PACT EAC2
Promoting Agriculture, Climate and Trade Linkages in the East African Community

Briefing Paper

Making Buy Kenya, Build Kenya Strategy Work for Local Agro-processors

By Boniface Otieno Owino

Summary

This briefing paper aims to inform the finalisation of the Buy Kenya, Build Kenya Strategy by suggesting provisions that can promote agro-processing in the country while remaining conscious of the challenges posed by climate change. Agro-processing holds the key to industrialisation, food security, creation of employment opportunities, and poverty alleviation in Kenya. However, it needs governmental support and targeted actions that will be needed to leverage the Buy Kenya, Build Kenya strategy to develop agro-industries through consumption of local agro-processed products.

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PROMOTING AGRICULTURE, CLIMATE AND TRADE LINKAGES IN THE EAST AFRICAN COMMUNITY – PHASE 2
The PACT EAC2 project builds capacities of East African stakeholders for climate-aware, trade-driven and food security enhancing agro-processing development in the region. Web: www.cuts-geneva.org/pacteac2

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Introduction

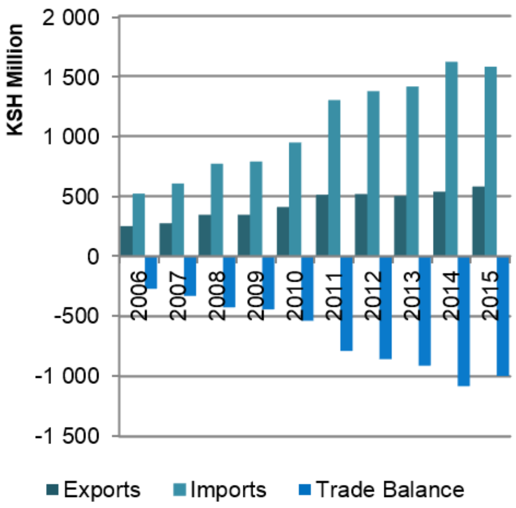
Kenya is largely an agriculture-based economy given that the agricultural sector contributes nearly 25 per cent of the Gross Domestic Product (GDP), absorbs 18 per cent of formal employment, and accounts for 60 per cent of total employment (MALF, 2014). This means that tapping into the economic growth and industrialisation potential of the agricultural sector through agro-processing is central to achievement of Kenya's long-term development agenda as enshrined in Vision 2030. The government considers agro-processing a cornerstone of rapid industrialisation, job creation, poverty reduction, food security, and export performance. Agro-processing is a subset of the manufacturing sector that processes raw materials obtained from agriculture, fisheries, and forestry into finished or intermediate goods (Silva, Baker, Shepherd, Jenane, & Miranda-da-Cruz, 2009). The agro-industrial sector includes manufactures of textiles, apparel, food products, beverages, tobacco, and wood products, among others. In Kenya, the agro-industry sub-sector accounts for nearly 60 per cent of total output in the manufacturing sector.

In a bid to promote agro-processing, the government has focused on supporting producers, processors, traders and marketers in the agriculture sector to develop innovative and competitive products through value addition (Onyango & Nyaberi, 2016). This includes provision of incentives to actors in the sector to invest in the facilities and technology required to improve value addition. Other policy interventions include improving market access through trade agreements, developing physical infrastructure, promoting access to credit, and provision of technical support to farmers and agro-processors. Nonetheless, fierce competition from cheap imports remains one of the major challenges that continue to impede expansion of the agro-processing sub-sector. In the face of rising competition, stimulating local demand and consumption should be considered a key tool in a wider toolbox for enhancing agro-processing in Kenya.

Competition and Agro-processing

Kenya has focused on improving its export performance through enhanced market access. To this end, the country has entered into several Free Trade Agreements (FTAs) with its trade partners to enhance market access through reciprocal removal of tariff and non-tariff barriers to trade. These include: the East African Community (EAC), the Common Market for Eastern and Southern Africa (COMESA), EU-EAC Economic Partnerhips Agreement, and COMESA-EAC-SADC Tripartiate Agreement. Kenya is also a member of the World Trade Organization (WTO) and hence bound by its obligations in the multilateral trading system. This has led to progressive liberalisation of the domestic market to allow entry of foreign products. Although the value of Kenya's exports has increased under a liberalized trade regime, imports have grown much faster. This is evidenced by the deterioration of the trade balance, which remained negative since 2006

Figure 1: Kenya's exports, imports, and trade balance



Source: KNBS

The increase in imports can be an indication of the high competition that locally produced products face from their foreign counterparts. Within the agro-processing sub-sector, textile and apparel is one of the industries that have not been able to achieve optimal growth due to competition from imports (Maiyo & Imo, 2012). For instance, imports of cheap second hand clothes has not only led to the collapse of some local textile manufacturers, but has also limited the ability of existing firms to sell their products in the local market. Other agro-industries that have also been negatively affected by import surges include food, beverages, tobacco, and paper products.

Several factors explain the difficulty that local agro-processed products face in competing with imports. To begin with, local products in some industries such as sugar and textile tend to be more expensive than imports. The high price of local products is an indictment of the high cost of production in the local market (Maiyo & Imo, 2012). This includes the high cost of electricity and energy, logistics services, and reliance on expensive imported inputs such as fertilisers used by farmers. Agricultural producers in developed countries, on the other hand, often benefit from subsidies from their governments. As a result, their products can be cheaper than Kenyan products on the domestic market. Local products also face intense competition from cheap imported counterfeit goods. Counterfeits not only reduce the market shares of genuine local products, but also expose consumers to health risks due to their substandard quality.

Quality is another major factor that contributes to low competitiveness of Kenya's products. Inconsistency in meeting quality standards has over time dented consumer confidence in local products, thereby shifting consumption to imports. In some cases, local products may meet quality standards but fail to satisfy consumers' tastes and preferences. This in turn impedes market penetration. Maintaining high product quality has been a challenge, especially among micro and small agro-processors who lack the technical and financial capacity to comply with quality regulations. Inconsistency in enforcement of quality standards has also led to prevalence of substandard products.

Supply constraints also affect negatively the competitiveness of Kenya's agro-processed products. Factors such as climate change often reduce agricultural production, thereby limiting access to the raw materials needed by agro-processors (Otieno & Washington, 2017). This leads to either inconsistent supply or high cost of local products. Consequently, consumers tend to purchase readily available imports. These factors have together contributed to the high preference for imports that are generally believed to be of high quality and cheaper than local products. This perception has made it difficult for local products, including those whose quality and prices are equal to or better than imports, to penetrate the domestic market.

Towards a Strategy for Supporting Local Consumption

The promulgation of the Constitution of Kenya (CoK), 2010 was among the first major steps towards promoting consumption of local products by government entities. The CoK, 2010 requires government entities to procure goods and services through a system that is fair, transparent, competitive, and cost-effective. To this end, the Constitution provided for enactment of a legislation that provides for categories of preferences, as well as, protection of individuals or groups that have historically been disadvantaged due to unfair competition or discrimination in the procurement of goods and services. This provision led to the enactment of the Public Procurement and Asset Disposal Act (PPAD), 2015. The Act requires all government organisations to allocate at least one third of their procurement budget to women, youth, and people living with disability. Thus, agro-processors falling under this category of preference are expected to benefit from government procurement.

In a bid to improve consumption of local products by the public and the private sector, the government in 2015 launched the Buy Kenya, Build Kenya (BKBK) initiative. The initiative involved reserving at least 40 per cent of all goods and services procured by the government to local producers or suppliers. This was meant to protect local producers from intense competition from imports. In 2017, the Ministry of Industry, Trade, and Cooperatives developed the draft Buy Kenya, Build Kenya Strategy (BKBKS) to provide guidelines and policy interventions that are expected to help achieving the objectives of the BKBK initiative. The main objective of the draft BKBKS, 2017 is to increase competitiveness and consumption of locally produced goods and services.

Remaining gaps

However, the draft BKBKS, 2017 fails to capture some of the key constraints in the business environment that continue to bedevil efforts to improve consumption of local agro-processed products. These include the high cost of production occasioned by high and unreliable supply of electricity for industrial use. Excessive delays in payment of suppliers including agro-processors by retailers also hamper production. Delays in payment ties up capital for a long time, thereby forcing agro-processors to resort to expensive borrowing that in turn increase their operating costs. This challenge is exacerbated by the recent introduction of interest rate capping which has led to rationing of credit to the private sector, especially to small and medium size agro-enterprises that are considered high risk. The negative effect of delays in payment has economy-wide negative macroeconomic effects. For instance, farmers have to wait until agro-processors are paid for them to receive their payment for raw materials. Creditors, on the other hand, have to grapple with huge non-performing loans since suppliers including agro-processors are not able to service their loans due to delays in payment by retailers.

The draft also fails to recognise the importance of mitigating and adapting to climate change as a way of promoting sustainable production of cheap and high quality agro-processed products. Adverse climatic conditions such as drought are known to affect the competitiveness of agro-processed products by limiting access to raw materials from the agricultural sector. In the absence of local cheap raw materials, agro-processors have to rely on imports.

The focus of the draft BKBKS is skewed towards promoting consumption of local products by the government. Given that the private sector is expanding rapidly, private firms must also be encouraged to consume local products. Further, the draft does not provide for the articulation of a legal framework to facilitate inclusion of local content in the goods manufactured in Kenya in ways that are compatible with its WTO obligations. Civil society and Non-governmental organizations have also not been included in the draft as key actors in the implementation stage. Finally, the draft has no provisions for developing market infrastructure as a way of facilitating access to and consumption of local products.

Recommendations

In order to make the BKBK strategy work for agro-processors, the following provisions should be considered:

1. *Reducing cost of production*

Reducing the cost of production should be prioritized to improve the competitiveness of local products. This includes implementing measures to ensure supply of affordable and reliable electricity for industrial use. Tax incentives such as removal or reduction of value added tax (VAT) and excise duty on agro-processed products is necessary to enhance their consumption.

2. *Ensure timely payments*

Second, a legal framework should be developed to ensure timely payment of suppliers by retailers to promote sustainable production by agro-industries. The current payment period of 90 days should be reduced to 30 days and the bottlenecks in resolving disputes related to non-payment or delays should be addressed. This will allow suppliers to access their revenues in time and allocate them to production of innovative and competitive products.

3. *Capacity for climate adaptation*

Climate change should be acknowledged as a potential threat to competitiveness of local products. Building the capacity of agro-processors to mitigate and adapt to climate change is expected to improve the competitiveness of their products in terms of price and quality, which in turn will enhance domestic consumption.

4. *SME Incentives to source locally*

The draft BKBK strategy should provide incentives to private sector firms to encourage them to source their inputs from locally produced products.

5. *Leverage civil society*

Civil society and non-governmental organizations such as consumer organizations should be recognized and included in the draft as key stakeholders during its implementation, monitoring and evaluation. Civil society organizations are expected to play a key role in promoting consumption of local products through awareness creation, ensuring accountability, and advocating for policy reforms.

6. *Develop market infrastructure*

The draft should incorporate provisions for developing market infrastructure to facilitate access to local products. This includes expansion of market facilities that are mainly used by local producers to market their products. Agro-processors and marketers should also be equipped with practical skills to use e-commerce as a means of improving the visibility of their products to increase sales.

Conclusion

Promoting consumption of locally produced goods holds the key to unlocking the potential of the agro-processing sector. To this end, the BKBK strategy should incorporate measures to address the key challenges that impede access to the local market by agro-processors. The resulting expansion of the agro-processing sub-sector is expected to promote rapid industrialization. This will lead to creation of more job opportunities, alleviation of poverty, and improved standards of living among all Kenyans while mitigating and adapting to climate change. This will also lead to better trade performance through improvements in quality and competitiveness.

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