KENYA

TRADE SUMMARY

The U.S. trade balance with Kenya went from a trade deficit in 2003 of $53 million to a trade surplus of $42 million in 2004. U.S. goods exports in 2004 were $398 million, up 100.5 percent from the previous year. Corresponding U.S. imports from Kenya were $352 million, up 41.2 percent. Kenya is the 80th largest export market for U.S. goods. The stock of U.S. foreign direct investment (FDI) in Kenya in 2003 was $92 million, up from $73 million in 2002

IMPORT POLICIES

Kenya's trade regime has been liberalized, apart from a small list of import licensing controls based on health, environmental, and security concerns. However, imports are still subject to some barriers to access. All imports with f.o.b. value of more than $5,000 are subject to pre-shipment inspection (PSI) for quality, quantity, and price, and require a Clean Report of Findings by a government-appointed inspection agency. In June 2003, the Finance Minister specified that the Import Declaration fee, which includes a PSI fee, would be 5,000 Kenya shillings (about $64). Importers who fail to obtain inspection in advance pay a 15 percent penalty for local inspection (25 percent for motor vehicles).

High import duties and value-added tax (VAT) pose trade barriers, especially in the agricultural sector. Kenya's import regulations on agricultural products are sometimes altered to reflect fluctuations in domestic supply and demand as well as political factors. Effective January 1, 2005, the government eliminated the import duty for inputs and raw materials used in the manufacturing sector. Duties on a number of raw materials and capital goods previously taxed at 5 percent were reduced to zero in the 2002-03 budget. Current rates are 10 percent for intermediate goods and 25 percent for finished goods. Import duties for fabrics are set between 25 percent and 35 percent, while duties on basic inputs such as yarn are zero. The current import duty on foodstuffs that compete with Kenyan products -- including meat and meat products, poultry and poultry products, and dairy products -- is 35 percent. In its 2004-05 budget statement, the government introduced an export tax on hides, skins, and scrap metal to encourage local processing rather than the export of these items. There is now a flat tax of Ksh 10 and Ksh 3 (approximately $0.12 and $0.04) per kilogram for hides/skins and scrap metal, respectively. Effective January 1, 2005, Kenya significantly raised duties on worn clothing to $0.75/kilo or 50 percent *ad valorem*, whichever is higher, reportedly as part of its implementation of the East African Customs Union. U.S. industry claims that this tariff hike constitutes a *de facto* ban on the entry into Kenya of used clothing.

The Kenyan government continues to carefully control imports of seed corn by subjecting hybrid varieties to a certification process that effectively restricts trade. Until a seed variety is fully

registered (a process that can take 3-4 years), the Ministry of Agriculture restricts cereal seed imports by setting quantitative ceilings. However, once a variety is certified, the quantitative restrictions are lifted.

The government sometimes manipulates the application of the VAT to support policy priorities, both to protect "strategic" sectors, such as transportation and agriculture, and to address short-term needs. In 2004, Kenya eliminated the VAT and duty on a limited quantity of imported maize to address severe food shortages.

Customs Procedures

In 2000, Kenya started implementing the WTO Customs Valuation Agreement. Under the agreement, Kenya uses the transaction value for valuation of goods imported from other WTO signatories. Kenya's customs procedures are detailed and rigidly implemented, often leading to delays in clearance of both imports and exports. The delays negatively impact Kenya's business climate by reducing the private sector's legal options in trade disputes. The two private sector firms that administer Kenya's pre-shipment inspection regime are charged with ensuring that up-to-date customs valuation and risk assessment methods are applied.

Regional Trade Agreements

Kenya is a member of several regional trade arrangements, including the East African Community (EAC), the Intergovernmental Authority on Development (IGAD), and the Common Market for Eastern and Southern Africa (COMESA). Kenya is one of 11 members of COMESA's Free Trade Area. The EAC's Customs Union, which entered into force on January 1, 2005, will phase in duty-free transit of most goods between Kenya, Tanzania, and Uganda over a five-year period.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Commercial and research applications of agricultural biotechnology in Kenya are currently regulated through guidelines, which are neither formal regulations nor enacted law. The guidelines, published in 1998, describe a committee-based approach for review and approval of agricultural biotechnology imports, including specific review of end uses (e.g., planting seeds for trials). Substantial quantities of agricultural biotechnology products have been imported into Kenya for food aid purposes since the establishment of the Biosafety Committee, and significant volumes of food products derived from agricultural biotechnology crops are available commercially. Kenya has received food aid containing biotechnology components. These shipments do not appear to have been tested for biotechnology content. Kenya also imports maize from South Africa, where biotechnology varieties are commercially available. Kenya is a party to the Cartagena Protocol on Biosafety.

Certain Kenyan standards do not conform to international standards, and this has adversely affected foreign investment in the country. The Kenya Plant Health Inspectorate Service (KEPHIS) subjects certain imported agricultural goods to further inspection. The Inspectorate also regulates the import and export of plant materials and trade in biosafety control organisms (organisms that require special handling to ensure they are not accidentally released into the environment). KEPHIS evaluates commercial hybrid grain seeds for a period of three years before the seeds can be released to market. Industry has found this certification process to be tedious and restrictive.

GOVERNMENT PROCUREMENT

The Public Procurement Directorate in the Finance Ministry is the central organ for policy formulation, implementation, and oversight of the public procurement process in Kenya. The Directorate monitors the overall functioning of the public procurement process in Kenya and submits proposals for action to the Minister. Regulations require establishment of Ministerial or District Tender Committees (MTCs or DTCs). The Accounting Officer (the permanent secretary for ministries and the chief executive for corporations) chairs and directs the procurement process for goods worth less than Ksh 500,000 (about $6,400), according to the Exchequer and Audit (Public Procurement) Regulations of 2001. Tenders for goods and services exceeding that amount are supposed to go through the MTC or DTC. The MTC and DTC review tender documents and requests for proposals where the estimated value exceeds Ksh 1 million (approximately $12,800). The chairman can veto any committee decision. Any veto is supposed to be reported to the Public Procurement Complaints, Review and Appeals Board. The Minister of Finance appoints a chair of the Board from the private sector. Board decisions are final unless judicial review action is commenced within thirty days under any existing written law concerning judicial review of administrative decisions.

Any member of a procuring entity, the Public Procurement Directorate, or the Appeals Board who breaches regulations, is subject to a fine not to exceed Ksh 2 million (about $25,600). A corporation that violates the regulations is subject to a fine not to exceed Ksh 5 million (approximately $64,000). In 2003 the government proposed the Public Procurement and Disposal Bill to establish the Public Procurement Oversight Authority. The bill aims to make procurement more transparent and accountable and would require procurement agencies to carry out an annual update of pre-qualified firms, especially when dealing with restricted tenders such as military tenders. The bill as drafted does not address one common area of potential abuse by which government property is significantly undervalued for disposal to private entities. To date, Parliament has not voted on this important legislation.

Despite continuing concerns about transparency in public procurement, there has been some improvement in this area in recent years. For example, the government increased transparency in bidding by removing from its tenders the clause that read, “the government reserves the right to accept or reject any bid and is not obliged to give any reasons for its decisions.” The Central

Tender Board (CTB) now publishes its decisions and, if the bidder asks, provides reasons for rejecting certain bids.

Nonetheless, the public procurement system remains an area of considerable controversy. The World Bank, IMF, European Union, and other donors have conditioned some of their official assistance programs, including direct budget support, to reform of public procurement and privatization. Tenders are frequently manipulated and awarded to noncompetitive firms in which government officials have a significant interest, and conflict-of-interest regulations are rarely enforced. Cases have been reported in which tender specifications are tailored to favor one firm. In November 2003, a tender worth over $190 million involving procurement of Kenya Ports Authority cranes was cancelled after it was established that three Kenyan cabinet ministers had, by seeking postponement of the tender, interfered in the tender process. In early 2004, press reports exposed two procurement scandals involving government officials and a previously unknown international financing company, Anglo Leasing and Finance, Ltd., involving over $90 million in secret, single-source contracts for security-related items. Although two permanent secretaries were sacked following the scandals, Cabinet Ministers and other senior government officials alleged to have been involved in the deals have not been indicted. Similar cases involving corruption and tendering for insurance of public property have been reported.

In May 2003, the government suspended more than 1,000 procurement officers after an internal audit found massive and widespread irregularities in government tendering and procurement. Since that time, many of the same officers were brought back to work so that the government could function and there have been no more significant changes in government procurement procedures. Kenya is not a signatory to the WTO Agreement on Government Procurement.

EXPORT SUBSIDIES

In 2001, Kenya established the Manufacturing Under Bond (MUB) program to encourage manufacturing for export. The program is open to both local and foreign investors. Enterprises operating under the program are exempted from duty and VAT on imported raw materials and other imported inputs and have 100 percent investment allowance on plant, machinery, equipment, and building. Firms operating in Export-Processing Zones (EPZs) are exempted from all withholding taxes on dividends and other payments to non-residents during the first 10 years. They are also exempted from import duties on machinery, raw materials, and intermediate inputs. There are no restrictions on management or technical arrangements, and EPZ companies are allowed expedited licensing procedures.

EPZ firms are allowed to sell up to 20 percent of their output on the domestic market. However, EPZ firms are liable for all taxes on products sold domestically plus a 2.5 percent penalty. There is no general system of preferential financing, although sectoral government development agencies in areas such as tourism and tea are supposed to provide funds at below-market rates to promote investment and exports.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Kenya is a member of most major international and regional intellectual property conventions – the World Intellectual Property Organization (WIPO), the African Regional Industrial Property Organization, the Paris Convention for the Protection of Industrial Property, and the Berne Convention on the Protection of Literary and Artistic Works.

The Kenyan Parliament passed an amended version of the Kenya Industrial Property Act, which came into force in June 2002, in an effort to make the Act compliant with Kenya's obligations under the WTO Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement.

An amended Trademarks Bill was passed in August 2002. The bill provides that goods and services for which application is made for registration of a mark shall be classified in accordance with the Nice Classification System for Goods and Services. The amended bill is designed to be in conformity with the Madrid Agreement and Protocol as well as the TRIPS Agreement. The government has drafted a "Layout Designs of Integrated Circuit Bill" and circulated copies to stakeholders and the WIPO for comments.

An amended Copyright Bill came into force on February 1, 2003. Computer programs, sound recordings, broadcasts, and literary, musical, artistic, and audiovisual works are protected under the Act. The Act created the Kenya Copyright Board, which was established in July 2003 with a broad mandate for assuring that Kenya is in compliance with TRIPS. The Board also coordinates all licensing and treaty activity and has the authority to inspect, seize, and detain suspect articles and to prosecute offenses. Violation of copyrights, especially on music and films, is pervasive, and enforcement remains sporadic at best. Kenyan artists have formed organizations to raise awareness of intellectual property rights and to lobby the government for better enforcement, but merchants are still free to peddle pirated versions of Kenyan and international works without fear of arrest or prosecution. Pirated materials and counterfeit goods produced in other countries are readily available in all major towns in the country. These materials include pre-recorded audiocassette tapes, videocassettes, CDs, and consumer products. Although the exact amount is not available, in June 2004 the Kenya Revenue Authority, through a newly created Counterfeit Department, said the illegal trade costs the Kenyan economy an estimated Ksh 20 billion (about $256 million) in unpaid taxes. Imported drugs, shoes and textiles, office supplies, tubes and tires, batteries, shoe polish, soaps and detergents are the most commonly counterfeited items. Historically, however, penalties and enforcement for copyright infringement have been low. General understanding of the importance of intellectual property is very limited.

SERVICES BARRIERS

In general, individuals and companies supplying services, whether local or foreign, are accorded the same treatment. However, foreign companies offering services in construction, engineering, and architecture may face discrimination on tenders for public projects. New foreign investors

with expatriate staff are required to submit plans for the gradual phasing out of non-Kenyan employees. In 1999, the government of Kenya increased fees and security bonds under the Immigration Act by 50 percent to 100 percent in an attempt to discourage the employment of foreign labor. The Kenyan bar admits foreign lawyers for a maximum duration of 12 years. Medical doctors must serve a one-year "induction" in the public hospitals and sit for exams before they are considered for registration in the country.

Since 1995, the government has privatized some government assets through the sale of state-owned tourist facilities, the flotation of shares of state-owned financial institutions on the Nairobi Stock Exchange, and the off-loading of government shares in the Mumias Sugar Company. After awarding a tender for the sale of Kenya Reinsurance Corporation (Kenya-Re) in October 2002, the government suspended the sale. The government has indicated its intention to offload 10 percent of its 35 percent stake in Kenya Commercial Bank although there is no deadline set for this.

The government of Kenya has been hesitant to open public infrastructure to competition because the state-owned companies that control infrastructure are considered "strategic" enterprises. As a result, the reform and partial privatization of telecommunications, power, and rail has fallen behind schedule.

Telecommunications

In July 1999, the government dissolved the Kenya Posts and Telecommunications Corporation, under the Kenya Communications Act of 1998. Three separate entities were then formed: Telkom Kenya (telecommunications); the Communications Commission of Kenya (CCK), the regulatory body; and the Postal Corporation of Kenya (postal services). In January 2005 the Government ended Telekom Kenya's monopoly on Very Small Aperture Terminals (VSATs), Internet bandwidth, and most landlines and has licensed a number of competing firms. In July 2004 the Minister for Information and Communications halted the awarding of a second national operator (SNO) for fixed-line telephone service, citing irregularities in the tendering process. The government announced at the time that a new bidding process for the SNO would be announced later, but this had not yet occurred by year's end. In August 2001, the government announced that three Kenyan firms had succeeded in acquiring the rights to operate eight regional licenses in competition with Telkom Kenya. Telair Communications landed five of the eight licenses for a reported $23 million. Safitel netted two regional licenses for $9 million, and Bell-Western acquired the remaining regional license for $25,000. However, these regional entities have not begun operations. As a result, the government has said it will cancel their licenses while the firms argue that changes in circumstances merit renegotiated contracts.

The CCK has licensed two firms, Safaricom (a joint venture of Telkom and Vodafone) and Kencell (a joint venture of Vivendi and Sameer Investments), to provide mobile cellular telecommunications. These two companies have well over 2.8 million subscribers (as of September 2004), almost twelve times the 240,000 landlines provided by Telkom. In fall 2003,

the government awarded a tender to a third mobile operator, Econet Wireless, but the award has been challenged in court.

After more than one year of negotiations to sell its 49-percent stake in Telkom Kenya, the government cancelled the sale in late 2001. In an October 2004 draft National Information and Communication Technology Policy, the government proposed major changes in the sector, including further restructuring Telkom Kenya prior to its privatization in 2005. The government's failure to privatize Telkom Kenya and sell Kenya-Reinsurance (Kenya-Re) has cast doubts on the willingness of the government to privatize other parastatals, such as the Kenya Ports Authority and the Kenya Railways Corporation. The government says its draft Privatization Bill, published in November 2003, will lay the framework for privatization. Although the government has often indicated that the Privatization Bill is an economic policy priority, the bill is unlikely to be passed before mid-2005 at the earliest.

The Communication Commission of Kenya (CCK) regulates telecommunications and radio communications in the country. As of April 2004 there were 73 registered ISPs, but only 16 were actively providing commercial service. Foreign ownership of an ISP is restricted to 40 percent. June 30, 2004 marked the end of exclusivity granted to Telkom Kenya in the provision of certain segments of telecommunication services. The Commission developed a new licensing approach to address challenges and create opportunity for additional players to provide various communication services under a competitive environment. The new approach provides equal licensing opportunities to all players on a first-come-first served basis subject to the potential licensees demonstrating adequate capacity to provide the services for which they are seeking licenses. The new regulatory strategy:

- allows cellular mobile operators (GSM) to construct and operate their own international gateways if they choose, a move necessitated by the need for diversity in international links, high traffic volumes, the need to expand and better manage roaming services including General Packet Radio Service (GPRS) roaming;

- provides for the licensing of additional Internet Backbone and Gateway Operators, Broadcast Signal Distributors, and Commercial VSAT Operators on a first-come, first-served basis;

- allows Public Data Network Operators (PDNOs) to establish International Gateways for data communication services; and

- allows Internet Backbone and Gateway Operators, Broadcast Signal Distributors, Commercial VSAT Operators, and Public Data Network Operators to carry any form of multimedia traffic such as Voice Over Internet Protocol (VOIP.).

Power Generation and Distribution

The Kenyan government split the Kenya Power and Lighting Company (KPLC) into three entities in 1997: a power generator (KenGen); a distributor (KPLC); and a regulator, the Electricity Regulatory Board (ERB), to regulate retail tariffs and to approve power purchase contracts between KPLC and producers. The government also licensed Independent Power Producers to sell electricity to the grid. In late 2001 the ERB commissioned a study to review electricity tariff policy. The draft report was presented to key stakeholders in January 2002 recommending an upward adjustment of electricity tariffs to make the struggling KPLC profitable. The study recommendations are yet to be implemented. In June 2004, the ERB released new rules to govern future operations as part of the ongoing reforms in the sector. The first set, Electricity (Licensing) Rules, 2004 governs power production, local generating, transmission, distribution and supply licensing. The second is the Electric Power (Metering and Consumer Installations) Rules 2004 that covers rights of both customers and electricity supplier. Electric Power (Electric Supply Lines) Rules 2004 allows the public utility to install and access power lines on any property upon appropriate agreement. The rules are enforced alongside the Kenya Electricity Industry Safety Code that spells out obligations of the industry players in ensuring safety. In May 2004, the ERB proposed a new code seeking to end the distribution monopoly of KPLC, although transmission is to remain the preserve of KPLC. The draft Kenya Electricity Grid Code says among its key principles is "to promote competition wherever practicable and facilitate a commercial environment" leading to competition among distributors for contracts with the transmission entity.

Railways

The Kenya Railways Corporation has contracted for the maintenance of all of its locomotives to General Electric. The corporation has restructured its operations and recruited senior management from the private sector in the hope of turning the loss-making company into a profitable entity. The government has indicated it would like to contract with a private company to operate the railway, but plans for privatization seem to have stalled. However, a joint concessioning of the Kenya-Uganda Railways is moving forward. By the end of October 2004, five companies that had presented bids for the undertaking had been cleared. Among the firms bidding to run the two railways for the next 25 years include the U.S.-based Railway Development Corporation.

INVESTMENT BARRIERS

The Kenyan government maintains some restrictions on foreign ownership of publicly traded companies and companies in the financial services and telecommunications sectors. In June 2002, the rules were amended to allow up to 75 percent foreign ownership (personal or corporate) of firms listed on the Nairobi Stock Exchange (NSE). If foreign ownership in a company is 75 percent at the time of listing on the NSE, the foreign owner is allowed to maintain (or reduce) but not to increase its share. Foreign investors may be allowed to increase their

investment with prior written approval from the Capital Market Authority if the shares reserved for local investors are not fully subscribed. Foreign brokerage companies and fund management firms must be locally registered companies, with Kenyan ownership of at least 30 percent and 51 percent, respectively.

The legal system protects and facilitates acquisition and disposition of all property rights, including land, buildings, and mortgages. Foreigners are not allowed to have a freehold title anywhere in the country. However, leasehold titles -- normally 99 years for land in towns and coastal beachfronts and 999 years elsewhere -- are allowed. The cumbersome and opaque process required to purchase land, and concerns about security of title because of past abuses relating to distribution of public land, constitute serious impediments to new investment. Lack of confidence in the speedy and fair resolution of disputes, and requests from officials for illicit payments, continue to dampen the country's ability to attract more foreign investment.

The Kenyan government says it would like to attract foreign investment, and has taken some steps to improve the investment climate. Private investment, however, has responded slowly to the reform measures. The share of investors who perceive the investment climate to be deteriorating outnumbers the share who perceive it to be improving, according to a recent World Bank study. If Kenya is to attract meaningful foreign investment it will need to address rampant corruption; degraded road, rail, and telecommunications infrastructure; relatively high energy costs; and inefficient government expenditures. In December 2004, the government enacted the Investment Promotion Act, which is expected to streamline administrative and legal procedures.

The government has begun to restructure the financial system and taken measures to increase the role of the private sector and to establish greater accountability and transparency. A managed, floating exchange rate regime has been adopted, and companies may retain foreign exchange earnings and repatriate capital and profits without certification. Technology transfer requirements have been abolished. Local partners are encouraged but not required. Kenyan partners are no longer required for small-scale commercial enterprises.

OTHER BARRIERS

Although the new Kenyan government undertook some noteworthy anti-corruption measures in the first half of 2003 -- including enactment of two key anti-corruption bills and a much-lauded purge of corrupt judges and magistrates -- there are concerns among donors and others that progress in this area has stalled. In September 2004, the government finalized the long-awaited establishment of the Kenya Anti-Corruption Commission when President Kibaki approved the appointment of the director and three assistant directors. On December 20, 2004, the IMF, based on its first review of Kenya's economic performance under a three-year Poverty Reduction and Growth Facility arrangement, which was originally approved on November 21, 2003, approved a $76.9 million disbursement for Kenya based on the Board's assessment that Kenya is making adequate progress on its economic reform agenda. At the same time, the IMF noted that

corruption in Kenya remains a concern for business, potential investors, and donors, and that Kenya needs to make more progress in this area to restore donor and investor confidence.