Transforming the Informal Economy: Social Protection & Inclusive Growth

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The Informal Economy

Economic Contribution
Informalisation of Kenya’s employment over time

**Formal and informal employment in Kenya (1981-2018)**

- **Structural adjustment programmes** - decline in formal opportunities (e.g. in manufacture & industry)
- **Rise in informality** (enterprises & jobs)

(Source: Ahmed, A (2018), ‘Inter-industry gender wage differentials in Kenya’, University of Nairobi)

See also ILO 2021
Intersections between informal & formal economy are numerous and complex

How and where do relationships between formal and informal add value; and how and where are they extractive?
The informal sector is a major component of the economy; but suffers from chronic underinvestment, diluting its contribution to growth

**MACRO**
- Contributes a third of GDP
- 83% of jobs (ILO) (but quality of employment is low)

**MESO**
- Drives local economies through distribution and production of goods and services
- Manages supply-chain costs through informal subsidies

**MICRO**
- Major contributor to household income, especially for women
- Enables access to low-cost goods and services for households

**MACRO**
- Receives minimal support and investment
- Taxation is largely extractive rather than enabling

**MESO**
- Receives minimal access to support services (e.g. finance), technology and training

**MICRO**
- Relies on extensive subsidies from households and social networks
The intersection between households and MSEs

Challenges for Growth
Household vulnerability has increased substantially

Perceptions of personal financial status in past year:
Worsened / Improved

Vulnerability: % of adults whose households had....

- Gone without Food: 33% in 2019, 33% in 2021
- Gone without medicine: 36% in 2019, 36% in 2021
- Child sent home for lack of school fees: 38% in 2019, 48% in 2021

74% of the population claim their financial situation has worsened in the past year

Source: FinAccess 2016-2021
While Kenya’s GDP growth has been resilient, growth is uneven, and income has stagnated or declined since 2016.

Business has been especially hard hit: women make up over half of those who earn their livelihoods from business.

Source: FinAccess 2016-2021
Livelihoods: declining opportunities in employment and business; rising dependence on transfers and insecure casual labour

Source: FinAccess 2016-2021
Exposure to shocks has doubled

The percentage of the population who experienced a major financial shock in the past year rose from 36% in 2019 to 67% in 2021. The most prevalent shock was rising cost of living.

Most prevent financial shocks
(% of adults who experienced a shock, 2021)

- Women, who are often responsible for household food security and wellbeing, bear the brunt
- Cost of living: 83%
- Health: 32%
- Loss of Income: 23%

Source: FinAccess 2016-2021
Cost of goods and services has increased significantly since 2015, with the price of basic foods rising by 85% between 2015 and 2022.

If you spent 1,000 KSh in January 2015 on FOOD AND NON-ALCOHOLIC BEVERAGES, the cost for the same equivalent goods in May 2022 would be 1,847.9 KSh.

Declining incomes combined with increased exposure to shocks, especially rising cost of living has put tremendous pressure on household budgets.

Source: Kenya National Bureau of Statistics
As a result, the financial health of Kenya’s adult population has been falling steeply across all demographics.

The financial health index

Ability to manage day to day:
- never went without food during the last year
- doesn’t have trouble making ends meet between income cycles
- has a plan/budget for allocating income and expenses

Ability to cope with risk:
- never went without medicine in the last year
- regularly kept money aside for emergencies
- can get hold of a lump sum within 3 days

Ability to invest in the future:
- using savings or credit to invest in productive assets
- education or old age; is using/plans to use savings
- pension or investment income to make ends meet in old age; has been regularly putting aside money for the future.

Financial Health 2016-2021 by wealth group

Source: FinAccess 2016-2021
Vicious Circle: as household incomes decline, businesses suffer from lack of demand leading to overall sluggish growth at the lower end of the economy and fewer opportunities to earn income.

% population earning income from business has **reduced** since 2019. The main challenge facing businesses is lack of demand.

Source: FinAccess 2016-2021
Despite rising GDP, Africa’s demographic transition means that per capita income will remain stagnant over the medium term.

**Outlook:**
Africa’s **demographic transition** means that household income and expenditure will remain stagnant even with growing GDP.

**Economic stimulus** at the household layer (e.g. through social security) could:
- Support households to **maintain human capital** and manage Kenya’s demographic transition
- Support **business growth and employment** through increased consumption creating multipliers across the economy

This will better **position Kenya to take advantage of a demographic dividend** (avoiding a demographic curse)

*Source: Cripps 2022*
Social Security and the Informal Sector

The ambition should not be to simply to cushion the informal sector from largescale shocks; but to improve its resilience and contribution to growth
Role of universal social security programmes: an engine for growth

Injection of liquidity at the lower end of the economy can generate multipliers across the economy. In the context of a large-scale shock such as COVID-19, social security can act as a demand-side stimulus, substantially strengthening prospects of economic recovery.

*Source: Kidd et al (2020a).*
Pathways between social security and growth

Short-term
- Strengthen recovery from COVID-19 through stimulating demand and rebuilding markets; cushioning the impact of shocks; stimulating investment

Medium-term
- Generate higher levels of employment and jobs; extend access to finance

Longer-term:
- Strengthen human capital through health/nutrition and education outcomes
- Reduce inequality which can impede growth
- Strengthen national and social cohesion and investment climate, improving revenue

Source: FSD Kenya (forthcoming)
Social security and the informal sector – a virtuous cycle

- Access to long-term reliable social security increases consumer spending and investment in assets
- In low-income countries, consumers are most likely to spend on locally produced goods and services
- Increase in consumer spending generates revenue for MSEs
- Improved revenue, and resilience of MSE households, leads to more investment in businesses
- This boosts employment at the lower end of the economy, which is particularly impactful for women

Increases in employment resulting from a 1% GDP increase in investment in social security, across eight countries, for both male and females

In many countries, the impact on employment would be particularly high for women

Source: Development Pathways and ITUC (2021).
Social security and MSEs during COVID-19: Marsabit case

Drop in revenue for MSEs nation-wide

Increase in revenue for MSEs in Marsabit locations with HSNP*
- MSEs cushioned against shocks
- Consumers maintain purchasing power

*Hunger Safety Net Programme

Source: FSD Kenya 2022

Source: FinAccess MSE COVID-19 tracker

MSEs with additional support in terms of capabilities and access to finance grew even more

Source: FSD Kenya 2022
A universal social security framework can act as a foundation for inclusive growth

Households
- Consume goods and services
- Absorb shocks
- Support investment

Informal Enterprises
- Generate more revenue from increased consumer spending
- Invest in growth
- Create employment

Through the link between households and MSEs, a universal, reliable social security framework can be an engine for inclusive growth
Example: Modeling an investment path for a Universal Child Benefit (UCB) by 2040

All children under the age of 18 covered by UCB by 2040

Level of investment required annually as a percentage of national GDP

Investment peaks at 0.78% in 2038 before steadily decreasing as the economy grows

Average budget increase per year is only 0.04% of GDP

Source: FSD Kenya & Development Pathways (forthcoming)
Projected impacts of the UCB on growth and employment in the medium term, would be significant.

Cumulative increase in GDP of 1.7% by 2033

Boost employment by nearly 1% per year by 2033

Source: FSD Kenya & Development Pathways (forthcoming)
The potential impacts of the UCB on consumption would be substantial.

Once the scheme is fully rolled out, the increase in consumption among the poorest households will be very high. It will also be significant among those on middle, but still low, incomes.

Simulated increase in household consumption expenditure among recipients once all children are reached, by consumption expenditure deciles.

Source: FSD Kenya & Development Pathways (forthcoming)
Investing in the proposed UCB would also have significant impacts on poverty and wellbeing.

- The national poverty rate is estimated to be reduced by roughly **23%** by the time all children are reached, as a result of the transfers (using national poverty line).

- Among children, the impact on poverty will be particularly high, reducing poverty by **29%** among 0-4 year olds and **26%** among 5-14 year olds on average.

*Source: FSD Kenya & Development Pathways (forthcoming)*
Recommendations:

- Increase investment in a **National Social Security** framework as a key foundation for Kenya’s growth and economic recovery post COVID-19
- Execute in **partnership with development partners**
- **Ringfence the social security budget** as part of the recurring budget at the National Treasury
- **Maximise impacts on women:** focus on **Universal Child Benefit (UCB)** as well as improving the coverage of the OPCT
- **Strengthen the role of the Department of Social Protection** in implementation, monitoring and impact assessment; and creating linkages with other initiatives at national and county levels to boost the impact of social security, especially for women
Thank You