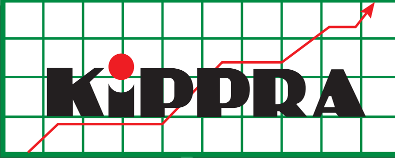

The KENYA INSTITUTE for PUBLIC POLICY RESEARCH and ANALYSIS

Policy Brief

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Improving public policy making for economic growth and poverty reduction

Safeguarding Kenya's Agricultural Sector from Import Surges

Kenya became a member of the World Trade Organization (WTO) in 1995. As a WTO member, the country was obliged to make commitments towards market access in agricultural trade. During the Uruguay Round, Kenya bound the entire agricultural tariff lines at 100 per cent (at very high disaggregated levels 8-HS digit level). The implication of this binding is that no tariffs of any agricultural product can be levied beyond this level. In addition, each WTO member country was to make an option of either converting (tarifying) her non-tariff barriers to tariffs or binding them as well. Countries that opted for the latter option were not eligible to use a Special Safeguard (SSG) provided in the Agreement on Agriculture (AoA) under the WTO. Kenya was among the countries that opted for binding and therefore had no recourse to the use of Special Safeguard under the WTO.

Since the start of liberalization in 1992, Kenya has drastically reduced her agricultural tariff lines from an average of 43.7 per cent in 1990 to about 23.4 percent in 2006. Quantitative restrictions such as import quotas, import licenses, state monopolies and variable levies, which were part of trade policy instruments that Kenya used to protect strategic and important sectors of the economy were gradually removed. This led to increased competition from foreign products while cheaper imports are dumped into the local markets. The end result has been cases of production shortfalls and unemployment, since there is no incentive to produce due to increased imports (import surges). Import surges can disrupt domestic markets and hurt domestic producers, thus threatening food security.

Challenges of Import Surges and Price Depressions

There have been many cases of imports surges on some of Kenya's main agricultural products. Wheat, rice, eggs, maize, cotton, sugar, vegetable oils, milk and pork are some of the products that have been most affected by import surges in Kenya. Since 1984, these products have experienced at least more than five cases of import surges, one in every four years. This is a major challenge to the country given that majority of the Kenyan population depend on these products either directly or indirectly. Many of these products are not only of high nutritional value, but their production is also labour-intensive, thus contributing immensely to the health status and employment of the Kenyan people. The products contribute to more than 50 per cent of national employment and 54 per cent of agricultural Gross Domestic Product (GDP).

Rice, wheat, maize and sugar imports have been increasing in a fluctuating trend over time, with some years experiencing sharp increases especially on wheat and maize. The high imports peaks started immediately after liberalization in 1992. Maize imports increased from the lowest levels of 100,808 metric tonnes in 1992 to about 1,101105 metric tonnes in 1997 when it was at its highest peak (1,000% increment), while rice imports have increased from 27,989 metric tonnes in 1990 to about 228,206 metric tonnes in 2005 (about 700% increment).

A study done by the International Centre for Trade and Sustainable Development (ICTSD) shows that during the 1980-1990 period, the volume of processed milk rose steadily from 179,000 metric tonnes to 392,000 metric tonnes. However, this trend reversed from 1990 as a result of liberalization; the volume of processed milk fell drastically to 126,000 tonnes in 1998 while imports of milk powder rose from 48 metric tonnes to 2,500 metric tonnes (in fresh milk equivalent 408,000 metric tonnes to 21 million litres). This influx of imported milk powder as well as other dairy products depressed the demand for fresh local milk (ICTSD Issue Paper No. 6). What followed was the collapse of many dairy processing

This policy brief is based on KIPPRA Discussion Paper No. 69 on Effectiveness of Triggers and Remedy for Special Safeguard Mechanisms: A Case for Kenya's Agricultural Sector, by Fred Miencha, Nicholas Waiyaki and Hezron Nyangito.

factories, including the giant Kenya Co-operative Creameries (KCC).

Increased imports have resulted to production shortfalls of the country's major commodities. Kenya has experienced a number of production shortfalls. For example, between 1984 and 2004, Kenya experienced 85 cases of import surges in 13 important agricultural products, with 50 per cent of them experiencing production shortfalls. The highest production shortfall was experienced on wheat, rice, maize, vegetable oils, pork, poultry meat and milk. Wheat had the highest production shortfall.

Prices have also been fluctuating over time, leaving the producer uncertain on what to expect in the next planting season. This is a disincentive to producers; it causes domestic production shortfalls in favour of imports.

Despite these expected negative outcomes of trade liberalization, negotiations on further tariff reductions are going on. Given the past experience and the characteristics of the country's agricultural sector in terms of international competitiveness and vulnerability to vagaries of nature, more import surges cannot be overruled in the future. This calls for effective safeguard mechanisms to cushion the producers from the negative impact of liberalization.

Available Safeguard Measures

Kenya accords Most Favoured Nation (MFN) treatment to all trading partners, whether members of WTO or not. Goods imported into Kenya may be subject to tariffs, import declaration fee and internal taxes (exercise duties and value-added tax), which apply equally to imports and domestic products. Kenya has no specific legislation on safeguard measures but they can be applied on a case-by-case basis. The country has no reserved right to invoke the Special Safeguard clause of Article 5 of the WTO Agreement on Agriculture.

Kenya has also not applied anti-dumping and countervailing measures. Section 125 and 126 of the Customs and Excise Act provide the legal basis for anti-dumping and countervailing measures in Kenya (WTO document G/ ADP/N/1, 22 May 1996). Under Section 125, a dumping duty may be imposed on dumped or subsidized goods if their importation threatens to cause material injury to an established industry or is such as to retard materially the establishment of an industry in Kenya. Industries that consider to be affected by dumping are required to contact the Ministry of Finance and supply evidence of the nature and source of dumped imports as well as substantiation that the industry is being damaged by the dumped imports. However, the situation is rarely, if ever, that simple. In most cases, it is necessary to undertake a series of complex analytical steps to determine the appropriate price in the market of the exporting country (normal value) and the appropriate price in the market of the importing country (export price) so as to undertake an appropriate comparison. There are no domestic policies on subsidies or compensation mechanisms that can protect the local industry from increased imports and depressed prices.

Challenges of Further Liberalization

The World Trade Organization member countries have agreed in principle that all member countries will have to undertake tariff reductions on their agricultural tariff lines as a commitment to the fulfilment of the Doha Development Round Agreement. Although no concrete modalities have been agreed upon, various proposals have been presented by member countries for discussion. Member countries have re-aligned themselves into various groups. Kenya belongs to mainly the African-Carribean Pacific (ACP) group of countries, the G-33 and recently the G-6. The various groups have presented proposals for discussions and consideration. There seems to be some convergence towards the G-20 proposals, which are not very different from the G-33 and ACP proposals.

The G-20 Proposal

A Group of 20 developing countries comprising of Argentina, Brazil, China, Cuba, Egypt, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, Philippines, South Africa, Thailand, Tanzania, Valenzuela and Zimbabwe presented proposals on market access, which was subsequently referred to as the G-20 proposal. The G-20 proposed two different scenarios; for developed countries and for developing countries. According to the proposal, developed countries will be expected to undertake a tariff cut of at least 54 per cent on average, while developing countries will be subject to a maximum tariff cut of 36 per cent on average. The group maintains that overall proportionality of commitments between developed and developing countries should be achieved through lower tariff reductions and higher threshold for the bands. Developing countries should cut less than two-thirds of what should be undertaken by developed countries. Going by this proposal, Kenya's agricultural bound tariffs will be cut by 24 per cent, implying that the maximum tariff that Kenya will be allowed to levy on agricultural imports at any given time is 76 per cent from the previous 100 percent.

Other Proposals

Other proposals include the Harbinson, Swiss and Uruguay Round. The Uruguay proposal will cut Kenya's agricultural tariffs by 24 per cent, Swiss by 33 per cent, while the Harbinson will cut by 35 per cent. If any of the four formulae is agreed, Kenya is expected to cut tariffs by

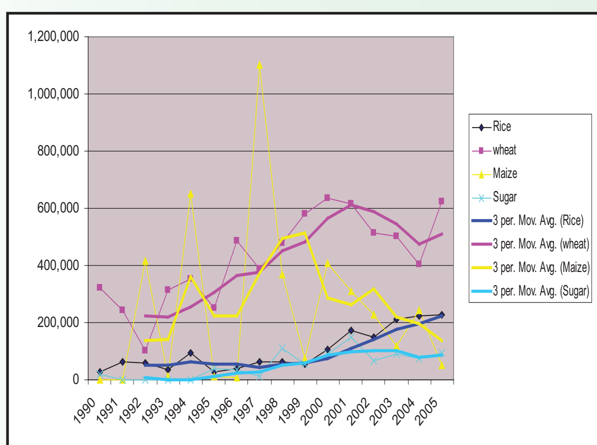
at least a minimum of 24 per cent and a maximum of 35 per cent, thus reducing the current bound rate to at least a maximum of 65 per cent and minimum of 75 per cent. This will erode the flexibility that existed of levying duties to a maximum of 100 per cent in case of injury from import surges and fall in prices.

Concerned with the implications of tariff reductions to developing countries' sensitive and important agricultural sectors especially in poverty reduction and rural employment, the Hong Kong Ministerial Conference on WTO agreed, in principle, that according to paragraph 1(b) of Article II of GATT 1994 or of Article 4 of the Hong Kong Agreement, developing countries may take recourse to the imposition of an additional duty in the importation of any agricultural product, which threatens or causes serious injury to domestic import competing products.

The Proposed SSM Triggers

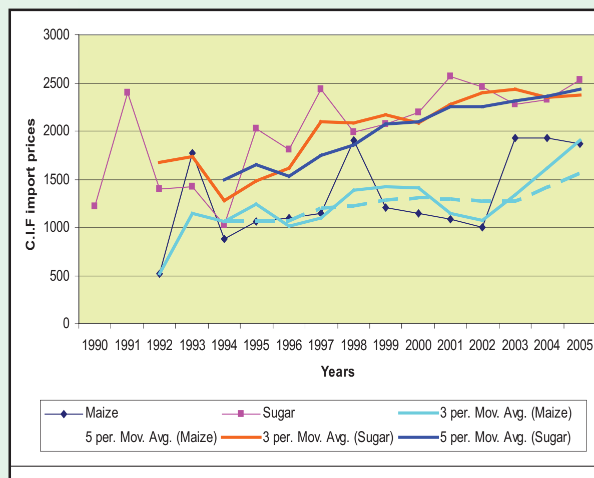
An effective Special Safeguard Mechanism (SSM) should allow a country to raise tariffs beyond its bound tariffs to protect import-competing sectors against price depression or import surges. To fulfill this objective, it is expected that once a trigger has been activated, remedies under SSM should be commensurate with the depth of the import surge or the level of price depression of the commodity in question. The duration of the application of the safeguard should correspond to the duration of the injury. The Hong Kong Ministerial Conference proposed volume and price triggers for developing countries. Threshold and reference price and their triggers were also proposed. A group of developing countries, Kenya included, have proposed some threshold figures in the G33. A three year moving average has been proposed as reference price and trigger for both prices and import volumes.

Figure 1: Three year moving average of selected food crops



Source: Statistical Abstracts (various)

Figure 2: Three and five year moving average CIF import prices of maize and sugar



Source: Statistical Abstracts (various) and author

Figures 1 and 2 provide cases of three year moving import volume and price averages of selected agricultural food crops in Kenya. Figure 2 provides for both a three year and five year import CIF price moving average. The figures show that there are differences in cases of import surges in some years when applying the three and five year moving averages. The depth or extent of the deviations from the current trends is also different depending on which moving average is used.

Other observations from the figures include:

- The proposed three year moving average for CIF import prices and import volume trigger references will not be able to trigger all cases of increased import volumes and depressed prices.

- While the three year moving average can trigger many cases of import surges, the five year moving average is very important when there are persistent depressions in prices, even when the three year moving average is unable to trigger.

- The size of the level of thresholds or *de minimis* is important as the triggers may be ineffective in cases of small deviations of current import prices and import volume trends from the reference moving averages.

- Both the import volume and import price moving averages show cases of import surges in different years and may be difficult to determine the appropriate moving average to apply.

- The three and five year moving averages provide different levels of triggers since their deviations from current levels differ. The five year moving average tends to rise above the three year moving average when prices are falling and can therefore

provide a higher trigger. A five year moving average is more effective in safeguarding low prices when world market prices are persistently depressed.

- Some deviations from moving averages are quite small from the proposed *de minimis*, but may cause a great impact on domestic production.

- In some products, there are cases where increase in imports does not depress domestic prices or domestic production. This implies that other factors also play a role in increases in imports. Domestic production capacity constraints include: inability to cope with seasonal supply shortages caused by weather conditions; lack of smooth transition to market liberalization; poor handling of imports; lack of effective trade surveillance system, in particular access to accurate statistics and prices; and infrastructural constraints such as high costs of production due to high electricity tariffs and poor condition of roads. This makes it difficult for domestic products to compete with imports.

Policy Recommendations

(i) Policy makers and negotiators should negotiate for a Special Safeguard Mechanism that is practical in addressing increases in imports and price depression beyond reasonable levels. Such mechanism should, once a trigger has been invoked, be able to commensurate with the depth of the increase in imports or fall in price of the affected product. The duration of the application should also correspond to the duration of the injury.

(ii) There is need to negotiate for a more flexible modality for tariff reduction, which will not drastically reduce the country's bound tariff levels. In addition, this presents an opportunity for the country to negotiate to vary agricultural bound levels depending on the sensitivity of a particular sector so long as an average bound rate of 100 per cent is maintained or whichever will be the final bound rate after tariff reductions as will be agreed during the ongoing WTO negotiations. Otherwise, there seems to be no rationale as to how a binding average of 100 per cent across all agricultural tariff lines was arrived at during the Uruguay Round.

(iii) A higher provision for a list of special products should be negotiated to include all products likely to be adversely affected by the proposed formula for tariff reduction in the ongoing WTO negotiations, given that over the past years, Kenya has significantly liberalized most strategic sectors of the economy. There is need for credit for past efforts of liberalization through Structural Adjustment Programmes, in both the use of the formula and in the number of products to be designated as special products.

(iv) Flexibility in the use of both three year and five years moving averages. There are instances where in the same period, a three year moving average shows cases of import surges while the five year moving average does not and vise versa. In addition, each moving average provides different levels of deviations from the current trends, with the five year moving average providing a larger deviation.

(v) Finally, there is need to address infrastructural constraints, which raise the cost of production and domestic capacity constraints to be able to cope with seasonal supply shortages caused by weather conditions.

About KIPPRA Policy Briefs

KIPPRA Policy Briefs are aimed at a wide dissemination of the Institute's policy research findings. The findings are expected to stimulate discussion and also build capacity of public policy makers in Kenya. KIPPRA acknowledges support from the Government of Kenya, the European Union (EU), the African Capacity Building Foundation (ACBF), and all other development partners who have supported the Institute's activities.

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