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How Inadequate Structural and Trade Policy Reforms in the Kenya Sugar Industry Have Threatened Its Survival in the Common Market of East and Southern African Region (Comesa)

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Abstract:
This paper examined why certain sectors have either delayed or halted regional trade liberalization because of domestic economic challenges in their sectors. Though the WTO promotes formation of regional blocs, questions abound, whether 'complete' trade liberalization really exists in regional blocs. The Kenya sugar industry, for instance, has delayed sugar trade liberalization in the COMESA region for some time. This paper interrogated how trade policy applied in the Kenya sugar industry contribute to the industry's inefficiency and lack of self sufficiency, and regional liberalization as a whole. Many a scholar has argued that an industry should realize a certain level of economic maturity before being integrated into regional or the global economy. On several occasions, Kenya has postponed the full integration of its sugar industry into regional sugar economy. The argument given is that the Kenya domestic industry is not ready for regional competition, and thus need time to reorganize and revamp it into a world class sugar industry. But despite several efforts, realizing this has been rather difficult. The researcher used questionnaires and interviews to collect primary data. Data was analyzed by use of descriptive statistics such as tables, frequencies and percentages, and presented in form of graph, pie charts and tables. The Kenya sugar industry lacked selected mercantilist trade policy that would otherwise propel it into a regional competitor and stakeholders agreed that it was time to change strategy. The findings of the study revealed that trade policy that apply to a sector determined its level of maturity and preparedness for either regional or global economic competition. The industry lacked support from the government in terms of fair taxation and infrastructure. Therefore, trade policy applied in the Kenya sugar industry was yet to promote self-sufficiency and efficiency in the industry, and its subsequent integration in regional sugar economy.

Keywords: *Regionalism, trade liberalization, integration, self-sufficiency*

1. Introduction
The emergence of vibrant regional economic blocs has caught same sectors of member countries off guard. Some member states, however, have invoked the WTO window period of ten years or staggered liberalization to allow smooth transition (Kwa, 2005). Several examples could be cited to this end, for instance, the NAFTA trade agreement eliminated trade barriers between the United States, Canada and Mexico was staggered for a 15-year period. The original agreement did not include sugar trade between US and Canada since this was covered by United States-Canada Free Trade Agreement of 1989 (Alvarez, 2009). There were situations where certain trade items were excluded from the list of items to be subjected to liberalisation. The bilateral agreement between the EU and South Africa was unique since sugar as a trade item was excluded among products to be liberalized.
In the COMESA pact, the removal of tariffs barriers happened in 2001 and all trade products originating from the eleven COMESA member-states were subjected to zero-border tariffs. Unfortunately, the application of uniform border tariffs almost brought the Kenya sugar industry to its knees. This brings into focus the Kenya sugar industry that operates in a regional environment where it does not enjoy a comparative advantage. Kenya has, on several occasions, negotiated for the postponement of domestic sugar industry's full integration into COMESA sugar economy. Sugar trade liberalization in the region as per the COMESA pact should have taken place

in 2001. But its implementation exposed the domestic sugar industries' in competitiveness when a majority of factories suffered major financial losses.

The economic state of the Kenya sugar industry could be understood in the context of Shafaeddin postulation that different levels of economic development or maturity of sectors or regions made it impossible for uniform tariffs to apply. He argued that the level of economic maturity, however, is determined by trade policy that applies among other factors. He argued that a universal and uniform tariff structure cannot apply across sectors or regions or countries (Shafaeddin, 2005).

That line of thought vividly explains why the Kenya domestic industry has struggled against counterparts in the region for quite some time. The Kenya sugar industry has lost its market share in liberalized regional sugar trade. On the other hand, COMESA partner states sugar industries increased their market share at the expense of the local sugar industry. Sugar industries in COMESA partner states are large and mature such that economies of scale are realized in their operations. This is contrary to the belief that infant or inefficient industries were found in the developing world and that; these industries could not compete with those in the developed world. Kenya sugar industry was established in 1927 and thus cannot be termed as infant. It is an established industry, but very inefficient. This means that the National Trade Policy of 1995 has not enabled the domestic sugar industry to compete favourably in the COMESA region (Republic of Kenya, 2009). The policy has not transformed the local sugar industry into a globally competitive industry. As a result, Kenya has remained a net importer of sugar and a high cost producer within the COMESA region.

2. Materials and Methods

The study was conducted in Kenya as a net importer of sugar. In the 2008/09 season, the average industry sugar production cost per tonne was USD 428 versus an estimated cost of USD 263 for its regional competitors. As a result, importers in the region view Kenya as an attractive sugar market. Kenya needs to bring its cost structure, productivity and quality control to levels comparable to those of its competitors in order to exploit the opportunities availed by the regional market (KSI, 2009). The cost structure is high because the local sugar industry suffers from internal and external weaknesses.

The study population included KSB managers, directors, corporate unit managers, sales and marketing managers, managing directors and field managers of sugar mills in Kenya, trade desks at the Ministry of Agriculture, Economic Planning, EAC and Trade in Kenya. The study employed stratified random sampling technique to select for the purpose of gathering data. Simple Stratified sampling is used when a population is divided into subgroups of private and state run sugar industries. The research randomly picked one category of sugar factory in each. Purposive sampling was used in the case of selecting stakeholders in the Kenya sugar industry. Sugar cane farming is into three regions namely Western, Nyanza and Coast. These regions are divided into seventeen zones such that Kenya Sugar Board consists of seventeen directors, three managers and four corporate unit managers (one at headquarters in Nairobi). Each sugar mills has one managing director and field manager, and two sale and marketing managers. A sample of 30% was appropriate for this study because number of respondents in each category were few. Therefore, (2) KSB managers, (6) directors, (2) corporate unit managers, (6) sales and marketing managers, (2) managing directors and (3) field managers of sugar mills in Kenya, trade desks at the (1) Ministry of Agriculture, and (1) Ministry of Trade in Kenya were considered. The sample size was twenty three (23)

To gather information, the researcher used structured questionnaires and interview schedules, which were trial tested in a pilot study. The questionnaires used had both open and closed questions intended to capture a detailed level of content. Secondly, the researcher used interview schedule. This was one of the main tools of data collection due to its ability to get in-depth information. The tools of data collection focused on trade policy and how it affected sugar production, and focused on import and export policy Kenya applied in relation to sugar trade. The researcher sourced secondary data by analysis of publications such as sugar trade journals, sugar related legislations and government documents. With secondary data, the researcher, focused on sugar prices, import and export volumes. Quantitative data was analyzed using descriptive statistics such as frequencies and percentages while qualitative data responses were grouped in themes and frequencies done. The researcher presented data findings in form of frequency tables, pie charts, bar graphs and narratives.

3. Results, Discussion and Conclusion

3.1. Taxes, Levies and Charges on Farm Inputs and Plant

Most respondents agreed that sugar producers did not enjoy either tax exemptions or allowances when importing farm inputs, machines or equipments. Other levies and charges were applied on the aforementioned items. The respondents such as KSB directors, managers, corporate unit managers, sugar mill managers, field managers, sales and marketing managers, economists with Ministry of Trade and Agriculture through a questionnaire were asked to identify any tax exemptions or allowances enjoyed by sugar farmers and millers. The total number of respondents was 24, two questionnaires were not returned. 23(100%) agreed that the sugar producer did not enjoy any VAT exemption or allowances on machinery, farm inputs and other materials, the same applied to tax holiday and tax breaks as illustrated in figure 1. This means that sugar producers paid VAT of 16% on import of farm inputs, machinery or plant for use in production. They also paid taxes on any new investment and during maintenance periods after closure of factory for repairs. The sugar industry did not enjoy tax breaks because after closure for repairs, the millers continued to sell sugar from the stores. Sugar factories were closed regularly to conduct minor and major repair and upgrades. During this period, they imported large quantity of machinery, spare and technical skills to facilitate repairs and maintenance. As such, they incur expenses because taxes such as VAT, withholding tax, custom and excise duties and import declaration charges were paid. This means that VAT paid on import of materials used in sugar production added indirectly to end sugar prices. Therefore, the local sugar producer should benefit from tax exemptions

or allowances to lower cost of sugar production in Kenya. Other aspects that determine cost of sugar production are domestic taxation and level of government support.

The only tax relief enjoyed by sugar producers was in form of tax remission since 17(73%) of the respondents posited that tax remissions applied on the value of sugar exports. The following figure 1 is a summary of the findings.

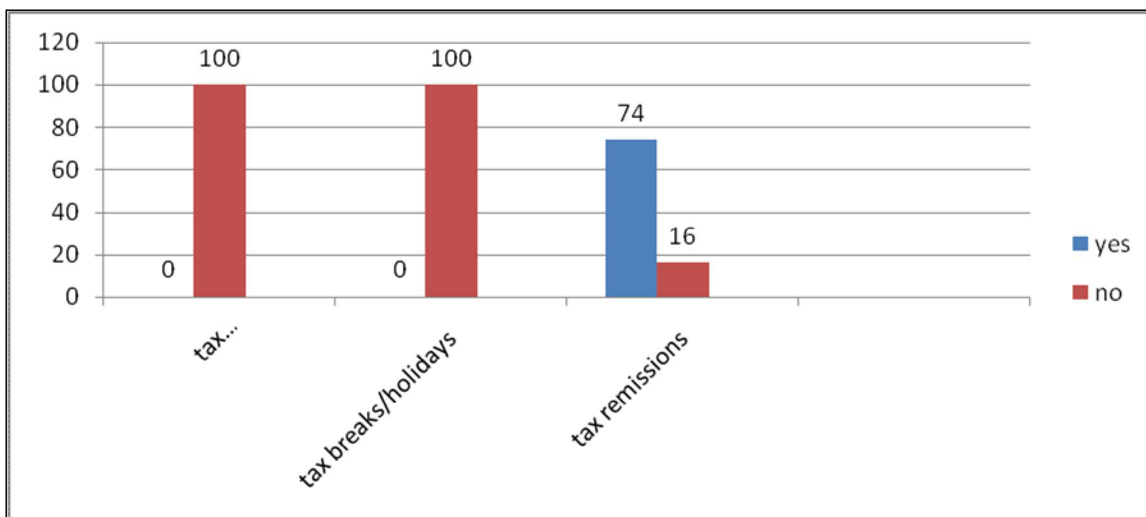

Figure1: Exemptions and Allowances for Import of Farm Inputs, Machinery and Plant in Sugar Production

The analysis of Kenya national trade policy (2007) confirmed the sentiments of respondents. Import policy regulations or rules stipulate that charitable bodies, churches, the military, the police and diplomatic organizations enjoyed tax exemptions and waivers when importing plant or farm inputs for use in production. However, other firms could benefit from export subsidies and incentives under the Manufacturing under Bond Scheme on condition that they export their total output. These incentives are investment allowance of 100% on immovable fixed assets, a ten-year corporate tax holiday, income and withholding tax holiday for firms that produced for export. These firms may sell products on the domestic market but must pay normal duties and taxes plus a 2.5% surcharge on dutiable value. This means that firms that produced mainly for domestic consumption did not enjoy any of these incentives or subsidies (Republic of Kenya, 2009).

3.2. Domestic Taxation in the Kenya Sugar Industry

The national trade policy has a range of taxes payable by firms operating in Kenya. The VAT is levied at a standard rate of 16% on the sale price of locally produced goods and services or on customs value (plus border charges) of imports while excise taxes apply to both import and locally produced goods. Other taxes include the corporate tax and local government levies payable by firms manufacturing in Kenya (Republic of Kenya, 2009). The Sugar Act (2001) contains other levies such as the sugar development levy. The sugar development levy (4%) is imposed on both locally manufactured and imported sugar (SDL on refined white sugar for manufacturing is 0%). The levy is used to fund factory development rehabilitation, research, extension, cane development, maintenance, industry infrastructure, KBS administration, sugar arbitration, and sugar strategic reserve (KSB, 2010). Beside analysis of the National Trade Policy, stakeholders in the sugar industry were asked to identify specific taxes payable by sugar producers and traders in Kenya. Table 2 is a summary of the findings.

	Sugar development levy (4%) N=23	**%**	**Corporate tax N=23**	**%**	**VAT (16) N=23**	**%**	**Other levies (4%) N=23**	**%**
Yes	23	100	23	100	23	100	18	78
No	0	0	0	0	0	0	5	22
Total	23	100	23	100	23	100	23	100

Table 1: Taxation in the Kenya Sugar Industry
Source: Field data, 2013

Table 1 above indicate that 23(100%) posited that sugar development levy, VAT, corporate tax while 18 (78%) agreed that out grower and cess levies applied to sugar production in Kenya. The crop cess and out grower levies were applied at 1% and 2% respectively. Moreover, the current policy regime on domestic trade indicates that companies that produced goods for the domestic market paid corporate tax (a high profit tax of 32.5%). Total taxation with the omission of the corporate tax adds to 24%. Surprisingly, the VAT applied on SDL is 1%, which passed on to affect the cost of sugar.

The following Figure 3 is a stacked bar graph indicating taxes applied in sugar production

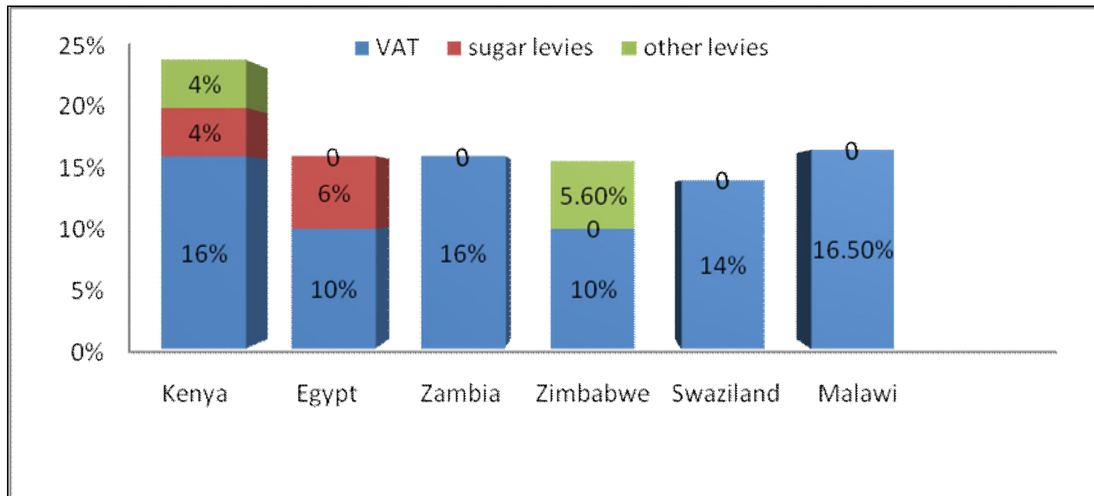

Figure 3: Taxation in the Kenya Sugar Industry and Other COMESA Countries
Source: Adopted from KSB Report, 2012

Sugar producers in Kenya were highly taxed compared to their counterparts in the region as illustrated in figure 2. The findings indicate that SDL formed part of the subsidiary cost of sugar in arriving at vatable value. The SDL (4%) on ex-factory price was added to the net cost and then the total subjected to VAT at 16%. This means that the local sugar producer was double taxed. This finding concurs with Vink and Hans (2010) observation that taxation in the Kenya sugar industry was high.

3.3. Government Support for the Kenya Sugar Industry
The support of government would range from policy formulation, and involvement in infrastructure particularly in sugar zones. Therefore, 23 respondents were asked to identify infrastructural areas supported by the government to lower cost of sugar production, documents from the Kenya Sugar Board to ascertain some of the information were also analyzed. Document analysis indicated that there was potential to increase irrigated sugarcane production in Kenya, particularly in Tana River Basin, Nyando and Nzoia Basin. The potential irrigable land in these three basins was in the range of 700,000 hectors, and yields from irrigated fields range from 120-150 TCH compared to 70-100 TCH from rain fed fields. The sucrose content in the sugarcane could be boosted to an average of 15% compared to 13.5% for rain-fed conditions. The industry projected to invest in irrigation in Tana, Nyando and Nzoia river basins (KSI, 2009). This means that it is possible to grow sugarcane under irrigation in Kenya, which would stabilize sugar supply and prices in the local market. The following Figure 4 is a summary of findings.

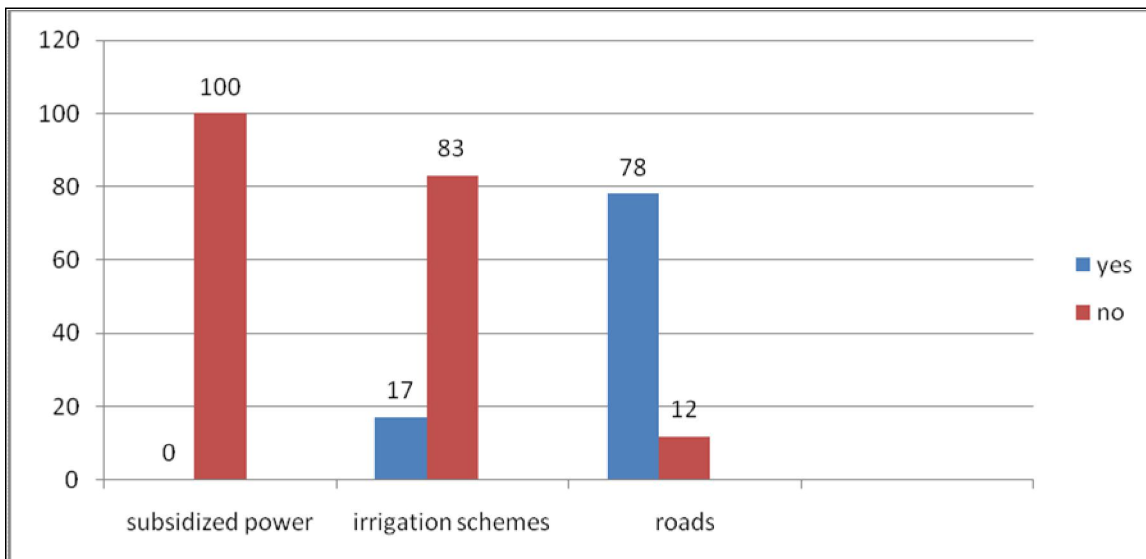

Figure 4: Government Support for Infrastructure in the Sugar Industry

Figure 4 indicates that 23(100%) posited that the industry lacked support of the government in the area of energy while 21(91%) indicated that the government did not support irrigation in sugarcane zone. However, 18(78%) of the respondents agreed that the government supported maintenance of roads in sugar zones. Stakeholders agreed that the cost of energy and transport of cane in

Kenya was high. The cost of energy was high because most sugar factories used hydroelectric power in their operations which was expensive. Hydroelectric power is expensive because in dry seasons Kenya Power and Lighting Company used diesel generators. High cost of sugar cane transportation was due to poor road network in sugar zones which caused regular break downs of cane tractors. This means that sugar millers were forced to do a regular repair of tractors which was costly. The government had not done legislation on how the production of ethanol would be sold to fuel dealers.

3.4. Import and Export Sugar Policies

The import policy indicates that Kenya's main instrument on trade with the outside world is the COMESA Common External Tariff while intra-regional trade is duty free. This means that goods imported from COMESA countries such as sugar did not attract any duty (Republic of Kenya, 2009). To ascertain some of this information, 23 respondents were asked to identify sugar import policies in Kenya. The following Table 2 is a summary of findings.

	Import tariff and quota N=23	%	Registration and licenses N=23	%	Content requirement N=23	%	Roadblocks and weighbridges N=23	%
Yes	23	100	23	100	23	100	16	69
No	0	0	0	0	0	0	7	31
Total	23	100	23	100	23	100	23	100

Table 2: Import Trade Policies that Apply to Sugar Importation in Kenya

Table 2 indicates that 23(100%) confirmed that import quotas, licenses, registration, content requirements and rules of origin were used while 16(69%) indicated that weighbridges and roadblocks applied to sugar trade. These trade remedy mechanisms protect local firms that are yet to reach maturity in production or those firms strategic to socio-economic development of the country. For example, the COMESA Safeguard allowed Kenya to apply high tariffs, licenses and import quotas to protect the domestic sugar industry from cheap imports in the region (Republic of Kenya, 2009). These findings do not concur with observations of Gertz (2008) that Kenya shifted its trade policy from the uses of quotas and licenses in late 1980s during the SAPS period to only tariffs. Nevertheless, this import policy is ineffective as discussed below.

The export policy requires exporters to register and acquire licenses. The policy has provision on export finance and insurance to encourage exporters to venture into the regional and world market markets. However, the findings indicate that Kenya did not have public export finance, insurance or guarantee schemes (Republic of Kenya, 2009). Study findings indicate that sugar exporters incurred costs in the process of exporting sugar to the EU and Rwanda through clearing, booking and shipping. On insurance, 6(26%) indicated that an exporting company was insured against risks in the process of exporting its sugar. This means non-tariff barriers were used to limit sugar exports.

3.5. COMESA Sugar Imports, Kenya Sugar Production and Exports

The COMESA FTA affected sugar imports and exports as illustrated in Figure 5 below.

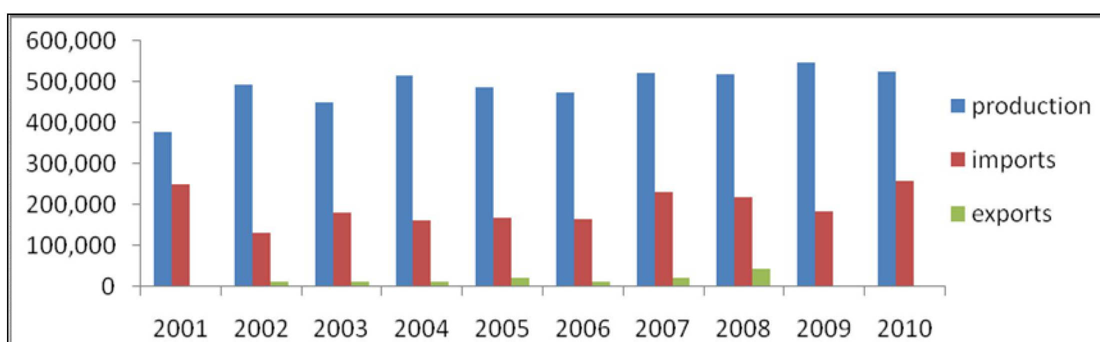

Figure 5: Sugar Production, Imports and Exports in Kenya 2001-2010, in Metric Tonne
Source: Document Analysis, Kenya Sugar Board, 2010

Figure 5 illustrates that local sugar production and exports decline whenever imports increase. The figure indicates that sugar imports increased in 2001 following the implementation of COMESA FTA. In the same year, sugar exports were a paltry 3,600 MT. It was similar in the year 2002 but production increased and dropped in 2003 that led to increased imports. Sugar production increased from 448,489 to 516,803 so did the exports in 2004 after the COMESA Safeguard was implemented. Sugar imports from COMESA into Kenya increased in 2010 because the border tariff was reduced from 100% to 70%. According to Kwa (2005), liberalization was the genesis of sugar imports in the Kenyan market, which led to a decline of sugarcane production. He argues that Kenya began to experience severe surges of sugar imports in 1998, 2001, 2002 and 2005. This means that Kenya does not export any sugar whenever the border tariff is lowered or removed.

3.6. Policy Impacts

A poor trade policy environment had limited investment options for the local sugar industry as discussed above. As a result, a majority of sugar industries in Kenya used outdated technology such that only Mumias Sugar Company crushed sugarcane using a diffuser while the rest used a closed pan. There are economic benefits in terms of costs when using a diffuser. A sugar factory that used a diffuser crushed eight tonnes of cane to produce one tonne of sugar. Moreover, the process required a maximum of two people. On the other hand, a factory such as Nzoia that used a closed pan required fifteen tonnes of cane to produce one tonne of sugar. It required at least six people to oversee the operation, which meant that Nzoia incurred more production costs. Furthermore, the type of technology determined whether an industry added value and diversified in its production. Diversification and value addition enabled an industry to spread cost of production across various vote heads. Of the sampled sugar mills, Mumias Sugar Company had diversified into production of bottled water, power generation, molasses and added value to its sugar; the Fortified Vitamin A. The company was working on an ethanol project that could increase revenue for the miller. However, low capacity of most sugar mills and financial constraints are obstacles to diversification and value addition in the local sugar industry.

Kenya Sugar Board journals revealed that sugar was the core commodity produced from sugarcane. Value addition to the core products of sugarcane processing, i.e. molasses, bargasse and filter mud was still low-keyed and largely unexploited. Apart from Mumias Sugar Company, all other sugar factories were below 4,000 TCD. This means that achieving economy of scale was difficult in the local sugar industry. However, the envisaged privatization of sugar mills could increase economies of scale through factory mergers in Western and Nyando zones. Major sugar producing economies, notably Brazil, Mauritius and Egypt, are diversified to other enterprises such as ethanol and power co-generation (KSI, 2009). This result concurs with Kwa observation that the local sugar producer was yet to explore opportunities such as energy production (ethanol and power generation) and refined sugar for pharmaceuticals. However, it was noted that the government had not enacted an energy policy that would enable sugar mills sell energy to the national grid.

Trade policies that apply to sugar production and trade have led to negative growth and inefficiency in the Kenya sugar industry. The industry could not diversify due to lack of adequate capital and skilled labour. Therefore, the local sugar industry achieved little in exports of manufactured goods and the structure of exports were still concentrated in primary commodity, sugar. This means that structural reforms in the structure of output and export have failed in the local sugar industry. It also means that trade negotiations have not been successful. These findings concur with Shafaeddin (2005) argument that trade policies determined an industry's capacity to export manufactured goods before trade liberalization. However, the local sugar industry cannot be categorized as infant since it was established back in 1927. Lack of structural and trade reforms have limited investment options in the local sugar industry. It also means that trade negotiations with regard to attracting foreign investors have not bore fruit.

3.7. Conclusion

Kenya trade policy is restrictive in terms of not motivating the domestic sugar industry to venture into regional export trade; instead the policy is prohibitive of liberalized sugar trade in the region. As a result, the industry has remained a net importer of sugar even when opportunities exist for it to diversify and enjoy comparative advantage ahead of others in the region. The study findings indicate that the industry lacked selected mercantilist trade policies such as tax exemptions or allowances, subsidies, light taxation, government support on policy and infrastructure. Due to lack of these trade policies, the industry is unable to attract sufficient capital, state of art technology and expertise in its operations. This has in turn limited diversification, value addition and effective management in the industry.

Sugar import and export policies are bureaucratic and inefficient in nature, which contribute to corruption, smuggling and sugar shortage in the domestic sugar market. The local sugar industry's failure to compete in the COMESA regional market is because of insufficient liberalization and inappropriate liberalization in the local sugar industry. First, Kenya's trade policy is not industry specific; therefore, industry uniqueness is not catered for by the trade policy. Secondly, trade policy reforms in Kenya were ineffective as regards sugar production and trade in Kenya. This was caused by insufficient structural reforms in the local sugar industry which should have taken place hand in hand with trade reforms. The local sugar industry is largely government owned with little private participation which hampers investment and management. This means that trade policy determines how robust an industry could be in regional trade.

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