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SUBSIDIZATION OF COTTON FARMING IN THE UNITED STATES OF AMERICA AND ITS IMPLICATIONS FOR KENYA'S COTTON SECTOR FROM 1990 – 2006

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Declaration

I Njeri Mwangi-Kinyoho hereby declare that this research project is my original work and has not been presented for a degree in any other university.

Signed.................................... Date....13.11.2007..

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This project has been submitted for examination with my approval as university supervisor.

Signature .... Date..............................15/11/07

Dr. Adams Oloo

(Supervisor)

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Dedication

I dedicate this research study to my family, my husband Kinyoho and children Mburu and Mwangi, for their endless support. I also dedicate it to both Anne Gikonyo and Fr. Francis Kangwa who never ceased to encourage and give me the moral support that I needed to finish this project.

Thank you all and may God Bless you.

Abstract

Agriculture still remains the key sector in African economies as it contributes significantly to their growth. A large proportion of agricultural produce from these countries is meant for the export market but shifts in local, regional and international policies have resulted in declining performance of this sector especially cotton. Implementation of biased policies by developed countries in particular United States of America, has resulted in limited access to the world cotton market by developing countries, Kenya included. These policies in particular subsidization of the US cotton industry have resulted in a fall of cotton prices at the world market. The neo-liberalism theory assists the study in deducing the reasons behind unfair competition in cotton trade. While the theory advocates for free trade, this was not the case in the cotton industry as the American government continued to be actively involved in its cotton industry by classifying its subsidies to be within the World Trade Organization (WTO) allowed standards of support. This continued to aggravate the inequalities between the cotton producing countries.

This project notes that the Kenyan government had implemented different programs to revive the sector at the local level. At the international level, the government in liaison with other developing countries is lobbying at the WTO for developed countries to reduce their subsidies. It is anticipated that this will improve developing countries access to the world market. As a result, such initiatives would significantly revive the cotton sector to enjoy its comparative advantage and enable it contribute as expected to the country's economy.

From the project findings, it is recommended that the Kenyan government undertakes a significant role in the cotton sector. This will be through provision of incentives, implementation of limited subsidization policies, infrastructure development and establishment of an apex institution to supervise the sector. Changes in terms of government policies also need to be analyzed before implementation to reduce the negative impacts resulting from rush or poor implementation. Lobbying at the WTO would also play a significant role in the revitalization of the industry. This would increase the access of Kenyan cotton at the world market.

Abbreviations

AGOA	–	African Growth Opportunity Act
AIA	–	Africa Industrial Association
CDP	–	Cotton Development Programme
CDO	–	Cotton Development Organization
CL&SMB	–	Cotton Lint and Seed Marketing Board
CRIP	–	Crop Revenue and Insurance Program
DDT	–	Dominant Development Theory
EU	–	European Union
ECGP	–	Export Credit Guarantee Program
EPZ	–	Export Processing Zone
FKE	–	federation of Kenya Employers
GDP	–	Gross Domestic Product
ICAC	–	International Cotton Advisory Committee
IMF	–	International Monetary Fund
KAMEA	–	Kenya Apparel Manufacturers Exporters Association
KAM	–	Kenya Association of Manufacturers
KCGA	–	Kenya Cotton Ginners Association
KIPPRA	–	Kenya Institute of Public Policy Research and Analysis
LDCs	–	Least Developed Countries
MUB	–	Manufacturing Under Bond
NCC	–	National Cotton Council
NIE	–	New Institutional Economics
OECD	–	Organization for Economic Co-operation
UNCTAD	–	United Nations Conference on Trade and Development
US	–	United States of America
WTO	–	World Trade Organization

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CHAPTER ONE
INTRODUCTION

1.1 Background

Agriculture remains the key sector for most developing countries as they move towards industrializing their economies. In the sub-Saharan Africa, the sector forms the backbone of most of the economies. Despite this importance, the performance of the sector has experienced a slump in the recent decades mainly as a result of a shift from government controlled policies to liberalized market policies (Nyangito and Okello, 1998).[1] In recent years, agricultural protection and its impact on developing countries have attracted growing attention. Agricultural protection continues to be among the most contentious issues in global trade negotiations. Events in the global agricultural market are important for both exporting and importing countries beyond the price changes triggered by global reforms. This is because global trade contributes significantly to the growth of agriculture and economy as a whole of developing countries (Bennis, 1995).

As liberalization of world economies becomes the norm, the fear in many developing countries especially, is that developed countries are instituting various trade barriers to protect their markets thereby resulting in unfair competition. Given their lack of market power, developing countries may be extremely vulnerable to changing market conditions in the North, fuelled by an often intricate mixture of political and socio-economic interests.

Countries must export to import, and integrating an economy into world markets induces institutional change, which facilitates increased rates of economic growth. Internationally traded

[1] Kenya's Agricultural Policy and Sector Performance: 1964 to 1996

commodities such as horticultural products, coffee, tea and cotton are directly or indirectly, major sources of employment and income for millions of people in developing countries, particularly in Sub-Saharan Africa. However, many commodity dependent countries and their producers face acute and very damaging problems, brought about partly, by the nature of the markets in which they operate. The ever declining price of commodities such as cotton have caught most countries in a vicious circle of declining income and investment, stagnating competitiveness, persistent increase in levels of poverty and high levels of dependence. The commodity sector in general is having difficulties in adapting to the increasingly harsh international competition and changes in the international market environment.[2]

1.1.1 The Cotton Industry

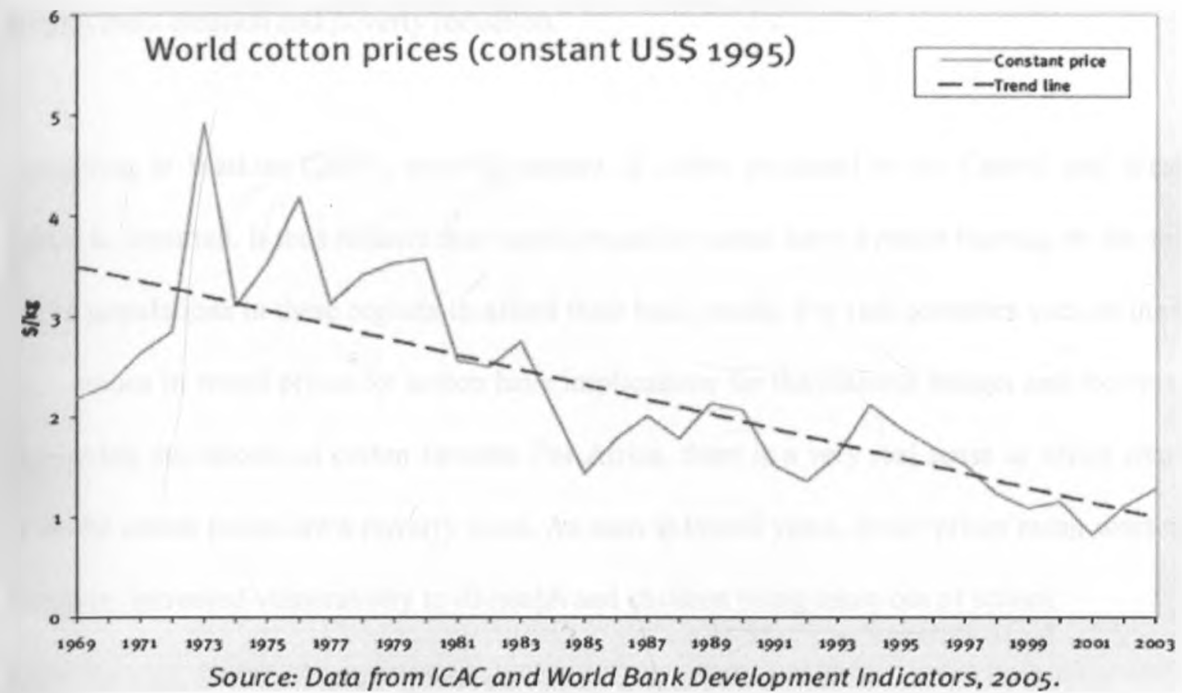
Cotton is produced in many countries, but the northern hemisphere accounts for nearly 90 percent of global output. More than two-thirds of cotton is produced by developing countries. During the last four decades cotton production grew at an annual average rate of 1.8 percent to reach 20 million tons in 2001 from 10.2 million tons in 1960. Most of this growth came from China and India, which tripled and doubled their production, respectively, during this 40-year period. Francophone Africa produced less than 100,000 tons in the 1960s and now produces ten times as much. The United States and the Central Asian republics of the former Soviet Union, the two dominant cotton producers during the 1960s, have maintained their output levels at about 3.5 and 1.5 million tons, respectively, halving their shares. The share of East African cotton producers has declined considerably during this period (Baffes et al, 2004).

[2] New EU Action Plan on Agricultural Commodities, Dependence and Poverty and a Specific Action for Cotton, May 2004

One-third of cotton production is traded internationally. The four dominant exporters are United States, Uzbekistan, Francophone Africa, and Australia that account for more than two-thirds of world exports. Real cotton prices have declined over the last two decades, although with temporary spikes. The reasons for the long-term decline are similar to those characterizing most primary commodities: reduction in the costs of production due to technological improvements, stagnant per capita demand, and competition from synthetic products. Between 1960–64 and 1999–2003, real cotton prices fell by 55 percent, quite similar to the 50 percent decline in the broad agriculture price index of most commodities (Baffes et al, 2004).

An UNCTAD Report in 2004 on 'Trade Performance and Commodity Dependence' indicated that the cotton industry had witnessed a sharp fall and instability of world prices in the last 15 years. The report indicates that real prices of cotton have lost their value by half compared to its level in 1960. At the time, the prices reached, on rate, US $ 2.3 against US $ 1.34 during the 1990s. In 1999, changes made by China, which is also a major cotton producer, contributed to further increase the instability of world prices. Between 1985 and 2002, world cotton prices fell by 0.9 per year. Synthetic fibers, which now represent almost 60 percent of world textiles consumption, also had a significant impact on the world cotton market. This situation continues to threaten the stability of revenues of countries depending on this 'white gold'. Figure 1 below indicates the fall in world cotton prices between 1969 and 2003. It is worth noting that in 1973, the prices reached an all time high of nearly US $ 5 per kilogram and has dropped to below US $ 2 per kilogram.

Figure 1: Fall of world cotton prices: 1969 – 2003



Source: Data from ICAC and World Bank Development Indicators, 2005.

1.1.2 The Cotton Industry in Africa

Baffes et al, (2004) indicates that cotton supports the livelihoods of millions of rural households especially in West and Central Africa where it is a typical, and often dominant, smallholder cash crop. Cotton also has macroeconomic significance in several countries of the region, as it accounts for approximately more than 30 percent of total merchandise export earnings of the countries.

The Africa Industrial Association (2004) indicates that at least 15 percent of world cotton exports originate in 9 countries from Central and Western Africa. Western and Central Africa represent a relative weak share of total production (5 percent), but these regions are responsible for not less than 13% of total exports. It is estimated that at least 10 – 15 million people from these regions

are directly dependent on cotton activities, hence the critical role played by the sector in employment creation and poverty reduction.

According to Watkins (2003), over 90 percent of cotton produced in the Central and Western Africa is exported. It thus follows that world prices for cotton have a major bearing on the ability of the populations in these regions to afford their basic needs. For rich countries such as the US, fluctuations in world prices for cotton have implications for the national budget and the costs of supporting the income of cotton farmers. For Africa, there is a very real sense in which changes in world cotton prices are a poverty issue. As seen in recent years, lower prices mean worsening nutrition, increased vulnerability to ill-health and children being taken out of school.

Since cotton represents at least one-third of export earnings for many countries in Africa, and a larger share of agricultural export earnings, it follows that world cotton prices have a major bearing on balance-of-payments, debt sustainability and by extension the capacity of countries to import. Over the past decade, governments in the region have made major efforts to improve both the quality and efficiency of production. According to the International Cotton Advisory Committee, West Africa is one of the world's most efficient producers as the costs of production are around one-third lower than in the United States, reflecting the advantages of small scale farms over highly mechanized capital intensive agriculture (Watkins, 2003).

Ironically despite this comparative advantage, the fall of cotton prices by nearly half since mid 1990s presents a grim picture for the industry in Africa. When these prices are adjusted for inflation, they are now lower than at any time since the Great Depression in the 1930s, with

limited scope for recovery (Oxfam, 2002). Cotton producers are under pressure from declining prices, competition from chemical fibers, stagnant per capita demand, and domestic policies.

Cotton trade and production are highly distorted by policy. Attempts by poor countries, including cotton-producing African states, to get the World Trade Organization to rule such policy support illegal have generally failed as noted by Gillson (2005). Several developing countries rightly estimate that subsidies, high tariff and non tariff policies practiced by the EU and the US are contradictory to free trade principles encouraged by the WTO. The effect of these policies especially subsidies, has been to depress world cotton prices, damaging poorer countries that rely on exports of cotton for foreign exchange earnings. Subsidies in the form of support to cotton producers in developed countries by virtue of their magnitude, is particularly damaging and responsible for most of the reduction in earning potential of other cotton-producing countries. For industrialized countries, cotton is a minor component of economic activity but its production plays a major role in some developing countries especially in Africa, for example in Benin, Burkina Faso, Chad, Mali and Togo, cotton accounts for 5–10 percent of GDP, more than one-third of total export receipts and over two-thirds of the value of all agricultural exports. Thus implementation of subsidies in the US, China and Europe have had a major impact on cotton producing countries.

A subsidy as defined by Wikipedia (2007) is generally a monetary grant given by government to lower the price faced by producers or consumers of a good, generally considered to be in the public interest. Subsidy refers to the grants of money made by the government to either a seller or a buyer of a certain product or service, thereby altering the price or cost in a way which affects

the output. Governments usually make payments to domestic producers to offset partially their costs of producing and selling certain goods and services. Subsidies are normally in the form of government programs and policies intended to encourage certain types and forms of industry, and thus giving them an advantage in the marketplace. This leads to unfair competition and lower returns for those producers producing the good without assistance, and rewards those whose production processes may be inefficient.

According to Ikiara and Ndirangu (2003), massive government support to farmers in form of subsidies in the leading cotton production countries distorts world cotton prices. For instance, farmers in the two main producing countries that account for almost half of the world production benefit from subsidies as high as 20 percent of world prices in China and 50 percent in the United States. Cotton subsidies in the European Union exceed 100 percent. The U.S heavily subsidizes its farmers through price support mechanism, which ensures that domestic producer prices are higher than world prices. Total support to the cotton sector was estimated to be US $ 4.2 billion in 2001/02. In the European Union, support to farmers in form of subsidies was estimated to be about US $ 716 million in 2001/02. In China, government support amounted to US $ 1.2 billion. The above interventions translate to distortion and suppression of world cotton prices. The consequences are harsh and detrimental to countries such as Kenya where cotton farmers do not benefit from subsidies or insulation from price instability. The International Cotton Advisory Committee (ICAC) estimates show that in the absence of heavy subsidies in 2001/02, market prices of cotton would have been approximately 70 percent higher than they were.

As noted in the Oxfam Report (2002), American subsidies led to a loss of US $ 301 million for the whole Sub-Saharan region. Financial prejudices generated by these subvention policies diminish revenues of the balance of trade of these countries. Table 1 below presents an estimation of the loss that some countries from Western and Central Africa, the most stricken ones, have undergone in 2002, due to American subsidies.

Table 1: Loss related to American subventions to cotton (values in millions US $)

Country	Real revenues from cotton exports	Total exports benefits if American subsidies were withdrawn*	Losses due to American subsidies
Mali	161	204	43
Benin	124	157	33
Ivory Coast	121	153	32
Burkina Faso	105	133	28
Cameroon	81	102	21
Chad	63	79	16
Togo	61	77	16
Nigeria	55	69	14

* *The figures are those of the 2001 – 2002 seasons.*

In total, American subsidies prevented Western and Central Africa from benefiting an additional US $ 203 million from their cotton exports. Such losses not only directly affect all actors of the African cotton sector, from the farmer to the industrial operator, but they also reduce governments capacities to grant significant budgets necessary in key areas such as health or education.

The African Industrial Association notes that the fall in cotton prices can be explained by various factors with the most significant cause being agricultural subsidies policies mainly implemented

by the European Union (EU) and the United States (US). For instance, for the 2001-2002 periods, the amount of subventions granted to cotton producers reached US $ 700 million in EU and US $ 3.7 billion in the US. These subventions favoured a surplus of production in industrialized countries. These surplus, poured in the world market, and sold at prices inferior to their real cost of production thus accentuating the fall of world cotton prices. In May 2002, the US adopted a regulation more commonly called the 'Farm Bill Act', aimed at increasing the amount of subsidies paid to farmers. For the cotton sector, the Farm Bill Act planned to dedicate, in the next 5 years, an additional US $ 2.5 billion per year. It seems unquestionable that such a high level of subsidies of American and European cotton represents a real distortion of exchanges.

Since independence Kenya's cotton industry has undergone various phases, from domination by private colonial ginners, to formation of cooperative societies that were formed to buy out the ginneries from the colonialists. The cooperative societies instituted a regime of strict control on cotton prices, and invested in textile mills that supplied the private apparel manufacturers.[3] During this early period, the sector grew tremendously until government and donor assistance was withdrawn in the mid 1980s when the sector sharply declined and many textile firms collapsed. This problem was accelerated by liberalization and the ban of textile imports from Kenya by the US in 1994.[4] The government and the private sector have in the recent past shown substantial interest in the revival of the industry (Rates, 2003). This is partly due to the fact that

[3] Ikiara M. and Ndirangu K. 2003, *Developing a Revival Strategy for Kenya's Cotton-Textile Industry: A Value Chain Approach*

[4] ibid

the cotton-textile industry offers unique opportunities for increased employment, poverty reduction, rural development and increased incomes for arid and semi-arid areas.

Currently, cotton's contribution to the GDP is relatively small, less than 2 percent when compared to major export crops like tea and horticulture whose contributions are above 15 percent (Central Bureau of Statistics, 2007). However, the demand for textile materials in Kenya is increasing rapidly as a result of the African Growth Opportunity Act (AGOA), an American initiative to expand trade between the USA and Sub-Saharan Africa, Latin America and the Caribbean. This would be achieved through reduction of tariff, non-tariff and other barriers, and through negotiation of trade agreements to integrate the region into the global economy, and expand US assistance to regional integration in Africa. Notably, Kenya's textile exports to the US increased from US $ 39.5 million in 1999 to US $ 277million in 2004.[5] However, despite this positive growth, the impact/benefits of AGOA have had little impact in the cotton industry.

It is against this background that this study seeks to reveal whether subsidization policies in America affect the cotton industry in Kenya, thereby eroding the gains made in developing the industry. As Diao et al (2003) points out, the industrialized countries need to reduce the high levels of protection to allow fair trading between developed and developing countries.

[5] Kenya's Apparel and Textile Industry, 2005, A report by the Export processing Zones Authority

1.2 Statement of the Problem

The performance of cotton industries in Africa is improving but with limited benefits for the countries. The prevalence of subsidization policies in developed countries especially USA, has limited access of African countries to the global cotton market. The subsidies deprive African exporters the world market share resulting in negative consequences in their macro-economies. Faced with such competition, the African cotton industry cannot compete despite the comparative advantages it enjoys such as low costs of production.

Kenya as a cotton growing nation is not an exception to this issue. While attempting to revive the industry, the government faces an uphill task of enabling the industry's products access the global market that is characterized by unfair competition in the form of subsidization. It is thus important to identify the subsidies that affect the cotton industry. In view of this, the study seeks to answer the following research questions:

i) What are the subsidization policies in the US cotton industry?

ii) What are the effects of these policies to the Kenyan cotton industry?

This will enable the study to draw out general recommendations on how Kenya could respond to ensure sustainability of the cotton industry and accessibility to the global cotton market.

1.3 Objectives of the study

The main objective of the study is to identify the level of subsidization in the US cotton industry and its impact on the cotton industry in Kenya. The specific objectives are:

i) To identify subsidization policies in the US cotton industry.

ii) To determine the effects of these subsidization policies on the Kenyan cotton industry.

1.4 Justification of the study

With the changing global economy and integration of regional economies into trading blocks, there is need for any individual country's economy to realign itself and seek its comparative advantage in the global market. This is because the country's import and export market tends to determine the growth of the country's economy. Kenya's economy is still heavily reliant on agriculture as its main base for economic development. The cotton sector in Kenya is considered particularly critical to the economy especially in the revival of the textile industries which have the potential for increased foreign exchange earnings.

The government of Kenya has identified the cotton sector as one that can play a significant role in poverty alleviation because of its potential to offer labour-intensive employment to the rural communities in arid and semi-arid areas (Republic of Kenya, 2000). This is because these areas have limited alternative development use and vast land area.[6]

The study thus attempts to shed light on the US subsidization policies and their respective effects to Kenya's cotton industry. Concrete recommendations from the study findings would enable the relevant stakeholders in the sector to seek and implement measures that would enable the revival of the country's cotton industry to maximize on the available opportunities in the world market.

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[6] Ikiara M. Moses & Ndirangu K. Lydia, *Prospects of Kenya's Clothing Exports under AGOA after 2004*, KIPPRA Discussion Paper No. 24, January 2003 – p 52-53

1.5 Scope and Limitations

The study focuses on the influence of US policies on Kenya's cotton industry and hence secondary data will be the source of information and hence limit the study to desk (library) research. The study will concentrate on the period between 1995 and 2007 of which the cotton industry has been struggling to revive itself despite the implementation of various policies that affect it negatively.

1.6 Methodology

The nature of this project eschews primary sources as it will be based on library/desk research and use of the internet. There is heavy reliance on the library materials namely government policy documents, literature of similar studies in other countries, journals, magazines and newspapers which are extensively used in developing the arguments. International treaties and legislations are also used to illustrate the underlying theme of the study.

1.7 Literature Review

This study reviews literature under the category of globalization and liberalization with specific focus on the inequalities prevailing in the cotton industry between developed and developing countries. Liberalization calls for opening up of markets and is an agenda that is pursued by global institutions namely the World Trade Organization, the World Bank and the International Monetary Fund (IMF). Newfarmer (2005) argues that, while enormously beneficial for most

people in developing countries, globalization had bypassed many of the poorest countries.[7] While domestic policies and obstacles matter, inequities in the world trading system also put developing countries at a disadvantage. Although agriculture is central to the development of developing countries, the protection facing developing country exporters in agriculture is four to seven times higher than in manufacturing in the Organization for Economic Co-operation (OECD) countries. The tariff peaks against products from poor countries are particularly high in rich countries. This results in the developed countries being able to further develop their own industries while simultaneously crippling the ability of developing country producers to acquire capital by selling their products to the rich countries where effective (the demand for a product coupled with the funds sufficient to purchase the product) is much more abundant than it is domestically. The existence of these tariffs has contributed immensely to the diminution of the developing countries' ability to effectively get fair market access and a fair price for their products.[8]

According to the United Nations Economic Commission for Africa's Economic Report on Africa 2004, "Unlocking Africa's Trade Potential", the search for broad-based human development in Africa could benefit from trade liberalization. However, it recognizes the meager benefits that Africa's trade reforms have brought in and the need for correct trade policies to be put in place. The report states that Africa has not achieved much from trade liberalization especially in terms of economic growth and integration into the global economy. The continent has not grown fast enough to break out of poverty. It has, instead, become increasingly marginalized in international

[7] Richard Newfarmer (Ed), *Trade, Doha, and Development; A Window into the Issues*, World Bank, November 2005
[8] Ibid, p16

trade. In fact, Africa's share of global exports fell from 4.1 percent to 1.6 percent between 1980 and 2000, while its share of imports fell from 3.2 percent to 1.3 percent over the same period.[9]

The report states that the major challenge to Africa's agricultural sector is paused by the continuation of developed country protectionism, despite the commitments entered into during multilateral negotiations. Rich countries continue to subsidize their agricultural sectors while African countries, under successive Structural Adjustment Programmes (SAPs), have made large cuts in all forms of support to their farmers.

Stiglitz (2002)[10] argues that the immediate impact of trade liberalization was loss of jobs as local industries closed down since they could not compete with international market players. The IMF held the notion that through trade liberalization, new and more productive jobs will be created as the old inefficient jobs are done away with. This however, has not always been the case. Stiglitz argues that forced trade liberalization on weak African economies has led to sudden closure and deaths of local industries. Cotton farmers have been pushed out of business and so have poultry, tomato and cocoa farmers amongst many others. It is, therefore, not necessarily true that the so-called 'leading corporations' have created employment. They have, instead, led to massive loss of jobs in Africa as they strive towards having 'effective' work-forces and as a result laying off workers. It is also true, that commodity prices have not necessarily gone down by having these lead corporations dominate local markets. Monopolies have been known to arbitrarily raise commodity prices with impunity thus hurting citizens of poor economies especially in Africa.

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[9] UN Economic Commission for Africa, *Economic Report on Africa, 2004, Unlocking Africa's Trade* Potential
[10] Joseph E. Stiglitz, *Globalization and its Discontents,* (Allen Lane/Penguin Books, 2002)

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Stiglitz (2002)[11] argues that the Washington Consensus policies were based on a simplistic model of market economy, the competitive equilibrium model, in which Adam Smith's invisible hand works, and works perfectly. In this model, there is no need for government – that is, free, unfettered, "liberal" markets work perfectly. The Washington Consensus policies, sometimes referred to as 'neo-liberal', based on market fundamentalism, a resurrection of the laissez-faire policies that were popular in some circles in the nineteenth Century. In the aftermath of the Great Depression and the recognition of other failings of the market system, from massive inequality to unlivable cities marred by pollution and decay, these free market policies have been widely rejected in the more advanced industrial countries, though within these countries there remains an active debate about the appropriate balance between government and markets.[12]

Stiglitz[13] further states that it is a sham that the West, through their multi and transnational corporations have continued to push trade liberalization so that they can find markets for their exports while being highly hypocritical and continuing to protect those sectors in which competition from developing countries might threaten their own economies.

According to Sachs,[14] sustained economic growth requires that poor countries increase their exports to the rich countries, to earn them foreign exchange to import capital goods from the rich countries. Despite this, trade barriers in rich countries hamper export growth. African countries require trade plus aid since trade alone is not powerful enough to pull most poor African countries out of the poverty trap. While condemning agricultural subsidies by the rich countries,

[11] Ibid
[12] Ibid
[13] Ibid
[14] Jeffrey Sachs, " *The End of Poverty, How we Can make it Happen in Our Lifetime*", 2005

Sachs argues that cutting agricultural subsidies will not necessarily result in a great boon for developing countries, but tropical products could benefit from such cuts in subsidies. These products include cotton, sugar and bananas amongst others.

Openness to international trade is not a recent phenomenon for developing countries, according to Khor.[15] Developing countries' trade in commodities continues to decline, with the decline becoming more acute in the recent years, leading to a transfer of huge volumes of real resources from commodity-exporting developing countries through the mechanism of income losses arising from terms-of-trade changes. The pressure for import liberalization under loan conditionality has left many poor countries even poorer.

According to Fabiosa et al,[16] many developing countries have been disappointed with the limited achievements of the WTO's Uruguay Round Agreement on Agriculture, which led to their unified front in Cancun where they shifted focus to the lack of market access in high-income countries especially in the US and the EU. The protection and support provided by the two members is perceived as unfair given that most developing countries cannot compete in terms of fiscal resources. The lack of market access constrains trading from exporting countries due to the imposition of tariff rate quotas. They confirm that agricultural subsidies in high-income countries depress world market prices, and they end up dumping into the world markets. The objective of income transfer to domestic farmers frustrates competitive exporters in developing countries and compromise income generation in the poor countries such as in the case of cotton. They state that

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[15] Martin Khor, *"Globalization and the South; Some Critical Issues"*, April 2000
[16] Jay Fabiosa et al , *" The Doha Round of the World Trade Organizational and Agricultural Markets Liberalization; Impacts on Developing Economies"*, Review of Agricultural Economics – Vol 27 No. 3 Pages 317 – 335, DOI:10.1111/J.1467- 9353.2005.00252.x

trade barriers are a regressive policy instrument that hurts poor consumers.[17] They argue that with the removal of subsidies Africa could expand production of cotton by 6 percent (112,000 metric tons) and exports by almost 13 percent (158,000 metric tons).[18] Nel and McGowan[19] allude to the fact that the impact of restricting protectionist measures is twofold: on the one hand, it makes it difficult for developing states to protect young industries or regulate the price of agricultural products; while on the other hand, the multilaterally agreed anti-protectionist rules of the WTO also place pressure on the developed rich countries to open their markets more for developing country exports.

Stiglitz and Charlton[20] argue that trade can have a significant positive effect on economic growth and development. They cite examples of the technological breakthroughs that put Britain on the path to becoming the first truly 'modern' economy, and between 1870 and 1950, the British population nearly tripled. These trends are linked to Britain's trade with her neighbours and colonies. Japan's rapid industrialization in the twentieth century was also a result of a combination of domestic and international factors, such as adopting the Western technology, student exchange programmes with the US and Europe. They argue that almost every state today imposes some trade restrictions and taxes. However, they hasten to add that, some of the developed countries that have some of the most ardent advocates of trade liberalization have been somewhat duplicitous in their advocacy. They have negotiated the reduction of tariffs and the elimination of subsidies for the goods in which they have a comparative advantage, but are more reluctant to open up their own markets and to eliminate their own subsidies in other areas

[17] Ibid (p 2)
[18] Ibid (p 10)
[19] Philip Nel and Patrick J. McGowan, "*Power, Wealth and Global Order, An International Relations Textbook for Africa,* Commissioned by The Foundation for Global Dialogue, University of Cape Town press, 1999 (p 45)
[20] Joseoh Stiglitz and Andrew Charlton, " *Fair Trade for All; How Trade can Promote Development,* Oxford University Press, 2005 (p 11)

where the developing countries have an advantage. As a result, the current global trade regime in many ways is disadvantageous to the developing countries. They state that if the developed countries truly wanted to promote development in the Doha Round, they should reduce their tariffs and subsidies on the goods of interest to the developing countries.[21]

Cairncross et al[22] talk of the rising tide of protectionism. They allude to the fact that it is not easy to stem the tide of protectionism in a world in which markets have ceased to expand. They say that there all manner of rigidities e.g. reluctance to change jobs, problems of re-training and the dilemma of macro-economic management in seeking to maintain a steady pressure of demand, all of which may force governments to retreat from policies of full employment due to the danger of inflation or external deficit. In such instances, governments tend to listen to demands for protectionism. This has in turn hurt the imports from developing countries the most. New protectionist measures such as voluntary export restraints and orderly marketing arrangements are a sign of a general weakening of the resolve to maintain an open trading system. However, Shepherd and Langoni[23]argue that throughout, the developing countries are abandoning systems of extensive protection, and are opening up to foreign trade, as they recognize that restrictive trade policies have been costly to their economies, underwriting inefficiency and limiting growth. They argue that although adjustment costs, in particular, possible unemployment, are to be expected in the transition from restricted to free trade, there is little evidence to suggest that liberalization has led to net unemployment.

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[21] Ibid (p 13)

[22] Alec Cairncross et al' " *Protectionism Threat to International Order; The Impact on Developing Countries,* Commonwealth Secretariat, 1982 (p 15)

[23] Geoffrey Shepherd and Carlos Langoni, "*Trade Reform Lessons from Eight Countries*" Executive Summary, An International Centre for Economic Growth Publication, ICS Press (1991)

According to the UNCTAD report, "The Least Developed Countries Report 2004; Linking International Trade with Poverty Reduction[24] international trade can play a powerful role in poverty reduction in the Least Developed Countries (LDCs). The report argues that international trade is important because exports and imports facilitate a process of sustained economic growth, the development of productive capacities and expansion of employment opportunities and sustainable livelihoods. For most LDCs, the primary sector, particularly agriculture dominates production and employment in the economy and productive capacities are weakly developed. In this situation, exports enable the acquisition, through importation goods which are necessary for economic growth, raw materials, machinery, equipment and means of transport amongst others.

The report further argues that international trade is important for poverty reduction in LDCs because contrary to popular belief that their "openness" measured by the level of trade integration with the rest of the world, is high. For example, 1999-2001 exports and imports of goods and services constituted an average of 51 percent of the GDP of the LDCs, much higher than that of high-income OECD countries which stood at 43 percent in those years.

1.8 Theoretical Framework

This study will employ the neo-liberal theory in order to understand the policies implemented by the US and their respective effects to the cotton sector in Kenya. The term neo-liberalism was coined by Conservative Republicans to describe a political-economic philosophy. The

[24] The report was prepared by the UNCTAD Secretariat in 2004

philosophy advocated for achievement of economic progress as well as social justice by encouraging free market methods and fewer restrictions on business operations.[25]

Neo-liberalism in theory is essentially about making trade between and among nations easier. It is about freer movement of goods, resources, capital and enterprises with a view to finding cheaper resources, to maximize profits and increase efficiency. To accomplish this, neo-liberalism calls for amongst other conditions, removal of barriers to trade such as tariffs, and putting regulatory measures in place. It is an economic system based on free enterprise and free trade ("liber" in Latin means "free") that holds that no government action should inhibit absolute freedom of commerce by people or corporations anywhere in the world.[26]

Adam Smith, in his book, *The Wealth of Nations,* suggests that for maximum efficiency, all forms of government intervention in economic issues should be removed. There should be no restrictions or tariffs on manufacturing and commerce within nations for it to develop.

However, even during its prevalent times before the Second World War, neo-liberalism had already started to show signs of increasing disparities between the rich and the poor. John Maynard Keynes, using the 'Keynesian' model of development suggested that regulation and government intervention was actually needed in order to provide more equity in development. This laid the foundation for the re-building of the US-European-centered international economic system. The Marshall Plan for Europe helped reconstruct it and the European nations saw the benefits of social provisions such as health, education as did the US under President Roosevelt's

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[25] Wikipedia Dictionary: http://en.wikipedia.org/wiki/Neoliberalism
[26] Ibid

New Deal. [27] Similar trends in reconstruction of Europe were noted in England as a result of creation of deregulated markets as noted by Prof. John Gray.[28]

According to Martinez and Garcia (1999), it is possible for the state to suppress the market, but also to promote it. They indicate that the free market emerged in Europe under the protection of the state, and that the market needs the state, more than the other way around. This is due to the fact that the market needs internal regulation, in order to function: the state, in the form of the legal system, establishment of uniform systems of weights and measures, and a uniform currency. Without these there would be no free market, no market forces, and no resulting market society. Thus the free market is itself a form of social organization and if no one ever promoted or enforced it, there would be no free market on the planet. The modern free market came into existence primarily because liberalism demanded its existence. This demand was a political demand, and it was enforced through the state.[29]

The neo-liberal ideology sees the nation primarily as a business firm selling itself as an investment location, rather than simply selling export goods. A neo-liberal government will pursue policies designed to make the nation more attractive as an investment location. However, these national policies are directed ultimately at the welfare of the nation and not of the market. Paradoxically, they are a form of protectionism: if there is a global market of investment

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[27] Anup Shah, Free Trade and Globalization; A Primer on Neo-liberalism, March 5, 2007, (http://www..globalissues.org/TradeRelated/Free Trade/Neo-liberlaism.asp)

[28] John Gray, *False Dawn: The Delusions of Global Capitalism,* (The New Press, 1998), p 1
[29] Elizabeth Martinez and Arnoldo García, What is "Neo-Liberalism?

locations, then it is 'unfair competition' for governments to artificially increase the attractiveness of their own country.[30]

The underlying assumption of this theory is that free markets are a good thing. According to Prof Yash Tandon, neo-liberalism would attract foreign direct investment and technology into a country; achieve competitiveness in the global market; remove inefficiencies in the economy and, bring growth in the long-run. As a result of most African countries being timid in liberalizing their economies, their growth and expansion in global trade has been limited and hence the slow growth of their economies.[31]

Despite the fact that neo-liberalism discourages government intervention, policies such as tariffs and subsidies are more than significantly employed in developed nations. The equality advocated by the theory cannot explain the gap between the rich West and the poor South. Critics of this theory further argue that it highly undermines human development, and creates marginalization of the poor. Neo-liberalism is merely an abstraction from reality as the concept of 'free trade' is pure fiction and has never existed. This is due to the fact that all international trade is conditioned by those countries and firms that have either the power of capital or power over market, or in the final analysis, military power.[32]

As the World Trade Organization (WTO) advocates for fairness in global trade, as per the neo-liberalism theory, it is worth noting that this is not the reality on the ground. The neo-liberal

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[30] Saskia Sassen. Losing Control: Sovereignty in an Age of globalization (1996).

[31] Prof. Yash Tandon, *Economic Policy and Conflict in Africa ,Articles;* http://en.wikipedia.org/wiki/history-of-international-development
[32] Ibid, p 7

agenda only serves the interests of the rich countries at the expense of the poor countries. As developed countries continue to pursue neo-liberalism, African countries continue to face further hurdles in competing in the global market. Therefore, this study seeks to bring to light the inequality presented by the neo-liberal theory in the cotton industry.

1.9 Research Hypotheses

This study proceeds on the premise that:

i) Subsidization of the cotton sector in the US is primarily responsible for deterioration of the same sector in Kenya.

ii) Liberalization promotes free trade amongst developed and developing countries.

1.10 Summary

With the onset of the 21st century, there has been a rapid change in terms of the global economy especially in the area of trade. There has been an integration of local and regional economies into the world trade with liberalization and globalization taking center stage. For developing countries to participate effectively in this world market, they have implemented various policies as recommended by the Bretton Woods institutions. However, the implementation of these policies has not always resulted in the desired results especially in the agricultural sector. It is evident that developing countries experience unfair trade patterns at the global market. Literature reviewed indicates that a reduction in all forms of trade barriers by all countries in the global market will result in a more liberalized global market that would enable developing countries have full market access to the Northern markets and reap full benefits of a globalized world.

CHAPTER TWO
THE COTTON SECTOR IN KENYA

2.1 Introduction

This chapter reviews the cotton sector in Kenya with a brief account of the historical developments in the cotton sector from past to present in terms of policies. The agricultural policies used in Kenya can be divided into government controls and liberalized markets thus presenting two general periods namely, the period of government control (1960s to 1980s) and the period of policy reforms (liberalization – 1980s to date). However, the bipolar division of policies between full government controls and free markets created problems in agricultural development.

2.2 Government Control Period

Nyangito and Okello (1998) have argued that a diverse range of policies were used to foster growth of the agricultural sector in Kenya. The first set of policies for the period 1964 to 1980 emphasized government intervention in nearly all aspects of agricultural production and marketing. This meant that the government had control on almost all the institutions involved in agricultural development.

Upon attainment of independence, agricultural policies were based on principles outlined in the *Sessional Paper No. 10 on African Socialism and its Implications to Planning in Kenya* which emphasized political equality, social justice, and human dignity. These principles, following the example of the Soviet Union, were based on state control of the economy and defined the state as the entity that not only maintains law and order but also outlines and implements social and

economic programs in a bid to remedy historical and social inequalities. The principles were reinforced by the failure of capitalism and markets after the Great Depression when state intervention, in the form of the Marshal Plan, the Keynesian demand management, and the welfare state seemed to record one success after another.[33]

Under the principles, agricultural policies were founded on equitable income distribution, employment and self-sufficiency. The state played a paternalistic role with the citizenry having no role in policy formulation, design and implementation. For example, once the government decided on the most important commodity to promote, the government created incentive structures (such as pricing and marketing policies) favouring that commodity. The responsibility of controlling the policies was vested in the Ministry of Agriculture but implementation of the policies was undertaken by a plethora of public institutions. Although farmers had their own institutions (such as the Kenya Farmers Union for purchase and distribution of farm inputs and marketing of outputs, the Kenya National Farmers Union for policy advocacy on behalf of farmers, and co-operative societies for marketing of outputs), in reality, the state controlled the commodity to be grown and how it was marketed through established statutory boards.[34] Government intervention in agriculture was more pronounced in marketing, as this was controlled through the statutory boards and state institutions which were granted a monopoly status in the marketing of the commodities. Consequently, each of the commodities listed under scheduled crops and livestock products as essential for the country had a board or an authority responsible for its production and marketing.

[33] Nyangito & Okello, 1998, Kenya's Agricultural Policy and Sector Performance: 1964 to 1996.
[34] Ibid

The controls the government exercised worked somewhat well in the first decade after independence. During this period, agriculture grew very rapidly with the export sub-sector outpacing the domestic one until 1978 when the former virtually stagnated. The policies responsible for this performance were land reforms, agricultural pricing and marketing, and public investment in research, extension and other agricultural services.[35]

A major land reform took place soon after independence when the government distributed considerable amounts of the former white settlers' farms in medium and high potential areas to small-scale farmers. This resulted in an increase in production by the small-scale farmers. During the same period, the government, through the Ministry of Agriculture, devoted about 10 per cent of its annual budget to agricultural research. As a result, cash crops (coffee, tea, sugarcane, and cotton) enjoyed special research programmes funded through their respective parastatals. To ensure that research findings were adopted by farmers, the government expanded agricultural extension both in quality and quantity. These boards provided ready-market outlets for export crops and, because of the existence of un-official parallel markets. The prices were usually set by the Ministry of Agriculture but were implemented by the marketing boards. The official producer prices were most favourable for export crops due to a deliberate government policy of promoting the production of export crops.[36]

Ikiara and Ndirangu (2003) indicate that the cotton sector in Kenya has experienced major production and marketing changes and challenges over the years. The post-independence period was marked by direct government intervention in the production and marketing of cotton through a parastatal body, the Cotton Lint and Seed Marketing Board (CL&SMB). This was done with

[35] Ibid
[36] Ibid

the aim of achieving the self-sufficiency policy of the government.[37] The policy placed restrictions on importation of cotton lint and encouraged domestic production. In pursuit of the policy, the Board played a fundamental role in buying seed cotton from farmers and selling lint to textile firms at fixed prices. Co-operative societies and unions were established and supported by the government. These were the principal agents of the Board in supplying of inputs to farmers and buying of seed cotton. The activities of CL&SMB were supported under the auspices of the Cotton Development Programme (CDP) established in 1976. Through this programme, producer prices of cotton were increased by 80% between 1975 and 1979 and farm inputs such as pesticides, spraying pumps and land preparation services were provided to farmers through interest-free loans. The above measures resulted to almost doubling of cotton production from 32,000 bales in 1975 to 62,000 bales in 1979. The impact of CDP was impressive and encouraging but the initiative could not be sustained for long. Poor recovery of credit pushed CL&MSB to a state of bankruptcy in the 1980s. Agents of the Board mainly cooperative societies and unions faced acute financial and management problems culminating to their collapse.

The African Development and Economic Consultants report on cotton ginning and textile industry development (1998) indicated that investments in the Kenyan cotton industry started in the early 1960s with predominant investments being large scale joint ventures with local investment banks, Asian and European investors.[38] Most of these joint-venture investments in the textile industry were made with highly overpriced and sometimes even obsolete equipment.

[37] KIPPRA, 2003.

[38] These included Japanese investment in United Textile Mills, 1962 and Kenya Toray Mills, 1965. Indian investment in Kicomi, 1965 and Raymonds, 1969. In the 1970s, joint local investment banks and European ventures surfaced that included the East Africa Fine Spinners, 1972, Mt. Kenya Textiles, 1976, Rivatex, 1975 and African Synthetic Fibres, 1979.

Management and other problems forced a number of joint-ventures out of business. Studies indicate that the joint ventures and especially with multinationals were less successful than firms owned by local entrepreneurs. The local firms were more profitable, more likely to export and manifested more indigenous technological capability.

Despite the success of the policies in the first decade after independence, agricultural growth started to decline in the mid 1970s. This was mainly due to inefficiencies in marketing, limited land expansion of small holder farming, limited development and use of new technologies, restriction on private trade and processing of commodities, and deteriorating infrastructure. These internal factors were compounded by the economic crisis caused by oil shocks of the 1970s and bad weather.[39]

In marketing it became evident that too much government intervention had stifled the private sector and was forcing the government to do what the private sector would have done more efficiently. The parastatals, which enjoyed nation-wide monopoly, had failed to achieve the objectives for which they were set: price and income stabilization for farmers, efficient and inexpensive nation-wide distribution of commodities to consumers without government subsidies and buyers of last resort. The pricing policy set by the government was generally lower than to world market ones owing, first, to the numerous deductions along the marketing channel in form of levies and, second, to the controlled exchange rate. The government investment pattern also changed as more incentives were directed towards industrial and commercial sectors compared to agriculture. The expenditure on agriculture, for instance, declined from 11 per cent in 1965/66 to 8 per cent in 1979/80. Moreover, most of the funds allocated to the development budget

[39] Nyangito & Okello, 1998, Kenya's Agricultural Policy and Sector Performance: 1964 to 1996.

remained unspent while those in recurrent expenditure were usually exhausted before end of the year.[40]

Bedi (2003) indicates that the closed market policies of the 1960s up to 1980s ensured backward integration of the textile industry. This resulted in majority of the textile mills being composite. In addition, the small domestic market further led to poor economies of scale in most factories resulting in their collapse.[41]

2.3 Policy Reforms Period

Nyangito and Okello (1998) indicate that from 1981, there was a major shift in economic policy towards a liberal state ideology in developing countries. This ideology emphasized a reduction of state intervention in the economy and free market operations. Part of the reason for the shift was the high cost of socialist development strategies which became clear with the failure of most publicly-owned enterprises. The liberal state ideology, which was strongly marketed through aid conditions set out by the World Bank and the IMF in the 1980s and 1990s, emphasized the state's role as that of creating an enabling environment for individuals and associations to freely pursue their economic and social objectives. This shift meant that the government had to reduce its control of agricultural production and marketing and provide an enabling environment for enhanced participation by the private sector.

The first attempt to introduce liberal policies in Kenya was indicated in the *4th Development Plan*, 1979-83, but it was not until 1982 that reforms gained momentum mainly because of the World Bank's requirement that distortions in the markets be removed as a condition for loan

[40] Ibid
[41] Bedi J. 2003, Textile and Apparel Sector in Kenya.

disbursement. The stages, based on the government's rigour and commitment, of the implementation of the reforms can be divided into two: 1980 to 1992 and 1993 to 1997.The period between 1980 to 1992 was characterized by documentation but limited and intermittent implementation of the reforms, while 1993 – 1997 was characterized by substantial liberalization of markets and implementation of the policy reforms (Ikiara and Ndirangu, 2003).

Initially, policy reforms in the agricultural sector emphasized a liberalization of the grain market and a removal of price controls for all agricultural commodities. This emphasis was followed with proposals on a decontrol and relaxation of import licensing systems, price decontrol and removal of obstacles in the marketing and distribution system. Detailed policy reforms for the whole economy were spelt out in *Sessional Paper No. 1 on Economic Management for Renewed Growth* (Republic of Kenya, 1986). The policies spelt out in the paper included a liberalization of markets from government controls and a concomitant shift to open market operation and a removal of government support (subsidies) on most investments and services and a corresponding shift towards privatization and cost sharing.

Official commitment to these reforms however was often lacking: in most cases, the reforms met with overt and covert resistance and tended to be patchy, intermittent and unstable. The implementation of policy reforms since their inception to late 1991 was unimpressive and characterized by considerable official ambiguity (Ikiara and Ndirangu, 2003). While the government gave the impression that it was not opposed to agricultural and other economic reforms, it made only half-hearted efforts to implement them. As a result, there was an on-and-off removal of controls until 1993 when the sector was fully liberalized.

Although there was a modest growth in agricultural production, averaging about 3.5 percent per annum during the first period of implementation of the reforms (1980 to 1990), this growth was followed by a steady decline in the second phase ranging from minus 0.4 percent in 1990-91 to the lowest level of minus 4.1 percent in 1992-93. The reasons for the decline in agricultural growth included: poor implementation of the policies, bad weather, deteriorating terms of trade between agricultural exports and imports, rapid population growth and shortage of land in the high- and medium-potential areas of agricultural production, and a decline in public investment in agriculture in real terms which was about one third of the levels in the 1960s and 1970s. The withholding of external aid on the advice of the World Bank and the International Monetary Fund in 1991 and 1992 was also a factor which denied the country foreign exchange resources for financing imports of agricultural inputs and agricultural investment.[42]

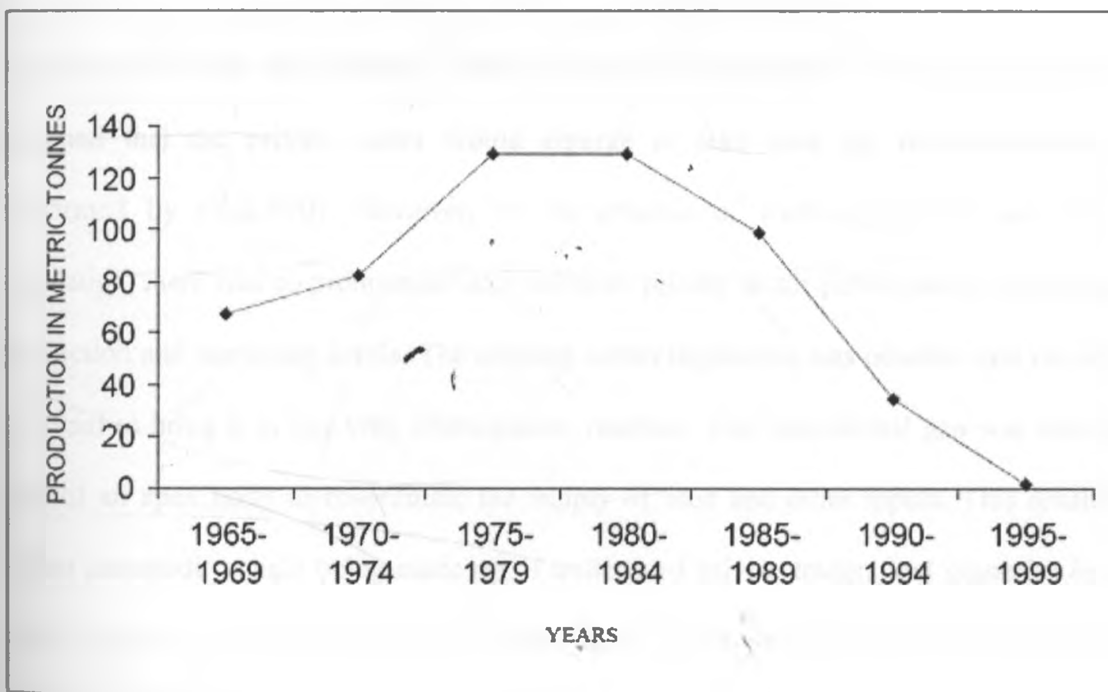
A substantial implementation of agricultural policy reforms towards liberalized markets was started in 1993. Coupled with good weather conditions, an upsurge in agricultural growth occurred and the first positive growth rate in the 1990s was registered at 2.8 per cent in 1993-94 followed by 4.8 per cent in 1994-95. Despite this development, controversies arose in the implementation of the reforms among various stake-holders. The liberalization of most of the sub-sectors also raised controversies with respect to the reduced role of public marketing agencies and the poorly developed private sector which was exhibiting exploitative monopolistic tendencies. Further, privatization and provision of some agricultural services to farmers at full-cost were questioned, given that some of the services such as control of epidemic diseases were

[42] KIPPRA, 2003.

public goods. Thus the impacts of the policy reforms on the development of the agricultural sector were mixed.[43]

In the cotton industry, the onset of liberalization policies resulted in withdrawal of the Board from buying and selling of cotton as well as provision of credit to farmers which had a negative impact on the sector. In addition, producer prices were decontrolled and support to farmers in form of extension significantly reduced. The withdrawal of CL&MSB had a major impact on the cotton sector in Kenya in terms of production.[44] Figure 2 below presents a grim picture of the growth and decline of seed cotton production in the country between 1965 and 1999.

Figure 2: Seed cotton production trends in Kenya, 1965 – 1999



Source: KIPPRA, 2003

[43] Ibid
[44] Ibid

Figure 2 illustrates that cotton production in Kenya reached its peak between 1979 – 1984 as a result of the CDP. With the adoption of liberalization policies, cotton production started declining sharply. Government's withdrawal of credit and unfavourable producer prices stifled supply response. Cotton production declined further due to competition from imported textiles both new and second-hand which competed with the domestic textile industry. A plethora of the above institutional changes and inefficiencies were compounded by climatic factors and high incidence of pests and diseases. With the removal of government subsidies on inputs, the cost of pest control chemicals shot up. Farmers responded by reducing the application of recommended pesticides.[45]

2.4 Post Liberalization Period

According to Ikiara and Ndirangu (2003), following liberalization of the cotton sector, it was assumed that the private sector would emerge to take over the responsibilities formerly performed by CL&SMB. However, in the absence of enabling policies and new cotton legislation, there was no pronounced and elaborate private sector participation, particularly at the production and marketing levels. The existing cotton legislation was obsolete and required major overhaul to bring it in line with liberalization realities. The institutional gap was manifested by lack of an apex body to co-ordinate the supply of seed and other inputs. This resulted in the cotton commodity chain being made up of unlicensed private traders and ginneries involved in selling inputs to farmers and buying cotton on an *ad hoc* basis. Unlicensed traders thus took advantage of the regulatory and institutional vacuum to import poor quality and uncertified seeds, which were sold to unsuspecting farmers thus compounding the cotton sector problems.

[45] Ibid

The capacity of farmers to negotiate or bargain for better prices of inputs and seed cotton is constrained by weak or lack of producer institutions. The producer prices of cotton were further determined through an auction system based on the world market supply and demand dynamics. The prices are erratic and unfavourable to cotton farmers in Kenya, particularly when they fall below the cost of production. For instance, during the 2001/02-cotton season, the cost of producing cotton was Kshs. 23.80 per kg of seed cotton while the market price of seed cotton was Kshs. 20.60 per kg. As a result, the cotton farmers experienced negative gross margins.

With the reduction in government support, most of the cotton ginneries in Kenya have taken over some of the important functions that were performed by the government before liberalization. Such functions include the provision of seeds, chemicals and extension services on credit to the cotton farmers. These efforts are bearing fruits in terms of supply response. In the face of these efforts, problems facing Kenya's cotton industry are not only confined to farmers. The ginneries are not running effectively and efficiently because of high overhead costs. For instance, the power tariffs and taxation rates are high. They are also affected by the problem of fluctuating cotton prices. There is lack of a regulatory body to moderate and balance prices at which ginneries buy cotton thus resulting in an imperfect competitive market situation.[46]

During the import substitution era, the Kenyan textile and garment industries were not very successful in penetrating export markets. The enterprising firms which would have excelled in export trade were able to make good profits selling in the heavily protected domestic market thus shunning away from the more demanding and risky export market. The fact that high priced local raw materials made prices of most final products internationally uncompetitive added to the

[46] African Development and Economic Consultants report on cotton ginning and textile industry development, 1998

dismal performance of export trade.[47] Notwithstanding the aforesaid, the introduction of Manufacturing Under Bond (MUB) and Export Processing Zone (EPZ) factories, which are mainly garment factories boosted export activities. The products from MUB and EPZ factories were exported mainly to the USA, UK and in smaller portions to the COMESA countries. However, this was also faced with numerous restrictions especially at the world market stage.

2.5 Policy Implications

Two decades after independence, the government's domination of the economy, that is, from production to marketing, stifled the development of the private sector. The government appears to have abdicated the duties it could perform well and instead engaged in activities in which it had no comparative advantage and in which the private sector, given incentives, could excel. In the 1960s and the 1970s, most of the policies were implemented adequately, possibly because of realistic policies and an abundance of government resources. These policies were unlike those pursued from the mid-1970s onwards when overambitious policies, in face of a rapidly expanding population, increased the burden on the government's support of most services. At the same time, the government had limited opportunities to internalize the later policies, most of which resulted from dialogues between it and donors. Further, inappropriate timing and sequencing, were another cause of poor implementation of policies. In this connection, proper timing, logical sequencing and co-ordination are some of the necessary requirements for an effective implementation of policies, while inadequate implementation of the policies is partly

[47] Ibid

responsible for the poor performance of the agricultural sector during the eras of government controls and policy reforms.[48]

During the era of policy reforms, the initial stop-go stance taken by the government on reforms appears to have created confusion and uncertainty on the part of the private sector. The government's inability to continuously support agricultural activities financially and technically led to a decline in agricultural growth and development as a whole. As noted by Ikiara and Ndirangu (2003), this led to the slow growth of the private sector and, as a result, when the government started to off-load the activities to the private sector there seemed to be a vacuum. This resulted in retarded growth and development of the agricultural sector because the poorly developed private sector lacked the capacity to undertake the activities adequately.

On the whole, it is clear from the analysis that the main problems in agricultural policy and development in Kenya lie in marketing and pricing, investment policies (extension, research, animal health, and irrigation), macro-policies (taxation, trade controls, interest rates, and credit), biased commodity policies, and implementation of the policies (Ikiara and Ndirangu, 2003).

After the first and second decades of independence the parastatals which were granted nation-wide monopolies had not achieved the objectives for which they were set. The performance of these monopolies had remained poor due to both lack of competition and weak management. While government monopolies were in no better position to serve producers well, it was not beneficial to replace a government monopoly with a single private monopoly. This is because the private monopolies were certainly worse than the government monopolies in terms of efficiency.

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[48] KIPPRA, 2003

Selective government intervention to provide both an enabling environment and an incentive structure for the private sector to thrive in is a necessary requirement if market-based reforms have to be effective.

Trends in investment spending during the controls period indicated that the government granted a lot more incentives to the industrial and commercial sectors than to the agricultural sector. This resulted in a deterioration of the terms of trade against the agricultural sector and made investments in the agricultural sector less profitable than in the other sectors of the economy. The implementation of policy reforms, particularly the requirement that the government reduces its fiscal deficit, worsened the situation to the extent that limited resources were availed for investments in agricultural research and extension and development of infrastructure in rural areas. All this had a detrimental effect on agricultural development since these investments were major sources of agricultural growth (Nyangito and Okello, 1998).

Nyangito and Okello (1998) further indicate that over the years, Kenyan farmers, like most farmers in sub-Saharan African countries, faced heavy rates of explicit and implicit taxation through unfavourable macroeconomic policies, especially in regard to over-valued exchange rates and inappropriate fiscal policies, which reduced the prices farmers obtained for their exports. Further, inflation and the government deficit rose, while interest rates became increasingly negative. With the introduction of policy reforms, the government effected changes, such as removal of foreign exchange controls and trade liberalization, in macroeconomic management. Some of the reforms, such as the removal of exchange controls, enhanced agricultural growth by providing incentives to producers in the form of high producer prices, while liberalized trade had a dampening effect on agricultural production. While custom duties

and value added taxes are revised continuously and generally downwards, tariff schedules on agricultural inputs seem to discriminate against smallholders and encourage machinery-intensive means of production in the large-scale sector. On the output side, tariffs are aimed at protecting producers but their use has been questioned due to lack of adequate law enforcement which has led to their misuse. A removal of distortions created by macroeconomic policies will ensure that resources are efficiently allocated as guided by prices (for example, world prices) which reflect the opportunity costs of producing different commodities.

2.6 Summary

The policies examined have made provisions that confer the need to further develop policies that will enable revival of the cotton sector despite the existence of various global policies that stifle its growth. From the literature, it is evident that the cotton industry is an important agricultural sub-sector for the country especially to the revival of cotton mills and the textile industry that will enable the country compete effectively in the regional and global markets. However, there is need to examine the global policies in particular American policies in the cotton industry that have a significant impact in the world cotton market to be able to chart influential policies in the Kenyan cotton industry.

CHAPTER THREE
UNITED STATES OF AMERICA COTTON SUBSIDIES AND THEIR EFFECTS

3.1 Introduction

This chapter examines the US cotton sector with the subsidization policies used to promote the sector. The chapter underlines the strength of the US cotton industry and hence its dominance in the global market. As a result of this, shifts in the US cotton policies have significant effects at the global cotton market.

3.2 US Position in the Global Cotton Market

According to Hutson et al (2005) the global market for cotton and cotton based products has undergone several changes over the past two decades. Most notable among these changes are the emergence of China as the dominant consumer and importer of cotton and the US as the dominant exporter of cotton. In 1985, China was one of the world's largest exporters of cotton lint, now it is the world's largest net importer of cotton, with 27 percent of all global cotton exports going to China. Accordingly, China's hunger for cotton is fueling a boom in US exports, as it can no longer meet its demand with domestic production of cotton lint. Production in the US over this period has remained relatively constant in terms of world share over the past two decades, but it has conquered the export market. The US in now responsible for over 41 percent of global cotton exports with 36 percent of these exports going directly to China. Decreased textile production in the US has forced the US cotton industry to look beyond its own borders to

meet the demands of the global textile market and as a result China is providing a healthy market for US cotton.[49]

Over this period other Asian countries, most notably India and Pakistan, increased their presence in all segments of the industry as well becoming among the world's largest consumers and producers of cotton lint (though they mostly meet their demand with domestic production), as well as well as exporters of cotton yarn and fabrics. The rise of these countries along with China led to the decline in the once strong textile production in countries such as Japan and several countries of Western Europe. During this period, cotton production in several countries of Africa rose.[50]

Currently the US is the world's second largest producer of cotton after China, outstripping both India and Pakistan. What makes the US distinctive among large producers is its export dependence as more than 40 per cent of its total output is exported. As a result of the US exporting nearly half of its output, this has resulted in the country being a significant player in the global cotton market. In 2003/2004 year, the US share of world trade was just over 37 percent while its market share continued to increase. In addition to these facts, the US consistently continued to increase its area under cultivation (Watkins, 2003). As at 2003, the US cotton belt extended from southern California in the West, through Texas and Arizona, to Mississippi, Alabama, and the Carolinas in the East. In total it covered approximately 14 million acres of farmland. The farm sizes ranged from an average of 2,000 acres in the more arid regions of the Texas Plains to 500 acres in the Carolinas and Mississippi. The largest farm in the US, and

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[49] Hutson A. Biravadolu M. and Gereffi G. 2005, Value Chain for US Cotton Industry, Oxfam America, University of North Carolina, USA.
[50] Ibid

one of the largest in the world was a cotton farm of nearly 200,000 acres, located in Central California.

As a result, the overall level of US subsidies affects the world markets as a large share of domestic production is exported. In effect, American export prices set or greatly influence the world price, with attendant implications for farmers in developing countries who are competing against US exporters in international and domestic markets. While different subsidies have different consequences, to the extent that they are linked to production or influence production decisions, they inevitably impact on world markets by virtue of their sheer scale.

3.3 US Cotton Subsidies

Watkins (2003) argues that even by the normal standards of American and European agricultural policy, the US cotton sector is governed by a curiously bizarre set of public policies. These policies are built and driven by powerful vested interests masquerading as defenders of the public good. No sector does better out of the pork barrel congressional politics that dictate the distribution of subsidies. Despite the scale of US cotton production, and in contrast to other sectors such as cereals, the number of cotton farmers is small. Yet they inflict enormous damage on poor farmers in Africa and elsewhere. To paraphrase Winston Churchill, nowhere in the entire field of human trade is so much damage inflicted on so many vulnerable people by so few wealthy farm corporations. [51]

The political lobby for cotton is one of the strongest in US agriculture, as witnessed by the 2002 Farm Act. Led by the National Cotton Council of America, cotton barons have helped to foster

[51] Watkins K. 2003, 'Challenges Ahead on the Road to Cancun' speech at the WTO Public Symposium, 16 – 18th June 2003.

an image of a sector dominated by farmers operating in a harsh environment, but displaying an entrepreneurial drive that benefits the entire nation. The pre-eminence of the US in world markets is a common theme. Some of the major quotations during the debate of the 2002 Farm Act include:[52]

> "The US cotton industry...contributes significantly to the nation's economic health." The National Cotton Council of America.

> "I believe the (farm) bill is balanced regionally and by commodity, but it will undoubtedly be an economic shot in the arm for the West Texas region... I have been criticized by the national media because the Farm Bill benefits producers and communities in the 19th District of Texas. I welcome that criticism, because I believe that constituents want me to represent our interests in Congress. I believe the new Farm Bill will benefit our area and our farmers." Larry Combest, Republican Chair of the House of Representatives Agricultural Committee, and Representative for a major cotton-growing area in West Texas."

> "This (Farm Bill) is a good compromise and sends a strong message to our producers that the US Government will stand shoulder-to-shoulder with them in the market place." Charlie Stenholm, ranking Democrat on the House of Representatives Agricultural Committee, and cotton farmer in West Texas."

Watkins (2003) further indicates that there is one area in which US cotton farmers have a distinct and unrivalled advantage over producers in both developed and developing countries, namely,

[52] Ibid

the collection of subsidies. When it comes to government support, America's 25,000 cotton farmers are the kings. The form in which subsidies are provided to US cotton producers affects the world market in terms and in relation to compliance with World Trade Organization (WTO) rules. Under the WTO Agreement on Agriculture, governments are required progressively to reduce production and export subsidies subject to one exemption, the wording of which is critical;

> "Domestic support measures for which exemption is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects on production."

Measures that meet these criteria fall into a category known as the Green Box. Policies that influence production fall into another category (the Amber Box) where the overall level of subsidies (the 'aggregate measure of support') has to be cut. The main forms of US subsidy can be categorized into four groups namely;[53]

i). Direct payments

ii). Counter-cyclical payments

iii). Loan deficiency payments and marketing loan gains

iv). Step 2 payments – Export credit guarantee program and the US crop revenue and insurance program

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[53] Ibid

3.3.1 Direct payments

Most US cotton farmers benefit from direct payments under the 2002 Farm Act. These payments are based on the value of production and yields during a previous production period, that is, the payments are issued regardless of market price, based on historical acreage and payment yields, not current production. On this basis, the US Government insists that its support is 'decoupled' from production, and therefore eligible for the Green Box. Until 2002, the reference period for calculating payment levels was 1986-1988. Under the 2002 Farm Act, the reference period was updated to 1998-2001. This seemingly technical change had a significant effect, since acreage under cotton and yields were higher in the latter period thereby raising the entitlement to subsidies. In effect, the change 're-coupled' subsidies to production by linking payments to recent output levels. Other implicit incentives provided for cotton production included eligibility for direct payments which was contingent on farmers using land for an agricultural purpose, which inevitably had an influence on production for crops such as cotton. In addition, the 2002 Farm Act prohibited direct payments on land used for cultivating fruits, vegetables, and other crops. This encouraged farmers to grow crops eligible for support, including cotton. For all of these reasons, there is serious doubt whether these direct payments to US cotton farmers are properly within the Green Box.

3.3.2 Counter – cyclical payments

The counter – cyclical payments were introduced under the 2002 Farm Act, and replaced the 'emergency market loss payments' provided by the US to cotton farmers from 1998-2001. Under this subsidy, payments are triggered by lower prices. These are made when market prices (plus direct payments) produce an income below a stipulated level (known as the Target Price). The

same payment conditions prevail as for direct payments. The subsidy is designed to increase payments to farmers during periods of low world prices, thus enhancing production at the very time it should be declining. In the case of cotton, at today's prices they would amount to as much as one-third of the market value of the crop. On this basis, US cotton farmers would receive US $1.1 billion in subsidies from this program in 2002/2003, but due to the fact that these payments are based on the market price falling to a certain level, they fall into the Amber Box.

3.3.3 Loan deficiency payments and marketing loan gains

These payments are triggered when world prices fall below US $ 0.52 per pound. The further world prices fall below that level, the more they increase. In effect, these define the minimum market price (or Loan Rate) defended through government purchasing operations. As a result of them being linked to the volume of farm production, they fall into the Amber Box.

3.3.4 Step 2 payments

In effect, this is an officially supported credit programme available to users of US cotton in both the domestic markets and export markets. It is registered as Amber Box domestic support. The Step 2 payments are in two forms namely, the Export Credit Guarantee Program (ECGP) and the US Crop Revenue and Insurance Program (CRIP). These payments aim to keep US export prices in line with low-cost competitors. They are provided both to exporters of US cotton and to domestic mills using US cotton, the aim being to eliminate any difference between US internal prices and the international price.

Under the ECGP program, importers can borrow in dollars at US interest rates, and banks lending to them have the loans guaranteed by the US government. This gives American exporters

an enormous advantage over rival exporters in countries with shortages of hard currency and high interest rates. Exporters in countries such as India, Pakistan, and Egypt, let alone in Africa, are obviously unable to draw on comparable levels of support.

The US Crop Revenue and Insurance Program covers over 90 percent of cotton acreage and protects farmers against crop loss caused by adverse weather or other conditions. It effectively takes a large share of the risk out of farming. These programs are part of the Amber Box for cotton producers. However, because they are implemented using non-commodity specific interventions, that is, they apply to all crops, they are permissible by the WTO, as long as they do not exceed five per cent of the total value of production.

3.4 Interpretation of the Subsidies

Like the EU, the US has developed a strong track record in creative interpretation of WTO rules. For example, any claim that Direct Payments do not influence production decisions is clearly incorrect, not least for reasons explained in a recent US Department of Agriculture paper:[54]

> "Because...these...payments raise farmers' income and financial well-being, they can potentially affect agricultural investment and thereby enhance production. Lenders are more willing to make loans to farmers with higher guaranteed incomes and lower risk of default. Greater loan availability facilitates additional agricultural production. By the same token, Step 2 payments and export credit guarantees are export subsidies that clearly serve to lower the costs of US exports in third markets, while subsidized insurance programs remove the risk from investment decisions."

[54] Ibid

In the 2001/2002 year, the transfer rose up to 18 percent of the world market price and the total export subsidization under this heading was around US $ 197 million in 2001. However, the US insisted that, for the purposes of the WTO rules, these were not export subsidies, on the grounds that they formed part of a program that did not discriminate between exporters and domestic users. In the context of the WTO negotiations, the structure of support matters as much as overall levels. In most years, over half of the US government support came in the form of direct payments treated for WTO purposes as Green Box, and therefore not deemed 'trade distorting'. Market loss assistance payments were treated by the US Department of Agriculture as Amber Box, but subject to the *de minimis* rule. Although a significant share of Step 2 payments, around half in most years, were geared towards export markets, for WTO purposes they counted not as export subsidies, but as domestic support.

Overall levels of support for US cotton in the form of direct payments range from US $ 3 to 4 billion annually. These subsidies represent a large share of the value-added by cotton. Indeed, in 2000 the cost of subsidies was equivalent to value-added to the US economy by cotton production. The high levels of support to the cotton sector reflect the formidable power of the US National Cotton Council (NCC), arguably the most effective agricultural lobby in the industrialized world. The NCC has welded different players in the cotton sector into a unified political force with immense clout at all levels of government. This is noted by the extraordinarily generous treatment accorded to cotton under successive farm bills, culminating in the 2002 Farm Security and Rural Investment Act. The latter reflects a clear 'preference for Texas' or, more accurately, for its cotton barons under the Bush Administration as noted by Watkins (2003).

As in other aspects of farm policy, good public relations and political influence has helped to obscure some hard truths. Watkins (2003) concludes that in relative terms, the scale of the transfers dwarf those made to other producer groups. Cotton farmers receive more per capita and more per acre (US $ 230 compared with US $ 40-50 for cereals) than any other group of producers. US cotton is also the site of greatest inequality in a highly unequal system of subsidy distribution. The top 10 percent of cotton produces account for over three quarters of subsidy to agriculture. The ten biggest shared over US $ 17 million in direct payments, not taking into account a range of indirect payments. At the other end of the spectrum, more than half of America's farms get no subsidies at all. In addition to these, the US is an inefficient producer of cotton at current levels relative to many other countries, while the sector represents a huge drain on taxpayers. Viability depends on huge infusions of capital from the general public on an annualized basis.

3.5 Effects of the Subsidies

Cotton production occupies a critical place in the livelihoods of some of the world's poorest farmers and some of the richest. In Africa and other developing regions, the world price of cotton is a major factor influencing vulnerability to poverty. For farmers on the US cotton belt, prosperity is guaranteed. High levels of subsidy provide insulation from fluctuations in world prices. They also insulate US producers from market signals, depressed global prices, and ultimately reinforce poverty in the developing world. US cotton subsidies graphically illustrate how world trade rules are rigged against poor countries. They also cast into sharp relief some of the double standards in world agricultural trade negotiations.

It is widely held that domestic subsidies are the main source of distortion for cotton, which is unlike the case with many other farm commodities where distortions at the border are also widespread. Worth noting is that while looking at both the level of the subsidy and the size of the industry, what matters most for world market effects are the subsidies in China and the United States, the two largest producing and trading countries.[55] Overall, far fewer countries grant subsidies on cotton, according to official information provided to the WTO.

Subsidies tend to affect production and hence trade. However, different forms of subsidies have potentially different impact on production. Whenever a subsidy affects directly the total returns per unit produced, then it acts as if the price received by the producer is increased, and its effect is no different than if the market price was higher. In this sense such forms of subsidy are "coupled", as they affect directly the resources allocated to production. On the other hand there are some types of interventions that affect production cost and returns only indirectly, and sometimes not at all. For instance programs that directly affect farm income, such as payments for residing in a given locality, without being dependent on product specific production, tend to have lower impact on production of specific products. Such payments are considered "decoupled", and as they do not affect production are not market and trade distorting.[56]

This issue applies mainly to the United States since subsidies in most other countries are acknowledged to be coupled, that is, similar to market price support. The existence of different programmes indicates different impacts on production and tràde. Watkins (2003) concludes that the overall structure of support to the cotton sector is a major source of concern to cotton

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[55] FAO, 2005, The Impact of domestic and trade policies on the world cotton market. http://www.fao.org/docrep/007/j2731e/j2731e06.htm

[56] Ibid

producers in the world and in particular Africa on two counts. First, a large proportion of US subsidy payments continue to evade effective WTO disciplines on domestic support if the current Green Box provision is retained. This is despite the fact that many of these payments clearly stimulate production. As Brazil has pointed out in its submission to the WTO, restrictions on what crops can be grown clearly stimulates cotton cultivation. Moreover, the 2002 Farm Act decouples support for direct and counter-cyclical payments by allowing producers to update their base acreage. Second, to the extent that current support maintains levels of production in excess of domestic demand, common-sense would suggest the presence of an implicit export subsidy. In the case of Step 2 payment, the export subsidy is explicit. However, the structure of the prevailing subsidy regime allows the US to escape the consequences of more stringent WTO rules on export subsidies, with attendant consequences for African farmers.

3.6 Summary

The section has identified the US policies implemented in the cotton sector that result in the US cotton enjoying superior strength at the world market. It is clear that with the US defining its subsidies to be in adherence to WTO regulations, developing countries especially Africa and in particular Kenya, have to develop relevant policies that will enable them to compete at the world market.

CHAPTER FOUR

KENYA'S COTTON SECTOR POLICIES

4.1 Introduction

This chapter presents the various policies that have been implemented in the Kenyan cotton sector and suggests interventions that are necessary to counter the US policies. Changes in the policies will enable Kenyan cotton penetrate the world market. In order to do this, the chapter first presents what the country can do at an internal level and then what it needs to do at the world stage level to enable its cotton compete.

4.2 Internal Level Policies

The future of the cotton sector is at the heart of African countries concerns as cotton is key in the economies of many Western, Central and Eastern Africa countries. Cotton is one of the few sectors where the African industry can be highly competitive. Furthermore, the cotton sector plays a key role in the development efforts and the fight against poverty as the sector provides income to more than 10 million people.[57]

The International Food and Agricultural Trade Council (2006) noted that progress margins in the competitiveness of the cotton sector can be carried out, if producers improve their productivity, the delivery of inputs, and the quality of their harvests and as soon as transport infrastructures will be better developed. Governments should implement efforts towards a modernization of the African cotton sector in spite of the absence of real solutions concerning subventions and the instability of world market prices. There is need for African governments and the private sector

[57] International Food & Agricultural Trade Policy Council, 2006, "IPC talks Doha, Cotton and Biofuels"

to increase the competitiveness of their cotton sectors by instituting agriculture a priority in their development plans.

According to the PanAfrican News Agency (2000), Kenyan authorities had outlined strategies aimed at reviving the country's cotton sector, which had been tottering on the brink of collapse following the liberalization of the textile industry. The strategies were also part of the government's efforts to reduce poverty, especially in the cotton growing areas. In order to achieve the objectives of the industry, the government indicated the need to first address issues of production, marketing and review the regulations on the management of the crop. This would be contained in a cotton policy paper that would also recommend establishment of a new regulatory body or reconstitution of the Cotton Board of Kenya to handle the industry in a liberalized environment.

Participation in the AGOA initiative was expected to contribute towards the revival of the industry and hence trigger higher production of cotton. In addition, privatization of the cotton ginneries which were underutilized would provide market outlets for cotton and support farmers in cotton production while at the same time developing a sustainable programme for future cotton seed supply. The development of new high-yield cotton varieties suitable for specific regions of the country would also take priority.[58] Between 2001 and 2006, the government had already disbursed Kshs. 492 million to establish the cotton authority and a secretariat to regulate cotton growing and ginning while at the same time conducting research and development in

[58] PanAfrican News Agency, 2000.

production and processing.[59] The result of attempting to revive the sector was due to the fact that cotton plays a significant role in the economy through various ways, namely:[60]

i). Potential to benefit many people – it is estimated that at least one-quarter of the country's population can benefit from cotton production especially through various linkages between the sector and others.

ii). The sectors suitability for marginal areas that are inhabited by the country's poorest people which will improve their incomes.

iii). Employment creation – this potential is attributable to the labour-intensiveness of the cotton-textile industry and its involvement of small-scale operators.

iv). The high potential of the sector to generate small and medium enterprises (SMEs) activity in the Kenyan economy.

v). The potential to promote regional dispersion of development and reduce rural-urban migration from the marginal areas.

Ikiara and Ndirangu (2002) note that a major weakness of Kenya's cotton – textile – apparel chain is that there is essentially no operating chain. Following liberalization, a general institutional failure resulted in different actors in the industry operating independently of each other, without co-ordination and consultation, yet these are key ingredients to good performance in terms of quality and distribution of profits. Such a vacuum exposed the industry to total external control. Besides lack of chain coordination, institutional failure was also manifested in the lack of strong producer associations; weak or ineffective mechanisms for overseeing critical issues such as quality seed production and distribution, provision of inputs to producers on

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[59] The Nation, 31st July 2007, "Kenya: Kshs. 490 million Cotton Plan Takes off", Kaaburu Mugambi, Nairobi.
[60] Ikiara and Ndirangu, 2002, Developing a Revival Strategy for the Kenyan Cotton-Textile Industry: A value chain approach, Nairobi.

credit, quality of such important inputs as pesticides; and virtual collapse of extension services. However, not all parts of the chain lack strong producer associations, though. Textile and garment manufactures, in particular, have very influential associations, including the Kenya Association of Manufacturers (KAM), the federation of Kenya Employers (FKE), and the Kenya Apparel Manufacturers Exporters Association (KAMEA). Ginners have the Kenya Cotton Ginners Association (KCGA), which is also increasingly active in the industry.

Cotton farmers and micro and small garment producers are the weakest in terms of institutions for lobbying. They lack broad representation and aggressive associations. Besides this, there is little evidence to show that the existing associations work together to coordinate the cotton-textile apparel chain. Policy failure also characterizes the cotton-textile industry. Key among policy failures is the way liberalization was carried out as there was no time for readjustment while no alternative to the Cotton Board of Kenya was set up to carry out crucial regulatory and coordination tasks. In addition, the industry lacks a manpower development policy, a dynamic technology development policy, a regulatory and legal framework consistent with the current liberal environment, a comprehensive policy framework covering all links in and aspects of the cotton-textile value chain, and comprehensive institutional deepening policy. There is also a glaring absence of strategic positioning policy. Thus, even as global dynamics of the cotton – textile chain governance change, there is no strategic response in the country, with the result that the country's producers continue experiencing unequal terms of trade while other countries are subsidizing their farmers. The Strategic policy is meant to deal with issues of whether the

country should continue encouraging activities in all parts of the chain or whether the country is better off specializing (and establishing market niches) in a few of them. [61]

Ikiara and Ndirangu (2002) summarized conditions that Kenya needs to address in order to revive its cotton industry. These are presented in the table below.

Table 2: Summary of conditions favouring cotton: comparing Kenya and case study countries

Conditions	Countries				
	South Africa	Kenya	India	China	Mexico
Access to credit and inputs	Strong	Lacking	Fair	Strong	Strong
Farmers access to information	Weak	Weak	Weak	Strong	Strong
Farmers' producer institutions	Strong	Lacking/ weak	N/A	Strong	Strong
Government support (subsidies & producer prices)	N/A	Lacking	Fair	Strong	Strong
Seed quality and certification laws	N/A	Weak	Weak	Strong	Strong
Seed distribution infrastructure	Strong	Weak	Strong	Strong	Strong
Marketing arrangements	Strong	Weak,	N/A	Strong	Strong

Source: KIPPRA, 2003

Kenya may not be able to exploit the opportunities unless the industry is revived and nudged towards a sustainable growth path. Without appropriate institutional and policy arrangements for supporting production and marketing of cotton in place, it is unlikely that smallholder farmers in Kenya will realize its potential. The sections below present various policy initiatives that may revive the sector.

UNIVERSITY OF NAIROBI
EAST AFRICANA COLLECTION

[61] Ibid

4.2.1 Pricing Policy

The key issue is how to make price determination more transparent and less uncertain for farmers. As indicated by Ikiara and Ndirangu (2002) farmers are exposed to a range of prices being offered by the competing ginneries. For instance, during the 2000/01 season, the price varied between Kshs. 18 and 26 per kg in one of the provinces of which most farmers felt that they were being exploited. Farmers need to work with ginners, middlemen, and other industry stakeholders to develop a transparent approach to pricing which should distribute the risk of price fluctuations among the market participants. Farmers may need to be informed of prevailing and expected world prices in advance of the planting season so that they make informed decisions. Ways of utilizing resources provided by the Common Fund for Commodities for developing cotton price risk management instruments for producers in Eastern and Southern Africa needs to be explored.

In addition, there is also need to reduce the prices of pesticides that account for about 57 percent of the total cotton production costs. Although the long-term solution lies in biotechnology to produce pest-resistant varieties, it is imperative that in the short run, further investigations be done to find ways of reducing their costs.

4.2.2 Provision of services to farmers

The challenge for the industry is how to provide inputs including credit and extension support to farmers and how to make investments in agricultural research and extension needed to achieve long-run productivity growth in an environment where the public sector is unlikely to provide the investments. This calls for a system of contract farming to begin with, until the ground is

completely level for full competitiveness. Such a contractual arrangement would enable farmers to deal effectively with the production technology and marketing problems confronting them. But for such a system to work effectively there is need to promote the formation of industry associations to enforce contracts and agreements. In particular, local farmer organizations should be encouraged and facilitated and their technical organizational and commercial capacities strengthened. The industry could, moreover, establish an effective contract enforcement system and impose costs on illegal buyers. The government could play the important role of facilitating the enforcement of such systems.[62]

Access to credit is a decisive factor in the revival and development of cotton production. Currently in Kenya, there is no specific credit facility or fund devoted to cotton farmers. In addition, weak farmers' cooperative societies or organizations have limited the farmers' access to credit.

As a result of these, there is need to establish the farmer cooperatives at the local, national and international levels to enable farmers' access various services.[63] The strengthening of cooperatives, farmer groups, or farmer associations will enable them engage jointly in value adding activities such as processing, smoothening supplies, and building of relationships with buyers. At the international level, Kenya could join hands with other regional cotton producers to consider the possibility of establishing strong producer cartels to control supply and coordinate with consuming country actors. Support of influential international NGOs and other anti-globalization movement agents could be sought.

[62] Ibid
[63] Ibid

4.2.3 Provision of good quality seed

Farmers need good quality seed on time. Late seed supply results in delayed planting that seriously reduces yield. An organized system for certified seed production and distribution is critical. The Kenya Agricultural Research Institute (KARI) is currently collaborating with the Cotton Board of Kenya to establish such a system.[64] The long – term goal is to improve productivity and competitiveness by investing in research on biotechnology and organic cotton so as to enhance cotton yield, fiber quality and pest resistance. In addition, seed multiplication and distribution infrastructure for supplying seeds to farmers is a critical element in the delivery of any agricultural technology. The seeds supplied must also be certified to be of the recommended standards and quality.

Ikiara and Ndirangu (2002) underscore the importance of seed regulation by stating that "any crop variety (conventional or transgenic) must conform to national regulations regarding variety release and registration, whilst seed sale is governed by seed quality and certification regulations". Kenya lacks a well coordinated and efficient seed distribution system. After CL & SMB became defunct, Kenya did not have an apex organization to handle multiplication and distribution of seeds. Currently standards for seed certification have been developed by KEPHIS. However, both farmers and ginneries are ignorant of the standards. Farmers buy seeds from the ginneries without knowledge of what constitutes a certified seed. Although the quality standards exist on paper, KEPHIS has not been able to enforce them which therefore indicates that the seed and plant varieties legislation is weak, both in enforcing certification and regulating the seed industry.

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[64] Ibid

4.2.4 Access to information, technology adoption factors and perceptions

The South African experience demonstrates that, apart from access to input and output markets, access to information is an important determinant in the development of cotton industry. Smallholder farmers are risk averse and slow in investing in and replacing old varieties with new ones. Given that extension services in Kenya have collapsed, farmers may not be willing to incur transaction costs to access information on cotton. Furthermore, in an environment of uncertainty and imperfect information, they may be reluctant to switch seeds or ways of farming the crop.[65]

4.2.5 Bio-safety measures

Biosafety management measures at the farmers' level are critical if adoption of the technology is going to be a long-term, ecologically sustainable and a profitable venture for farmers. In South Africa, China and Mexico, biosafety measures have been enforced, not only to safeguard farmers but also to protect commercial interests and future markets for the company. In Kenya, capacity building in biotechnology and biosafety at the national level is relatively strong, but, this is not matched by capacity at the local level, where awareness of biotechnology and biosafety among farmers is either low or non-existing.[66]

4.2.6 Infrastructure and cotton selling logistics

Access roads are critical to revival of cotton growing. Without access roads and cotton selling centers, interaction between cotton farmers and buyers is likely to be unsuccessful. Ikiara and Ndirangu (2002) envisage that both government and/or donor support can facilitate provision of the infrastructure services. Development of convenient and reliable buying schedules and

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[65] Ibid
[66] Ibid

weighing practices is also important. This can be done through a collaborative effort of farmers associations, Kenya Cotton Ginners association, and government extension staff.

A revival of the cotton irrigation schemes will also play a significant role in raising the utilized capacity for ginning which may then trigger investments at this level. Other initiatives that would attract investment in ginning include: the disposal of unsold lint by allowing textile firms (spinners) to exhaust locally produced lint before importing; improvement of the ginnery infrastructure (access roads, storage facilities, cotton buying centers; and an improvement in ginning coordination in order to strengthen the sector.

In concluding, it is worth noting that the role of government support was fundamental to revival of the sector in terms of institutional and policy prerequisites such as access to credit, extension services, attractive marketing arrangements and sound regulatory framework. Following the liberalization of the cotton industry, there has been an institutional and policy vacuum in Kenya that has resulted in weak or totally lacking cotton production and marketing arrangements. The government through specific policies would also control the high costs of cotton production as a result of high costs of chemicals though rationalizing and where possible subsidizing. There is need for the government to intercede for minimum indicative floor prices, which should be fair to farmers and ginners. Thus the government needs to support the development of the private sector before leaving the market to perform allocative functions. If the government does not do this, then problems will continue to be experienced by producers, processors and consumes in the cotton sector.

4.3 External Level Policies

In addition to implementing policies within the country to improve the cotton sector, Kenya as a member of the WTO has debated on policies that would assist the cotton sector in Africa as a whole. The main focus of debate has been the question of price distortion at the global market. Kenya in liaison with other African countries namely Benin, Burkina Faso, Mali and Chad proposed solutions to this problem as noted by the African Industrial Association (2004). The first proposal was to set a reduction plan of the support to production with a view to eliminating them within a 3 year period. The second proposal was to set transitory measures under the form of financial indemnity to compensate for the loss undergone, as long as subventions were not eliminated. Many developed countries involved in cotton production supported these proposals that demanded genuine trade liberalization rather than a special and differentiated treatment.

In 2004, the European Commission presented an action plan in favour of the African cotton sector by addressing the need to provide aid in Africa to support the cotton industry. These support strategy envisaged by the EU consisted of 3 key aspects namely: obtaining fairer trade conditions on international cotton markets; delivering a trade-related technical assistance in order to help developing countries to defend their interests; and supporting African cotton producing countries in consolidating the competitiveness of their cotton sectors.[67] The proposed partnership between the EU and Africa on cotton allowed the adoption of an Action Plan to improve the production performance of African countries and to favour their exports. This partnership aims at reducing the vulnerability of African cotton producers with regard to world prices instability.

[67] African Industrial Association, 2004, The cotton sector in Africa. The African Industrial Association (AIA) is an organization which gathers major African industrial operators. AIA's main objective is to promote the development of the African industry

The ultimate objective is to allow the cotton sector in Africa to fully reap the benefits of its competitiveness in the international market and to grow.

A reduction of cotton subventions constitutes a necessary step towards an efficient reform of the African cotton sector. Liberalization and the improvement of the sector competitiveness, so encouraged by the current globalization context, can only be implemented in the framework of a world market in which African producers can exploit their comparative advantage. Thus AIA (2004) considers that it is urgent to redefine the rules of international trade which prevails in this sector, in order to allow to African operators to evolve in a loyal and fair trade environment.

On 9 September, 2004, a WTO panel severely condemned the American regime of support to the cotton industry and requested the US to take appropriate measures to eliminate rapidly their illegal subsidies. This was due to the fact that subsidies granted to the cotton industry of developed countries caused a high prejudice to the sector of the cotton production in Africa. They undermined local African markets and pushed cotton world prices down.[68]

The AIA (2004) considers that the definition of a solid and consistent strategy at regional level is an indispensable step to efficiently address concerns of the African cotton sector's actors with other international stakeholders. Consequently, Kenya cannot be left out of these strategies to ensure that the sector gains what it deserves. In order to succeed, Kenya and other African countries set out a compelling agenda for reform with decisions set to be taken at the Cancun Ministerial meeting. The decisions in the reforms agenda indicated the need for:[69]

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[68] Ibid
[69] Ibid

i). An accelerated phase out of production subsidies which included a substantial and accelerated reduction in each of the boxes of support for cotton production, with a view to total elimination; and,

ii). Compensation as an immediate measure until subsidies were effectively eliminated. The African governments would request the northern cotton producers to provide transitional compensation in which payment rates would be adjusted in proportion to the level of support provided by industrial countries to their cotton sectors.

These were important, practical and achievable starting points but it was noted that the African proposals raised wider issues. It was evident that both the European Union and the US had become adept at reclassifying subsidies from one box to another, evading real disciplines. The Northern governments have legitimate reasons for supporting interventions aimed at furthering goals such as environmental sustainability and rural development. However, these goals have to be pursued under a WTO regime that prevents them from damaging developing country interests.

4.4 Summary

There is potential to increase cotton production and improve on capacity utilization in Kenya. The industry can create more jobs in various stages of production and through linkages especially through small scale enterprises within the cotton production chain. Furthermore, the unexploited export markets are a potential source of foreign exchange earnings and growth of the industry. By implementing the right policies within the country and advocating for relevant policies at the world stage through the WTO, Kenya and other African countries stand to develop their cotton sectors and compete effectively at the world market.

CHAPTER FIVE
SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

As developing countries strive to industrialize, the agricultural sector still remains a vital sector to their economies. Agriculture remains the driving sector of most developing countries as it contributes considerably towards the respective countries GDPs. However, shifts in international, regional and local policies have had negative impacts towards the sector especially in Africa. This is due to the fact that a significant proportion of agricultural output is exported out of the producing countries. Changes in terms of inhibiting trade policies implemented by the developed countries have resulted in developing countries not being able to penetrate global markets. Cotton is not an exception to this fact but has suffered more compared to other crops. This is as a result of a fall in prices at the world market resulting in massive losses for African farmers. This is despite the comparative advantage that the crop enjoys in Africa. The reason for the fall in prices is due to consistent subsidization of the US cotton sector therefore resulting in unfair competition. With this grim scenario, the study sought to identify the subsidies implemented by US and what effects they had on the Kenyan cotton sector.

In order to exhaustively understand the effects of the subsidies, the study adopted the neo-liberalism theory that advocated for free movement of goods and services between countries, that is, free trade. The theory underlines the need to reduce the role of governments in transactions amongst countries as they should be dictated by markets. An examination of liberalization policies especially in Africa indicated that they resulted in decline in productions of agricultural

commodities as they could not compete with imports. The liberalization policies only aggravated the inequalities situation in developing countries.

An examination of the cotton sector in Kenya revealed that the sector had undergone two significant policy periods, that is, government controlled and liberalized periods. The government controlled period was characterized by implementation of policies that fostered the growth of cotton. Direct government intervention through established institutions resulted in significant growth of the sector in the first decade of independence. Despite the success of government policies in the first decade of independence, the sector's growth declined in the 1970s as a result of inefficiencies in marketing, limited land expansion, limited development and use of new technologies, restriction on private trade and processing of commodities, and deteriorating infrastructure. These internal factors were compounded by the economic crisis caused by oil shocks of the 1970s and bad weather further affected performance of the sector. A shift in government policy towards a liberal state ideology in the 1980s further exacerbated this situation with the sector not being able to compete with already established cotton producing countries of Europe, Asia and America. The study noted that at the turn of the century, the government made initiatives to revive the sector by implementing certain policies geared towards improving the sector's performance.

The identification of subsidies implemented by the US brought forth the fact African countries especially Kenya cannot compete at the world stage. This is due to the favourable subsidies that the US government provides to its farmers who even though do not enjoy comparative advantage produce nearly one-third of the world's cotton. Further revelation that the US categorizes such subsidies within the WTO agreements paints a bleak future to Kenya's cotton sector.

Despite this, the study noted that Kenya had already made policy initiatives that could enable the sector grow and in future compete at the world markets. Such initiatives were listed as improved pricing policy, infrastructure, provision of extension services and quality seeds to farmers, access to information and technology amongst others. Other initiatives implemented at the world level stage included the lobbying done by Kenya with other countries at the WTO for developed countries especially the US to reduce its subsidies and thus enable Kenya's cotton access the world market. These initiatives would significantly revive the cotton sector to enjoy its comparative advantage and enable it contribute as expected to the country's economy.

5.2 Conclusion

The major finding of this study is that US subsidies have a negative effect on Kenya's cotton sector. The neo-liberalism theory advocates for free trade with reduced government involvement to enable markets dictate the nature of trade between countries. However, this is not the case in the cotton sector as the US government is directly involved in its trade resulting it being a major player in the world market thus affecting all the players in the sector worldwide. With this in mind, the neo-liberal theory thus advocates for inequalities between nations rather than equality. Further classification of US subsidies to be allowed by the WTO indicates that rich nations tend to control the decisions made by the organizations. Although Europe and other developed countries support Kenya's and Africa's request for implementation of changes by the US to reduce its subsidization, it is highly doubtful whether this shall be implemented as the developed countries tend to enjoy cartel like relationships at the world market.

Significant intervention by the Kenyan government is needed to enable the sector stabilize and realize its potential before leaving it to the market forces. This direct government intervention would go against the neo-liberal ideology but would enable the country realize its selfish ambition of stabilizing the sector to a given level before encouraging the private sector to take over.

5.3 Recommendations

The following are some of the major recommendations from the results of the study:

i) In order for the Kenyan cotton sector to be revived, there is need for direct government involvement through subsidization policies, incentives to farmers, infrastructure development and establishment of an apex institution at the initial level to supervise the sector until it stabilizes.

ii) There is need for Kenya to lobby with other cotton growing developing nations and present their case at the WTO to seek reduction of subsidies in the US cotton sector.

iii) Implementation of policies by the government should only be implemented after through consultation and studies to ensure that sectors affected will not slump but continue to perform well. This would prevent massive losses as experienced by liberalization of the economy in the 1980's.

5.4 Suggestions for further research

Given the potential of the cotton sector in Kenya's economy and need to industrialize the agricultural sector, there is need to undertake a study on the policies that would enable fast-

tracking the revival of the sector. This could assist the policy makers in the government to develop relevant programmes specifically targeting revival of the sector. Furthermore, there should be continuous studies on changes in policies within the sector at the world markets and the resulting effects to Kenya's cotton sector.

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