The Economic Cost of Conflict of Interest: The Kenyatta Dairy Industry Case

By David Ndii

Two weeks ago, Uhuru Kenyatta called the country to order to make what I gather was anticipated to be a very consequential address to the nation. When a country is in as much political and economic turmoil as Kenya is, it is understandable that a rare formal presidential address to the nation would be highly anticipated.

It is difficult to say whether it met expectations. It certainly did not overwhelm. I don't get the sense that the country came out of it with a clearer sense of direction of either politics or economics.

The political highlight was without doubt the dismissal of agriculture Cabinet Secretary Mwangi Kiunjuri. Kiunjuri promptly called a press conference at which he intimated that he'd endured a fair amount of humiliation, and had been pretty much prepared for the dismissal. A master of Gĩkũyũ orature, he shrugged off the sacking by saying *mumagari nĩ wa njũa igĩrĩ (when* you leave home it is wise to carry a spare garment), meaning in politics you need to have a "plan b". Figuratively, it's the equivalent of a middle finger.

But the main talking point of the speech was Kenyatta's directive asking the national Treasury to release Sh500 million to the New Kenya Co-operative Creameries (New KCC) to purchase milk from farmers, and another Sh575 million to revamp two of its processing plants in Kenyatta's central

Kenya political base. This was one of a raft of financial bailouts of various troubled agriculture sub-sectors that Kenyatta said were his plan to put money in people's pockets.

Kenyatta's family enterprise, Brookside Dairies is the largest milk processor in Kenya. It achieved this through a string of acquisitions executed since Kenyatta became finance minister and subsequently president. The reason why Kenyatta's directive is a talking point is because, since he assumed power, Brookside has been taking money out of people's pockets. When he took office, processors bought milk from farmers at between Sh30 and Sh35, and sold it to consumers at between Sh60 and Sh65, obtaining a margin of about the same, i.e. Sh30 to Sh35. By the end of Kenyatta's first term, the consumer price had increased to between Sh110 and Sh120 (i.e by Sh55 to Sh60 per half-litre packet), while the producer price remained unchanged, raising the processors' margin to the Sh75-Sh90 range.

Over the last two years, the squeeze has shifted from consumers to producers. In August last year Brookside reduced the purchase price of milk from Sh30 to Sh25 per kilo. By December, the media reported that farm-gate prices had fallen to Sh20, and to as low as Sh17 in some places.

The dairy farmers' woes are blamed on milk imports from Uganda. It has been alleged that some of this milk is sourced from elsewhere and passed off as Ugandan. Kenya and Uganda being part of the East African common market, there is little Kenya can do to protect its market from Ugandan products, but transhipment would violate rules of origin and give Kenya reason to restrict Ugandan imports. In response to these allegations, the Kenyan government dispatched a fact-finding mission to establish whether Uganda had the capacity to export that much milk to Kenya. The trade Principal Secretary was quoted saying that not only did the delegation not find any evidence of transhipment, it had established that Uganda's milk production has increased significantly in recent years.

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There's plenty of information in the public domain on Uganda's growing dairy export industry. A paper published by the Economic Policy Research Centre (EPRC) shows that Uganda's dairy exports have grown steadily from virtually zero a decade ago to $79m in 2017. We did not need to go to Uganda to know this. According to the EPRC paper, the Kenyatta-owned Brookside Dairies is the third-largest milk processor in the country in terms of installed capacity at 500,000 litres/day (19 per cent) but second in terms of production at 450,000 litres/day (29 per cent). Still, the allegations have degenerated into a trade row. Last week the Ugandan government sent a formal protest note objecting to what it termed illegal seizures of Ugandan milk, and demanding immediate release.

More fundamentally, why the Kenyan market is attracting Ugandan milk has little to do with Uganda's demand-supply balance, and everything to do with Kenya's consumer price. As observed earlier, the retail price of processed milk has doubled from Sh65 to Sh120. In Uganda, a litre of processed milk retails at between USh2,800 and USh3,000 which translates to an average of Sh80, i.e. Sh40 per half-litre packet, compared to Sh60 in Kenya. Ugandan producers are not obliged to satisfy their domestic market when a more profitable market is available across the border. If consumer prices had increased at the rate of inflation faced by Kenyan manufacturers, as measured by the producer price index (2.5 per cent per year), the retail price in Kenya today would be in the Sh70-75 range, which is well below the Uganda retail price.

In a competitive market, Uganda should sell milk to Kenya until the profits for producers in both markets are equal. But the consumer prices in Kenya are not a reflection of market forces. They are

a reflection of the market power exercised by Brookside. Why Brookside? Why not New KCC and Githunguri Dairy, or collusion between the three? The answer is simple enough. New KCC and Githunguri Dairy are public entities, the former a state corporation, the latter farmer-owned. They have nothing to gain from a fat bottom line as their mandates are to maximise farmers' earnings. Whether they pay a decent producer price or distribute dividends, the money ends up with farmers.

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But even if in the place of New KCC and Githunguri Dairy we had purely capitalist enterprises in the same market position, Brookside, as the market leader, would still be the culprit. In the economics of industrial organisation, the branch that informs competition policy, we call a market dominated by a few players an oligopoly. In an oligopoly, the market leader is the price maker. When the market leader raises prices, the weaker players benefit also. You don't need a conspiracy to get a cartel. Each of the players acting in their self-interest can result in cartel-like behaviour. We call this non-cooperative collusion.

In essence then, the problem of the milk industry is not an agricultural policy one. It is not a trade policy one either. It is a problem of competition policy. Having sanctioned the Brookside acquisitions, the Competition Authority was obliged to keep an eye on the market to ensure that cartelisation did not occur. As noted, normal prices should be in the order of Sh75 a litre, Sh80 at most, compared to Sh120 today. This is *prima facie* evidence of abuse of dominance.

I am frequently asked, including by people close to Kenyatta, what it is that he, Kenyatta should do to turn around the economy. My answer is invariably is that there is a world of difference between what can be done, and what Kenyatta can do. The reasons are clear. Kenyatta is so severely enmeshed in the conflict between his family's business and the public interest that there is hardly a sector of the economy in which the required reforms do not conflict with his personal interests.

For the last four years, the economy has suffered the consequences of ill-advised populist interest rate regulation. Kenyatta expressed reservations about the law, but he went ahead and signed it anyway. The banking industry vigorously opposed the law, and as a bank owner, Kenyatta may not have wanted to be seen to be on the side on which his bread is buttered. If Kenyatta had no personal interest, he would have been in a much stronger position to argue against, and veto the law.

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Two years ago, a sugar import scandal of monumental proportions unfolded. Initial reports pointed to traders of Somali ethnicity who were reportedly repackaging contaminated contraband sugar and passing it off as "Kabras Sugar", a local brand owned by West Kenya Sugar Company. The government was threatening damnation. So much so that the CEO of the Kenya Bureau of Standards (KEBS) was slapped with an attempted murder charge for allowing the contaminated sugar, said to be laced with copper and mercury, to enter the country. But soon, mountains of sugar, way beyond the capacity of the contraband traders, was discovered in warehouses associated with the owners of the West Kenya Sugar Company, who also happen to be Kenyatta family business associates. It turned out that just before the elections the Government had opened the floodgates and allowed in 990,000 tonnes of duty free-sugar. West Kenya Sugar imported a quarter of it. As soon as this was exposed, the matter died.

The convergence of family and state is best exemplified by Stawi, a mobile phone-based lending platform owned by NCBA Bank—another Kenyatta family enterprise—that is being passed off as a national policy initiative to provide affordable credit to small businesses. Kenyatta himself first spoke of it in his 2019 State of the Nation address, and again in his Mombasa address two weeks ago:

> *"Measures to enable MSMEs access affordable credit include the recently launched Stawi. This will provide unsecured credit to MSMEs, which, because of their informal nature and lack of collateral securities, had been locked out of the formal credit market. Five commercial banks have set aside 10 billion shillings to be lent to MSMEs at an interest rate of 9 percent per annum, in loan amounts ranging between 30,000 to 250,000 shillings."*

This is sleight of hand, also known in trade lingo as mis-selling. First, the Stawi platform belongs to NCBA, the other four banks are agents. Second, the interest rate of 9 per cent per year, while true, amounts to mis-selling. The true cost of credit is given by the Annual Percentage Rate (APR) which combines both interest and other fees. In addition to the 9 per cent per year interest, there is a facility fee of 4 per cent of the loan amount, a 20 per cent excise duty on the facility fee and a 0.7 percent insurance fee. All in all, these add up to an APR of 14.5 per cent for a one-year loan, 20 per cent for a six-month loan, 31 per cent for a three-month loan and 75 per cent for a one-month loan.

> "We're pleased to see the new scheme, Stawi, under which loans will be made available to SME's at 9%. Our young people and our small scale traders hard work and innovation deserve our support; with the Stawi loans, they'll get it." ~ @KanzeDena pic.twitter.com/VcoqGMBG20
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> — State House Kenya (@StateHouseKenya) June 18, 2019

Kenyatta has spoken out against conflict of interest on a number of occasions, including quite recently when he made a big hullabaloo about lawyers who are also senators representing county governors in court. The conflict of interest here is actually tenuous, since all that would be required to avoid it is for the lawyers to recuse themselves if their client's case comes before the Senate. It remains a profound mystery whether Kenyatta is unaware how egregiously conflicted he is, or it is impunity, or perhaps he suffers from multiple personality disorder. Remarkably, throughout his presidency, no journalist has found it fit to ask Kenyatta this question. It needs to be asked.

Whatever the case, Kenyatta cannot have been unaware that personally wading into the dairy industry was inviting scrutiny of Brookside's role in the dairy industry mess. That he did so suggests that he may be finally waking up from whatever reverie led him to wonder aloud not too long ago why Kenyans are broke. He may even be finally making the connection between the economic despondency in the country, and the popularity his deputy and now nemesis is enjoying in his central Kenya backyard.

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And of course, that his administration's borrowing binge has the government in financial dire straits can no longer be denied. Mr Kenyatta has little to show for the debt. The SGR railway, his flagship project, has become a bugbear that is bleeding the country dry. It costs more and is less efficient

than road haulage. The only reason it is running is because importers are forced to use it, gutting the Mombasa economy in the process. Even then, it cannot cover the management fees we are paying the Chinese to run it, let alone service its debt. It is bleeding taxpayers, consumers, importers, business and Mombasa—the only beneficiaries are China and whoever was bribed to build it.

A legacy of economic delinquency is one that Kenyatta cannot be relishing. We can expect him to be increasingly preoccupied with salvaging what he can. He has his work cut out. The government is in negotiations with the World Bank and the IMF for a financial bailout. If that goes through, Kenyatta is likely to spend the rest of his term hemmed in between an IMF straightjacket and his myriad conflicting interests, amidst a brutal vacuous power struggle between his deputy and Raila Odinga, neither of whom, if truth be told, inspire confidence in terms of economic stewardship.

Gakīīhotora nīko koī ūria karīina (one does not adorn for dance without knowing how they will dance) which is to say, as you make your bed, so you must lie on it.

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