Institute of Economic Affairs

52 ECONOMIC FALLACIES

52 FALLACIES:
ECONOMIC UNTRUTHS THAT KENYANS BELIEVE

Contributing Authors

Kwame Owino
John Mutua
Annah-Grace Kemunto
Jackline Kagume
Leo Kipkogei Kemboi
Maureen Barasa
Noah Wamalwa
Fiona Okadia
Stephen Jairo
Victoria Kwamboka
Darmi Jattani

CONTENTS

FOREWORD

Among the most valuable institutions in a republic is the right to speech and to be both a consumer and purveyor of ideas with freedom. Kenya is a country whose foundations as a republic are asserted in the constitution but are not fully formed or fortified. In spite of this, Kenyan citizens show an admirable affinity for exploration of ideas and their relevance for the improvement of public welfare. Indeed, the responsibility to provide a platform for discourse was a defining attribute that Institute of Economic Affairs was formed for and which its staff and governing Board of directors have taken seriously.

That expansion of this platform for public discourse has led to a vibrant public square in which proximate democratic debates occur. The existence of this platform has in turn led us to the realisation that Kenyan citizens are curious about topical issues in Kenya's public sphere in general. In this fluid environment enters the place of economics in public affairs within Kenya. While many consider it an esoteric subject, they readily pontificate, act and express ideas about the economy.

A cursory surveillance of the popular press, spheres of popular and open discussion, expressions by political and business leaders and even in parts of the national press, a careful student of economics would detect improper but popular reasoning about the economy. We consider that the national public sphere is too valuable a facility to allow this deficit in economic reasoning to persist. A number of staff at the Institute of Economic Affairs have isolated unto 52 (perhaps more) instances of incorrect reasoning about the economy in Kenya and written accessible essays with the aim of elevating the quality of quality of public discourse on economic affairs.

In this publication, we confront 52 and more of these errors of logic, established economic theory and observed facts. This is in furtherance of our responsible quest to raise economic literacy, encourage enlightened discourse in the public square and moderate the power of dogma in public affairs in Kenya. We take full responsibility for the views expressed herein, and acknowledge with thanks the comments made by the seven anonymous reviewers who provided feedback on each of the essays.

1. A Vaccine is a Public Good

Writing in December 2020, there's a high likelihood that in the next year, the primary goal of governments regarding the Covid-19 emergency will involve a policy plan for ensuring universal access to vaccines. Whether the public infrastructure to deploy the solution effectively is available or not, will be evident in Kenya in a short while. One guess is that even if the vaccine were made available in sufficient quantities, the inherent weaknesses in the public sector's management and execution will show.

There is no doubt that the ability to bring under control infections from the Covid-19 illness is not only a public health challenge but also an imperative of economic policy in 2021. The Kenya Economic Update by the World Bank in November 2020 estimated that the effect of the reduction in the growth rate was not only severe but that it had resulted in a rise in the household poverty rates in Kenya. It finds that the cumulative effect of loss of employment, depressed economic growth, firm closures, reduced earnings and other disruptions has led to the expectation that the Gross Domestic Product will at best contract by 1.0%, a number well below the population growth rate.

Public attention now moves to what options the government of Kenya has to ensure that vaccines are procured from the pharmaceutical firms that have developed them. There is justifiable worry that affordability of the vaccines will be an issue for both African and other low-income countries. Access to vaccines could be constrained further by hoarding of medicines required for bringing the Covid-19 emergency under control.

An estimate derived from a static model by the Institute of Economic Affairs showed that the monthly economic value foregone from the restrictions and the cessation of economic activity due to this illness lies in the 34 -50 billion shillings range throughout 2020. That estimate was based on the early assumption that GDP growth rates in Kenya would decline to 2%, a figure that seems to have been overly-optimistic. That notwithstanding, the recorded loss makes it obvious that the government of Kenya should spend as much as it can up to that limit to procure vaccines or any treatment to ensure prompt resumption of economic activity.

And yet at the global level, the vaccines that have been produced vary in cost between US$3-$37 per dose with a requirement of at least two doses administered at least a month apart and one booster within the year. Given these costs, there is a justifiable concern about ensuring access for the populations of low-income countries. Granted, there are initiatives such as COVAX initiative under the direct coordination of the World Health Organization, it is evident that the countries with poorer populations would need to be careful about what options they have for access to the vaccines. This is because besides the fact that these countries have poorer populations, the convergence of the negative effects of the pandemic has damaged the economies and affected the growth rates and the revenues available to the governments.

In prosecuting the claim on behalf of low income countries, Mohammed Yunus signed a declaration by many scholars and other political leaders calling for a global mechanism to ensure free access to vaccines developed to prevent Covid-19. Understandably, the signatories were responding to the advance purchase agreements that many countries with richer populations were making to have earlier and abundant access to vaccines for their populations.

The logic of this statement resonates with many people in low-income countries because it is supported by the correct view that while the production and administration of the vaccine against Covid-19 has real costs, vaccination of people in one part of the world would be less effective if other parts of the world are unable to provide vaccine protection to their populations. A student of economics would recognise this argument as stating that pandemic control is a good that requires vaccines to be universally provided for maximum effectiveness.

This situation presents an opportunity to clarify certain points about the nature of a vaccine as a good and whether the specific health service of vaccination makes the vaccine a public good. Settled economics literature classifies goods (including services) as either excludable or non-rival. By definition, a good is rival if consumption by one person diminishes another person's consumption of the same good. On the other hand, a good or service is excludable, if a person can be prevented from using it. The typical introduction class in microeconomics will present a two-by-two matrix of the attributes as illustrated the table below. Table used on Education is a pubic good

While the statement by the eminent persons calls for a global mechanism to expand access by providing free or low-cost vaccines, it does not make a claim that vaccines are public goods. However, some well-meaning Kenyans with statist impulses have claimed that vaccines being public goods, access should be provided automatically as either a right. While this statement is well-meaning in the sense that it argues for reduction of suffering, its claim that vaccines generally and the Covid-19 vaccines that have been developed by December 2020 are public goods is mistaken.

First, vaccines are by nature administered in doses requiring each recipient to receive 2 doses within a half year. By example, the specific vial for inoculation provided to an individual in the United Kingdom or Brazil, would not be available to another in Kenya, implying that the vaccine itself is rivalrous (subtractive). In addition, inoculation of a person based in those same countries would have no effect in preventing illness for a person in Kenya, indicating that it is also excludable. By virtue of the fact that the vaccine is both excludable and rival confirms the reality that it is a private good and not a public good as has been stated by pundits and people with supreme confidence in the authority and capability of states.

However, considering clearly the statement that Mohammed Yunus co-authored, the call was to ensure that the access to vaccines is provided liberally and specifically to ensure that "Covid-19 vaccines are a global common good". They argue for global policy to ensure that the patents and knowledge for the production of vaccines are placed in the public domain to enable the production of generic medicines. This is sensible reasoning based on an appreciation of the commercial rights of developers of medicines and the incentive structure for firms.

The nature of the vaccine as a technology of medical intervention leaves no doubt that it is a private good. Governments may have an interest in increasing access to vaccines out of the realisation that the Covid-19 is a vicious illness and that pandemic control requires universal access to the vaccines. Regardless of that, it merely shows that governments have an interest in dramatically raising access to a private good (the vaccine) in the service of society through pandemic control. The latter (pandemic control) is a public good and it is most efficiently achieved through universal access to a private good. To conflate the preference for payment for vaccination by government with its effect is is either mistaken or to be hacking at an ideological point. There is a legitimate purpose for governments to pay for the Covid-19 vaccination for as many citizens as possible in order to restore economic activity. The political preference for a good or service to be paid for out of taxes does not make it a public good.

Arts Should be funded by the State as a Public Good

Acknowledging that the arts in Kenya, performing arts and visual arts, are not public goods as they are both rivalrous and excludible forms the basis for the debunking of this fallacy.

The colonial government established the Kenya National Theatre under the premise of the Kenya Cultural Centre Act Cap 218 of 1951. That statute defines The Kenya National Theatre as a semi-autonomous institution permitting it to receive funding from the government and generous donors such as Absa Bank and EABL in Kenya's private sector.

Browsing the website of the Kenya National Theatre (KNT), one would notice that a reservation for use of the auditorium for a show would cost up to Ksh.100,000. This is the element of rivalry. It means that if a set of actors reserve the auditorium for a play on a Friday afternoon for two hours, nobody else can have the auditorium on the same day for the same time.
Now consider, just like any other play, the producer of the performance charges for a seat to the play. The auditorium has a maximum sitting capacity of 200 people. Meaning that if the play is sold out, one can only walk in to enjoy the show if they have one of the 200 tickets. The lack of which warrants the producer to exclude a guest from their play.

Four reason exist to make taxpayers suspicious of and therefore oppose state funding for the arts under the guise of paying for public goods.

1. **Inefficient subsidies**

During the Covid-19 pandemic in 2020, the Ministry of Sports, Culture and Heritage redirected Ksh. 100M from the sports fund towards artists, actors and musicians to encourage the continued production of artistic their work. This was a form of subsidy to the arts. Though it was not made clear what economics reasoning lay behind the provision of this subsidy as the industry was not severely affected by the pandemic given that consumption of the arts has almost entirely migrated to digital platforms, some literature states that the arts play a major role in society to prevent the consumption of demerit goods such as gambling and lowered crime rates thus making it a good vital for the health of the society.

For accountability of the taxpayer's shilling, measurement of results for funding of the arts - a private good being provided by the government- would be necessary. The lack of evaluation of progress would in the worst-case lead to continued dependence on government support in the name of poor performance.

2. Overdependence on subsidies

Government subsidies either partially cover the cost of production or pay off a portion of the price the consumer. By paying the artists directly, the Kenyan government provided a producer subsidy. As a result, the this might have created a sense of entitlement in the artists thus providing an incentive for the artist to increase their prices to raise revenues and thus depend on continued government support barely making any effort to meet market demand for the arts.

3. The arts are not a reflection of general public interest

For the government to provide a service, it must be done so in the clear interest of the general public. However, in the case of performing arts in Kenya, the market like any other responds to the forces of demand and supply. One unchanging characteristic of the arts both in colonial times and in modern day society is that the demand for performing arts is driven by the desires of the affluent and politically powerful who sign off on funding the industry or not. The artists, knowing who butters their bread, have no option but to supply the kind of artistic material that will keep the money flowing in. It is in such vein that those who finance the subsidies through taxes (the poorer) are more often than not a different lot from those who benefit from the subsidies to the arts.

4. The power of incentives

As we have already argued above, the arts are private goods and consumed by a specific category of income earners. Sound economics reasoning dictates that private goods are most efficiently provided by the private sector. If the government determined that one industry is lacking in funding, one way it can encourage the private sector to invest in it is by offering incentives in the form of tax reliefs on charitable donations to the arts. Already in Kenya, some charitable donations to registered charities are tax deductible. The task now lies on the beneficiaries to register their art organisations as charities and to produce content that meets market demand.

In conclusion, funding of the arts using tax payers' money is not ideal because, the arts are a private good, inefficient subsidy design which results in overdependence on the subsidies, the regressive effect on income distribution when it comes to demand for the arts excludes the lower income tax payers from enjoying the payoff of government investment in the arts and because the arts can survive and thrive independently in the private sector.

6. Buy Kenya Build Kenya will make Manufacturing grow faster

Buy Kenya Build Kenya" has been dubbed as the manufacturing sector's Achilles heel, with the promise of significantly improving the sector's fortunes. The claim "Buy Kenya, Build Kenya" is a fallacy that will not result in the benefits claimed by its proponents. It's important to note that this claim has been embedded in governments policy as a strategy.

The key result areas of the Buy Kenya Build Kenya strategy show that this is a policy to guide public procurement rather than providing mechanisms to improve the performance of Kenya's manufacturing sector. According to the Buy Kenya, Build Kenya strategy paper, it is expected to enhance the competitiveness of local firms, stimulate local production, and promote industrialization and mitigate the impacts of trade deficits. The proposal goes on to propose key results for implementing Buy Kenya Build Kenya which include provision of (i) legal and regulatory framework to guide public procurement, (ii)provision of an enabling business environment, (iii) enhancing market access of locally produced goods and services, and (iv) advocacy and institutional framework for sustainability-related activities . The expected outcomes and the steps taken to achieve them are not in sync. Reading the strategy, it is clear that it's a protectionist policy that seeks to protect local firms from foreign competition through the use of state power of coercion.

Buy Kenya Build Kenya freezes the benefits of competition to employees and firms. Boushey and Knudsen make the economic argument that when firms compete for customers, it leads to lower prices, higher quality goods and services, greater variety, and more innovation. To demonstrate the wider economic effects, competition is critical not only in product markets but also in labour markets. When firms compete to attract workers, they must increase compensation and improve working conditions . Kenyan manufacturing firms competing locally and globally would benefit consumers in terms of competitive pricing, product quality, variety and innovation. At present, manufacturing remains the sector with high-value jobs as per the Economic Survey 2020.

Buy Kenya Build Kenya will contribute to consumers having to pay higher prices for goods imported. Most firms argue for protectionist policies because their prices cannot compete unless they use state power to coerce consumers to buy their products. By using the state's power to coerce consumers, the state captures market share for those firms and guarantees

[3]Ministry of Trade and Indurstrialization,"Buy Kenya Build Kenya Strategy" 2017, https://www.tralac.org/documents/resources/by-country/kenya/576-buy-kenya-build-kenya-strategy-june-2017/file.html.

[4]Heather Boushey and Helen Knudsen, "The Importance of Competition for the American Economy," The White House, July 9, 2021, https://www.whitehouse.gov/cea/blog/2021/07/09/the-importance-of-competition-for-the-american-economy/.

them gains notwithstanding the quality, prices and other factors that affect prices of goods. This kind of industrialization policy is known as an import substitution policy. Import substitution industrialization consumes more forex than it saves since capital costs are higher than final goods. An illustration of this is that if Kenya buys products of the same quality from a country that is cheaper than Kenya, the country saves forex.

Due to market liberalization and the increasing complexity of goods and services, most firms now specialize in fitting into the global supply chains. Firms become part of value chains because of a variety of factors such as availability of labour, availability of raw materials and specializations gained over time. For example, supply chains of covid-19 vaccines emerged as a result of the existing strengths of existing pharmaceutical firms and other suppliers. Bown and Bolloky (2021) show that the separability of fixed costs contributed to breaking apart the vaccine production process and this allowed firms to specialize in one step, leaving the remainder to be done by other firms through arm's length contracts . By the time someone receives a jab, there are several firms that participated in the manufacturing process because of the efficiency in doing that one task.

Buy Kenya, Build Kenya puts in place a protectionist policy that encourages inefficient firms to stay in business while limiting opportunities for specialization and economies of scale. The World Bank conducted research on Kenya's manufacturing sector and classified Kenyan manufacturing firms into two categories: laggards and highly competitive firms . The highly competitive firms form part of the top 25% of Kenyan manufacturing firms. The top 25% of Kenyan firms could compete with firms in the middle and upper-income countries. The laggard firms require a protective state policy in the form of tariffs, quota systems and other mechanisms that raise the barrier to entry for new firms into the market or directly ban fully or partially importing otherwise cheaper alternatives into the market. The study also found that highly competitive firms could compete in upper- and middle-income economies. This broadens the market reach of those companies because a country is a small market with high prices for goods and services due to diseconomies of scale.

In conclusion, Buy Kenya Build Kenya freezes the benefits of competition and denies Kenyans the freedom to choose from a wide range of goods and services. By failing to compete and relying on government policy to survive, firms reduce the country's ability to innovate, raise productivity and increase complexity in the production of goods. Firms that target a country's market will produce products that are expensive due to diseconomies of scale. This claim that Buys Kenya Build Kenya will accelerate growth of the manufacturing is a fallacy.

---

[5]Chad Bown et al Page 6-7., "21-12 How COVID-19 Vaccine Supply Chains Emerged in the Midst of a Pandemic" 2021, https://www.piie.com/sites/default/files/documents/wp21-12.pdf.

[6]Ana Cusolito and Xavier Cirera, "A Firm-Level Productivity Diagnostic for Kenya's Manufacturing and Services Sector," World Bank, 2016.

7. Import of Chinese Goods is bad for Kenya's Manufacturing Industry

For more than a decade, China has emerged as the world's leading exporter. Her success story can be traced back to the 1970s when she implemented a series of reforms to upgrade her economy and open up to the rest of the world. The emergence of global value chains (GVCs) and China's accession to the World Trade Organization (WTO) in the early 2000s accelerated her progress toward becoming the manufacturing powerhouse of today.

Kenya has maintained diplomatic relations with China which were further strengthened with the signing of a bilateral agreement on "Economic and Technological Cooperation between the People's Republic of China and the Republic of Kenya". According to the Kenya National Bureau of Statistics 2019 Report, China's imports to Kenya were valued at Ksh 376.7 billion in 2019, making it the top country of origin for Kenya's imports. China has maintained its top position since 2015, increasing the value of its imports by 17% in just five years. China's imports clearly dominate the Kenyan market and are rapidly expanding accounting for one fifth of total imports. As a result, claims regarding the negative effect of import of Chinese goods on Kenya's manufacturing industry have surfaced in public discourse. In 2016, the Business Daily newspaper published an article titled "Chinese imports threaten manufacturing goals in Kenya".

The claim has been supported by arguments that Kenya is facing a possible premature decline in industrialisation owing to cheap Chinese manufactured goods and poor domestic conditions. Another related myth is that Chinese companies do not hire local workers, and that as a consequence China's exploitation of Kenya's resources, the country will be unable to industrialize. However, do economic theories on international trade support this claim?

Countries around the world have varying abilities to produce specific products due to geographical, demographic, social-economic, and taxation differences, among other factors. It is these natural differences in production abilities as well as competition that encourages international trade. For instance, partly due to Kenya's geographical location, the quality of its coffee is ranked second only to Ethiopia in the world. This means that Kenya has a natural ability to compete in the trade of commodities such as coffee. On the other hand, 32% of Kenya's top imports in 2019 included petroleum fuel, machinery, electronics and vehicles – all of which are capital intensive products that Kenya does naturally produce.

In 1776, Adam Smith was among the early proponents of countries specialising in producing goods and services that they can produce more efficiently. Specialization generates more efficiencies as labour becomes more skilled. The support for specialisation is bolstered further by differences in the endowments of the factors of production among countries. Given that the costs of these factors, such as labour, capital, and land, are heavily influenced by forces of supply and demand, factors in high supply relative to demand will be cheaper; factors in high demand relative to supply will be more expensive. It is expected that a country will produce and export a product whose required resources are in great supply resulting in lower production costs. In contrast, a country would import goods for which the required resources are scarce, but in high demand.

From the practical point of view, the realities that global businesses face are heavily influenced by the cost of production and the competitiveness of the produced products in both the domestic and international markets. In the free market economy, forces of supply and demand determine the cost of factors of production, which are key determinants on the production policy decisions.

International trade has enabled countries such as Kenya to expand their markets and gain access to goods and services that would otherwise be unavailable or prohibitively expensive to produce domestically. Kenyan goods have primarily been agro-based with tea, horticultural products and coffee accounting for more than half of the value of Kenya's exports. According to a study conducted by Kenya Institute of Public Policy Research Institute (KIPPRA), factors such as excessive regulation and poor governance were identified as key factors curtailing the adoption of value addition methodologies in the coffee industry.

Looking at the current composition of Kenya's exports vis-à-vis imports, it is reasonable to conclude that its trade is largely governed by the principle of comparative advantage; that is, whereas Kenya may not be the most efficient country in the production of her leading exports such as tea and horticulture, it can produce these products better and more efficiently than it does other products and so, are her manufactured goods and services. Therefore, the claim that Chinese imports are detrimental for Kenya's manufacturing industry is unfounded.

Through trade, the welfare of Kenyans has improved as a result of increased access to relatively high-quality products at competitive prices – products that would have been far more costly to produce in Kenya and which would have been sold at uncompetitive prices. By importing goods that would have been expensive to produce, Kenya has freed up scarce resources such as labour and capital for production of products in which it has comparative advantage. In the long run, this is a more sustainable model resulting in higher sales margins.

Kenya should focus more on innovation of production technologies for goods and services that can be produced at a lower opportunity cost than its trading partners. For instance, Kenya should adopt innovations to reduce energy costs by shifting to energy efficient technologies and implementing optimal taxation measures. Kenya can also redesign its marketing approach for its leading exports such as tea and horticulture, by focusing on awareness campaigns and advocacy as well as diversifying the market destinations. This can be achieved through bilateral trade agreements and by investing in market research especially on market behaviour in a bid to consolidate existing markets and explore new ones. Furthermore, there is need to improve governance and institutional reforms in order to increase farmers' participation in all stages of the value chain. There is also need to provide incentives such as tax reform, to encourage the formation of networks and alliances among economic agents.

12. Demonetization Gets Rid of Black Money from the Economy

Sometime in the middle of the decade after 2010, a number of countries chose to use the high-sounding policy choice of demonetisation. This fad captured the imagination not only of policy makers but also of many citizens. In essence, demonetisation is the policy choice of ensuring the obsolescence of state-issued currency denomination against a tight timeline of a few months or less. The literature shows that three main reasons are often cited for this policy measure.

The first is where a statute or law expressly requires the replacement of a currency. In this case the obsolescence of the chosen denomination of fiat currency is driven by a statute or constitutional command. In this instance, the underlying reason may be to update the currency by issuing a new material to replace the paper or features embedded on the face of the currency in order to ensure durability or to raise the cost of illegal duplication or counterfeiting. The second case is often because a government is compelled to reissue currency because the economy has undergone persistent hyperinflation that makes the currency worthless and therefore needs replacement. The third reason and the relevant one for the fallacy being addressed is the recent fad of 2010s when governments sold demonetisation policy as a solution to crime. The crime control angle is predicated on the reasoning that most of the criminal enterprises depend on transaction through cash and. To change the currency without prior warning would render cash reserves held by these enterprises either unusable or compel criminals to expose their culpability by having to declare the sources of their cash prior to making deposits in regular retail banking facilities.

Kenya's most recent demonetisation started in 2019 and was predicated on the constitutional requirement under article 234 (4) which commands the Central Bank of Kenya to ensure that "notes and coins" shall not bear the portrait of an individual. Full compliance with this policy was due by the fifth anniversary of the passage of the constitution of 2010 but this deadline was extended, leading to the 2019 commencement of demonetisation. While this was sufficient reason for institution of the demonetisation policy, several state offices and some communication from the Central Bank of Kenya, suggested that the demonetisation would also help to expunge black money from the Kenyan economy, thereby introducing a secondary goal to the policy.

With respect to the specifics, the demonetisation approach used by Kenya was akin to that implemented by the Indian government in 2016 except that the former provided an extended period of three months instead of immediate declaration of the invalidity of its largest currency denomination. Specifically, the CBK declared that the highest denomination notes in Kenya, which is Kshs. 1,000 would not be legal currency within the 4-month period from June 01 to

September 30, 2019. All the other denominations would be phased out gradually. Thinking in simple economics theory, the intention of this demonetisation was aimed at raising the cost of keeping cash in the highest denomination by forcing disclosure that may lead to either forfeiture or obsolescence of cash whose sources the claimant is unable to account for.

In terms of the identification of the right unit, the focus on escalated obsolescence of the largest denomination currency note made sense. Of the 261.8 million units of legal paper currency value (20, 50, 200, 200, 500, 1000) in circulation at the commencement of the demonetization policy in 2019, 217.6 million were of the highest value, supporting the plausible claim that it would be the most preferred unit for storage of illegally acquired income. The 1000 shillings note represented 83.1% of the overall value of currency in Kenya but only 40.2% of the volume of the number of notes in circulation as legal currency. The assumption behind the secondary goal of the demonetisation policy is that because of the Kshs. 1000 is most efficient way of carrying cash value in comparison to the other denominations, most of the black money would be disproportionately held in the highest currency denomination.

Because the Central Bank of Kenya has a monopoly granted by law for the issuance of currency, it means that any currency that is issued and forfeited because of demonetisation would be a gain for the agent of the government in monetary issuance. At the end of the four-month period, the Central Bank of Kenya reported that 96.35% of the total volume of the largest denomination currency were effectively demonetised, representing 80.08% of the value of all currency in circulation within Kenya in 2019. Noting that the extended policy reason for the demonetisation was to reduce the size of black money that manifests in illegal financial flows and counterfeit currency, it is difficult to argue that keeping out about 3.75% of that value through demonetisation was both cost effective or a policy success. Indeed even 3.75% is generous because it takes the assumption that all of the currency that was not surrendered belonged to black market or holders of illicit wealth.

Despite the fact that the Central Bank of Kenya did not declare the threshold upon which to judge the success of demonetization policy in reducing black market and illicit financial flows (IFFs), it declared that the policy was a success and gave itself a pat on the back. Soon after, the press made revelations of individuals who because of itinerant lives and inadequate access to public information, had lost wealth because they kept vast sums of cash which had now been rendered unusable. It is evident that this situation was more common as only people who had the largest cash savings that had been made worthless would have the incentive to advertise their predicament in the press. This proves that the results of demonetization policy for the purposes of reducing the black market was not only unimpressive in the quantum but also disproportionately affected less savvy and lower income people.

At the level of economic theory, it is also evident that the tame effects of the demonetization policy were predictable. To begin with, Kenya has a large informal sector in which cash transactions dominate. Thus, despite the fact that it would be efficient for any beneficiary of income generated by crime to store the proceeds in the highest currency, the conclusion that an escalated demonetization of the currency would extinguish the stash is fallacious because the currency is not the exclusive form of storage of wealth, whether illegally acquire or not. All the currency in Kenya in 2019 represented a face value of Kshs. 261.8 billion, equivalent to 2.68% of the Gross Domestic Product at the end of that year. Given that the currency is such a small share of the GDP, it immediately evident that that forced dilution of demand for one currency type is unlikely to be the cost effective or even sensible approach to reducing the size of the black market. This is because cash is such a small share of wealth created in Kenya that most sizeable incomes would be held in other property forms with cash only useful for transactional purposes and not for wealth storage. There is no surprise that the demonetization policy didn't achieve much, the claims of the Central Bank of Kenya notwithstanding.

Standard economics theory classifies cash as a form of money and which has three attributes namely, a unit of account, a store of value and a unit of exchange. Having known that the availability of currency in Kenya is a small share of the overall Gross Domestic Product (GDP) it is clear that other forms of storage, exchange and units of account are readily available. In rapid demonetization of the Kshs. 1000 note, the policy assumed (naively perhaps) that for the participants of the illicit markets, the cash reserves that individuals had is where the three factors converge. For a comparatively open economy such as Kenya, wealth holders and income earners can and do resort to storage in different forms such as foreign exchange, precious metals, jewellery or even real property, even if the first instance of payments comes as cash. The ease of conversion of cash into various forms of property shows that basic economics understanding would predict that a demonetization policy is unlikely to have the widespread effect or erasing the property of criminals that was anticipated. While the corrupt and criminal people primarily steal and exchange in cash, it doesn't imply that they store the wealth in cash.

With the benefit of hindsight, it is also evident that the promise to wipe out the fortunes gained from IFFs and the black money through demonetization failed. It carries unintended consequences in the sense that non-criminals who were unable to access banking facilities within the arbitrary deadlines that were set lost substantial amounts of their property. For these people, the demonetisation policy was simply an expropriation policy based on a fallacy that demonetization is both and efficient and effective means to rid a country of black money. The Central Bank of Kenya announced that it was actively investigating about 3,000 different transactions that it considered suspicious. Even if each of these were represented attempts to launder black money, the quantity is too low to justify the expense and effort of demonetisation for the secondary policy purpose.

14. Government Should Raise National Savings Rate

The major commentators of raising the national savings rate want the government of Kenya to mandate savings rates through a national law or a policy or any other government instruments. The major assumption made is that resources available to households, firms and governments are available but what is lacking is their ability and willingness to save. Therefore, what government should do is to make it compulsory for firms, and households to save. For context, the national savings rate measures the amount of income that households, businesses, and governments save and is It is calculated by subtracting consumption from income and dividing it as a share of income . National savings consist of private savings and public savings. The claim has gained popularity because of declining gross savings as a share of GDP from 16.7% in 2007 to 7.97% in 2016(as per the latest available data). This claim that government should raise the national saving rate using national law or regulation is a fallacy. In this piece, I will demonstrate using facts, economic theory and logic why this claim is a fallacy.

Public Savings which determines the national savings rate is determined by budget deficits. Sustained budget deficits reduce national savings. National saving as explained in the introduction is the sum of private saving (the after-tax income that households save rather than consume) and public saving (the tax revenue that government saves rather than spends). Ball and Mankiw (1995) find that when the government-run budget deficits, public saving becomes negative which reduces national saving below private saving . This is one of the immediate effects of the budget deficits. By the deficits making public savings lower, it automatically affects the national savings. This confirms that the national savings rate is something that government cannot sustainably mandate through coercion or compulsion by law, but through proper economic management.

Private savings which form part of national savings is determined by demographic factors. These factors include the age structure of the population, educational attainment, income levels. The age structure of the population determines the size of the labour market where middle-aged and old people are savers. Kenya is a young population with 75% of the population considered youthful and the median age is 19 years. Cook (2006) shows that population growth can have two conflicting effects on savings. It reduces savings as it leads to more dependent children, but if balanced it can also increase savings by increasing the number entering the working part of the life cycle and hence the number of potential savers . These demographic factors are outside the control of the government and depend on time factors. This confirms that private savings are dependent on so many factors that are not controlled by the government through a law mandate.

It is impossible to mandate a national savings rate through law because it is an outcome is dependent on the performance of the economic growth. The national savings rate and economic growth correlate highly. The economic growth (GDP growth rate) has a positive correlation to the average propensity to save (APS). For context, the average propensity to save (APS) is a macroeconomic term that refers to the proportion of income that is saved rather than spent on current goods and services. The average propensity to save is known as the savings ratio and is usually expressed as a percentage of total household disposable income (income minus taxes) . To add to this, the more the savings in an economy, the greater chance that the economic growth rate will improve immensely. Successful economies have experienced the growth that is private sector-led, which implies that government role within the economy is limited to regulations and other few constitutional obligations.

In conclusion, public savings and private sector savings are affected by a variety of factors in the economy. This means that the national savings rate cannot be mandated through the instruments of government because those factors are outside the reach of the government. However, the factors that affect the private and public savings can be influenced to increase the national savings rate. Therefore, the claim that Government should raise the national savings rate is a fallacy.

15. A Country Needs a Strong Currency

The Kenyan Shilling has been depreciating rapidly in recent times, having declined from Ksh 96.11 / US Dollar in 2015 to Ksh 108.83 / US Dollar in 2021. The decline has led to increased debate in the media, the academia as well as members of the public asserting it portends a bad outcome for the economy.

Underlying the claim is the imagined expectations that the Shilling should always strengthen against the hard currencies such as the dollar. The aim of this piece is to assess whether this perception is true or false from both an empirical as well as theoretical perspective.

The proponents of the claim may have not considered the fact that: Kenya operates a floating exchange regime which means that the rate is subject to forces of demand and supply. A competitive exchange rate ensures that the interests of both exporters and importers are balanced. In this regard, movements in the exchange rate serve to correct any imbalances in the market through the adjustments to economic factors.

The mandate of the Central Bank of Kenya is to ensure overall price stability within the framework of a floating exchange rate regime and a liberalised capital account. This policy setting means that the exchange rate adjusts – weakens or strengthens – in line with economic factors including external trade and financial flows. The CBK therefore provides the policy environment and does not target a particular level or direction of change of the exchange rate. It participates in the foreign exchange market as and when it is necessary to stem excessive volatility emanating from external shocks, or to cover short-term shortages of foreign exchange liquidity in the market, or to effect Government external payments obligations, also when it is building its foreign exchange reserves to increase the months of import cover position.

A relatively "weak" Shilling lowers foreign prices for exports (from an exporter's perspective). This increases the country's competitiveness in the world market, which improves Kenya's balance of trade position. Further, a "weak" Shilling promotes domestic investments that create employment and also discourages final consumption of luxury imports. All these are necessary to improve the current account balance and support economic growth.

On the other hand, a relatively "strong" Shilling reduces the competitiveness of Kenyan exports which could worsen balance of trade position and thus dampening economic growth. Kenyan exports become expensive abroad and imports become cheaper thereby discouraging domestic competitive industries as the share of foreign goods in domestic market increases.

It can therefore be concluded that a weak or strong Shilling is neither “bad” or “good” since all are a reflective of the economic fundamentals as determined by the forces of demand and supply of the shilling on the international market and adjustments gravitate towards the equilibrium/stable price which ensures that the interests of both exporters and importers are balanced. The policy focus should be towards ensuring stability in the exchange rate in order to reduce foreign exchange risks to investors.

17. Kenya's Budget Deficits are Caused by Lower Tax Collections

The claim that Kenya's budget deficits are caused by lower tax collections has been popular in the last decade. The claim arose because Kenya's public debt went up more quickly which changed Kenya's overall risk of debt distress from low in 2013 to moderate in 2017, and subsequently high in 2020 . The overall risk of debt distress remains high in 2021 . This argument gained traction and resulted in tougher measures being instituted through law and policy on taxation either through various finance bills every fiscal year, or through tax laws such as Tax Procedures act, and legal notices provided by Cabinet Secretary in charge of Treasury and approved by National Assembly committee on delegated legislation. This claim is a fallacy.

The high budget deficits are driven partly by spending on infrastructure financed by debt which has led to higher total levels of debt . Between 2013 and 2020, the debt stock increased by 300% to reach Ksh 7.25 trillion by November 2020. The IMF Report 21/72 dated April 2021 puts Kenya's nominal debt as a share of GDP at 70.4%. The high level of debt stock has resulted in a surge in debt servicing charges. In 2019/20, Ksh 718 billion amount of debt was repaid compared to Ksh 886 billion that was borrowed, this was equivalent to 7% and 8.7% share of GDP respectively. The Debt Service to Tax Revenue ratio has increased from 30% in 2013/14 to 49% in 2020/21.

A tenable public finance management system requires that growth in expenditure does not outpace revenues consistently. Kenya went on a fiscal expansion to fund key infrastructural programs such as the Standard Gauge Railway, last-mile Electricity connections, tarmacking of the then planned 10,000 km road network within the country amongst many other projects. Kenya went on a fiscal expansion that outpaced revenues. Kenya's expenditure increased from Ksh 1.64 trillion in 2012/2013 to Ksh 3.64 trillion. Over eight years, Kenya's the budget increased by Ksh 2 trillion or an equivalent of Ksh 250 billion.

Comparatively, while expenditure increased, revenues increased at a slower rate in nominal terms, revenue increased from Ksh 867 billion in the 2012/2013 financial year to 1.75 trillion in the 2019/2020 financial years. The revenue collected doubled within those eight years. The revenue increases annually-averaged Ksh 111 billion within those eight years. Within those eight years, parliament introduced new tax measures and expanding the scope of already existing taxes. Remember that Revenues are dependent on the size of the economy. As per the analysis by the National Treasury, the major drivers of economic growth on the demand side have been largely private-sector consumption and government expenditure while the contribution from private sector investment that would be responsible for more revenues for the government has been falling .

it is clear then that expenditure was growing at a faster rate than the revenues. As such, it is no surprise that Despite increased revenues annually, deficits continued to manifest. This makes deficits a spending problem and not a revenue problem. This is one of the effects of government debt as described by Elmendorf and Mankiw (1998) that where government revenue does not need to be matched with additional revenue, it reduces the discipline of the budget process .

In conclusion, the claim that Kenya's budget deficits are caused by lower tax collections is a fallacy. The budget deficits are a problem of spending problem- where increasing expenditures have far outpaced revenues.

18. The Government of Kenya is Too Small and Lacks State Capacity

A common argument in Kenya is that the Kenyan state is too small and therefore, there is need to increase it in order to build state capacity. The idea behind this is that part of the dysfunction of the Kenyan state is explained by its being inadequately resourced with the instruments, skills and resources necessary to provide the core public services intended to improve the lives of citizens. Whether state capacity refers to intellectual, financial, managerial or other meaning, there is no doubt that the result would be a larger or more elaborate bureaucracy with greater command of the overall resources in the economy.

A statement that the Kenyan state is small by itself is not a useful claim except that is suggests that government should be larger than it is at the moment when this assertion is made. From a perspective of logic, the very size and capacity of the state ought to depend on what roles and activities it actively pursues. And a state that pursues every goal that strikes its fancy will always be too small, meaning that this claim cannot be refuted without examining what the state and its bureaucracy is focussed on pursuing. At this basic level, the claim that the state is small is reducible to two ridiculous statements, which is that the state should undertake additional activities to those that it does presently or should undertake the same activity but with more resources at hand.

Coming from the absurdity of the state size at the logical level, the use of some empirical evidence in Kenya shows why the claim that the Kenyan state is small is mistaken. One way of testing the claim that the Kenyan state is small is to review the share of the Kenyan work force dedicated to providing the public services which constitute state capacity. In 2020, the Kenya National Bureau of Statistics estimated that about 2.9 million people were working for a direct wage in Kenya. Of these 2.9 million people about 865,200 are employees of the government in various positions at national and local government. Irrespective of the scale that is used, it is impressive that in Kenya's formals sector, 30% of all employees are employed to perform functions of the state.

For each state employee in Kenya in the year 2020, there are 55 citizens. It is not clear that this ratio represents a diminished status that requires its being raised towards an arbitrary threshold of state capacity. It is not self-evident that expanding the size of the state, whether it is achieved through the addition of workers, provision of new instruments for work or even assumption of heavier duties, will result in is its effectiveness. What is incontrovertible is that the conventional arguments that are used to support the growth of the state must expand the bureaucratic apparatus of government. In turn, this is just a euphemism for raising taxes and expanding the state's claim on the resources of its working citizens.

This call to increase the size of the Kenyan state to allow it to maintain higher state capacity is mainly an argument the expanding the bureaucracy. Judging by the fact that none of these arguments start with the argument for government to reallocate existing human and financial resources that is held internally, the proponents assume that state capacity can only be added through a claim for more resources from households and firms. Among the proponents of this idea that the ineffectiveness of Kenya's state is explained by its small size, finding new things for the state to do and apply the its resources doesn't require much imagination. Justifying why the tax payers outside the state should believe that expanding the bureaucracy would create the state capacity is far more difficult and remains a transparent fallacy.

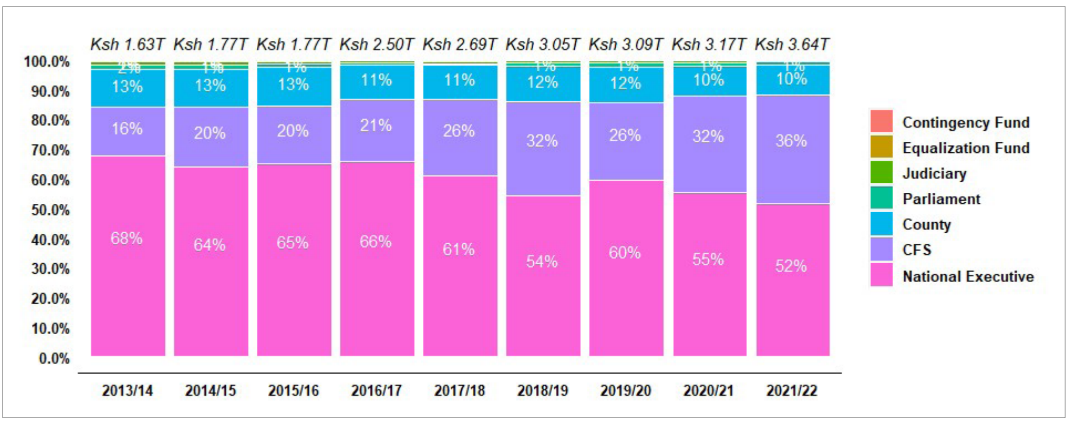
19. Devolution Caused a Rise in Government Spending

Political power and revenue sharing between the national government and the 47 county governments are at the heart of Kenya's decentralization of government. Devolution opponents have blamed the increase in overall government spending on devolution. One of the reasons for this claim is the general increase in overall government spending that has coincided with the period of devolution. But could this be a mere coincidence rather than a causal effect? Based on public finance principles and empirical data on public spending trends, this piece seeks to determine whether this claim is true or false.

Article 201 of Kenya's Constitution establishes key principles of public finance that govern all aspects of public finance in Kenya. Some of the key principles include, but are not limited to, the requirement that national revenue be distributed equitably among national and county governments. Furthermore, it states that public expenditure must promote equitable development in Kenya, and that the costs and benefits of resource use and public borrowing must be shared equitably between present and future generations.

If the claim that devolution increased government spending is correct, we should see a significant increase in total spending attributed to county governments. A significant change in the magnitude of county government expenditure will therefore lend credence to the claim that devolution is to blame for the increase in overall government expenditure. To investigate this claim further, we sought to examine the government budget allocation for various government entities from the beginning of devolution to the present (Figure 1).

Trends in the proportions of total budget allocation



Source: The National Treasury

According to the figure above, the country's overall budget has more than doubled since FY 2013/14, rising from Kshs 1.63 trillion in FY 2013/14 to Kshs 3.64 trillion in FY 2021/22. Over the same time period, the combined proportion of national government expenses (National Executive, Parliament, Judiciary, including the contingency fund and Consolidated Fund Services) increased from 87% to 90%, while the proportion of spending for devolved units decreased from 13% to 10%. This means that, while overall spending has increased significantly since devolution, the proportion of the relative amount allocated to counties has actually decreased.

In contrast, the sharp increase in Consolidated Fund Services (CFS) has been the primary cause of the sharp decline in the proportion of Executive spending. Because the Consolidated Fund Services expenses, which primarily consist of public debt and pension funds, are accounted for by the National Government, they are not accounted for by the County Government.

The declining trends in the proportions of spending to county governments are thus evidence enough that, contrary to the assertion that devolution is not responsible for the increase in government spending, devolution is indeed responsible.

26. Public Sector Workers in Kenya are Underpaid

Labour can be employed in one of two broad sectors: public, or private. The public sector employees who are commonly referred to as civil servants, are employed by government to offer services to citizens within a given jurisdiction. The private sector, on the other hand, encompasses employees of firms, organizations, and entities that have been legally established to provide specific goods and services to citizens, and even the government. The choice is not only incumbent on an individual, but also on some key factors that could be sector- specific, or at the behest of the employer. Indeed, some people have turned down employment offers in the public sector for offers in the private sector, and vice-versa.

This notwithstanding, there is widespread belief and consensus that the private sector employees are well compensated, especially those with higher educational qualifications and working in highly specialized disciplines. This therefore, has given rise to the fallacy that public sector workers in Kenya are underpaid in comparison to their private sector counterparts. This notion is further supported by the argument that while public sector employees are underpaid, they have better working conditions and a myriad of benefits including job security.

However, in order to examine this issue more critically, we must consider the key determinants of remuneration packages in either sector. Basic salaries, remunerative allowances (reimbursable amounts), facilitative allowances, pensions, gratuity , and fringe benefits are among the key determinants of the total remuneration package for an employee in the public sector. According to the Salaries and Remuneration Commission (SRC), the key drivers of the wage bill are performance and productivity management, wage policies, employee numbers, labour relations, and work ethics .On the other hand, the private sector salary determination is borne and driven by of a number of factors, including individual organizational performance, cost-of-living adjustments, and an employee's individual job performance , as well as their educational qualifications and skills.

The theory of competitive compensation is critical to the public sector's ability to recruit and retain highly trained and qualified employees. This calls for adequate remuneration packages comparable to those offered in the private sector.

Notably, the wage disparities between the private and public sectors are affected by the prevailing economic conditions in which either sector operates, as well as individual factors within each organization in either sector. In addition, the public and private sector wages will vary based on labour force skill distribution as well as labour force. Among the issues to consider when determining public sector wages are the minimum wage requirement (as prescribed by law), the public wage bill, inflation rates, allowances, and severance packages. The SRC commissioned a study that found wage disparities between the public and private sectors. The study further stated that the difference favours the public sector, particularly for employees with the same level of education.

Let us consider the teaching profession as an example. Teachers in the public sector are employed by the Teachers Service Commission (TSC), which sets their salary scales, and allowances in line with recommendations from the SRC. The allowances depend on factors such as job grades, work station, type of students being handled, and teacher responsibilities among others. Housing, commuter, hardship, transfer, special duty, and leave allowances are among the benefits provided to teachers in accordance with TSC guidelines. This narrative does not apply to teachers employed in private schools. In their case, it is the responsibility of the privately run-school's management to come up with what they deem as a competitive salary scale that will suffice for the specific teacher, as well as attract and retain top-quality teachers within these schools.

In light of the foregoing, we note that the determinants mentioned above come into play whenever an individual is to be engaged as an employee in either sector. However, proponents of the narrative that public sector workers are paid less than private sector workers often miss the point. Their comparison quite often based on different approaches, methods and datasets which results in skewed findings that favour their argument.

In conclusion therefore, the notion being peddled around in public discourse that public sector employees earn less than their private sector counterparts is indeed, a fallacy. Conclusions from previous comparison studies on pay and total compensation vary due to different approaches, methods, and data leading to disagreements about their applicability.

33. GDP does not Matter to Ordinary Kenyans

In comparison to its Sub-Saharan African peers, Kenya has been recording remarkable economic growth rates. According to Kenya Bureau of Statistics, the average growth rate for the Kenyan economy over the last five years to 2019 has been 5.56% compared to 2.88% for Sub-Saharan Africa. The claim that GDP statistic does not matter has featured in Kenya's public discourse in recent years. Such a claim was made in an article published on 2nd of August 2017 with the running headline: "Kenya may be growing but 'You can't eat GDP'". The main justification for this claim was that, despite the economy registering high economic growth rates, the prices of basic commodities were rising, implying that the growth was not benefiting the country's poor. While the statement may resonate well with the common populace, it may be fallacious. The claim is based on the wrong premise; mistaking economic growth which GDP seeks to measure with economic development which seeks to measure improvement in the quality of life and living standards, e.g., literacy, life-expectancy and health care. This brief seeks to establish whether it is correct assert that "GDP does not matter" by making use of economic theories and public sector accounting principles.

GDP is a macroeconomic statistic that is used to measure the overall wealth of a country. It is defined as the monetary value of all the final goods and services produced in a country in a given year. GDP can be computed on a nominal basis or a real basis, the latter accounting for inflation. Real GDP is an inflation-adjusted measure that reflects the quantity of goods and services produced by an economy in a given year, with prices held constant from year to year to separate out the impact of inflation or deflation from the trend in output over time. It therefore implies that GDP is equivalent to the value of all of the output generated within the borders of a country.

Examining the various approaches used in the estimation of GDP, it is clear that there is profound underlying meaning in the GDP statistic. Value added approach, for instance, helps us gauge the monetary value of all the final products added to the economy by all economic agents from various sectors of the economy. The spending approach, on the other hand, is useful in determining the amount of money used in purchasing on the final goods and services by all participants in the economy: households, firms and government.

While GDP approaches have some drawbacks, such as failing to account for activities that are not part of the legalized economy such as home care, GDP has been an important statistic that has helped policy makers in numerous ways, for instance to determining whether the economy is growing or contracting. Tracking GDP over time has helped the government make decisions such as whether and how to stimulate the economy. On the other hand, investors have used

GDP statistic to make decisions on whether to expand or contract production or whether to undertake major projects. Quarterly GDP statistics for specific sectors such as tourism, help us understand their overall performance and how it affects the industry's general employment level. Furthermore, derivative indicators of GDP such as GDP per capita have been used by policy makers to measure of the amount of output per person in an economy and therefore as an indicator of average productivity. This is also utilised in constructing other useful measures such as the human development index.

It is therefore important to distinguish between GDP which measures economic output and economic development which is concerned with economic well-being and quality of life of a country. Economic growth is a means towards economic development. Economic development encompasses qualitative dimensions such as health, education and life expectancy which can be attained with sustained economic growth (GDP) rates over a period of time. Since GDP is measured over a short horizon usually a quarter or a year, realisation in the improvement in the quality of life such as in the standards of living and life expectancy are expected to be realised over time. It is for this reason that the claim GDP does not matter is fallacious since GDP is not an end in itself but rather a means towards achieving improvement in the well-being and general quality of life.

34. A House Does Not Depreciate in Value

Understanding the value of a house in Kenya is not difficult because the housing structure exists to meet the demand for shelter. And this requirement for shelter is among the most obvious needs that any human has and whose satisfaction is an important indication of welfare of individuals. Many households strive to build or purchase dwellings in order to satisfy the need for the shelter and also as an asset of high value. In Kenya, the undoubted affinity to housing as shelter and the land on which it is based has led to a common claim that a house does not depreciate in value and is therefore the worthiest as a sure investment. To state that a physical dwelling that is constructed from finite materials is not subject to negative change in monetary value is a bold claim. And yet, this claim is a fallacy and demonstrably so.

The primary claim of this fallacy is that the physical structure called a house is an asset with the characteristic that it always maintains its value. This is a bold claim and implies that the purchaser or constructor of a house uses its value stay at the same monetary value or increases over time. An asset whose value does not depreciate is therefore one that is neither eroded neither by inflation nor by changes in demand.

A properly constructed house will require various inputs to complete the floor, walls and roof, all made of different materials. Considering that the materials used in construction have monetary cost, it is inconceivable that once they are assembled into a physical structure, they cannot depreciate in value. The phenomenon of a price of a house is the result of the convergence of the demand and the supply for dwelling units. With this realisation, it becomes a perversion of logic to state that the price would perpetually rise regardless of what happens to both the demand for or supply of houses.

Reasoning from first principles of the theory of demand and a logical standpoint, for the claim to remain valid requires that every price change for houses must be upwards and that a change in supply for instance would merely lead to more spending on housing without changing demand. It is not possible in these circumstances for demand to increase in tandem because the prices would be constant. The addition of supply of housing consumes resources that could be used elsewhere and doesn't have a negligent effect on the prices of houses in that market.

Coming to the demand side, the import of this claim is that if demand for housing increases, then any adjustment in supply must be modest and stay below that which would lead to a decline in house prices. In other words, the market for housing regulates itself in such a way to ensure that there is never an excess in supply that would tip prices downwards. Imposing these constraints on a market for houses, which are constructed from products with finite value results in a preposterous proposition and absurd outcome.

Most houses that are constructed for family habitation have a useful lifespan that ranges from 40-50 years. This quality therefore makes it a very durable asset and which the owners extract consumption over that time. It is not conceivable that an asset with a useful lifespan that erodes over time could maintain its price throughout the period. It is possible that many of those who claim that a house doesn't depreciate conflate its durability in use with its value over time.

To the extent that damage to a house would reduce its market value and that refurbishment would lead to increased value confirms that housing value is alterable. Indeed, the fact that the owner has to refurbish a house to keep it habitable and to retain its value shows that the depreciation in value has taken place and the restoration is additional spending to try and maintain its value or to enhance it. This change in the value of a house is dependent on what a buyer is willing to pay for it and the buyer must account for what value the structure would serve, regardless of what was the cost of its construction and value at the time of its first ownership.

There is no reason in reason to consider a house as a good with special purposes which makes its exempt from depreciation. In addition, the durability of the housing structure alters the operation of the rules of demand and supply for individual or a collection of houses. Prices not only vary for houses but they do depreciate. To maintain that a good of physical kind is not subject to permanent upwards value is as curious a statement as it is wrong.

48. Touts Should Not Raise Prices When It Rains

A common statement that has been widely accepted is that touts should not raise prices when it rains. Some even call the touts greedy stating that the changes in prices is not necessary. Weather patterns determine how people are transported and the amount of time it takes. Transport is sensitive to weather, that is transport services on a sunny day is a different from transport services on a rainy day. Therefore, transport prices change according to the weather condition.

Public transport fares in Kenya, as it is in most developing countries, is regulated and enforcement is facilitated by the National Transport and Safety Authority (NTSA). The regulations specify actual fares to be charged, a maximum permitted charge, or a charge for a basic service that operators are permitted to exceed at their own discretion for premium services. Different fare levels may be authorized to reflect different routes served by each vehicle.

According to the 2019 Kenya Population and Housing Census report, 15% of households in Kenya own bicycles, 6.3 % own cars, 0.9% own buses, lorry or three-wheeler truck, 9.2% own motorcycles while 0.5% own Tuk Tuks. This implies that 68.1% of the Kenyan population do not own any motorized form of transport and mostly depend on public service vehicles commonly referred to as matatus. Since majority of Kenyans rely on public service vehicles, the available seats on public service vehicles are competed for by many people. In October 2010, the then Minister of Transport gave directives that by January 2011, matatu operators had to belong to a Savings and Credit Cooperative Societies (SACCOs) before applying for a public service vehicle license. This move was to ensure self-regulation, efficient operations as per the legal requirements and cushion individual matatu owners. This also meant extra costs for public service vehicles in form of registration fees and SACCO fees.

The price of any good or service is an important source of information. Price sends signals to buyers and sellers about the relative scarcity of a good or service. Touts use prices to communicate the changes in conditions. Not only do touts raise prices when it rains but also during peak hours, mostly in the morning when majority people are going to work and, in the evenings, when majority are going home from work. The similarity between peak hours and rainy days is that the demand for matatus is high. As demand increases, touts respond by increasing prices which in turn incentivises more matatu operators to join the market. The law of supply states that the higher the prices of a good or service, the higher is its supply. The important concept to remember here is that of the users' willingness to pay for services at the set prices. Touts are aware that when it rains, more people are in a hurry to get home as rain disrupts activities otherwise planned. By increasing prices, touts are only responding to the change in demand by matatu users.

During off peak hours, the demand for vehicle services is lower than during peak hours and so are the prices. Critics of touts increasing prices when it rains only look at the impact on one side, the demand side. The matatu market is formed as a result of the interaction between the matatu operators (supply side) and the matatu users (demand side). Matatu operators are in the private sector and charge prices with considerations of the costs incurred to offer services. Profits are essential for vehicle operators just like wages for continuity of any business. Some costs incurred on a daily basis by the matatu operators include; SACCO fees, wages, fuel and parking spaces. During peak hours, the costs incurred by operators increase as more time is spent on the road due to traffic congestion.

Rain also reduces visibility on the road and this could partly explain the more hours spent on the road. Furthermore, public transport is a private good since it is both excludable and rivalrous. It is excludable in that if one won't pay then they cannot enjoy the service. It is rivalrous in that a vehicle can only carry a given set number of passengers at a time. Congestion therefore is caused by rivalry for road space. The only logical way for matatu operators to operate at the same price at all times is if they have some form of subsidy or tax break from the government. This means that the extra costs associated with peak hours and seasons will be absorbed by the government and not the consumers. But subsidy is meant for public goods and cannot be given to the matatus operating in the private sector. The vehicle operators can only cover their increased costs by increasing the prices.

On March 6th 2019, a motion was started in the National Assembly where parliamentarians'-initiated development and implementation of regulations on fares charged by public service vehicles. The parliamentarians noted that the increase in prices during bad weather and peak season is extortion and citizens are stranded when the prices go beyond their daily limit. Regulation requires a lot of bureaucracy and resources to be implemented. With the limited fiscal space this is not likely to be an area of interest.

If fare prices are regulated to ban the increase of prices during rainy days, we will be making both the suppliers and the consumers of these services worse off. The touts respond to the changes in the market and the forces of demand and supply should be used to determine prices. The statement that touts should not increase prices when it rains is therefore fallacious.

49. Kenya Must be Self-Sufficient in Food Production

Food is among the basic needs of humanity. In an effort to realize the right to food, governments and development partners strive to generate an economic environment enabling all persons to feed themselves either by producing their own food or by having the financial ability to access food . There are some pundits who believe that Kenya must be self-sufficient in food production. A country that is self-sufficient in food production is defined by the Food and Agriculture Organization as one that can satisfy its food needs from its own domestic production. However, those who advocate for Kenya to be self-sufficient in food production, more often than not, tend to mean a country eschewing all food trade and relying 100% on domestic food production to meet its food needs. This is an economic fallacy and here is why.

To begin with, those who advocate for the fallacy for self-sufficiency in food production have two main justifications for it. One is the Malthusian Theory of Population and the other is the price volatility in international food markets. The Malthusian Theory was developed by 18th century economist Thomas Malthus who believed that since populations exhibit exponential growth and food supply grows arithmetically, if left unchecked, growing populations could possibly outgrow their resources. Malthus and many others are right to think so but some take it too far to state that countries should be self-reliant in food production. The second rationale for self-sufficiency is protection from exorbitant prices in international food markets. In the event the demand for food exceeds the supply at a particular price, a shortage occurs. When this happens, food prices will increase until the supply and demand converge to restore an equilibrium. If a country cannot feed its own population it would have to depend on food from foreign countries therefore opening themselves to the rising food prices in the international scene. Bearing consciousness of the economic theory of comparative advantage would prevent one from making such a normative statement.

To state that a country, in this case Kenya, must be self-reliant in food production only pays attention to the theory of absolute advantage, completely disregarding the theory of competitive advantage which is the very foundation of international trade. Having an absolute advantage means being more productive or cost-efficient than another country whereas comparative advantage relates to how much more productive or cost efficient one country is than another . Kenya has a comparative advantage over another country if it is able to produce a similar good using fewer resources. In other words, Kenya has a comparative advantage if the opportunity cost of producing a certain good x is lower for Kenya compared to another country. Opportunity cost is the benefit given up when choosing between options. This would translate to supply the same quantity of good x at a lower price compared to another country. Let us say that good x is maize which is among Kenya's staple foods. Grown on about 1.5 million hectares of arable land and an annual average production of approximately 3 million tonnes, maize production in Kenya yields 2 tons per hectare of land. In Uganda on the other hand, maize is grown on 951,081 hectares of land yielding an annual maize production of 2.7 million tonnes resulting in a yield rate of 2.7 tonnes production per hectare of land. Absolute advantage is very clear in the fact that Kenya's total annual production is higher than Uganda's. However, the comparative advantage is evident in the yield per hectare of land. Uganda has the comparative advantage over Kenya in maize production because it manages to produce more maize per unit of land. This means that maize production in Uganda is more efficient than in Kenya as more maize is produce per unit of land. It therefore makes no economic sense for Kenyans to insist on relying merely on domestically produced maize which would be more expensive than Ugandan maize, the cheaper alternative.

Another point worth noting as we refute this fallacy is the sharp distinction between food self-sufficiency and food security. Although the two are related, self-sufficiency does not guarantee food security within a country. Food security is the situation that exists when all people, at all times, have physical, social and economic access to sufficient, safe and nutritious food that meets their dietary needs and food preferences for an effective and healthy life . The four pillars of food security are food availability, food access, utilization and stability . Food security is impartial to whether the food is produced within a country or not. Food self-sufficiency on the other hand is focused solely on one of the pillars of food security, food availability - a country's domestic food production capacity. It entirely dismisses the other aspects such as utilization which speaks to the nutritional value of the food and food access which is limited to the population's incomes. Some countries like China, Guinea, Zambia, Malawi and Cambodia produce more food than they consume - they are self-sufficient - but still have moderate to high levels of hunger. They produce more of some food crops but too little of others that are required to meet their dietary needs or are characteristic of high poverty levels that hinder access to food for some of their population. Enabling such countries to exchange a variety of food produce with other nations would improve the access to more nutritious food while increasing incomes as a result of international trade.

In conclusion, although Kenyans proposing self-sufficiency have good intentions, their intentions are completely misguided when weighed against economic theory. Self-sufficiency in food production is not the most efficient avenue to take to ensure Kenyans are feed. As established above, self-sufficiency does not ensure food security and the premise upon which the foundation for self-sufficiency is not consistent with the economic theory of comparative advantage

50. There should be a Guarantee Minimum Return (GMR) for Farmers

Generally, economic regulation is conducted in one of two ways, namely, entry controls and price controls. . Using price controls, different industries from time to time have been given price guidelines mandating specific price floors and ceilings, for example. Legislating a minimum legal price below the equilibrium price seldom works. Today, governments often seek to assist farmers by setting price floors in agricultural markets. A price floor is often set above the equilibrium price in the market, showing that the government seeks to change an already existing competitive price in the specific agricultural market. Therefore, with this price floor, the government forbids a price below the minimum, including the equilibrium price in question.

The Bill on the Dairy Industry (Pricing of dairy produce) Regulations, 2020, seeks to ensure that a primary producer receives a guaranteed minimum monetary return for their milk sales. It also seeks to protect the investment interests of both the seller and the buyer of dairy produce including the ultimate consumer. The Cabinet Secretary responsible for agriculture may on a need-basis and the advice of the Dairy Board, prescribe the minimum pay-out prices for raw milk or imported milk as the case may be through an order published in the Kenya Gazette. Further, in determining the minimum price factors such as production cost, quality of raw milk, production systems, changes in seasons, the needs of stakeholders, and any other factor that would impact the price of dairy products will be considered. The minimum pay-out price for milk shall follow a specific formula provided in the Regulations. This is just one isolated case. There have been demands many farmers producing different agricultural commodities, including maize farmers, imploring the government to put a guaranteed minimum price for a sack of maize. This is a common proposal made by different farmers.

The effect of this kind of regulation in a competitive market is that it will lead to an oversupply of the product in question. The US Department of Agriculture's long running support for dairy farmers in the US is an example of this. In 2016 the country had over 540,000 tons of surplus cheese and in 2020, the pandemic saw US farmers having large milk surpluses. They had to dump what stocks they had despite the prices of milk and butter rising.

When prices are set above the equilibrium price, farmers are motivated by profit to expand production. However, in as much as price controls of this nature inspire larger production, they lead to a reduction in consumption as the consumer will buy less of the product. This will lead to a rise in price resulting in oversupply. This is especially true when there are substitutes or other products that can be consumed in their place. This then implies that the regulation has failed to protect the consumer and won't meet its objective of protecting the investment of the buyer of the dairy produce. Then, eventually, market forces of supply and demand will return to the equilibrium price. This combined with the fact that these produces are perishable then informs the decision that primary producers will want to sell their produce before they incur loses of having to retain their product because consumers or middlemen have declined to purchase their milk. What happens then is that despite the government trying to ensure a certain price, the market will be operating at a parallel price. The National Cereals and Produce Board purchase price for maize can be referenced as an example. NCPB has a lower share of the total maize sales in the country. In 2013, the share of sales to NCPB and large millers stood at 9% . Therefore, this price floor doesn't determine the sale value of maize in the larger market. This shows that despite government setting a particular price floor for maize; the market operates at a different price.

Further, there are reasons why an intervention of this kind will be ineffective. First, it is easier to support the price of a commodity if a country's own do not produce enough of it to meet domestic consumption and the rest is imported. Even in this instance, supposing the price floor is way above the import price then the importers will make more profits instead of the farmers as people will prefer the cheaper imported produce to the domestic one. Kenya has witnessed this in the past as was the case with maize. Prices were set way above the border price. In response, the market imported the product was from neighboring countries. Thus, for the local farmers to benefit from the price control, the country will have to impose import duties on the specific produce brought into the country. This then will lead to a scenario where the imported produce is more expensive than the domestically produced produce. What will follow is the domestic farmer then will end up receiving a higher profit than before when the market operated at equilibrium price but the price but consumers will pay the higher price for both imports and domestic production of milk.

In Kenya today, a particular produce is cultivated by several farmers. This fact informs another point. Which is, that price controls of this nature should be confined to situations where markets are dominated by one or two firms because in a reasonably competitive market there is no place for price regulation. The rationale behind this is that buyers are limited in regards to where to purchase from. It is more appropriate to regulate prices when dealing with one or two firms as opposed to many.

In summary, these kinds of regulations should not happen because they will fail to meet the objective of protecting the welfare of the seller and the consumer. What governments should focus on instead is dealing with the other bottlenecks that producers are struggling with such as poor infrastructure and vast amounts of food loss and waste. Also, legislating minimum prices is a difficult and expensive process to enforce, it can lead to non-competitive behavior.

Institute of
Economic Affairs

5th Floor, ACK Garden House | P.O. Box 53989 - 00200 Nairobi, Kenya.
Tel: +254-20-2721262, +254-20-2717402 | Fax: +254-20-2716231
Email: admin@ieakenya.or.ke | Website: www.ieakenya.or.ke