Policy and Legal Framework for the Coffee Subsector and the Impact of Liberalization in Kenya

Hezron O. Nyangito

Productive Sector Division

Kenya Institute of Public Policy Research and Analysis

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Bishops Garden Towers, Bishops Road
PO Box 56445, Nairobi, Kenya
tel: +254 2 719933/4
fax: +254 2 719951
email: admin@kippra.or.ke

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Abstract

A major concern in liberalizing the coffee trade is the need to harmonize the legal framework with policy reform. In particular, the legal framework must change so the institutions previously involved in controlling and regulating coffee fit in well with the new policy framework. This paper shows that, despite policy reform in coffee processing and milling, the Coffee Board of Kenya remains the regulatory agency of the coffee industry and controls coffee marketing. Processing and milling are dominated by cooperatives and the Kenya Planters Cooperative Union. Coffee production has declined due to low use of inputs and neglect of coffee farms. This is attributed to lack of credit to purchase inputs, high prices for the inputs, poor delivery of processing and marketing services, and low payments to farmers. The low payments to farmers are due to high costs of delivery of services by various institutions, which take up about 60% of the f.o.b. world market price for smallholder farmers. Re-organization of the various institutions involved in the delivery of services to smallholder coffee farmers and enforcement of the rules that govern the delivery of the services is recommended as key to reducing the high costs.

Contents

Executive Summary

The effect of policy reform on developing commercial agriculture has become a subject of debate. Reform has allowed the private sector to participate in most commercial activities, but squabbles have emerged in running the institutions involved in delivering services to farmers. A major concern in liberalizing the coffee industry is the need to harmonize the legal framework with the policy reforms. In particular, the legal framework must allow institutions previously involved in controlling and regulating the industry to fit in well with the new policy changes.

The legal framework for operating the coffee industry is spelled out in the Coffee Act Chapter 333, which provides for the regulation of the industry and control over production, marketing and export of coffee, as well as incidental and connected matters. All these functions are undertaken or supervised by the Coffee Board of Kenya (CBK). The current act was revised in 1979, before the era of policy reform. A special legislative supplement was published in 1999, which altered coffee marketing rules to fit in with the liberalized market policies. However, the original Coffee Act remains the only legal framework for controlling and regulating the coffee subsector.

The major policy reforms that have affected the coffee industry are deregulating markets and prices for outputs and inputs, institutional reforms on regulation of the industry and delivery of services to farmers and macroeconomic reforms.

Deregulating markets and prices has led to liberalized coffee processing and milling. The farmers' coffee processing factories more control on processing coffee than previously when societies had more control. More millers are also now involved in coffee as opposed to the past when the Kenya Planters

Cooperative Union (KPCU) had the monopoly in coffee milling. However, farmers and millers have wrangled over the new rules on phases of production, particularly coffee marketing, which the Coffee Board Kenya (CBK) still dominates.

Institutional reforms have led to restructuring CBK to encourage private competition for services, such as extension, milling, marketing and making payments to farmers. However, disagreements that have arisen on regulating the coffee industry by CBK and the role of millers and societies on coffee marketing have greatly affected the performance of the industry.

Macroeconomic reforms, which include removing restrictions on the exchange rate, foreign exchange retention and remittances, and liberalizing interest rates, have allowed exporters to keep most earnings in foreign exchange. Coffee farmers are paid in foreign exchange for coffee exports. However, since most small-scale farmers are paid through their cooperative societies and therefore do not receive payment in foreign exchange directly, they do not benefit form the liberalization of foreign exchange markets. Furthermore, small holder farmers complain about the prices they receive because of the high deductions the cooperative societies make to cover the cost of their services.

In implementing policy reform, particularly exempting CBK from the State Corporations Act, the government withdrew its controls over CBK management. This meant that CBK officially became a farmer-managed organization, with the power to regulate and control the coffee industry. However, modification of the Coffee Act to accommodate these changes completely has yet to be done. The only changes in the legal framework so far have been in the Coffee Act through Gazette Supplement No. 7 of 1999, which allow more agencies to pulp, mill and market coffee. However, CBK remains the regulator and marketing agent of all the coffee produced in the country.

Impact of reforms

Coffee factories. Almost all existing coffee factories serving smallholder farmers belong to cooperative societies. A few private factories have started since coffee processing and milling has been liberalized, but they are still rare. Factory management is burdened with nepotism, which has led to mismanagement and run-down facilities—a factor that may contribute to cooperative break-up. In general, factory payout to farmers varies from about 50% to 80%, largely determined by the charges for the services of coffee processing, storage, bulking and transportation and for overheads. High deductions and lower-quality coffee result in low producer price, which discourages production.

Cooperative societies are wholly formed by a group of factories, but in some cases one factory may make up a society. Main society functions are to keep books, provide credit, market, repair and maintain factories, and employ factory staff. Most societies are poorly managed. This has led to a widespread break-up of large societies into smaller ones. The problem is made worse by huge deductions taken from farmers' returns to cover expenses incurred by the many factories a society may own. The payout from society to factory varies from about 46% to 93% depending on the performance of the cooperative and the services it offers to factories which in some cases include factory expenses. Over 95% of the expenses for factories are factory related, but much of these expenses are inflated because of corrupt practices, such as exaggerated deductions for both factory and the society services.

District cooperative unions draw membership from coffee cooperative societies and in some cases from other farming enterprises such as dairying. District unions help coffee farmers produce, process and market coffee, but they do not physically handle it. The unions are allowed by the Cooperative Societies Act to take up to 17.05% of the farmers' proceeds to finance their operations. However, recently unions have reduced what they provide farmers by not involving themselves directly in employing society staff. They have instead diversified into other functions such as banking. However, the fact that unions are no longer active in arbitrating society disputes has increased the wrangling.

Coffee milling before the coffee subsector was liberalized was a reserve of the Kenya Planters Cooperative Union (KPCU). Although more milling companies are now registered, KPCU dominates as a result of the monopoly it once had. With easy access to coffee factories through the district unions, KPCU is credited for the services it provides to farmers directly, such as extension and financing. Recovery of loans to farmers is, however, poor and has affected KPCU cash flow and financing ability. Coffee milling by the private sector is a new phenomenon. Milling charges vary from miller to miller but deductions on the farmers' proceeds should not exceed 4% of the export price according to CBK rules. This has restricted the range of services millers can provide. As a result, conflicts have arisen over unfulfilled promises millers have made to farmers.

Coffee Board of Kenya. In addition to regulating and controlling the industry, CBK functions include production services, monitoring of processing, marketing, production research and publicity. Despite the policy reforms in coffee processing and milling, CBK remains the regulatory agency in the coffee industry and controls export marketing at the auction market by appointing coffee brokers and regulating the activities of the coffee brokers and buyers. The CBK also receives all the proceeds of exported coffee which it later remits to farmers. The board further provides extension services to farmers, research and promotion of coffee in export markets. It charges about 8% of the export price on marketed coffee to cover its expenses and government levies. Board control over coffee marketing and regulatory functions in the industry has been a bone of contention with other stakeholders.

On the farm. The main reason for a general decline in coffee production in the country is that coffee farms have been neglected. Trees are bushy, unpruned, unweeded and diseased because farmers face production and marketing constraints and payments for their coffee are low. The most common production constraint is the low use of inputs, because prices for them are high and farmers lack credit to purchase the inputs. Other constraints include high labour costs and bad weather. The payment farmers receive is low (averaging 60% of the f.o.b. price) because of the high deductions made by factories, societies, unions, millers and CBK. Exaggerated deductions at the factory, which include corruption, cheating and false recording of farmers' coffee weights, are also a reason for low payments.

Recommendations emerging from the analysis are as follows:

- The legal framework, which gives CBK the power to control and regulate the industry, should be changed to allow it to play a leading role as the supervisory agency in the industry, supporting production services, such as extension and research, rather than regulating the industry. The CBK should delink itself from commercial services such as marketing coffee at the auction markets.
- A non-partisan government agency, preferably an independent body, should enforce the rules for delivering services, by registering institutions and controlling the industry, to make conditions for all stakeholders equitable.
- Farmers should be at liberty to choose their own coffee pulping, milling and marketing agents—private or public—

from among those registered with the regulatory agency to deliver services to planters. The roles of each institution should be clearly spelled out.

  – Coffee cooperative societies are necessary to provide production inputs, process coffee (pulping), and contract milling and marketing agents for smallholders, but rules on entry and exit of members from a society should be clear. The rules of management of the societies and factories should also be clear because these are in most cases the causes of conflict.
  – District unions can play a leading role in providing supervision but should not duplicate the roles of the societies.
  – The role of millers should be clear but those serving smallholders should not market coffee to avoid conflict of interest, which could lead to producers being exploited.

- All coffee should be marketed through the auction centre although private contracts could be allowed as long as they are reported to CBK as the farmers' supervisory agency and recorded with the coffee regulatory body.

1 Introduction

The effect of policy reform on agricultural development, particularly deregulating the market and divesting the government of its role in production, has become a topic of debate. Although agricultural trade has been liberalized and institutions reformed substantially since 1993, disagreements have emerged in running the institutions that deliver services to farmers, particularly those producing coffee and tea. The consequences are mixed trends in production of the two most important commodities in the Kenyan economy.

The policy reforms have had a negative impact, particularly on coffee production. Although coffee was the major export crop in Kenya in foreign exchange earnings in the 1970s and 1980s, the era of government controls, production declined in the 1990s from about 117,000 tonnes in 1989 to about 53,000 tonnes in 1998 – a 45 percent reduction (Figure 1). Worst hit were smallholder farms, which account for over 50% of coffee production. The reasons for the decline include low productivity due low levels of use of inputs, unfavorable climatic conditions and low producer prices.

[FIGURE 1 here]

Coffee yields on both small and large scale have been erratic over the years as shown in Table 1. The major reason for the erratic yields is the erratic rainfall conditions (droughts and excessive rains). The yields were lowest in 1998 for both small-scale farms and estates and this can be attributed to the heavy El Nino rains, which led to high levels of disease infestation and also provided poor conditions for development of coffee berries. The nominal export price during this period was highest and therefore it cannot be used to explain the low production observed during the period. However, the prices

Table 1. Coffee yields on small farms and estates and export prices received by the Coffee Board of Kenya 1985-1998

Year	Small farm Yields Kgs /ha	Estates Yields Kgs/ha	Price Kshs/kg Clean coffee
1985	556	809	39.7
1986	581	1,179	50.2
1987	577	942	36.6

1988	710	1,150	44.6
1989	673	1,054	43.1
1990	595	937	36.4
1991	569.3	930	46.5
1992	440	925.1	49.36
1993	352.7	860.5	98.9
1994	342.7	1,012.6	144.3
1995	510	852	159.7
1996	463.7	1,045	139.1
1997	312	774	251.5
1998	261.8	536.5	257.2

Source: Economic Surveys, 1990, 1995 and 1999

received by farmers could be low due to high deductions made by organizations involved in delivery of services to farmers. This is a subject of inquiry in this paper.

The yields on smallholder farms have been consistently lower averaging 2.5 times less (400 kg per hectare) than for estates, averaging 1000 kg per hectare. The reasons for these include high levels of disease infestation and low use fertilizer on coffee on small farms because of the high costs of the inputs and lack of credit for purchasing the inputs.

As a result of the decline in production in recent years, coffee's contribution to foreign exchange earnings and as a source of income to farmers and employment to the majority of the population has also declined. Coffee now lags behind tea and horticulture in foreign exchange earnings. However, it remains a major export crop in the Kenyan economy and government policy is to increase its production. The focus is on improved extension services to help farmers improve their husbandry practices, and more efficient processing, milling and marketing to provide price incentives to producers (Kenya 1998).

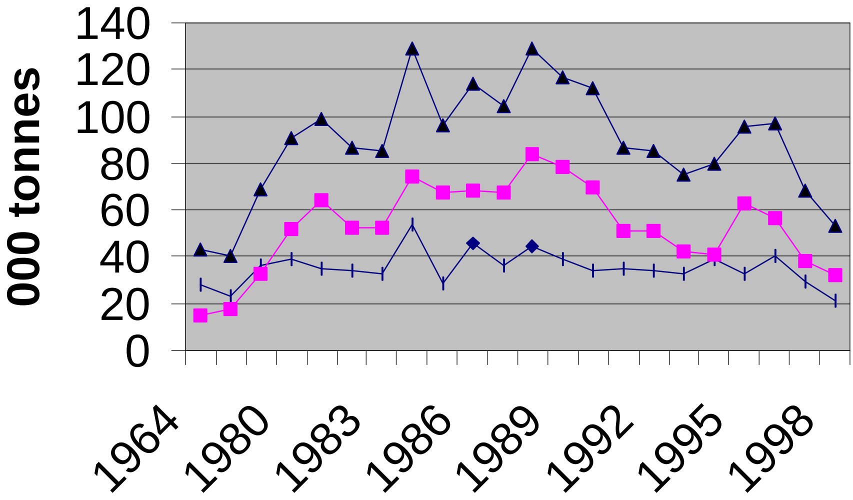

Figure 1. Coffee production in Kenya 1964-1998

A major concern in liberalizing the coffee trade is to harmonize the legal framework with policy reform—in particular, to mesh the roles of institutions previously involved in controlling and regulating coffee with the new policy changes. This paper outlines the policy reforms that have been implemented, the legal framework for operating the policies, and the effect of the policies on institutions and on the coffee farm. This is provided with a view to recommend specific improvements to the policies and workings of institutions involved in delivery of services in the coffee industry.

2. Type of Policy Reforms

The major policy reforms this paper addresses are deregulating markets and prices, and institutional and macroeconomic reforms.

2.1 Deregulating markets and prices

Deregulating markets and prices was aimed at encouraging the private sector to play an important role in producing, marketing and processing agricultural commodities. The government has therefore liberalized coffee processing and milling. However, farmers and other stakeholders have wrangled over the new rules published in 1999 on liberalizing the coffee trade, particularly on processing and marketing.

2.2 Institutional reform

Institutional reforms were aimed at reducing the government's involvement in management of institutions that deliver services such as processing, milling and marketing coffee. These reforms have been implemented by way of restructuring the Coffee Board of Kenya (CBK) and leaving the control on its management to farmers. The coffee factories, societies and millers have also been left to operate relatively independent of the CBK. However, the disagreements that have arisen on operating these institutions (CBK, coffee factories and societies, and millers) have greatly affected their performance.

2.3 Macroeconomic reform

Reforms in macro policies include removing restrictions on the exchange rate, retaining and remitting foreign exchange, and liberalizing interest rates. Removing restrictions on foreign exchange has allowed exporters to retain most earnings in foreign exchange. Coffee farmers are paid in foreign exchange by the CBK and are allowed to operate foreign exchange accounts. However, most small-scale farmers are paid through their cooperative societies and thus they do not directly benefit from payments in foreign exchange for coffee exports since they are paid by co-operative societies in local currency. Thus the implicit tax on coffee earnings by the government has been removed however farmers still complain about the prices they receive possibly because of high deductions made by societies and ineffective management of the societies and factories.

3 Legal Framework

The legal framework for agricultural policies in general is spelled out in the Agriculture Act Chapter 318. The laws governing coffee are spelled out in the Coffee Act Chapter 333, which controls producing, marketing and exporting coffee, and incidental connected matters. The Act is still based on government-controlled policies. With policy reform aimed towards liberalizing the market, some modifications have been made although they are not comprehensive. A special legislative supplement was published in 1999, which altered coffee marketing rules to fit in with the liberalized market policies. However, the original Coffee Act remains the only legal framework for controlling and regulating the coffee trade.

3.1 Requirements of Coffee Act before policy reform

The requirements of Coffee Act presented here focus on institutions, financing and levies, and the legal implications of the general rules on policy reform.

The Coffee Board of Kenya (CBK)

This is the main institution for controlling and regulating the coffee industry. It also has the authority to establish various institutions as it saw fit to assist it in controlling the industry and delivering services to farmers.

The CBK was composed of at least 14 members: 3 to represent plantations and 3 to represent cooperatives. All these were selected from a panel of names submitted from a conference of coffee farmer delegates and 8 other members including experts in coffee marketing and officials in the ministries of Agriculture and Finance. Members held office for three years; however, the Minister for Agriculture was at liberty to terminate the appointment of any member for absenteeism.

The Board had two major functions:

- Service delivery- promoting the coffee industry including marketing and processing coffee, licensing and controlling coffee producers and processors, and conducting coffee research.
- Regulatory - acting as a government agent in all matters pertaining domestic development of the industry and international agreements made or to be made in relation to coffee as the minister for Agriculture may direct.

The functions of the board have been of concern to many stakeholders, who have felt the dual roles the board played in both regulating services and delivering them created a conflict of interest and inefficiencies.

Other institutions and regulations

The *CBK* had the authority to license and register at its discretion planters, buyers, sellers, millers and any other persons dealing or transacting any business in coffee. Besides these licenses, the board had the mandate to control the curing, marketing and export of coffee. Planters were prohibited from roasting, selling or exporting coffee. All coffee from planters was to be sold to the board. Millers had to deliver all the coffee they roasted to the board within a specified period. Overall, the board had the discretion to buy and sell all the coffee produced in the country and all that is sold from other Eastern and Central African countries and, had the mandate to make contracts on the coffee as it deemed fit. The dominant role of the board over all the other stakeholders created conflicts with those it had the power to oversee.

Financing and levies

The Coffee Act empowered the minister for Agriculture, on the recommendation of the board, to publish levies in the government gazette and impose them, including export and planters levies. All money from the export levy was paid to the board and the Commission of Customs and Excise was authorized to collect the levy on its behalf. The board took the planters levy from any money due to the planter and kept it in a levy fund. It was also legally allowed to operate a coffee pool, which consisted of all money from the sale of coffee and any other payments to the board. The funds were used to purchase coffee, cover board operations, advertising, research and experiments, remunerate board staff and cover any other expenses incurred in promoting the welfare of the coffee industry, including keeping a reserve for future use.

The use of board funds had to be examined, audited and reported upon annually by the controller and auditor general or such person as the minister for Agriculture might appoint. The board had to lay before the auditor all its books and accounts, and produce all supporting evidence the auditor might require. The board's report and the auditor's report was tabled in the national assembly and also presented to farmers during the next-convened coffee conference. Use of board funds and payments to farmers have been a problem, with farmers complaining over payment delays.

General rules

In addition to the requirements for licensing and registering institutions involved in producing, processing and marketing coffee, the Coffee Act provided the legal framework that CBK used to control and regulate the industry. The act provided general rules on appeals, powers of inspectors and penalties for offences. Most important, perhaps, is that the minister had the power, after consulting with the board, to make rules for prescribing anything the act could require, generally for better carrying out the provisions of the act.

3.2 Modifications of the Coffee Act

Implementation of policy reforms affecting the coffee industry started in 1993. The first change was to exempt the Coffee Board from the State Corporations Act, which meant that the government withdrew its controls over CBK management. Thus CBK officially became a farmer-managed organization, with the power to regulate and control the coffee industry. However, the Coffee Act has yet to be modified to accommodate these changes completely and the exemption from the State Corporations Act was recently reversed.

The only changes undertaken in the legal framework for regulating and controlling the coffee sector were made in 1999 through Kenya Gazette Supplement No. 7. The focus of the changes was on rules controlling coffee marketing. The powers given to the CBK to control appointment of coffee pulping factories, millers and marketing agents were revoked. The planters were given the power to appoint their own processors, millers and marketing agents and were only required to request the board to register these agents. However, planters were still prohibited from selling cherry or parchment coffee directly to a miller, an individual coffee factory owner or a cooperative society. Nor was a planter or agents allowed to sell coffee other than at a central auction through an authorized marketing agent. Furthermore, planters are still not allowed to deal with other planters. If a planter mills and markets his own coffee, CBK must examine the records.

Under the changes, a cooperative society is considered an agent for the purposes of handling farmers' payments and issuing credit and advances on parchment and cherry coffee to growers. A coffee cooperative society can appoint its own marketing and commission agents to handle farmers' payments and buy merchandise mainly production inputs for the farmers and perform other related services. The cooperative societies, however, are restricted to using only one commission agent per crop year.

In summary, the policy reforms and changes in the Coffee Act through Gazette Supplement No. 7 empowers CBK to act as a regulator of the coffee industry and as a marketing agent for all the coffee produced in the country. Although the supplement allows for more players in coffee pulping, milling and marketing, these players must be licensed and registered by the board. CBK also has the power to arbitrate disputes that may arise between parties. In an arbitration panel where the board is involved, the minister of Agriculture appoints a chair and one member represents the board. The Minister is empowered to make changes in the regulation and control of the industry in consultation with the board. However, it is apparent that the board has supreme powers over all players in the sector, and this may be a source of conflict. The board can take advantage of the power the minister has to make changes and claim autonomy to challenge any changes the government makes if it is not consulted. It does so particularly when it disagrees with the government and wants its stand to prevail.

4 Effects of Policy Reform on Coffee Institutions

Policy reform has diverse effects on farms and on the institutions involved in the coffee trade. The observations in this section are based on a recent study undertaken in Murang'a, Meru and Kisii Districts, with the focus on small-holder coffee institutions and farming.

4.1 Coffee factories

Almost all the existing coffee factories serving smallholder coffee belong to farmer cooperative societies. Farmers who are licensed to grow coffee under the planters' licence for their respective cooperative society own them. The factories are financed by cooperative societies using members' funds or loans, which are repaid later. A few private factories have started since coffee processing and milling have been liberalized, but private factories for smallholder coffee processing are still rare.

Most coffee pulping factories operate below capacity and are therefore technically inefficient. Factory management is burdened with problems that nepotism causes, as an employee must be a coffee grower or a family member of a coffee grower. This requirement often overrides academic or other qualifications. As a result, most factories employ managers who are not well qualified, leading to their being mismanaged and run down. This is one factor that is causing societies to break up.

The volume of coffee handled by societies and the efficiency in delivering services determine the major factory operating costs (Table 2). The largest expense is for maintenance and operation. In general, factory payout to farmers varies from about 50% to 80%, largely determined by the charges for services such as coffee processing, storage, bulking and

Table 2. Coffee volume, payment and operation expenses 1996/97 for factories in three Kenyan regions

Item	Murang'a	Meru	Kisii
	Kilograms		
Coffee output	5528.5	2897.0	1636.2
	Kenya shillings per kilogram		
Producer price	35.25	33.40	22.10
Fuel costs	0.07	0.01	0.04
Wages and salaries	0.01	0.10	0.59
Maintenance, other costs	6.36	8.03	10.55
Total expenses	6.55	8.14	11.18
Payout to farmers	28.70	25.26	10.92
	Percentage		
Total expense /price	18.6	24.4	50.6

Source: Nyangito 2000

transportation, and overheads. The payout to farmers is lowest in Kisii district because of the high deductions for factory maintenance and other costs when compared to the other districts. The payments producer price is also low for Kisii district. Thus high deductions to cover factory expenses which are unproportionately high because of inefficiencies and lower quality coffee result in low final payments made out to farmers.

Cooperative societies

Coffee cooperative societies are formed by a group of factories although only one factory may comprise a society. The main functions of a society are

- bookkeeping and auditing factory records
- credit provision to members
- marketing for members—mainly transporting coffee

- repair and maintenance of factories
- employment of factory staff

Most societies are poorly managed, as judged by the wrangling among members, which has led to management coups in many societies countrywide. As a result, the break-up of large societies into smaller units has been widespread, with each factory becoming a single unit rather than being a member of a larger society with many factories. The main causes of the problem are

- corrupt practices by management committees, in most cases, management committee members rewarding themselves over and above the stipulated requirements than they are legally allowed
- poor management skills, as most officials of the management committee are poorly educated and lack skills for running societies such as understanding financial management statements
- nepotism, as leaders are selected through relationship or clan rather than for qualities to ensure achieving a common economic goal—as a result members in opposition gang up according to clan or political groupings, and unstable leadership results

Thus, the main reasons for society break-up are mismanagement and huge deductions on farmers' returns to cover factory expenses. The average payout to factories from societies is about 75% of the gross earnings received from CBK but varies from about 46% for Kisii District to 93% for Meru District (Table 3). The variation in the payout made to factories is due to performance of the society with respect to the expenses incurred-salaries and allowances, factory expenses, loan arrears and interests, fertilizers and pesticides—and the quality of coffee delivered.

Table 3. Relationship between expenses and payments for societies in 1996/1997 for survey districts

Item	Murang'a	Meru	Kisii
	Kenya shillings per kilogram		
Mean price	88.90	73.00	48.15
Wages	0.39	0.10	0.56
Management allowance	0.01	0.02	0.20
Factory expenses	11.64	4.84	25.14
Total expenses	12.04	4.96	25.90
Payout to factory	76.86	68.04	22.25
	Percentage		
Expense/price	13.54	6.80	53.80
Payout / price	86.46	93.20	46.20

Source: Nyangito 2000

As shown in Table 3, over 95% of the expenses are factory related, but most are inflated because of corrupt practices, such as exaggerated deductions in the factory and the wider society. These practices include payments for non-existent coffee and bank overdraft payments to the management committee members. This is due to poor or no supervision by CBK or any other authorized agent on service delivery by cooperative societies. The high proportion of expenses for factory operations indicates that if expenses can be reduced, payments to farmers can be improved.

District unions

District cooperative unions draw membership from coffee cooperative societies and in some cases from other farming enterprises such as dairying. The district unions facilitate production, processing and marketing for coffee farmers but do not physically handle the coffee. Their main functions include education and training of farmers, bookkeeping for the societies, supervising the societies and factories, employing society secretary managers, handling transport and credit. Although the services that unions offer societies are decreasing with liberalization, societies with strong links with unions, particularly for bookkeeping and supervision of accounts, such as in Murang'a District, have the best performance in terms of low operating costs and reduced wrangles among members.

The unions are allowed by the Cooperative Societies Act to take up to 17.05% of the farmers' proceeds to finance their operations for coffee farmers. However, recently unions have reduced the activities they provide farmers by not involving themselves directly in employing staff for societies. They have instead diversified into other functions such as banking. However, the absence of the union's active role to arbitrate disputes in societies has increased incidents of wrangles within societies.

Coffee millers

Prior to liberalization, coffee milling was reserved to the Kenya Planters Cooperative Union (KPCU). KPCU was registered as both a company and a cooperative society with membership drawn from coffee estates and cooperative unions countrywide, but it was exempted from the Cooperative Act when the coffee sector was liberalized. KPCU has easy access to coffee factories through the district unions, which hold shares in the Union. KPCU is credited for the services it provides to farmers directly such as extension and financing. The recovery record from lending funds to farmers is, however, poor and KPCU has had to write off bad debts over the years. The poor record in collecting debts has affected its cash flow and its ability to finance farmers.

Coffee milling by the private sector is a new phenomenon. Currently, new registered milling companies include Thika Coffee Mills, Socfinaf Coffee Mills, Gatatha Farmers' Company and Brooke Bond Coffee Millers. The major challenger to KPCU in milling for smallholders is the Thika Coffee Mills, which also offers services such as credit for coffee production and transportation of coffee for societies. The company has new milling machines and posts lower milling losses but its capacity is low. It has tended to limit providing its services to farmers in Central and Eastern Provinces and is yet to penetrate to other areas of the country. The other private millers largely serve estates.

The charges for milling coffee vary from miller to miller, but CBK rules mean that deductions on the farmers' proceeds cannot exceed 4% of the export price. This has restricted the range of services millers can provide coffee farmers. As a result, conflicts have arisen over unfulfilled coffee production services millers have promised the farmers.

Coffee Board of Kenya

The Coffee Board of Kenya's functions other than regulating and controlling the industry include production services, process supervision, marketing, production research and publicity.

Production. The board, through the area managers and field inspectors of the Field Services Agriculture Department stationed in every coffee region, offers advisory services on good husbandry practices to farmers. Farmers are advised on the best seedlings and on applying insecticides, fungicides and other sprays for controlling diseases and pests. Field officers assist in developing annual coffee production estimates for planning by the board.

Processing supervision. The board does not process coffee directly but licenses the millers and processors who undertake the work. It monitors the processing losses by millers and advises farmers accordingly. It also advises millers when to deliver the coffee for marketing.

Marketing. CBK controls and regulates coffee marketing, which is done through a central marketing auction system. Most (95%) of the coffee produced is exported while, the domestic market consumes 5%. Before 1998, the auction market was wholly handled by Kenya Coffee Auctions, a subsidiary of CBK. Currently other auctioneers are allowed to participate in the market. The auctioneers sell on behalf of CBK or any other marketing agencies. After the coffee is sold, CBK pays in either US dollars or local currency directly to the planters' accounts for estates or through factory accounts for cooperative societies after making deductions to cover costs for functions undertaken by various institutions and other charges.

Research in coffee. CBK carries out research on coffee diseases and pest control and development of high-yielding varieties. Concern is mainly on the insecticide and fungicide sprays to be used, seedlings and better crop husbandry. Research is undertaken by the Coffee Research Foundation, which is funded by the board using a levy on coffee sales but is run by an independent board of directors. The coffee varieties grown by farmers and the recommended filed management practices for coffee growing are the products of research.

Publicity and product promotion. CBK carries out both local and international publicity. Locally it participates in Agricultural Society of Kenya shows, held annually in various provincial and district sites, and trade exhibitions. Local publicity is undertaken through the mass media. International publicity is undertaken through the board's London office, which has an overseas representative, who participates in exhibitions in different countries and attends all meetings or workshops concerning production and consumption of Kenya coffee.

Conclusion on institutional impacts

Despite the policy reforms in coffee processing and milling, CBK remains the regulatory agency in the coffee industry and also controls coffee marketing. The board also provides extension services to farmers, carries out research and promotes coffee in the export markets. CBK charges about 8% of the export price on the marketed coffee to cover its expenses and other government levies. Its control over coffee marketing and regulatory functions in the industry has been a bone of contention between CBK and other stakeholders, particularly coffee millers. The millers would like to participate in coffee marketing directly with the aim of enhancing their margins. A major argument for the involvement of CBK in coffee marketing is its ability to solicit loans for making payment advances to farmers. The CBK can however still undertake this function on behalf of marketing agents without being an active participant in marketing since it has the power to supervise the industry

The conflicts among CBK, millers, cooperative societies and farmers forced the government to revert CBK management back to government control in 1999. The aim was to reduce the wrangles among farmers, millers and CBK management and to develop a better system of liberalizing the industry. This justification implies that the policy reforms were implemented without clearly defining roles of the various stakeholders or putting in place an accompanying regulatory framework for enforcing the rules governing transactions among stakeholders in the industry. The roles to be made clear include: supervision of other institutions and provision of coffee production services to the industry for CBK; regulation and enforcement of rules for governing the industry by a non-partisan government agency; coffee processing for factories; provision of processing and production inputs for co-operative societies; coffee milling for millers and; coffee marketing for marketing agents and auctioneers.

Impact of Liberalisation on Coffee Farming

Coffee production in the country has generally declined—from about 120,000 tonnes in 1990 to about 51,300 tonnes in 1998 (Figure 1). The main reason is that coffee farms have been neglected—the trees are bushy, unpruned and diseased and need weeding—as a result of a number of production and marketing constraints farmers encountered.

The most common production constraint is the high price of inputs due to removal of subsidies with liberalization of the inputs market and high transport costs. Next is the high incidence of coffee berry disease due to low levels of use of pesticides. Other constraints include high labour costs and bad weather.

The low use of inputs is attributed to problems of access to funds in the societies. In the 1960s to early 1980s, the societies had a scheme of acquiring inputs in bulk and dispensing them to members on credit. However, because they had problems in recovering the advances to farmers, most resorted to selling inputs only for cash while some stopped supplying farmers altogether.

The services that the societies offer farmers through factories are becoming less and less visible. For most farmers, the most important services were providing inputs cheaply and processing their coffee while other services, such as bookkeeping, auditing, warehousing, transporting and arranging payments are secondary. With the withdrawal of society support from the primary role of input supply, farmers do not see the need for societies.

The decline in production and delivery of coffee to factories is also explained by the prices and therefore the earnings the farmers receive. The prices they receive for coffee cherry and mbuni (sun dried coffee cherries) have fluctuated over the years (Table 4). In general, the trend in producer prices from

1991/92 to 1994/95 was upward for all districts. Although the prices of mbuni received by farmers seems to be higher, on same weight basis, the prices of cherry are higher because the processing ratio of cherry to parchment is 6 to 1 while mbuni is not processed. Therefore price of processed cherry (parchment) is higher by a factor of 6. Thus the price received for cherry coffee is higher. Indeed, Kenyan coffee fetches a high price in the world market because it processes the berries into parchment rather than selling the bulk as mbuni. The price farmers receive is also determined by the quality of coffee and the deductions made by factories, societies, unions, millers and CBK.

The differences in prices received by farmers across districts are explained by quality of processed parchment and factory and society deductions. In addition corrupt practices, such as cheating and deliberate misrecording of farmers' coffee weights at the factory, are also reasons for low coffee payments to farmers. Theft of parchment coffee from the factory and society stores has also become a problem in recent years. This practice is attributed to liberalizing the local coffee market and hence making available other outlets for selling parchment and mbuni. There is no adequate regulatory framework to ensure protection for exchange of ownership rights in coffee.

Table 4. Coffee cherry and Mbuni payments in Kenya shillings per kilogram to farmers by district 1990/91 to 1996/97

Year	Murang'a		Meru		Kisii	
	Cherry	Mbuni	Cherry	Mbuni	Cherry	Mbuni
1990/91	12.20	13.70	6.90	13.90	4.40	10.30
1991/92	8.50	15.10	5.90	15.50	4.30	10.60
1992/93	13.30	26.10	6.10	19.30	4.80	15.20
1993/94	23.50	43.60	10.70	28.00	7.00	22.50
1994/95	23.30	45.80	15.90	33.60	7.00	32.40
1995/96	21.20	44.60	15.50	33.20	8.10	30.30
1996/97	25.90	42.40	14.90	32.90	11.00	27.60

Source: Nyangito 2000

Although most farmers sell their coffee to society factories, in some districts, for example, Meru and Kisii, they may sell to private individuals. But the amounts are unrecorded and undeclared, because farmers are usually afraid to admit that they sell to private traders who bulk and sell to private factories. Yet evidence on the ground indicates that farmers do sell coffee informally.

4 Issues and Recommendations

Ten major issues with respect to policy reform and the legal framework need focus to develop and revive the coffee industry.

4.1 Conflicting roles of CBK

The legal framework, which gives CBK power to control and regulate the sector as well as provide services, should be changed. These dual roles create conflicts of interest. With the liberalized economy and exemption of CBK from the State Corporations Act, farmers should govern the board. The board has the legal authority to run the coffee industry with minimal government interference unless the minister consults with it. However, the board functions should be clearly defined to avoid conflict with the organizations it oversees—coffee factories, cooperative societies, millers and marketing agents. It should play a leading role as a supervisory agency in the industry on behalf of farmers and also support production services such as extension and research.

4.2 Need for a non-partisan agency to regulate the coffee industry

A non-partisan government agency is needed—preferably an independent body answerable to the minister for Agriculture—

to enforce the laws for delivering services such as coffee processing and marketing. The organization will license or register various actors in the industry and control the industry, to allow for a level playing field for all stakeholders. Although CBK is well placed to monitor, supervise and direct delivery of services such as marketing, extension, research and processing of payments to farmers or their agents, its regulatory and control roles put it on a collision path with other private or farmers' organizations also involved in providing these services. Furthermore, the Coffee Act gives little room for the government to ensure that the rules governing the sector are well enforced without consulting CBK, because most powers are vested in CBK.

4.3 Roles of institutions

Farmers should be at liberty to choose their own coffee pulping, milling and marketing agents. These institutions need to be registered with the regulatory agency, but CBK as a farmer organization can supervise and monitor the delivery of services to planters. This means that the present legislation, which empowers CBK to control and regulate the industry and act as the marketing agent for all coffee produced in the country, should be abolished so that the board plays only an advisory role as watchdog over delivering services to farmers.

4.4 Role of coffee factories

Coffee factories are satellite organizations for coffee planters. Coffee estates and large-scale farmers may have their own factories but smallholder coffee producers should be at liberty to use factories of their own choice, whether public or private. An important requirement, however, is that the rules of entry into or exit from any factory membership should be clear. Each planter and factory should be a signatory to the rules and requirements for factory membership, which should also stipulate the roles of members and of the factory owner or owners.

4.5 Role of co-operative societies

Coffee cooperative societies are a focal point for providing production inputs, process coffee (pulping) and contract milling and marketing agents for smallholders. However, rules on entry and exit of members from a society should be clear. A society may have one or more factories, depending on the size of the coffee area for smallholders and the willingness of farmers to join.

4.6 Management of cooperative societies

The managers of a cooperative society should have adequate management skills, regardless of clan or tribal affiliation. The management team should answer to a board of directors or a committee elected by members. The board should be the policy-making body for the society. However, both members and boards of directors need to realize that the foremost role of a cooperative is economic, not social or political. Therefore, the cooperative should be managed on efficient economic and financial principles.

4.7 District unions

District unions used to play a pivotal role in facilitating services for cooperative societies. Now, however, because millers and CBK duplicate the services they provide, these unions merely add extra expense for farmers. But it is clear that where unions play an active role in overseeing financial management of societies and in arbitrating disputes among factory members in a society, the cooperatives they serve perform well. Farmers should have choice of union membership. Unions should strive to market their services, because they are well placed to act as marketing agents for coffee societies.

4.8 Role of millers

Liberalizing the options for coffee milling is appropriate; however, factories should enter into clear contracts with planters. To avoid conflict of interest, millers serving smallholders should not market coffee, which could lead to exploiting producers.

4.9 Marketing agents

Planters should be at liberty to choose their marketing agents. Millers can act as marketing agents but to avoid conflict and compromise in price setting for farmers, marketing agents should not directly sell in auction markets. Instead, registered brokers should act as sellers for marketing agents.

4.10 Coffee marketing

All coffee should be marketed through the auction centre, but private contracts can be allowed as long as they are reported to the auction centre management. CBK should play a leading role in overseeing and organizing the activities of the auction market—it should develop and supervise the electronic trading system and the futures market rather than act as an active participant which can lead to conflict of interest. The coffee auction market can benefit by patterning itself on the tea auction market run by the East African Tea Traders Association and the Tea Board of Kenya.

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