# The Challenges and Way Forward for the Sugar Sub-sector in Kenya

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# List of Abbreviations

1. **ACP -** African Caribbean and Pacific
2. **CSA** – Commonwealth Sugar Agreement
3. **COMESA** – Common Market for East and South Africa

   The Member countries are: Angola, Burundi, The Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

   ***Note:*** *Tanzania was a member of COMESA but has withdrawn.*
   *Namibia has given notice of withdrawal to cease membership in July 2004.*

4. **CET** – Common External Tariff
5. **EU** – European Union
6. **EAC** – East African Community
7. **KESGA** – Kenya Sugarcane Growers Association
8. **KESREF -** Kenya Sugar Research Foundation
9. **KSB** – Kenya Sugar Board
10. **SDF** – Sugar Development Fund
11. **SUCAM** – Sugar Campaign for Change
12. **SPS** – Special Preferential Sugar
13. **SONY** – South Nyanza Sugar Company
14. **SUPAC** – Sugar Parliamentary Committee
15. **SDG** – Sugar Development Group
16. **US** – United States of America
17. **VAT** – Value Added Tax
18. **WTO** – World Trade Organization

# Foreword

Sugar is a political as well as a strategic commodity. The sugar sub-sector is a source of livelihood to over one million people in Kenya. It offers employment and helps in rural infrastructural development. It is a commodity that faces competition from imported sugar under the COMESA protocol or from the residual world market. The cost of production in Kenya is high when compared to other regional producers and world market prices, which – for political reasons – are lower than the production costs in any sugar producing country. The milling firms in Kenya are riddled with a heavy debt burden. The cane yield per hectare in Kenya does not compare well with global trends. In order to deliberate on the challenges facing the sugar sub-sector, Honourable Members of Parliament from the sugar belt and Directors of Kenya Sugar Board were facilitated by the Friedrich Ebert Foundation to attend a workshop at Mombasa on 4th – 5th July 2003.

The aim of the workshop was to identify the problems facing the sugar sub-sector and to come up with recommendation on the way forward. This report is written in a book format for ease of reading and to avoid the monotony of reproducing the papers presented in a verbatim format. The aim is also to produce the results of the workshop in an easy to read format where the main points are easily discernible.

Members of Parliament have been at the forefront in urging for the revival of the sugar sub-sector. It was through their efforts that The Sugar Act, 2001 was passed. It is due to their interest in having the country deal with the challenges afflicting the sub-sector that the Friedrich Ebert Foundation was only too glad to organize a meeting for them to critically discuss the challenges for the sector. First, we thank the Honourable Members of Parliament from the sugar belt and the Directors of the Kenya Sugar Board for agreeing to leave their busy schedules to deliberate on issues affecting this important sub-sector of the Kenyan economy. We are also grateful to The Minister for Agriculture, Honourable Kipruto Arap Kirwa for participating at the deliberations and officially closing the session. We are also grateful to The Chair of the Sugar Parliamentary Group Hon Soita Shitanda and Hon Dr Noah Wekesa the chair of the Departmental Committee on Agriculture for their contributions and attendance. Honourable Wycliffe Osundwa played a key role in the conceptualization and organization of this meeting together with my Colleague Collins Odote. I thank them for this. Our gratitude also go to the key resource persons at the meeting Dr Otieno Odek, Peter Kegode and Shem Ochola for not only making excellent presentations but also for preparing this report. Lastly I thank Dr Paul Goodison for also making a presentation at the workshop on the impact of international trade regimes like WTO and COTONOU on the sugar sector in Kenya.

It is our hope that some of the recommendations made at the workshop will be implemented to revamp and resuscitate the sugar industry in Kenya.

**Dr. Roland Schwartz**
**Resident Director**
**Friedrich Ebert Stiftung – Kenya Office**

# Objectives of the Workshop

Between 1990 todate, the Kenya sugar sub-sector has been in crisis. It has experienced strikes, shutdowns and political name calling in and out of Parliament. During the same period, the sector was characterized with chaos, poor stewardship, mismanagement, low utilization capacities, obsolete technology in the mills and lack of political will to address the myriad problems.

At the milling level, there was decline in sustainability and growth with factories such as Miwani and Muhoroni shutting down or being put under receivership. This was coupled with the general increase in sugar imports to the country and a non-sequenced government trade liberalization policy. Cartel operations in the sub-sector and the myth of cheap imported sugar versus expensive sugar in the Kenyan market added to the malaise in the sugar industry. The sub-sector by and large remained stuck up with cost-price imbalance and inconspicuous huge unsold stocks. The operational benchmarks in the sub-sector revealed below competitive levels in terms of optimal factory capacity and milling efficiency. Poor seed variety, excess reliance on limited ratoon crops, limited use of technology and over reliance on small scale outgrower farms as well as lack of irrigation facilities is the norm in the sub-sector.

To succinctly address the predicament in the sugar sub-sector and to make recommendations, the Friedrich Ebert Foundation in collaboration with members of Parliament from the sugar belt held a workshop in Mombasa. The workshop was held at Nyali Beach Hotel on 4th and 5th of July 2003. In attendance were the Minister for Agriculture Hon. Kipruto Arap Kirwa and Minister for Energy Hon. Ochilo Ayacko. Several Assistant Ministers, Members of Parliament and seven directors for the Kenya Sugar Board were present.

The key issues deliberated upon were:

(a) The nature and historical background to the sugar sub-sector in Kenya.

(b) The problems of the sugar industry cost of production and prospects for Kenya.

(c) The impact of regional and multilateral trade arrangements on sugar sub-sector in Kenya and

(d) The way forward and strategies for resuscitating the sugar industry.

At the workshop, three main presentations were made by resource persons. The topics covered were:

(i) The Kenya Sugar Industry, Cost of Production, Problems and Prospects by Mr. Shem Ochola;

(ii) Impact of Regional and Multilateral Trade Arrangements and Agreements on Sugar Industry in Kenya by Dr. Otieno-Odek and

(iii) Role of Farmers, their Representatives and Members of Parliament in Addressing the Problems Facing the Sugar Industry by Mr. Peter Kegode.

This report is a summary of the main deliberations and recommendations of the workshop.

# Nature of Sugar as a Product

Sugar as a commodity can be economically derived from two products:

(a) Sugar Cane and (b) Sugar Beet.

Sugar cane is cultivated in the tropical countries while sugar beet is a temperate product. Seventy per cent of world sugar is produced from cane. The biggest world producers are Brazil (20.3 million metric tones), India (19.9 million metric tones) and the European Union (15.5 million metric tones). Sugar as an ingredient can also be found in various fruits, milk and maize stem. However, these sources have limited quantities of sugar.

The key element of sugar is *Sucrose*. The aim of sugar cultivation is to derive *Sucrose*.

# History of the Sugar Sub-sector in Kenya

Sugar cane as a crop was introduced in Kenya in 1902. The first sugar cane factory was set up at Miwani near Kisumu in 1922 and later at Ramisi in the coast province in 1927. The Government of Kenya has been widely involved in the expansion of sugar production through investments in sugar cane growing schemes and factories. In 1966, Muhoroni Sugar Factory was put up by the government and this was followed in quick succession by Chemelil Sugar Factory in 1968, Mumias (1973), Nzoia (1978) and SONY (1979) at Awendo.

## Policies behind government involvement

The government involvement in the sugar sub-sector particularly after independence was due to five main policy considerations.

First, there was need to ensure self-sufficiency with exportable surplus in sugar production.

Second, sugar production was regarded as an essential import substitution strategy to save the country the much needed foreign exchange.

Third, sugar cane growing was seen as a tool for social development. It provided employment opportunities and wealth creation in the rural areas of Kenya. As a social tool, sugar cane production was seen as a catalyst for raising the standards of living in rural Kenya. The high proportion of workers in the sugar cane industry implies that sugar revenue directly permeates and "irrigates" the whole rural economy and thus contributing to rural stability.

Fourth, sugar cane growing is viewed as an agent for infrastructural and rural development. Sugar industries naturally promote other activities in agricultural, horticultural or recreational areas. It also promotes the much needed services for example mechanics, shopkeepers and agri-chemical workers. Within the sugar cane growing areas, the plantation and outgrower farms are supplied with roads, rural electrification, housing, health facilities and education centers. The construction of such facilities go along way to improve the infrastructure of the rural areas. Sugar cane growing was thus viewed as a justification for undertaking such projects and programs.

Fifth, at the time of independence, the domestic Kenyan market was served by imported sugar. In order to protect this domestic market, local sugar cane production was seen as a viable alternative. Deliberate policy measures were thus put in place to attain this goal.

In pursuit of the above policy objectives, the development of the sugar industry has been political and hence sugar can aptly be regarded both as a political commodity and a commodity, which is politically sensitive.

# Sugar as a Strategic Commodity

There are various products and by-products that can be derived from sugar cane. These are: (a) sugar crystals (i.e white mill or industrial sugar); (b) sugar syrup; (c) Molasses; (d) Bagasse and (e) Filter scums.

The above products are raw materials and foundation for various other industries. It is in these other industries that sugar becomes a strategic and multifunctional product. It has a forward and backward linkage effect in the economy.

As a multifunctional and strategic product, sugar is a key ingredient in the:

**(a) Beverage industry:**

The entire beverage industry is based on sugar. For example, the soft drink industry, the fruit juice industry, Cocoa, Milo and others are all having sugar as an essential ingredient.

**(b) Confectionery industry:**

Confectionery industry is dependent on two main ingredients: wheat and sugar. Biscuits, cake, bread and chocolate have sugar in them. Looked at from this perspective, it is clear that the entire breakfast and snack industry depends on sugar.

**(c) Pharmaceutical industry:**

Most oral contraceptives are sugar coated to reduce the bitter taste of the drugs. For example, Quinine and anti-malarial tablets are sugar coated. Brufen for pain relief, throat lozenges and multi-vitamins syrup and tablets are sugar coated. Due to the sugar coating aspects, the pharmaceutical industry and companies thus have an interest in the sugar industry.

**(d) Wine, spirit and power alcohol industry:**

Sugar is an ingredient used in wines and spirit products as well as in standard ale production. For example, a look at the ingredients of Tusker will reveal that sugar is one of its contents. To produce spirits, molasses is a raw material. For example, Mauritius produces rectified spirit, refined spirit, denatured spirit and vinegar.

**(e) Animal feed industry:**

The dairy and poultry industry as well as the pig industry rely on zero grazing as a mode of production. Molasses is an essential ingredient in the production of high quality animal feeds. This makes sugar a crucial product in this industry.

**(f) Electricity generation (co-generation):**

When cane is crushed and the juice separated for crystallization, the remaining dry matter - called bagasse - is burnt to provide energy. The bagasse resulting from the crushing of cane can be used to raise steam for driving turbines for co-generation. The process of generating energy avoids the need to use fossil fuels to generate electricity and therefore avoids the emission of greenhouse gasses, notably carbon dioxide. In Kenya, the aspect of generating energy from bagasse is not developed. It is only Mumias Sugar Company that has a very small scale capacity in this aspect.

**(g) Chemical and fertilizer industry:**

Raw Sugar and Molasses are an important raw material in the chemical industry. In Kenya, Agro- Chemical Industry at Muhoroni is using molasses as a raw material to support its chemical plant. The filter scum from cane contains a small amount of phosphoric acid. This is applied in the fields at planting.

**(h) Environment**

Sugar cane trash can be used for mulching, ratoon cropping and terracing which is environmentally friendly and biodegradable.

From the above analysis, the picture that emerges is that most countries are not producing sugar with the aim of getting white mill domestic sugar as the central activity. Cane is cultivated as a strategic product to support all the above industries. In economic terms, sugar production has both a forward and backward linkage effect in an economy. This linkage effect needs to be exploited to its full potential. It is from this perspective that sugar becomes a strategic product.

# Nature of the International Trade Regimes on Sugar

Sugar is produced in 127 countries in the world and consumed in all of them. Most sugar is produced and consumed in the same country. Only about 30 per cent of world output is traded internationally. The implication is that the world market is a residual market where only 30 per cent of world output is traded. The world market is not the main sugar market. Consequently, it is important to recognize that world market sugar prices are not an appropriate benchmark for determining the "fair" price for sugar since these prices represent the market only for residual production and residual demand.

Sixty five per cent of the sugar that is traded in the world comes from four countries namely Brazil, Australia, Cuba and Thailand. The biggest importer of sugar is Russia.

Today, non-sugar factors are exerting an influence on world market sugar prices often in excess of, and divorced from considerations of supply and demand. Multilateral corporation policies play a significant role. For example, nearly all exports to the European Union are purchased by the British Company Tate & Lyle.

Recalling that only 30 per cent of the world sugar output is traded at the world market, the remaining 70 per cent is traded under contract and preferential sub-vention regimes therefore the world prices are not real.

There are four types of regimes under which sugar is traded in the world:

(1) Preferential and Quota Regimes by developed countries:

70 percent of sugar produced in the world is traded under preferential and quota regimes. The balance of sugar is traded in the residual free market. In the preferential regime, the most notable are the USA and EU regimes.

The EU sugar regime was established in 1968 and is based on a system of administrative establishment of prices, an import regime and an export regime. The basic prices in the sugar sector are established administratively by the EU Ministers on an annual basis. In recent years, the EU prices have been set two to three times higher than the world market prices. The high internal EU sugar price requires the maintenance of high protective tariffs around EU sugar market and the markets for high sugar content products.

The EU Special Preferential Sugar Arrangement (SPS) is based on the concept of maximum supply needs. The maximum supply needs are established with reference to the needs of seven sugar cane refineries namely 2 in United Kingdom, 2 in France, 2 in Portugal and 1 in Finland. The maximum supply needs are met through an ACP Sugar Protocol quota, an Indian Quota, the Finnish MFN Quota and the exportable production of the French Overseas Territories. Any imports outside these requirements have to pay the full duty.

(2) International Sugar Agreements;

(3) Free Trade Arrangements such as COMESA, SADC, EAST AFRICAN COMMUNITY and

(4) Residual Free Market in Sugar. Trading in this regime is done under the World Trade Organization's Most Favored Nation Principle or bilateral commitments by individual countries.

## Preferential regimes

There are five preferential trade regimes of sugar in the world. These are:

(i) The United States quota arrangements which cover about one quarter of world trade. Sugar exports to the United States is governed by country quota system. This reserves US import requirements to offshore areas of the USA such as Hawaii and Puerto Rico and countries with special trade relations with the USA such as the Philippines. Prices are usually very favorable. Kenya does not have a quota for preferential access to the USA market.

(ii) The Commonwealth Sugar Agreement (CSA) was signed in London on 21 December 1951. The CSA guaranteed imports of agreed quantities of sugar by the United Kingdom at negotiated prices to commonwealth producers. Under this arrangement, there was a supplementary allowance for developing countries. Prices, though less attractive than the US scheme were usually substantially higher than the free world market prices. The CSA covered about 10 per cent of the world trade in sugar. With the Accession of the United Kingdom to the EU, the UK commitment under the CSA was translated into an EU commitment to the ACP states under the Lome Convention Sugar Protocol. Under the Lome Convention Sugar Protocol, Kenya had a quota of 5,000 tones, which was largely not utilized. In 1987, the EU distributed Kenya's quota to other ACP countries.

(iii) After the USA suspended Cuba's sugar quota in 1960, a special arrangement between Russia and Cuba has given price and quantity guarantees to Cuba on very favorable terms. It must be noted that Russia is the world's largest consumer of sugar and a preferential access to its market is an asset. Kenya does not have a preferential arrangement with Russia for sugar imports.

(iv) The EU-ACP Cotonou Partnership Agreement of which Kenya is a beneficiary. Under this regime, Kenya has a quota of 10,000 tons to export sugar at guaranteed high prices to the European Union. This regime is covered by the Sugar Protocol of the Cotonou Partnership Agreement. It is also subject to the EU Common Agricultural Policy Reforms.

(v) The EU Special Preferential Sugar (SPS) arrangement. This SPS arrangement is separate and distinct from the Cotonou Sugar Protocol. A country can have a quota allocation under the Protocol as well as under the SPS regime.

The SPS agreement with the ACP states and the EU was reached on 1 June 1995 and is a government-to-government agreement. It is a fixed duration agreement for an initial six years. Under this arrangement, the EU undertakes to open annually a special tariff quota for the import of raw cane sugar for refining which originates in ACP states on the basis of needs determined by the EU Commission. The ACP states undertake to supply the said quantities under specified conditions such as a minimum delivered price paid by EU refiners. This regime was largely influenced by Finland joining the EU in 1995. By joining the EU, Finland brought with it commitments and contracts that it had to buy 85,000 tons of sugar every year from Cuba and Brazil. Therefore the EU had to import this sugar on the already agreed terms.

# Impact of the International Sugar Trade Regimes on Kenya

Kenya's import and export of sugar is affected by what happens in the various trade regimes that exist in the world.

As a starting point, Kenya trades at four regimes in the world:

(a) The residual free world market on sugar or

(b) The preferential and quota regime given by developed countries particularly under the EU-ACP Cotonou Partnership Agreement

(c) The EU Special Preferential Arrangement on Sugar (SPS) and

(d) The Free Trade Arrangement of COMESA and the East African Community.

In addition to the above trade regimes, developments at the World Trade Organization will affect the future of the regimes identified above.

At the residual free world market on sugar, the world market price of sugar ranges between US $ 125-& 168 which is well below the cost of production of some countries particularly Kenya. In Kenya, the cost of production averages US $ 500 per ton. Further, the market consumer price of sugar in the Kenyan market sells at a premium of US $ 560 per ton. This contrasts sharply with the consumer prices in the United States where it is US $ 430 and in the European Union where it is US $ 530.

The sugar in this residual market is from all over the world. Primarily there are three main sources:

(i) Subsidized sugar from Europe: according to the EU Court of Auditors report, the considerable expansion of EU quota production has had an impact on the world market and the world market price has been influenced by subsidized exports.

(ii) Dumped sugar from other producers in the world;

(iii) Surplus sugar from low cost sugar producing countries such as Peru, Australia etc.

A person importing sugar into Kenya from this source can effectively compete and undercut local sugar since the cost of production is very high.

The only way to prevent sugar from this residual market from entering Kenya is through erection of barriers such as anti-dumping legislation, high tariffs and quotas and countervailing duties as well as other safeguard measures. *This can only be done within the BOUND TARIFF and QUOTA LIMITS that Kenya has committed itself to at the WTO.*

## Preferential and Quota Market

Kenya trades in this regime as an exporter of sugar. The importance of this regime largely stems from the EU-ACP Cotonou Partnership Agreement where Kenya has an annual quota of 10,000 tons. This quota only helps Kenya to access the high internal and guaranteed European Union Sugar Prices. With the reforms in the EU Common Agricultural Policy underway, the future of this access and the value thereof is not guaranteed. The EU reforms are projected to lower the internal EU sugar prices and hence the difference between the EU and the World Market price will come down. The implication is that the value of the EU preferential sugar arrangements will be reduced and country's relying on this will suffer revenue loss.

## Free Trade COMESA Arrangement

Under the COMESA Free Trade Area arrangement, the COMESA countries have a common internal tariff for products originating from the area. The tariff within the COMESA states for raw materials is 4 per cent and 35 per cent for finished products. Sugar imported from the COMESA member states into Kenya is subject technically to a tariff of 35 per cent.

HOWEVER, Kenya applied for the use of safeguard measures under the COMESA arrangement. Article 61 of the COMESA Treaty provides that:

1. In the event of serious disturbance occurring in the economy of a member state ... the member state concerned shall, after informing the Secretary General and other member states take necessary safeguard measures.

2. The Safeguard Measures taken ... shall remain in force for a period of one year and may be extended by the decision of the council provided that the member state concerned shall furnish proof that it has taken necessary and reasonable steps to overcome or correct imbalances for which the safeguard measures are being applied.

Article 51 of the COMESA Treaty deals with dumping where a member state is permitted for the purposes of offsetting or preventing dumping to levy an anti-dumping duty not greater in amount than the margin of dumping in respect of the product.

Under the COMESA Safeguard Clause, Kenya was allowed to impose:

(a) A Quota of 200,000 tons annually on sugar imported from COMESA countries. This is to meet the shortfall between domestic production and local consumption. Of this quota, 80,000 tons is for industrial sugar while 120,000 tons is for domestic sugar.

(b) A tariff of 120 per cent.

The problem with the tariff is that it is ad valorem hence linked to the value of the imported sugar. This value may be determined by the cost of production in the exporting country or the price at the place of purchase of the imported sugar. Whatever the cost or price, in most cases this cost or price is lower than the one prevailing in the Kenya domestic scene.

## East African Community Regime

Presently, sugar is traded within the EAC area on COMESA terms. However, there is a move to create a Customs Union for the East African Community states by November 2003. Upon the creation of the East African Customs Union, the Common External Tariff (CET) applicable will be Zero tariff rate for raw materials, 10 per cent for intermediate goods and 25 per cent for finished products. It must also be noted that within the EAC, the cost of sugar production is lowest in Uganda followed by Tanzania and then Kenya. The practical consequence is that even within the EAC, a duty free movement of sugar would imply that Ugandan and Tanzanian producers will effectively compete with their Kenyan counterparts.

## Project World Trade Organization regime

Most of the sugar produced in the developed countries is done under protective tariffs and is heavily subsidized. For this reason, sugar production in the developed world comes under the WTO regime on Subsidies and the Agreement on Agriculture. The fate of subsidies and farm support system is set to be discussed at the WTO Ministerial Conference to be held at Cancun, Mexico is September 2003.

Presently, the indication is that sugar subsidies, farm support systems and export subsidies as well as preferential trade arrangements on sugar will be done away with. The WTO Agreement on Agriculture will require internal EU agricultural support to be reduced. Already, the EU is undertaking reforms in its Common Agricultural Policy along these lines.

The impact of WTO removal or reduction on agricultural subsidies on sugar will basically depend on the extent to which the changes narrow the gap between the World Market Sugar prices and the internal EU and USA sugar prices. This will affect the value and margin of preferences granted by the EU and USA. More specifically, the actual impact on Kenya will to a large extent depend on the extent of Kenya's:

(a) Preferred access to the EU market and how the WTO changes affect the EU market;
(b) Preferred access to other markets;
(c) Local sugar consumption and the local pricing policy;
(d) Exposure to world markets;
(e) Underlying costs of production and
(f) The scope for the competitive expansion of sugar production to serve non-distorted world sugar markets.

# Comparative Analysis of the Cost of Production of Sugar in Kenya and other COMESA and EAC Countries

The cost of production of sugar varies from country to country and region to region. The basic costs included in calculating the cost of production are:

(a) Land preparation costs i.e. ploughing, harrowing and furrowing;
(b) Seed cane and transport;
(c) Planting;
(d) Weeding and cane maintenance;
(e) Cane cutting;
(f) Transport to factory;
(g) Cane reception and handling costs;
(h) Sugar processing and
(i) Sugar sale at domestic or foreign market.

In addition to these basic costs, government policy, taxation and various levies as well as middlemen costs such as Outgrower Company deductions contribute towards raising the domestic cost of production. The cost of production in various regions or countries can be enumerated as hereunder:

1. The EU sugar is produced through a system of subsidies and tariff protection to restrict imports and a quota regime. According to the Netherlands Economic Institute (Evaluation of the Common Organization of the Markets in the Sugar Sector Report of September 2000), the production costs of the lowest cost beet producers in the EU were 60 per cent higher than the costs of low cost cane production throughout the 1990s. Other studies put the average EU production costs at over twice those of low cost sugar cane producers. Without the common organization of the market in sugar, the EU would produce far less sugar, cease exporting sugar and become a major importer of sugar.

2. The ten lowest cost sugarcane producers of the world are Australia,

Brazil, Colombia, Guatemala, Fiji, Malawi, Swaziland, Thailand, Zambia and Zimbabwe. (Source: "markets for Swazi Sugar: Patterns, Challenges and Strategic Considerations, paper presented at a national sugar conference, May 2001).

3. The total field cost of sugar production in Swaziland per ton is US $ 168.6; while the total average cost including overheads is US $ 265.5.

4. The Kenyan total field cost of sugar production is $ US 420 per ton.

5. In Sudan, the Kenana average cost of production is US 230 per ton.

6. The average total field cost for the African EU-ACP Sugar Protocol holders is US $ 197.2; while the total average cost including overheads is US $ 340.0.

7. The average total field cost for the Caribbean EU-ACP Sugar Protocol holders is US $ 314.9; while the total average cost including overheads is US $ 537.9.

8. In Jamaica, the average cost of production is US $ 506.97 to US $ 661.26 per ton; in Belize, US $ 286.88; Barbados US $ 708.87; while in Trinidad US $ 1051.62. (Source: Statistical report from the Sugar Association of the Caribbean).

9. The average total field cost for the Pacific EU-ACP Sugar Protocol holders is US $ 221.6; while the total average cost including overheads is US $ 266.2.

10. The average cost for the tenth lowest cost producer in the world is US $ 178; while the total average cost including overheads is US $ 271.0. (Source: "markets for Swazi Sugar: Patterns, Challenges and Strategic Considerations, paper presented at a national sugar conference, May 2001).

11. In Sudan, Kenana sugar sells at US $ 345 per ton while Kenyan sugar is sold at an average of US $ 430 - $ 600 per ton; while the world market sugar sells at US $ 130 - $ 170. (See East African Standard Monday, July 21, 2003 at pg. 3 of the Big Issue).

# Problems of the Sugar Industry in Kenya

The status of the sugar industry in Kenya is influenced by internal and external factors. The external factors are the problems facing sugar industry in the world. These global problems are:

(i) Instability in world prices;

(ii) Tropical producers have limited and regulated access to the markets of the industrial countries particularly the US and EU markets;

(iii) There is high cost of sugar production in the developed world being done behind protectionism and barriers to trade;

(iv) Most countries pursue self sufficiency as a goal;

(v) There is a low elasticity of supply of cane exports: this has produced wild swings in free market sugar prices and

(vi) Production cost and efficiency is not the determinant of supply and market access conditions in the world market.

In Kenya, in addition to the global problems outline above, the sugar sub-sector problems were identified as multifaceted and due to various changing conditions. The main changed conditions are:

(a) Kenya's embrace of market liberalization which has led to removal of price controls.

(b) Removal of tariffs as a device to protect local sugar production which has permitted importation of sugar.

(c) Competition from low cost sugar producers within COMESA and

(d) Low free world market prices; this is caused by over production in the world. The estimation of the world raw sugar production in 2001 stands at 136 million tones; the consumption is estimated at 132 million tones. This puts pressure on the prices. Presently, the forecast is that the low world prices will continue in the medium term and there is no prospect of enduring increase in the price of sugar.

Internally, the sugar factories and outgrower farms have problems. The balance sheet of the milling and sugar factories reveal accumulated debt and losses. The existence of a ready Kenyan domestic market as well as political factors has influenced the decision to continue in cane production despite the fact that the high cost of production relative to prices makes it unprofitable to produce sugar. In the face of declining international sugar prices and stiff competition from low cost producers, the problems facing the sugar sub-sector in Kenya were identified as:

1. High Cost of Production.

2. High debt burden on the part of the millers.

   Most of the debt owed by millers are either to farmers for unpaid cane deliveries or debt due to the Sugar Development Fund (SDF) or government debt or commercial bank loans. Sugar milling firms owe approximately 10 billion shillings to the SDF. Unremitted levies to the fund also run into billions of shillings. Due to these debts, most sugar firms are technically insolvement with debts amounting to 91 per cent of total assets. Consequently, the milling firms have severe cash flow and liquidity problems. Nzoia sugar company owes farmers cane delivery arrears of upto Ksh. 681 million, SONY Ksh. 510 million, Chemelil Ksh. 200 million, Muhoroni Ksh. 190 million and Miwani Ksh. 112 million.

3. Low sucrose cane content. The cane delivered when crushed gives a very low sucrose yield and recovery rate. Poor seed variety and poor timing for harvest contribute to the low sucrose content.

4. Poor seed variety which is not smut disease resistant, not early maturing and low in sucrose content. For example, one advantage of Sudan's

sugar over Kenya is the fact that the cane varieties in Sudan mature within 14 months as opposed to Kenya;s cane that takes 18 to 24 months, besides the fact that harvesting delays cane crushing in Kenya for upto 36 months. (See East African Standard, Big Issue at page 3 July 21st, 2003).

5. Excessive number of middlemen in the industry who reduce the profitability of the farmers and millers.

6. Outgrower farms are inefficient and the outgrower companies have now become middlemen and further overburden the farmers.

7. High taxation levels in the form of Value Added Tax (VAT), CESS and Sugar Development Levy. The sugar industry is heavily taxed with the result that the gains accruing to the farmers and millers are heavily eroded through punitive taxation.

8. Low levels of incentives to farmers due to non payment for cane delivered.

9. Poor or non existent transport and road infrastructure.

10. Political interference in the appointment of managers of the milling firms leading to lack of professionalism and accountability in the management boards.

11. Uncoordinated and irrational role of key institutions in the sector such as KSB, KESREF, KESGA, SUPAC, SDG, MILLERS, OUTGROWERS and SAT.

12. Inadequate policy and market reform strategy.

13. Inadequate use of Sugar Development Fund (SDF).

    The SDF was created in 1992. It is financed through a system of levy imposed on both local and imported sugar. Presently, the sugar development levy is 7 per cent. SDF is supposed to use the collected funds to assist in rehabilitation and expansion of the sugar factories. It lends its funds to the millers. The process of recovery of the lent funds has been either weak or non existent. There has also been no guarantee that the SDF loans have been used for the intended statutory purposes.

The current components of the SDF are as follows:

(a) Financing research and cane development;
(b) Developing infrastructure i.e putting and maintaining roads in the sugar growing arrears;
(c) Factory rehabilitation;
(d) Management of the SDF.

14. Limited political will to undertake urgent and radical policy and legal reforms.

15. Importation of illegal and uncustomed sugar.

16. Competition from cheap legally imported sugar.

17. At factory level, one can identify the problems of the millers as:

(a) Inefficient factory operations;
(b) Inefficient agronomic practices;
(c) Poor cane quality;
(d) Untimely financing and supply of inputs;
(e) State intervention and debt burden and
(f) Management deficiencies at all levels of production and decision making

# Recommendations and Way Forward for the Sugar Industry

Having identified the key problems of the sugar sub-sector, the following recommendations were made as the way forward:

1. Efforts should be made to increase efficiency in cane and sugar production and marketing. The aim here is to lower the Kenyan cost of production without looking into competitiveness with other countries or regions. The basic motive is to lower the Kenyan cost. The efficiency should be measured in three areas:
   (a) Field level performance indicators: under this heading, the cane yield per hectare and sucrose content per ton should be improved.

   (b) Factory performance: under this heading, the average milling capacity, season lengths, factory recovery rate and sugar produced per ton should be examined.

   (c) Technical and management performance as well as improved marketing policy should be fostered.

2. Taking into account that one of the problems of the sugar sub-sector pertains to high and numerous taxes, the workshop expressed the need to mitigate the inadequate fiscal incentives and high tax regime. The following measures were recommended:
   (a) Removal of value added tax on locally produced sugar.
   (b) Streamlining the procurement system of spares, machinery and fertilizer.
   (c) Provision of rebates on fuel.
   (d) Provision of subsidy on fertilizer import and distribution.
   (e) Utilization of the Kenya Farmers Association distribution system to deliver cheaper Inputs to the farmers.

3. The Honorable members recommended the following Government measures necessary to revamp the sugar sub-sector:

(a) Reduction of taxes and levies on sugar production;
(b) Preservation of local and export preferential markets by using safeguard and anti- Dumping measures;
(c) Debt relief by writing off the monies due to the Sugar Development Fund;
(d) Lowering interest rate and removing penalties on outstanding debts;
(e) Increase in import tariff;
(f) Establishment of a price stabilization fund;
(g) Establishment of a sugar insurance scheme;
(h) Investment rehabilitation in the milling firms to use modern and efficient technology;
(i) Revision of the sugar importation policy;
(j) Development of alternative uses for cane land.
(k) Renegotiation for a longer period of the application of the COMESA safeguard Measures.
(l) Establishment of a sugar insurance scheme;
(m) Investment rehabilitation in the milling firms to use modern and efficient technology;
(n) Revision of the sugar importation policy;
(o) Development of alternative uses for cane land;
(p) Renegotiation for a longer period of the application of the **COMESA** safeguard measures.

4. Value adding and diversification should be encouraged.

The workshop noted that Kenya sugar industry had made no progress in diversifying its operations and product base from sugar. The industry needs to diversify its operations to production of other value added products including power alcohol, energy generation amongst others. The following were identified as critical:
(a) Co-generation and sale of power to the national grid;
(b) Alcohol distillation;
(c) Use of biogases and molasses to make feed block;
(d) Use of bagasse as fuel supplement to provide energy for the factories;
(b) Use of bagasse to produce newsprint, paper, building hardboard and Briquettes and
(c) Putting filter cake in economic use as an organic fertilizer or soil Ameliorate.

5. Debt Restructuring

The workshop noted that the sub-sector had a total non-performing debt portfolio of Kshs **20 Billion**. It was proposed that as a matter of priority, the Government intervene in the debt management in order to give the factories a clean balance sheet necessary to attract new investment in to the sector. It was proposed that the debt portfolio be analyzed and classified and recommendations be made, based on merit how the amounts should be dealt with, with respect to:

- Write off
- Rescheduling
- Forming a trust company to take up other debts for long-term servicing
- Ensuring that the individuals linked to debts incurred corruptly are held accountable.

The Members of Parliament and the Kenya Sugar Board be mandated to put in place mechanisms to implement the above proposals.

6. Legal framework

The operations of the sub-sector have been greatly hampered by the poor implementation and resistance to the Sugar Act 2001; lack of goodwill by the previous political regime, and selective implementation of the Act by the millers, leading to stalemate between the millers and the farmers. The forum identified the need for limited legislative framework to protect the farmers and domestic retaining companies in the sector. Currently, the lack of legislative support is manifested through lack of anti-dumping legislation, lack of enabling safeguard legislations and the lack of a rigid regulatory framework to check on adverse impact of sugar imports. There is therefore an urgent need to develop consensus on the areas that need to be amended. It was proposed that:

- The chairman of SUPAC, Hon. Soita Shitanda, form a technical team from among the Members of Parliament from the sugar zone, SUPAC, KSB, SUCAM and other resource persons to review the Sugar Act 2001 and forward their proposed amendments to the Minister for Agriculture. The industry must have a proper legal framework on which it should be run.

7. Sugar Importation Policy

Uncoordinated importation of sugar and illegal imports of sugar have been identified as a major contributor to the sub-sector problems. These imports are procured at world market prices, which average at US $ 125. The cost of Kenyan sugar has been averaging between US $ 426 - $600 (2000-2003) when compared to the EU preferential Sugar protocol price of US $ 536. Kenya sugar market is arguably the second most attractive open market in the world after the EU in terms of premium sugar destination market. This phenomenon has led to maintenance of a spurious and destructive sugar regime in Kenya. In order to mitigate this problem, the workshop participants made the following proposal:

- Proper research on the exact deficit requirements to be undertaken as a matter of urgency.
- Formulation of a proper government policy with regard to importation of sugar.
- Develop a policy and system on importation, which should be regulated by the government.
- Develop and institute a surveillance program that should indicate among others, the source of sugar; make it mandatory for the vessels to declare their cargo and avail their manifests for scrutiny.
- Ministry of Agriculture to evolve a central marketing system out of control of the KSB to be in charge of import and export of sugar.

8. Trade Policy.

Kenya lacks a strong and effective trade policy for long term survival of the sub-sector. The workshop identified the need to strengthen the negotiating team, and review the existing policy relating to COMESA, WTO, and COTONOU amongst others. The workshop appreciated the following:

- Urgent need to establish a strong negotiating team of senior government officials of the caliber of Minister etc, with the WTO, COMESA, EAC and the EU. This role must not be left entirely to civil servants, as had commonly been the case.
- Need for coordination between the Ministries of Trade & Industry and Ministry of Agriculture to work as a team to negotiate trade position for Kenya.
- Need to negotiate with the COMESA partners an extension of the

period of safeguard measures for up to 8 years in order that the industry may have ample time for restructuring.

9. Marketing reform

Marketing reforms were identified as crucial to the survival and restructuring of the sugar sub-sector. The current marketing arrangement afforded abnormal profits to sugar barons, distribution agents and brokers at the expense of millers and farmers. The workshop proposed the following:

- Adoption of **a single desk marketing system** in which the marketing body is mandated to export sugar and import the deficit quantity, and share proceeds among the industry stakeholders. This arrangement will plough back surplus funds into the sub-sector and also manage the conflict of interest, which currently exists. It is also a system that safeguards the public and consumer interests in the sub-sector.
- Reform the distribution system and enhance capacity of KFA to discharge the duty.
- Effect payment to sugarcane farmers on delivery. The sugar industry can borrow from the tea sector payment system in which payment is made in stages. It was suggested that an industry owned marketing firm would improve the cash flow in the sub-sector by providing advances to the millers and farmers.
- The industry was challenged to market its sugar to the COMESA region and markets as a strategy to capture new markets.
- Negotiate for higher quota allocation into the preferential markets of the ACP/EU, and the SPS.

10. Transportation:

Infrastructure for cane transport needs to be improved. Most of the roads within the cane growing areas are in bad shape. The cost of transport is high. Cane spillage is common and thus after harvest loss is high. There is also insufficient number of tractors and trailers to do the transportation work.

The workshop identified transportation as a major constraint in efficient management and transportation of cane. The mode of transporting cane does not lead to maximizing in payload and the following suggestions and proposals were presented to the workshop.

- Improve the system of cane transport by putting into use bigger tonnage trucks with closed sides for proper haulage of cane.
- Rehabilitation of rail system in the sugar belt to augment the road network.
- Maintenance of the road networks in the sugar growing areas should be the responsibility of the Government owing to the high costs implications and the fact that physical infrastructure is a public good in nature.
- Explore the possibility of positioning crushers strategically in the farmlands to crush the cane and transport the juice to the factories for final processing.

11. A further recommendation was that the SDF be expanded to incorporate the following additional needs in the sugar industry:

    (a) Creating an insurance scheme to cushion the farmers from losses arising in the industry;
    (d) Open SDF to organizations affiliated to the industry e.g. cooperative societies and transporters;
    (e) Use SDF as syndication fund by other financial institutions in setting up small and medium scale factories;
    (f) SDF component be increased to finance irrigation infrastructure in the
    sugar industry;
    (g) Management of the SDF be contracted to a financial institution that has capacity to assess and manage credit. The Kenya Sugar Board competence in this area is highly questionable as demonstrated by the audit reports, PIC reports and the report by Efficiency Monitoring Unit.

12. There is need to have a proper input supply system. A number of local firms have more or less specialized in the importation of the equipment required by the sugar industry which cannot yet be manufactured locally. The main orders are still with the exclusive agents in the United Kingdom, France and Germany. The local firms acting as middlemen attach high mark up values that add to the procurement costs. A reasonable and reliable procurement system for steam turbines, water tube boilers, centrifugal and alternators should be put in place. Further, a general policy to order from local manufacturers of equipment should be implemented. For

example, foundries, machine shops, welding and forging equipment, mill rollers, can carriers and juice heaters can be done locally.

13. There is need for the Kenya Sugar Research Foundation (KESREF) to conduct more research into new early maturing seed varieties that are disease resistant and have high sucrose content. Chemicals having the property of hastening ripening and increasing the sucrose content should be developed. The sugar sub-sector must quickly move towards sucrose based systems in order to make quantum leap and embrace efficient distribution of proceeds to both farmers and millers. The bedrock of sucrose based system hinges on adequate investment in research on high yielding, early maturing robust varieties.

14. Irrigation as a practice should be encouraged and introduced. The possibility of introducing furrow and overhead irrigation systems should be explored. Kenya can learn from the examples of Sudan and Mauritius in this respect.

15. Mechanization and intensive farming should be introduced. Cane cutting and loading in Kenya is largely manual. Mechanical cutting and loading should be considered.

16. There is need to establish a Sugar Insurance Fund to insure the sugar industry against losses due to any peril and low world market prices.

17. There is need for increased research and training. Presently, research on sugar issues is being done by KESREF. This research facility needs to be expanded to deal with molecular biology methods for disease diagnosis and characterizations of pathogens. Research should also focus on increase the cane sucrose content.

18. Agricultural diversification and withdrawing land from sugar cane needs to be considered as an option. Cuba has taken this example and should be used as a case study. (Source: unpublished GTZ Study "Consequence of Liberalization of the Sugar Market for ACP-Countries associated with the EU" page 249 - 251).

    In this respect, withdrawing land implies making a policy decision on how to use the limited land available and which crops to grow. The issue at hand is whether land presently used for sugar cane cultivation should be withdrawn and other food crops cultivated instead. In Mauritius, during 1939-1945 war, 13,750 hectares of land under sugar cane were temporarily devoted to food crops mainly maize, sweet potatoes and cassava.

Due to the high cost of cane production in Kenya and the comparative uncompetitive nature of the sugar industry, there are several advantages of withdrawing land from cane cultivation:

(a) The problems of monoculture in the sugar areas will be alleviated;
(b) Food security and sufficiency in basic food stuff will be improved due to new food crops being grown;
(c) Kenya will be able to purchase its domestic sugar requirement from the low priced world market and hence problems of high cost of domestic production will be eliminated.
(d) Government revenue will improve due to increased customs duty being collected from all sugar imports.
(e) The increased government revenue can be used to mount a domestic agricultural subsidy program which by implication will be funded by third countries.
(f) Recognizing that Kenya's cost of sugar production is uneconomic and uncompetitive, diversification will lead to Kenya having a bargaining chip to use in negotiating with countries exporting sugar into Kenya. Further, the existing milling plants can be re-designed for other economical use.

19. Lack of transparency in the sub-sector

The workshop noted the lack of transparency in the sector as exemplified by:

- Lack of public information and accurate data on costs of production.
- Lack of public information and data on who is importing what and what quantity and from what country.
- Lack of public announcement of tariff lines and rates applicable to sugar imported into Kenya.

20. Other emerging critical issues

- Lack of effective government policy to protect domestic producers and farmers.
- Insensitivity to the concerns and the interest of primary cane growers
- Use of uninformed safeguard measures without a clear policy framework. For example, 100% sugar import tariff is ineffective to operate as a barrier and protection to domestic producers.
- Competition from low, free world market sugar imported into Kenya.
- Failure to appreciate the fact that sugar is a strategic product and a raw material for other industries. There is urgent need to focus on value adding and agro-processing of sugar.
- Failure to develop further industries that can use raw sugar as a basic raw material.
- Ownership structure to be reviewed as there seems to be a direct relationship between government ownership and high costs of production.

# Conclusion

The Honourable Members of Parliament concluded and recognized that:

(i) The world market price of sugar has always been below the Kenyan cost of production. However for Kenya to be competitive with other sugar producing counties, there is need for protection of the sugar sub-sector. It is evident that Kenya sugar sub-sector is not competitive in a regional and global context. For this reason, it is inevitable that safeguards must be put in place to protect the industry.

(ii) That effective safeguard measures be immediately put in place to protect the local farmers and domestic refineries. The recommended measures are:

  (a) Immediate ban on sugar importation from non COMESA countries;

  (b) Renegotiation with COMESA states to raise the import tariff on sugar imported into Kenya to 1000 per cent.

  (c) Transparency be introduced into administration of the sugar import quota and clearly to publicize the information on who is importing what and from which country and at what price;

(iii) Immediate steps recommended above in item No.5 be taken to alleviate the debt burden of the milling firms and to create a clean balance sheet. Further, fiscal incentives be given to farmers and the burdensome taxation system be reviewed.

(iv) Sugar to be classified as a sensitive and special product in the list of products of the East African Customs Union.

(v) Government divestiture in sugar factories be considered as a means of reducing political interference in the running of mills.

(vi) It is imperative that the Kenya Government must put up a strong case and negotiating position with regional partners with the am to underscore the political sensitivity and multifunctional role that the sugar sub-sector plays in Kenya.

(vii) The management and governance structure in the milling factories and out grower companies be strengthened to introduce competence and transparency.

# Annexes:

Table 1

**Worlds Ten Largest Producers of Sugar.**

Sugar production in 1996 and 1997 in Millions of Metric tones

| Countries | 1997 Million tones | 1996 Million tones |
|---|---|---|
| European Union | 18.3 | 17.4 |
| Brazil | 16.4 | 14.7 |
| India | 14.4 | 16.9 |
| China | 7.4 | 7.9 |
| United States | 6.7 | 6.6 |
| Thailand | 6.2 | 6.2 |
| Australia | 5.9 | 5.6 |
| Mexico | 5.0 | 4.8 |
| Cuba | 4.3 | 4.4 |
| Pakistan | 2.7 | 2.1 |
| – | – | – |
| – | – | – |
| – | – | – |
| Swaziland | 0.47 | 0.42 |
| **Kenya** | **0.40** | **0.3** |

***Source:*** *cubagob (Government of Cuba) Statistic information 1996-1998; Reproduced from unpublished GTZ Study "Consequence of Liberalization of the Sugar Market for ACP-Countries associated with the EU" page 239.*

Table 2

## Raw Sugar Production Costs for Swaziland and Selected Regions: Average 1993 to 1998

The cost of production of sugar in Swaziland is one of the lowest in the world. This is due to the efficient and effective management of the industry at all stages of production. The production costs of raw sugar for Swaziland and selected regions are shown in this table.

Raw Sugar Production Costs for Swaziland and Selected Regions: Average 1993 to 1998.

| **Country/Region** | **Total Field Cost (US $ per Ton)** | **Total Factory Cost (US $ per Ton)** | **Total Cost (Incl.Overheads) US$/Ton** |
|---|---|---|---|
| Swaziland | 158.6 | 77.7 | 265.5 |
| Africa-a | 197.2 | 105.7 | 340.0 |
| Caribbean-b | 314.9 | 174.1 | 537.9 |
| Pacific-c | 181.7 | 67.9 | 266.2 |
| ACP-d | 221.6 | 116.0 | 374.6 |
| 10th Lowest Cost Producer-e | 178.0 | 84.9 | 271.8 |
| – | – | – | – |
| – | – | – | – |
| – | – | – | – |
| **Kenya** | **—*Uncertain** | **496.2** | **600.0** |

**Notes:** a= Africa Sugar Protocol (SP) quota holders
b= Caribbean SP quota holders
c= Pacific SP quota holders
d= ACP SP quota holders
e= The tenth lowest cost producer in the world
*= The uncertain Field cost of production in Kenya emanates from the fact that most production is done by small scale out growers farmers where there is unreliable and limited documentation.

***Source:*** *"Markets for Swazi sugar: Patterns, challenges and strategic considerations", paper presented at a National Sugar Conference, May 2001.*

The cost of production of Swazi sugar is comparatively low at both field and factory levels. It is in fact only superceded by the Pacific at factory level. As shown in the total cost column the sugar industry of Swaziland out performs Africa, the Caribbean and the Pacific individually and collectively and ranks as the lowest cost producer.

## Table 3
## Comparative internal prices of sugar in various regimes.

| Market | Price/Ton (US$) |
|---|---|
| EU Sugar protocol | 530 |
| SPS | 448.67 |
| US TRQ | 353 |
| World Mkt | 125 |
| Kenyan Domestic Market | 600 |

***Source:*** *"The Kenya Sugar Industry: Cost of Production, Problems and Prospects"*
*Paper presented by Shem Ochola at a Sugar Parliamentary Committee Workshop in Mombasa 4th - 5th July 2003*

## Table 4
## Projected global balance sheet of sugar regime for 2002/2003

- World Production/Consumption outlook 2002/2003 Cane

| Region | Production Metric Tones | Consuption Metric Tones |
|---|---|---|
| America | 46,532,000 | 35,164,000 |
| Africa | 9,515,000 | 12,898,000 |
| **(Kenya** | **400,000** | **630,000)** |
| Asia | 48,457,000 | 57,799,000 |
| Australia/Fiji/Papua | 5,767,000 | 1,493,000 |
| Europe | 37,288,000 | 33,933,000 |
| **Totals** | **147,559,000** | **141,287,000** |
| Surplus | 6,272,000 | |

***Source:*** *The Czarnikow Sugar Review June 2003.*