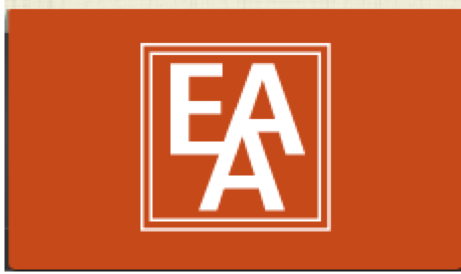


**WORLD TRADE**

**THE PLIGHT OF FREE TRADE**

Most economists agree that the benefits of free trade and globalisation have generally been advantageous to the global economy, dragging up living standards across the world. As more goods and services are exchanged, people get richer and the trend has been for growth in trade and GDP to go hand in hand.

However, free trade is now under attack from a new breed of populists, with the US possibly leading the way. Donald Trump, the Republican Presidential candidate, has railed against the accepted orthodoxy, accusing parties such as China "of the greatest theft in the history of the world". He does not believe that US openness with the rest of the world is a benefit. Both his potential Democratic opponents, Hilary Clinton and Bernie Sanders, have been equally sceptical and critical of the free-trade deals that have been negotiated or are in the process of being negotiated.

Against this backdrop of an increasingly hostile political climate, global trade growth has seemingly hit a wall. For the past five years, trade has grown more slowly than the global economy, a phenomenon unheard of since the Second World War. The pace of globalisation seems to have stalled and the sort of gains seen in the 1990's, a period when trade proliferated at breakneck speed, may not occur again.

The hiatus has now been going on for so long that it cannot any more be dismissed as a temporary business cycle. Growing protectionism may have played some part but it is plainly not the main reason. Many have concluded that the big surge in globalisation, which saw emerging markets entering the global economy for the first time and many companies globalising their supply chains accordingly, may have come to an end. However, whilst the trade in goods and services may have slowed, the digital economy is growing like Topsy, leading to an ever more connected world. Such digital flows were practically non-existent 15 years ago but now exert a greater impact on GDP growth than centuries-old trade in goods. As a consequence, protected single markets such as the EU and the US look increasingly less relevant in promoting trade.

As ever, politicians and officials are several steps behind the market. Furthermore, a growing populism now threatens to imperil deals that have been years, even decades, in the making. Many European voters are voicing opposition to the Transatlantic Trade & Investment Partnership (TTIP) between the US and the EU and various separatist movements have gained traction there, from Scotland to Catalonia. Falling commodity prices have led to a backlash against cheap Chinese steel and there are growing calls for protectionist measures to be implemented.

Whilst most economists do indeed agree free trade brings many benefits, they also agree that these are not always shared evenly, which has contributed to the public's aversion. The anti-trade stance of both Clinton and Trump could put the final nail in the coffin of the Trans-Pacific Partnership (TPP), a

trade deal between the US and 11 Asian economies that was only recently negotiated, as well as the deal with the EU, which now seems unlikely to progress.

By historical standards, restrictions on the trade of goods are already very low, as are duties and tariffs. Modern arrangements now seek to reduce further barriers to trade, such as so-called "non-tariff barriers" (NTB's), involving laws, regulations and standards. The trade deals that are being negotiated focus on the harmonisation of the swathes of regulation that already exist so that companies wishing to export do not have to jump through the same bureaucratic hoops twice – in their own country and the one they are intending to export to – in order to do so. These deals tend to be more beneficial to large international corporations but they can be quite harmful to small and medium-sized enterprises, which tend to struggle with the extra regulatory burden. However, the potential economic gains from these agreements may never materialise if popular hostility to them continues to grow. Negotiations are made especially complex by the various vested interests involved and the principle of "nothing is agreed until everything is agreed".

Getting one side to budge on one area of contention might mean that a trade-off has to be made elsewhere and compromises are inevitable.

With goods tariffs already low, negotiations are increasingly turning their attention to liberalising trade in services, which often comes hand in hand with the movement of workers from economy to economy. Achievements in this area are more difficult to measure and could explain why global trade growth has stalled.

Cultural boundaries are inevitably tested and rising fears about technological changes making many workers redundant, as well as a desire to protect workers in the West from global competition, all add to the complex mix. It is becoming increasingly clear that there is unlikely to be much consensus politically, whatever benefits economists believe should be possible.

A further criticism of traditionally-farmed free-trade agreements is just how out of date they already are. The nature of trade is changing in ways that have left regulations and politicians trailing in their wake. Free trade is alive and well but these days it is being championed by the digital economy, which trade agreements like TPP and TTIP barely touch on. One therefore has to question how relevant such elaborate treaties are to the modern trading environment, given all the hype and tortuous negotiations that tend to surround them.

**AFRICAN TRADE AND INVESTMENT**

Only a few years ago, people were queuing up to do business in Africa. Private-equity funds dedicated to the continent raised huge sums and traders salivated at the prospect of selling goods to Africa's growing middle class. Mining companies sank billions into African soil to feed China's appetite for oil and minerals. Now, investors are becoming increasingly glum, and, in the short term, they are right to worry. However, the potential rewards from a market of over one billion people are too good to ignore, despite the undoubted risks.

For decades, sentiment about Africa followed commodity prices, rising and falling in close correlation. The recent sudden and rapid decline has caused a steep drop in the ratio of the price of exports to those of imports in many countries and growth across the whole continent is expected to slow to about 3% this year, down from 7-8% a decade ago. This is barely above the rate of population growth and some countries, mainly oil exporters, will probably require IMF bailouts within the next 12 months.

However, commodity busts do not last forever and they do not hurt everyone – seventeen countries, several in Eastern Africa, which has a quarter of the continent's population, will enjoy a net benefit,

thanks to cheaper energy. By focusing too much on oil, gas and minerals, it is easy to miss some important trends that are happening above ground – and these are mostly positive.

The first is that most African countries are more peaceful than they were a decade ago, despite a few obvious exceptions, and they are also mostly far more democratic. Now, nearly all face regular elections, however flawed, and the process is improving because they are becoming more difficult to rig thanks to social media. Voters have real choices, which is one reason why economic policies have improved. Inflation has largely been tamed, most central banks are reasonably independent and efforts are being made to improve the business environments by cutting red tape.

Five of the ten fastest reformers in the World Bank's latest report on doing business are African and better government is mainly what has led to improved economic performance.

Poverty levels have fallen, primary school enrolment has risen and mortality rates have declined significantly. Some pessimists argue this progress will reverse now that Africa faces economic headwinds and there are undoubtedly some worrying signs, particularly in Nigeria and South Africa, the continent's two dominant economies. However, most countries are now following reasonably sound economic policies, trying to control government deficits and keeping inflation in check. Moreover, there is a growing momentum for further reform, with efforts to clamp down on corruption and trim bloated civil services. Foreign direct investment continues to flow into many countries as a result of these reform efforts but the continent's future is in the balance.

Where it goes from here very much depends on the various country leaders, who need to adjust to some new realities – a decline in their terms of trade, resulting in reduced buying power, and on how to maintain the progress made on improving the basics of doing business. Bad roads, congested ports and cities, a chronic shortage of energy, grasping officials and tariff barriers that still hinder trade between African countries all need to be tackled head on.

At the recent World Economic Forum held in Kigali, delegates emphasised that African countries must reduce the barriers to trade between them and make it easier for people and goods to cross borders to boost growth in the face of headwinds being experienced from the commodity price drop. As "integrated regional markets in Africa develop" the AfDB President said "the susceptibility of Africa to these global commodity price stocks will reduce". Trade between African nations accounted for just 11 % of the total, compared with nearly 40% in Asia and 70% in Europe. There are some positive signs but high tariffs and non-tariff barriers continue to be major obstacles. If there was a real willingness to dismantle these trade barriers, there would be growth gains regardless of what was happening in the rest of the world because of broader markets". The EAC has moved further than most trading blocs, but much more still needs to be done.

The future rests on the productivity of the continent's people and, given good governance, they will prosper. By 2050, the UN predicts that there will be 2.5 billion Africans, a quarter of the world's population. If the continent is to slip backwards into stagnation, the consequences are too dire to imagine.

**KENYA**

**BUSINESS SECTOR REVIEW**

Who is doing well?

Coffee export proceeds are up following an increase in demand and prices too have risen, by around 5%, especially for top quality beans.

Tea prices are down internationally, which clearly affects Kenya's exporters. This is coupled with worrying concerns, and curtailed new investment by tea multinationals, over the whole issue of land tenure, following a Supreme Court ruling to reduce ownership to 99 years from the previous 999 years. For the record, in this context, the current Constitution empowers County Governments to decide whether or not to renew all land leases.

Flower and horticultural producers for export are currently doing reasonably well, but, and a very big but, are faced with the challenge of whether or not the EPA (Economic Partnership Agreement) concessions with Europe will be successfully re-negotiated from 1st October this year. There is a rising concern that the Kenya Government, as before, is leaving these discussions to be very last minute, and could, if the agreement fails, prejudice the whole industry.

The oil exploration sector activity is well down this year compared to last, and Tullow says its spending this year will drop to Kshs1.2 billion (US$12 million) from Kshs7.9 billion (US$79 million) in 2015 – for two key reasons; the drop in global oil prices and secondly, because of no practical means either to refine or transport crude product to the coast.

Tourism, however, shows some signs of improvement, albeit modest. The prospect of additional direct charter flights from Europe into Mombasa is encouraging coast hoteliers; put bluntly, anything is better than last year.

Turning to the financial services sector

Insurance companies are facing very difficult times; the publication of their 2015 accounts reveals that few generate profit from their basic underwriting activities and all rely heavily on the returns they can make on invested funds. The slump in the Nairobi Stock Exchange has thus had a major impact on profits, and continues to do so.

The banking sector too is faced with challenging times. With the collapse last year of Imperial Bank and this year Chase Bank, public confidence has been upset. The result inevitably is that overall growth in the sector has stagnated, aggravated by an unprecedented increase in non-performing loans across the industry. Manufacturing and retail enterprises are holding their own, but with difficulty. And so, where will 2016 growth stem from?

Mobile phone activity, certainly. Voice and data transmission activity continues to rise, as does the volume of mobile transfer of monies within a market dominated by one player.

Construction activity too is booming – the growth displayed in 2015 is continuing into 2016, and contributes to around 13% of GDP. Power demand has fallen, allied inevitably to the reduced offtake by business as a whole.

And that is about it – perhaps it answers why Kenya's GDP continues at around 5.5% rather than the 8% or 9% that many feel is achievable.

## UGANDA

### THE ECONOMY

The latest economic statistics indicate a slowing down of the Ugandan economy to a growth rate of 4.6% from the projected 5% per annum. This is attributed to significant declines in industrial activity, which fell from 11% to 0.4%, and manufacturing, which fell from 7.8% to 3%. Foreign direct investment in Uganda also fell. Some growth was recorded in agriculture, from 2.3% to 3.2%, the service sector from 4.5% to 6.6% and construction from 2.5% to 5.7%. However, these improvements

will be insufficient to offset the fall in projected tax revenue resulting from the overall reduction in economic activity.

This decline will put public finances under even greater pressure. Currently the country's total public debt is UGShs24.9 trillion (US$7.6 billion). In 2015-16, the Government borrowed UGShs5.6 trillion (US$1.7 billion) to help fund the Budget. The National Budget Framework Paper projects that, in the next financial year, borrowing will rise to UGShs6.7 trillion (US$2.1 billion), to cover the shortfall in revenue and rising costs. Over 60% of Uganda's debts of UGShs15 trillion (US$4.6 billion) are with foreign lenders, primarily the Chinese. Most are on concessionary terms, but even so, cost an annual US$74 million to service.

Uganda is climbing rapidly up the table of most indebted countries, but in official government circles there is a worrying complacency about this growing financial burden, which now stands at a 40% debt to GDP ratio. The Ministry of Finance says it is not a problem because it is below the 50% threshold set by the EAC. However, it fails other EAC and international yardsticks for testing a country's ability to repay loans.

Another disturbing statistic is that US$71.6 million, the equivalent of 10% of the national budget, was spent by candidates on their general election campaigns, 90% of which was by the President and his ruling NRM. There was no disclosure as to how this money was raised and therefore strong suspicion that it was drawn illegally from the Consolidated Fund. It also demonstrates a cynical disregard for Uganda's long term interests in favour of selfish immediate advantage.

There are signs that even the Chinese, who have their own economic travails, are beginning to have reservations about Uganda's ability to repay existing loans. It is reported that the Chinese Export/Import Bank is holding back from approving a new US$2 billion loan for the construction of a Standard Gauge Railway link from Kampala to Kenya until they are satisfied it would be economically viable. They rejected the first feasibility study produced by the Ugandans as failing to make a convincing business case for the railway. It is understood that the Chinese are also waiting for the completion of the Karuma and Isimba hydro-power projects, for which they have already lent US$3 billion, to see if they generate sufficient revenue to repay the loans.

The new Chinese caution will have the effect of delaying work on the railway from the projected period 2018 to 2020 (if it goes ahead at all). It is also embarrassing for President Museveni, who, as mentioned above, in his inaugural speech not only did he specifically praise the Chinese as true friends of Uganda, but referred to the construction of the railway as one of the key future contributors to the country's progress to middle income status.

There is some better economic news. The bank rate has been retained at 16%, after the reduction in April. Inflation is up marginally month on month – headline 5.1% to 5.4%, core 6.4% to 7.0% - but both remain within the Bank of Uganda targets. The Ugandan Shilling remains stable at UGShs3360 to US$1. The banking sector, after some buffeting and downsizing, has stabilised, although commercial lending rates in the mid to high 20% range remain a disincentive to SME start-ups and new industrial and manufacturing investments.

The business community is understandably relieved that their worst fears of civil unrest during and after the elections have not been realised. However, there is very little confidence in the Government and its ability to effectively manage the economy.