

## AFRICA RISK CONSULTING

### Kenya Monthly Briefing July 2018

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#### Kenya Summary 23 July 2018

*A scandal over the importation of contraband sugar and dangerous contamination leads to a sugar shortage across Kenya. The Common Market for Eastern and Southern Africa (Comesa) Council of Ministers grants Kenya a two-year extension to delay duty-free sugar imports in order to safeguard its sugar industry from regional exporters. President Uhuru Kenyatta (2013-present) continues to wage war on corruption amid conjecture whether it is political in nature. Kenya's growing trade deficit and high levels of national debt show little sign of relenting. Kenyan exports to Tanzania increase after bilateral economic relations thaw.*

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#### Sugar scandal leaves a bitter taste ...

A sugar shortage across **Kenya** has followed large-scale seizures of sugar that was not only deemed to be illegally imported<sup>1</sup> but was also of questionable quality, contaminated with high levels of mercury and copper.<sup>2</sup> The breach of **Kenya Bureau of Standards (KEBS)** rules on product safety emerged after the **Kenya Revenue Authority (KRA)** seized over 500,000 tonnes of sugar in an ongoing crackdown on contraband sugar.<sup>3</sup> A **Nairobi** court charged KEBS managing director **Charles Ongwae** and six other officials on 25 June with attempted murder and abuse of office regarding their alleged complicity in the importation of substandard fertiliser and sugar.<sup>4</sup>

The sugar saga is rooted in inefficient production coupled with stringent import controls, and involves a large cast of industry players, bureaucrats and politicians. The government owns five sugar factories that are set for privatisation while the sugar sector is nearly crippled by obsolete milling technology, huge debts, poor production, mismanagement, corruption and non-payment of farmers.<sup>5</sup> As a result, Kenya's sugar production cost is the highest within the **Common Market for Eastern and Southern Africa (Comesa)** countries at \$840 per tonne, compared with the regional average of \$400.<sup>6</sup>

To compound the problem, Kenya consumes much more sugar than it can produce. Total domestic sugar production in 2017 was 376,100 tonnes, a 41.2% decline from 639,700 tonnes in 2016.<sup>7</sup> Annual consumption in 2017 was roughly 870,000 tonnes.<sup>8</sup> Kenya imports the deficit but the government strictly controls sugar imports, allowing in only 300,000 tonnes annually in order to protect local sugar production.<sup>9</sup> Due to a large shortage of sugar

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<sup>1</sup> BBC, 24 Jun 2018.

<sup>2</sup> BBC, 24 Jun 2018.

<sup>3</sup> Kenya Citizen TV, 4 Jun 2018; Daily Nation, 17 Jun 2018 and 1 Jul 2018.

<sup>4</sup> Capital FM, 25 Jun 2018 and The Star, 25 Jun 2018.

<sup>5</sup> The East African, 5 May 2018

<sup>6</sup> The East African, 5 May 2018

<sup>7</sup> The East African, 5 May 2018

<sup>8</sup> The East African, 5 May 2018

<sup>9</sup> Daily Nation, 1 Jul 2018

in 2017, the Kenyan government allowed it to be imported duty-free between May and August 2017.<sup>10</sup> **West Kenya Sugar** chairman and leading industry player **Jaswant Rai** reported to a joint parliamentary committee on trade and agriculture on 28 June that some members of the Kenyan business community exploited the resulting business opportunity and imported unsafe sugar supplies.<sup>11</sup> Rai claimed at least 178,000 metric tons of sugar were sold without being refined, contravening KEBS rules.<sup>12</sup> He also claimed that thousands of tons of sugar were transported in tipper trucks usually used to transport sand, cement and other building materials.<sup>13</sup>

Public disputes over sugar contamination have resulted in high-level dismissals. The now former cabinet secretary for trade and industry, **Adan Mohamed**, refuted claims of sugar contamination on 20 June, publicly contradicting interior cabinet secretary **Fred Matiang'i**.<sup>14</sup> Mohamed had appointed Ongwae, a former colleague at **Barclays Bank**, to his role at KEBS in January 2014.<sup>15</sup> President **Uhuru Kenyatta** (2013-present) removed Mohamed from his post in a cabinet reshuffle on 13 July, reallocating him to cabinet secretary for **East African Community (EAC) Affairs**.<sup>16</sup>

Kenya obtained a one-year extension in 2014 to delay duty-free sugar imports from Comesa member states until March 2015, to allow it to complete reforms in its sugar industry.<sup>17</sup> It has successfully applied for further extensions, the latest of which it obtained on 16 July during the **20<sup>th</sup> Comesa Summit in Lusaka (Zambia)**.<sup>18</sup> The two-year extension will take effect when the current safeguard expires in February 2019.<sup>19</sup>

The large amount of sugar seized, coupled with police warnings to distributors not to sell sugar to consumers until the product is confirmed to be fit for human consumption, has caused a severe shortage of sugar across Kenya.<sup>20</sup> There is also regional concern that Kenyan manufactured goods such as cakes, sweets and ice cream may contain contaminated sugar and may have found their way onto supermarket shelves.<sup>21</sup> Comesa's extension of Kenya's sugar import safeguards adds insult to injury for bloc members as it continues to limit regional sugar export opportunities.<sup>22</sup> However, for domestic producers, the current sugar shortage and another two-years of protectionism appear to be a sweet deal.

### ... as Kenyatta's war on corruption rages on

Corruption and other government scandals continue to make headlines in Kenya. Allegations of irregularities at the **National Youth Service (NYS)**, **Kenya Forestry Service (KFS)**, **Kenya Power and Lighting Company (KPLC)**, the **National Cereals and Produce Board (NCPB)**, **Kenya Pipeline Co.** and the **Kenya Electricity Transmission Company (Ketraco)** have rocked the country in recent months.<sup>23</sup> Police arrested KPLC officials on 14 July over an

<sup>10</sup> Business Daily, 9 Jan 2018.

<sup>11</sup> The Standard, 28 Jun 2018.

<sup>12</sup> The Standard, 29 Jun 2018.

<sup>13</sup> The Standard, 29 Jun 2018.

<sup>14</sup> Daily Nation, 23 Jul 2018.

<sup>15</sup> Business Daily, 26 Jan 2014.

<sup>16</sup> Daily Nation, 13 Jul 2018.

<sup>17</sup> CNBC Africa, 15 July 2014

<sup>18</sup> Comesa, 16 Jul 2018.

<sup>19</sup> Comesa, 16 Jul 2018.

<sup>20</sup> The Standard, 30 Jun 2018.

<sup>21</sup> The Standard, 10 Jul 2018.

<sup>22</sup> The Standard, 10 Jul 2018.

<sup>23</sup> Source, journalist, Nairobi

alleged billing scandal<sup>24</sup> and allegations of irregular tender processes.<sup>25</sup> A slew of MPs are also set to be arrested over a fraud regarding land in **Ruaraka, Nairobi** in which the **National Land Commission (NLC)** paid out KSh1.5 billion (\$14.9m) for a piece of land, the proceeds of which it dispersed to more than 24 entities.<sup>26</sup> Interior cabinet secretary Fred Matiang'i, a close ally of Uhuru Kenyatta, is under investigation for his involvement in the Ruaraka land saga.<sup>27</sup>

Although corruption allegations reach beyond any one political faction, some sources claim Kenyatta's war on graft may be a means to score political points over his deputy, **William Ruto** (see *ARC Briefing Kenya June 2018*). Ruto's allies claim with some legitimacy that corruption scandals have disproportionately fallen upon those loyal to the deputy president.<sup>28</sup> Kenyatta's war on corruption appears, at least in part, to be a bid to block Ruto's bid for presidency in 2022.<sup>29</sup> As Ruto's alliance with Kenyatta in 2013 and 2017 was essential in Kenyatta's successful presidential bids,<sup>30</sup> Ruto expects a "free pass" for the party presidential nomination of the ruling **Jubilee Party**.<sup>31</sup>

Just months after securing his second presidential term, Kenyatta already appears to be courting potential successors. Kenyatta met with his long-term adversary and three-time presidential candidate, **Raila Odinga**, in a show of friendship on 9 March,<sup>32</sup> and since then, Odinga has become officially involved with government business.<sup>33</sup> Odinga made a visit to **India** on 3 July and met Prime Minister **Narendra Modi** (2014-present),<sup>34</sup> with a memo sent to all of Kenya's foreign missions directing them to treat Odinga as a senior government representative.<sup>35</sup> There is speculation that Odinga left the **National Super Alliance (NASA)** coalition to manufacture another attempt to become president, thus placing himself in direct competition with Ruto for the 2022 election (see *ARC Briefing Kenya April 2018*).<sup>36</sup>

Ethnicity still plays an important role in Kenya politics. Kenyatta will be eager to preserve political power either within the **Kikuyu** political faction to which he belongs<sup>37</sup>, or rotate political power among the political dynasties that already exist rather than hand the torch to Ruto, an ethnic **Kalenjin** with his own patronage networks. Because of these preferences, Kenyatta may endorse **Baringo** Senator **Gideon Moi** for 2022, son of former president **Daniel arap Moi** (1978-2002) and a strong rival of Ruto, despite being a fellow Kalenjin.<sup>38</sup> Moi, leader of the **Kenya African National Union (KANU)**, announced his intention to run for president in 2022 on 15 July.<sup>39</sup> He has also spoken out in support of Kenyatta's war on corruption, a potential barb towards Ruto.<sup>40</sup>

<sup>24</sup> Daily Nation, 19 Jun 2018 and Reuters, 14 July 2018.

<sup>25</sup> Reuters, 17 Jul 2018.

<sup>26</sup> Daily Nation, 20 Jul 2018.

<sup>27</sup> Mediamax, 20 Jul 2018.

<sup>28</sup> Daily Nation, 10 Jun 2018, The Star, 28 Jun 2018 and Source, journalist, Nairobi.

<sup>29</sup> Daily Nation, 1 Jul 2018

<sup>30</sup> Daily Nation, 8 Jul 2018.

<sup>31</sup> Daily Nation, 24 June 2018.

<sup>32</sup> Daily Nation, 10 Apr 2018.

<sup>33</sup> The Star, 4 Jul 2018.

<sup>34</sup> The Star, 4 Jul 2018.

<sup>35</sup> Kenyans, 4 July 2018.

<sup>36</sup> Source, Kenya analyst, United Kingdom

<sup>37</sup> The Star, 30 Jun 2018.

<sup>38</sup> Kenya Today, 30 December 2017.

<sup>39</sup> Daily Nation, 16 Jul 2018.

<sup>40</sup> The Standard, 9 Jul 2018.

The government's current war on corruption demonstrates an effort to clean up high-level graft in government and at boardroom level. However, it also illustrates deeply rooted factionalism within Kenyan politics and the lengths to which political actors will go to pursue factional interests. As such, investors should exercise caution if dealing with politically exposed persons in Kenya.

### Growing trade deficit and high levels of national debt show little sign of relenting ...

The **Kenya National Bureau of Statistics (KNBS)** announced data on 25 April showing the country's trade deficit to stand at nearly \$5 billion for the first five months of 2018.<sup>41</sup> This signals an 8.66% increase from the same period of 2017 and sends a strong warning about the health of Kenya's economy.<sup>42</sup> An ever-increasing demand in Kenya for imported goods sourced primarily from **China** and **India** has contributed to the trade deficit and led to lower demand for domestic products, which has affected the Kenyan job market adversely.<sup>43</sup> The government have made efforts to bolster domestic industries such as textiles so that they can compete with foreign competition by implementing **Export Processing Zones (EPZ)** where machinery and materials for manufacturing purposes can be imported duty free.<sup>44</sup> To date, these efforts have been in vain.<sup>45</sup>

The **International Monetary Fund (IMF)** announced public concern in February over Kenya's growing trade deficit and "*runaway debt burden*".<sup>46</sup> The IMF's concern is well-founded. For the 2018-2019 financial year, the government plans to put aside KSh870.62 billion (\$8.6 billion) to pay off national debt and growing interest, which accounts for 49.95% of the Treasury's targeted tax revenue for the same period.<sup>47</sup>

Speaking to Kenyan newspaper Business Daily, **David Cowan**, chief economist for Africa at **United States**-based **Citibank**, stated that to resolve its macroeconomic woes, Kenya must keep the rate of inflation low and issue long-term local debt rather than foreign debt.<sup>48</sup> However, the announcement on 27 April that China loaned Kenya \$1.64 billion in 2017, and would loan another \$1.64 billion to extend the new **Standard Gauge Railway (SGR)** from Nairobi to **Naivasha** (see *ARC Briefing Kenya May 2018*), renders Cowan's advice academic. Kenya's economic problems appear set to continue as it climbs deeper in debt.<sup>49</sup>

### ... as Kenyan exports to Tanzania increase after bilateral economic relations thaw

A KNBS report on 25 April showed that Kenya's exports to Tanzania rose by the highest margin of all countries during the first five months of 2018 compared to the same period of 2017.<sup>50</sup> Tanzania bought \$100m worth of goods from Kenya during the period, 28.58% more than it did from January through May 2017.<sup>51</sup>

<sup>41</sup> The East African, 16 Jul 2018.

<sup>42</sup> The East African, 16 Jul 2018.

<sup>43</sup> The East African, 16 Jul 2018.

<sup>44</sup> Reuters, 21 Apr 2017.

<sup>45</sup> The East African, 16 Jul 2018.

<sup>46</sup> The Star, 22 Feb 2018.

<sup>47</sup> Business Daily, 17 Jul 2018.

<sup>48</sup> David Cowan quoted in Business Daily, 17 Jul 2018.

<sup>49</sup> The Standard, 3 May 2018.

<sup>50</sup> The East African, 16 Jul 2018.

<sup>51</sup> The East African, 16 Jul 2018.

Kenya's exports to Tanzania were at a 10-year low from January through October 2017, due to trade spats between the two countries.<sup>52</sup> Kenya and Tanzania squabbled throughout 2017 over items such as the 75% tariff on cigarettes imported to Tanzania from Kenya and Kenya's temporary ban on the importation of liquefied natural gas (LNG) from Tanzania.<sup>53</sup> President Kenyatta and Tanzania's President **John Magufuli** (2015 - present) ordered the pair to reconcile their respective countries' differences in February.<sup>54</sup> Trade talks between Kenya's Principal Secretary for Trade, **Chris Kiptoo**, and his Tanzanian counterpart, **Elisante ole Gabriel**, yielded a breakthrough on 5 July. Kiptoo and Gabriel resolved issues such as the export of Kenyan textiles to Tanzania, which had previously been subject to tariffs.<sup>55</sup> Under the new bilateral agreement, such products will enter the Tanzanian market with ease.<sup>56</sup>

Whilst both Kenya and Tanzania are members of the **East African Community (EAC)** and part of the EAC's common external tariff regime, the two countries express different attitudes towards international trade. Tanzania pursues a more protectionist economic agenda than Kenya. Tanzania has sought to increase the EAC's tariffs on as much as three quarters of goods imported into the economic area, whilst Kenya has sought more international trading opportunities.<sup>57</sup>

From an investor perspective, the new-found trade relationship between Kenya and Tanzania will benefit the manufacturing industries of both countries. With growth in Tanzania's fledgling manufacturing sector slowing considerably,<sup>58</sup> Kenyan manufactured imports look likely to become more and more attractive to the Tanzanian market.

## Planner

30 Jul 2018 **Nairobi (Kenya)** *Central Bank of Kenya* MPC meeting;  
 28 Oct 2018 **(Kenya)** *Daily Nation* Daily direct flights to **New York (United States)** expected to begin;  
 6-8 Mar 2019 **Mombasa (Kenya)** *East African Community* East African Petroleum Conference and Exhibition;  
 Aug 2019 **(Kenya)** *The Star* National Census planned;  
 2022 **(Kenya)** *The Nation* General elections to be held;

## Chronology

18 Jul 2018 **Nairobi (Kenya)** *Times Live*. Finance minister **Henry Rotich** announces that Nairobi will host Kenya's first international financial centre in order to attract large foreign financial firms and boost capital flows;  
 18 Jul 2018 **Nairobi (Kenya)** *Standard Media*. The **China**-funded Nairobi-**Mombasa** railway project reported losses of \$100m in its first year of operation;

<sup>52</sup> The East African, 2 Jan 2018.

<sup>53</sup> The East African, 2 Jan 2018.

<sup>54</sup> The East African, 16 Jul 2018.

<sup>55</sup> The East African, 6 Jul 2018.

<sup>56</sup> The East African, 6 Jul 2018.

<sup>57</sup> The East African, 16 Jun 2018.

<sup>58</sup> The Citizen (Tanzania), 26 Jun 2018.

- 18 Jul 2018 **Nairobi (Kenya)** *Reuters*. A high court temporarily suspends the 'Robin Hood' tax on bank transfers over \$5,000;
- 17 Jul 2018 **Nairobi (Kenya)** *Reuters*. Kenya-based telecoms company **Safaricom** begins to negotiate with the **Ethiopian** government to introduce the mobile money service **M-Pesa** to Ethiopia;
- 16 Jul 2018 **Nairobi (Kenya)** *Reuters*. Police charge Kenya-based **Kenya Power's** chief executive officer, **Ken Tarus**, his predecessor, **Ben Chumo**, and other senior managers at the company with conspiring to commit an economic crime and abuse of office;
- 16 Jul 2018 **Nairobi (Kenya)** *Capital FM*. Police arrest 14 **Kenya Power** officials on suspicion of corruption;
- 16 July 2018 **(Kenya)** *The East African*. Kenya's trade deficit hits almost \$5 billion for the first five months of 2018;
- 13 Jul 2018 **Nairobi (Kenya)** *Business Daily*. **Kenya**-based airline **Kenya Airways** announces that it will stop direct flights to **Jeddah, Saudi Arabia**, from mid-September 2018;
- 13 Jul 2018 **Nairobi (Kenya)** *Business Daily*. The **Government of Kenya** asks the **Common Market for Eastern and Southern Africa (Comesa)** to cap the amount of sugar that can be sold to Kenya by other Comesa member states;
- 13 Jul 2018 **Kwale (Kenya)** *Business Daily*. The Kenya government prohibits **Mauritian**-owned **Kwale International Sugar Company Ltd** from trading as it carries out checks to determine whether its sugar is contaminated;
- 12 Jul 2018 **Nairobi (Kenya)** *Daily Nation*. Hawkers start bonfires and pelt police with rocks after police crackdown on rate defaulters;
- 11 Jul 2018 **Nairobi (Kenya)** *Reuters*. **Joshua Oigara**, CEO of **Kenya**-based **Kenya Commercial Bank Group (KCB)**, states that KCB will look to take advantage of political and economic liberalisations and partner with a bank in **Ethiopia**;
- 10 Jul 2018 **Mombasa (Kenya)** *Business Daily*. Mombasa retailers run out of sugar;
- 9 Jul 2018 **Nairobi (Kenya)** *VOA*. President **Uhuru Kenyatta** and **Swiss** president **Alain Berset** sign a deal aimed to help Kenya recover illegally acquired assets obtained from the Kenya government held in Swiss banks;
- 5 Jul 2018 **Naivasha (Kenya)** *Reuters*. **Rift Valley** magistrate's court charges **Perry Kansagara, Vinoj Kumar**, and **Johnson Njunguna**, with manslaughter over a collapsed dam that killed 47 people;
- 3 Jul 2018 **Nairobi (Kenya)** *NDTV*. Opposition leader **Raila Odinga** meets with **Indian** prime minister, **Narendra Modi**,
- 28 Jun 2018 **Nairobi (Kenya)** *Al Jazeera*. A fire kills 15 and injures 70 at **Nairobi's** open-air **Gikomba** market;
- 26 Jun 2018 **Nairobi (Kenya)** *Standard Media*. **Kenya Association of Manufacturers** chair **Flora Mutahi** estimates that Kenya loses 200 billion shillings (\$1.9 billion) to counterfeit trade every year;

23 Jun 2018 **Nairobi (Kenya)** *Reuters*. Authorities arrest the managing director of the **Kenya Bureau of Standards, Charles Ongwae**, after KEBS officials allowed the import of fertiliser that failed KEBS tests;

14 Jun 2018 **Nairobi (Kenya)** *Reuters*. Finance minister **Henry Rotich** proposes repealing the cap on commercial lending rates which will allow banks to provide more credit, as well as a 'Robin Hood' tax of 0.05% on any bank transfer above KSh500,000 (\$5,000);

12 Jun 2018 **Nairobi (Kenya)** *Straits Times*. **Henry Rotich** signs a bilateral investment treaty and a double taxation treaty with **Singapore** to promote greater investment flows;

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