up the balance-sheet, we find little reason for optimism. We have seen that import substituting industrialization implied a process of uneven growth. Resources have been concentrated on a small part of the economy, (admittedly with great success in terms of output growth) and have to a large extent, neglected the rest. The type of industrialization, that occurred has not led to a 'structural transformation' of the Kenyan economy. Growth in the manufacturing sector has been growth within existing categories of industries.

Import substitution industrialization did not lessen Kenya's external dependence but merely changed its nature. Capital-and intermediate goods became much more important items on the import list. It is paradoxical that the provision of these goods have become vital for the new industries, and that any constraint on their importation (in the case of shortages of foreign exchange to pay for them) may cause industrial stagnation.

Import substitution policies tend to discriminate against agriculture. Price and tax policies were designed to transfer a considerable amount of capital out of agriculture to the benefit of the industrial sector. Generated income in the latter was to a limited extend used to create employment since employers in manufacturing, due to relatively cheap capital and other institutional factors, favoured foreign technologies. This in turn has contributed to underutilization of production capacity, inducing high costs of production.

Multinational corporations have taken advantage of 'distorted' factor markets and the inherited unequal income distribution by providing western-type consumer goods, thus accentuating the skewed

pattern of income distribution. They are also trying to 'redefine' consumer needs and tastes, often through mass advertising, thus threatening the market share of small indigenous enterpreneurs, who may use more appropriate (local resources) technologies. Furthermore the considerable outflow of dividends and other payments to foreign investors makes it necessary to rely even more on foreign investment in order to achieve further industrial growth, thus making the country even more dependent on external forces. It seems clear that Kenya needs to switch to a more redistributive development strategy, perhaps along the lines of the I.L.O. 1972 report.

Indeed, the last two Development Plans (1974 - 78 and 1979 - 83) show clear indications that the government is planning measures in this direction. (12) However a radical change in industrial and overall strategies, away from import substitution and inherent foreign involvement, will probably run counter to the interests of those (powerful) groups who have benefited most form past strategies.

(12) Studying the government responses to the ILO (1972) report, however, is not very encouraging. Killick (1976) characterizes government reaction to the ILO proposals 'as one of dilution'. (p. 30) For a similar conclusion see C. Leys (1979).

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