Introduction

In late March 2012, Kenya entered the East African oil scene with a surprising splash. After decades of unsuccessful on-and-off exploration by international oil companies, Tullow Oil, a UK-based firm, discovered oil in Kenya's north-west Turkana County. Quite unceremoniously, then President Mwai Kibaki announced the find at the end of a planned speech on performance evaluation results for public agencies: 'I wish to make an important announcement to the nation ... This morning, I have been informed by the Minister for Energy that our country has made a major breakthrough in oil exploration … This is the first time Kenya has made such a discovery and it is very good news for our country. It is, however, the beginning of a long journey to make our country an oil producer…'[1]

This paper analyses the opportunities and challenges facing Kenya's oil industry and role as a regional oil transport hub. First, it provides a snapshot of Kenya's political and economic environment. Second, the paper offers a comprehensive overview of the development of Kenya's oil industry, from exploration to the upcoming production phase, the main players, and the possibilities for regional oil infrastructure in cooperation with neighbouring countries in East Africa. Finally, the paper considers the potential political risk from new rules and regulations, the social risk from relations with local communities and officials in Turkana County (where oil has been discovered), and the security risk facing oil industry and regional infrastructure plans. The paper does not fully engage questions revolving around the 'resource curse' in Africa – concerning how oil will impact Kenya's economic, political, and social development. Rather it does the reverse, by examining how Kenya's political economy and security environment will impact the industry in the future.

Kenya Overview

Economic aspirations

Kenya is the economic centre of East Africa. It has the largest economy in the East African Community (Figures 1 and 2) and one of the largest in Africa. It also has one of the most diverse economies on the continent. Tea, coffee, and other agriculture, alongside tourism and services, are a major part of Kenya's economic success story (Figure 3). This is in sharp contrast to other large African economies where oil, gas, and minerals dominate. On the back of growth in tourism and telecommunications, Kenya enjoyed average annual growth rates of 5.4 per cent between 2002 and 2007.[2] The economy was unsettled by the insecurity that followed the 2007 general elections, but it has picked up pace again in recent years. In 2014, international investors demonstrated their confidence in the economy when Kenya raised $2 billion in its first sovereign bond offering, a record-breaking debut for an African country.[3]

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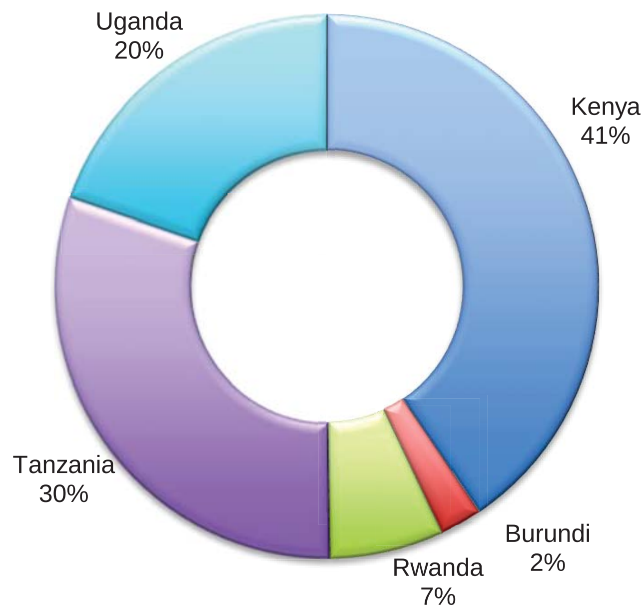
[1] 'Speech by his excellency Hon. Mwai Kibaki, C.G.H., M.P., President and Commander-in-Chief of the defence forces of the Republic of Kenya during the official announcement of the evaluation results of the performance of public agencies for the financial year 2010/11', Kenyatta International Conference Centre, Nairobi, 26 March 2012, statehousekenya.go.ke, accessed 23 July 2014.

[2] Geir Sundet & Eli Moen, 'Political Economy Analysis of Kenya', Norwegian Agency for Development Cooperation, Oslo, 2009, 10.

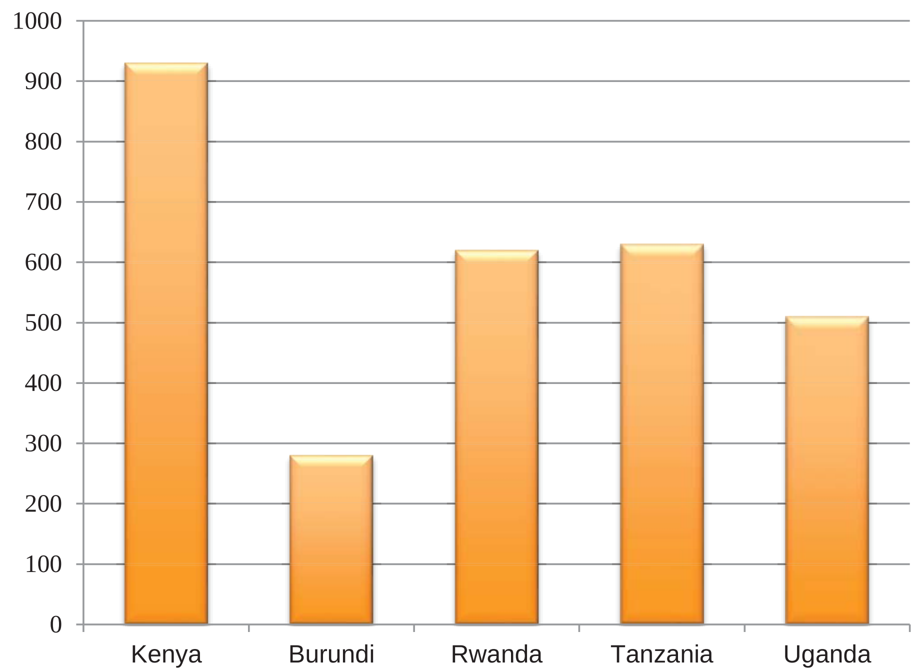
[3] Katrina Manson & Javier Blas, 'Kenya's debut $2bn bond breaks Africa record', *Financial Times*, 16 June 2014.

Figure 1: East African Community – GDP billion (USD, 2013)



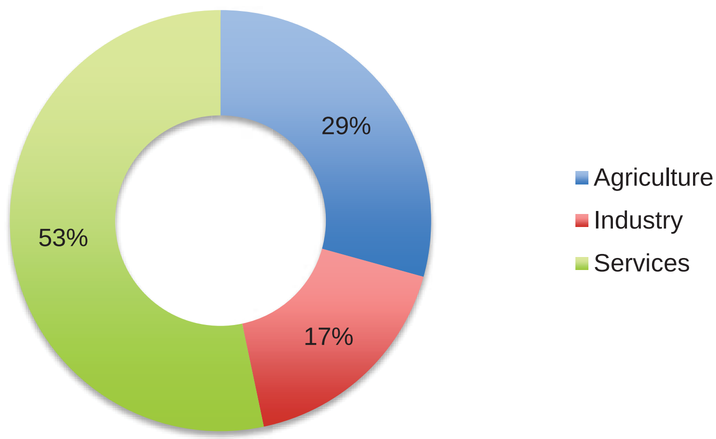
Source: World Bank

Figure 2: East African Community – GNI per capita (USD, 2013)



Source: World Bank

Figure 3: Economic Structure, Kenya 2013



Source: CIA – The World Factbook

Kenya's economic strength is bolstered by its strategic position in East Africa. It is the main entry and exit point for trade from landlocked East and Central African countries – Uganda, Rwanda, Burundi, and South Sudan. Uganda was its largest export partner in 2013, accounting for 13.6 per cent of total Kenyan exports.[4] Mombasa is East Africa's largest port, followed by those in Tanzania and Djibouti. Kenya is seeking to exploit its strategic location on the Indian Ocean further by leveraging its relative proximity to large and growing Asian markets, particularly those in India and China which are Kenya's largest import partners, representing 14.2 per cent and 12.2 per cent respectively of total imports in 2013.[5] Kenya is also the financial and communications hub for East Africa. 'Silicon Savannah', an initiative to establish a major techno-city in Konzo, 40 miles outside Nairobi, seeks to make Kenya East Africa's technology hub as well. IBM established its first African research lab in Nairobi, while Google, Microsoft, and Intel also have regional headquarters there.[6]

Kenya's diversified economy needs substantial infrastructure development in order to industrialize. In 2008, the Kenyan government under then President Mwai Kibaki established Vision 2030 to modernize Kenya and make it a middle-income country. One of the flagship projects of the initiative is the $25 billion Lamu Port, South Sudan, Ethiopia, Transport (LAPSSET) Corridor. This seeks to establish road, rail, and oil pipeline links between the regional neighbours, airports, and resort cities at Isiolo and Lamu, as well as a new port at Manda Bay and a 120,000 barrels/day (b/d) oil refinery at Lamu.[7] The twin goals of this ambitious undertaking are to promote regional economic development and to develop northern Kenya (which has long been economically marginalized compared to central counties) and integrate it into the national economy.

Although there has been little progress in its implementation since the 2012 official launch of LAPSSET,[8] Kenya is also spearheading other related regional infrastructure agreements. President Uhuru Kenyatta hosted Chinese Premier Li Keiqiang in May 2014 and, alongside regional leaders

[4] Economist Intelligence Unit, 'Kenya', Country Report, EIU, London, 1 June 2014.
[5] Economist Intelligence Unit, 'Kenya', Country Report, EIU, London, 1 June 2014.
[6] Mwangi S. Kimenyi & Josephine Kibe, 'Africa's Powerhouse', Brookings, Opinion, 6 January 2014 www.brookings.edu/research/opinions/2013/12/30-kenya-economy-kimenyi, accessed 28 July 2014.
[7] 'Lamu Port and New Transport Corridor Development to Southern Sudan and Ethiopia (LAPSSET)', Progress Report, Kenya Vision 2030, Government of the Republic of Kenya, www.vision2030.go.ke.
[8] Drazen Jorgic, 'Kenya attacks undermine plans for east African trade hub', *Reuters*, 20 June 2014.

from South Sudan, Rwanda, and Uganda, signed an agreement to establish a new East African railway line. At nearly $4 billion, Chinese companies will build the first stage, a 610-kilometre line from Mombasa to Nairobi.[9] As a sign of Kenya's broadening international ties, the planned Chinese-built railway will replace the original line established during British colonial rule over 100 years ago. If Kenya is to continue to act as the gateway to East Africa in the face of outside competition (Tanzania is busy enhancing its own ports with Chinese cooperation), then such infrastructure projects will need to move forward.

The discovery of oil could help Kenya finance its large infrastructure needs. The current government, under Uhuru Kenyatta, included oil, gas, and mineral resources as a sixth priority sector within the economic pillar of Vision 2030; this seeks to harness oil to increase export earnings and produce higher GDP growth, broader social development, infrastructure development, and job creation.[10] The oil industry needs billions in infrastructure development investment if it is to act as a driver for Kenya's broader economic and social development goals. But over the past two years political and security tensions have risen dramatically, threatening to upend Kenya's economic aspirations.

Political and security challenges

It had been expected that 2013 would be a breakout year for Kenya – the country was turning a corner after having held largely peaceful general elections in March that year. Its new Jubilee government may have been dogged by the indictment of President Uhuru and Deputy President Ruto by the International Criminal Court (ICC) for their alleged role in the 2007/08 post-election violence, but a resurgent economy gave promise for the future. Jubilee pushed forward with former president Kibaki's Vision 2030 to modernize Kenya; the government was generally business friendly, engaging a younger generation of industrialists and entrepreneurs compared to previous governments.[11]

But 2013 would not be the year of stability and growth for which Kenya had hoped. The 2010 constitution stipulated the devolution of powers from the central government to newly constituted counties, but its full realization needed to overcome enormous systematic, structural, and political implementation hurdles. All the while terrorist attacks – prominent among which was the September 2013 massacre carried out by the Somalia-based militant group al-Shabaab at Nairobi's upscale Westgate Shopping Mall – have grown in Kenya's coastal and north-eastern regions. These attacks threaten to enflame and intermingle with long-standing animosities between communities in these regions and the central government in Nairobi, undermining the popular development aspirations put forward by the new constitution.

Oil and other resources will influence disputes between central authorities and counties and communities seeking to assert new-found powers stipulated by the constitution. Possible insecurity due to political and social tensions sits ominously alongside the oil industry's plans to move from the exploration to the development phase, combined with construction of key export infrastructure on the coast. The insecurity has hurt Kenya's tourism sector, one of its main economic engines and job producers. The World Bank downgraded its forecast on economic growth in 2014 and 2015 from 5.2 per cent to 4.7 per cent for both years on account of the insecurity.[12] A failure to grapple with these structural problems through fully implementing devolution, to settle the ICC indictment, and to tackle terrorism will undermine development.

Kenyan politics are ethnically and regionally-driven and are deeply embedded in business. Kenya has been described as an 'ethnocracy'; a democracy in which politics are steered along ethnic lines and

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[9] 'China to build new East Africa railway line', *BBC News*, 12 May 2014.

[10] 'Second Medium Term Plan 2013-2017', Kenya Vision 2030, Government of the Republic of Kenya, Nairobi, 2013, 68.

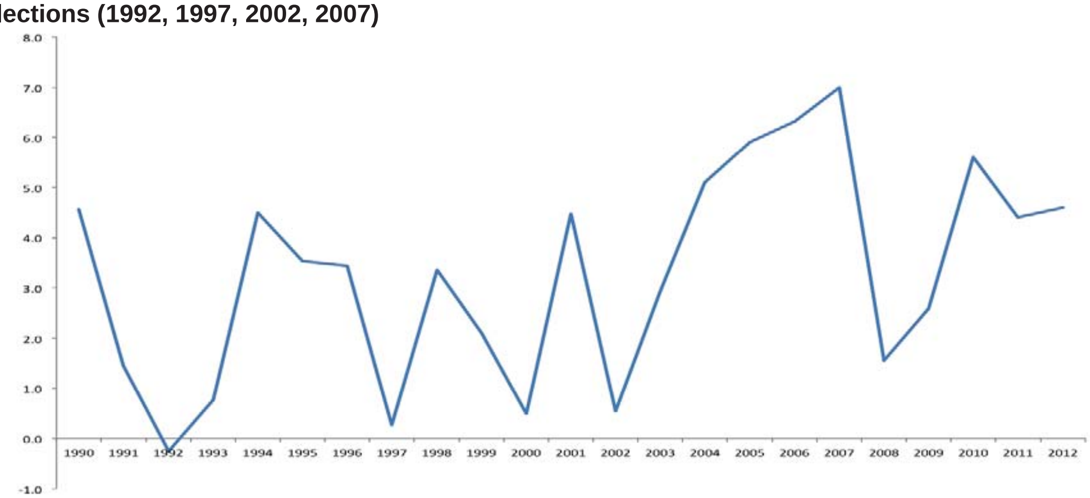
[11] David Booth, Brian Coosey, Frederick Golooba-Mutebi, and Karuti Kanyinga, 'East African prospects: An update on the political economy of Kenya, Rwanda, Tanzania, and Uganda', Overseas Development Institute, Report, May 2014, 22.

[12] David Malingha and Sarah McGregor, 'East Africa Powerhouse Kenya Shaken as Attacks, Politics Mix', *Bloomberg*, 8 July 2014.

coalitions, or 'tribal arithmetic' applied to form and structure the government.[13] The political culture is a product of the manner in which the British colonial administration limited political organization to specific regions in Kenya, to avoid the establishment of national movements; this served to ethnocize Kenyan politics early on.[14] The Kikuyu, roughly representing 20 per cent of the population, were the dominant group after Kenya's 1963 independence and remain so today. Kenya's first president, Jomo Kenyatta, the father of the current president Uhuru, established a patrimonial state where informal networks which formed around the president and ruling party rewarded clients with land, state contracts, and other preferential treatment.[15] After Daniel arap Moi became president in 1979, he set about shifting the centre of political and economic power away from the Kikuyu community and towards his Kalenjin community and Kenyan Asian business allies.[16] In 2002, the Kalenjin–Kenya–Asia alliance lost its strong position in politics and business after a coalition of opposition parties led by Mwai Kibaki, a Kikuyu, rose to power. This brought central political influence back to the Kikuyu community.

The political violence that followed the 2007 general elections dealt a serious blow to Kenya's political stability and growing economy. More than 1,000 people were killed and 650,000 displaced in the post-election ethnic fighting, which was mainly between Kenya's largest groups, the Kikuyus, Kalenjins, and Luo. An African Union mediation team led by former United Nations Secretary General Kofi Annan was able to broker a coalition government between President Kibaki and opposition leader Raila Odinga. But this was not the first time that election outcomes had sparked widespread violence and economic decline, political violence has been the norm rather than the exception in the lead up to and aftermath of Kenyan elections.[17] Since multiparty elections were established in 1992, the economy has suffered from periodic bouts of violence (Figure 4).

Figure 4: Kenya's annual growth rate (%) – illustrating economic decline and multi-party elections (1992, 1997, 2002, 2007)



Source: David Booth, Brian Coosey, Frederick Golooba-Mutebi, and Karuti Kanyinga, 'East African prospects: An update on the political economy of Kenya, Rwanda, Tanzania, and Uganda', Overseas Development Institute, Report, May 2014, 30.

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[13] Jeffrey Gettleman, 'Kenya's Future Clouds as Tensions Rise and Tourists Flee', *The New York Times*, 27 June 2014.
[14] Geir Sundet & Eli Moen, 'Political Economy Analysis of Kenya', Norwegian Agency for Development Cooperation, Oslo, 2009, 6.
[15] Geir Sundet & Eli Moen, 'Political Economy Analysis of Kenya', Norwegian Agency for Development Cooperation, Oslo, 2009, 1.
[16] David Booth, Brian Coosey, Frederick Golooba-Mutebi, and Karuti Kanyinga, 'East African prospects: An update on the political economy of Kenya, Rwanda, Tanzania, and Uganda', Overseas Development Institute, Report, May 2014, 13–15.
[17] Geir Sundet & Eli Moen, 'Political Economy Analysis of Kenya', Norwegian Agency for Development Cooperation, Oslo, 2009, 8.

The coalition government formed in 2008 succeeded in passing a new constitution in 2010; this strived to change the way in which Kenyan public affairs are managed and to repair the country's ethnocized and oft-violent political culture. It sets out to devolve political and economic decision-making from the presidency to 47 new counties throughout the country (Figure 5). The aim is to reverse the high regional inequalities and ethnic tensions that have mired politics and sparked violence since independence. These institutional changes are geared towards making government officials more accountable to local populations and addressing deep inequalities and grievances; between 2000 and 2010 Kenya's inequality levels were some of the worst in the world – higher than other budding African oil and gas producers such as Uganda, Mozambique, and Tanzania.[18] The restructuring of the entire fabric of how politics and business have functioned in Kenya for over a half century was to be a challenging endeavour.

In the 2012 general election then Prime Minister Raila Odinga faced off against Uhuru Kenyatta. It was again a close and contested election, but Uhuru prevailed and The National Alliance party formed a new government – the Jubilee Alliance – with William Ruto, a Kalenjin, leading the United Republican Party, as deputy president. Both Uhuru and Ruto were indicted by the International Criminal Court for their alleged role in inciting post-election violence in 2007/08. The ICC prosecutor's case, however, has been weakened by the retraction of statements and deaths of key witnesses, but the indictments may still drive a wedge between Uhuru and Ruto's political camps.[19]

While international oil companies are concerned about legal measures which may be taken by western governments if Kenya's leaders are convicted, in all likelihood Kenya's relationship with the USA and Europe will remain strong due to mutual regional security concerns revolving around al-Shabaab and other militant groups operating out of Somalia.[20] Kenya has, nonetheless, rebounded from the strained diplomatic relations with western countries caused by the ICC indictments to look east to China and other non-western partners for new avenues of economic engagement. Balancing between foreign partners, however, will not solve political divides at the national level.

The 2013 election outcome was no exception in Kenya's historical political trend. Kenyan politics remains polarized along ethnic-regional lines, with the Kikuyu/Kalenjin Jubilee Alliance in government and Odinga's CORD Alliance of Luo, Kamba, Luhya, and coastal groups in opposition.[21] Political tensions, corruption, poverty, and high levels of inequality are also still very real, and very challenging, hurdles to overcome. Devolution will remain a central feature of Kenya's political landscape in the coming years, especially in the lead up to new elections in 2017.[22] Important political questions on whether central authorities will fully implement institutional changes remain unanswered, as the process is in its early stages. At the same time, whether or not the counties will have the capacity and expertise to manage their new-found power is also unclear.

Devolution may only lead to the decentralization of Kenya's political troubles, including ethno-politics and corruption, to the local level, where more political officials are now in competition with one another. What is clear is that a failure to push forward with devolution and other key aspects of the new constitution by the central government will only heighten political tensions. But if Uhuru and Ruto were to move forward with implementing the new constitution, progress towards a more inclusive government is possible; this would strengthen the government's hand with both local constituents and western partners. The oil industry is set to develop midst this shifting political and security environment.

[18] Patricia I. Vasquez, 'Kenya at a crossroads: Hopes and fears concerning the development of oil and gas reserves', *Articles and Debates*, 4.3, International Development Policy, Graduate Institute of International and Development Studies, 2013, 7.
[19] 'Kenya, Chickens come home to roost', *Africa Confidential*, Vol. 55, No. 1, 10 January 2014.
[20] Andrea S. Pongo, 'Effects of the 2013 National Elections on Oil Exploration in Kenya', Institute for Defense Analyses, Alexandria VA, 2013, 7–8.
[21] David Booth, Brian Coosey, Frederick Golooba-Mutebi, and Karuti Kanyinga, 'East African prospects: An update on the political economy of Kenya, Rwanda, Tanzania, and Uganda', Overseas Development Institute, Report, May 2014, 27.
[22] David Booth, Brian Coosey, Frederick Golooba-Mutebi, and Karuti Kanyinga, 'East African prospects: An update on the political economy of Kenya, Rwanda, Tanzania, and Uganda', Overseas Development Institute, Report, May 2014, 31–2.

Figure 5: Kenya's new political constituencies

Source: Kenya Open Data, Government of Kenya