Future Agricultures

Briefing

www.future-agricultures.org
February 2008

The Politics of Policy Reforms in Kenya's Dairy Sector

Recent reforms of Kenya's dairy sector have been hailed as a long-term success story. This paper discusses the strengths and limits of Kenya's dairy sector reforms and identifies some lessons to be drawn from its experience.

Background

Kenya Cooperative Creameries (KCC) was established in 1925 to facilitate the production, processing and marketing of milk. KCC was set up to support the colonial settler economy and, specifically, to insulate dairy farmers from the economic downturn that followed the end of the First World War. KCC exercised a national monopoly in milk marketing and the industry grew steadily in a protected market.

White farmers' domination of the dairy sector continued until 1954, when Africans were allowed to engage in commercial dairy farming. New government programmes trained smallholders in animal husbandry.

In 1958, the Dairy Industries Act established KCC as the sole agent in the marketing of dairy products throughout the country. Under the same Act, the Kenya Dairy Board (KDB) was created to act as the state regulatory agency for the industry. The KDB was empowered to levy a cess on commercially handled milk. KCC collected these fees on behalf of the KDB.

After Independence in December 1963, state control of the dairy subsector was regarded as central to the country's development. The government adopted a broad policy goal for the country to be self-sufficient in diary products and to export some dairy products to the regional market.

At first, Kenya's dairy production grew steadily, as the country's farmers benefited from the well-established infrastructure inherited from the colonial economy, a rise in domestic demand for dairy products and a government-supported school milk programme.

Promoting smallholder dairy farming

In 1964, a commission of enquiry examined the reasons for the low levels of market participation by smallholder dairy farmers and recommended the abolition of contracted milk quotas and the widening of access to KCC's services, to include all farmers who were able to deliver an acceptable quality of milk.

KCC became a guaranteed market for all raw milk. The company embarked on a rapid expansion programme in order to create a national network of chilling stations and processing and packaging plants. This enabled it to be a reliable outlet for all dairy farmers, which cushioned smallholder farmers from price fluctuations.

During this period, the government supported the introduction of highly productive cattle breeds, and subsidised artificial insemination and veterinary services. The expansion of the sector was also facilitated by the land-transfer programme, which put more agricultural land into the hands of indigenous smallholders.

Box 1: The dairy sector in Kenya

Kenya is one of the largest producers and consumers of dairy products in Africa. The dairy sector accounts for 14 per cent of agricultural GDP and 3.5 per cent of national GDP.

Dairy production is a major segment of the livestock sector and a significant source of livelihood for about 625,000 smallholder farmers and 800,000 households.

Kenya's dairy industry is largely based on smallholder production, which accounts for about 70 per cent of the total annual milk production in the country.

Box 2: The dairy sector and economic development

The dairy sector offers certain advantages for economic and social development:

- Complementary to crop cultivation.
- A regular source of income for farmers.
- Contributes to household food security and improved nutrition.
- Supports gender equity – both dairy farming and milk selling can easily be undertaken by women.

By the mid-1970s, smallholders had overtaken large-scale farmers as the major producers of milk in Kenya. However, by the 1970s, KCC began to experience trading losses. Payments to farmers were often delayed and irregular. In response to these difficulties, the government empowered KCC to retain 50 per cent of the milk cess.

By the late 1980s, KCC was failing to cope with demand. Some farmers stopped supplying milk to KCC, switching their allegiance to new private companies and cooperatives. With reduced supplies of milk, KCC's financial difficulties increased.

In response, the government allowed KCC to retain the whole of the milk cess instead of remitting the funds to the KDB. This was one of a series of concessions that steadily limited the KDB's ability to carry out its regulatory responsibilities.

Liberalisation

During the 1980s, increasing budgetary constraints, arising partly from the pressure applied on the government by aid donors, drove the government to implement economic reforms. The dairy industry was progressively liberalised from the late 1980s onwards. Public breeding and health services were cut back and the feed sector was liberalised. Many farmers were no longer able to access important inputs and services.

Milk prices were deregulated in 1992. Private processors came into the market, who purchased milk directly from farmers. As a result, KCC could no longer control dairy prices and minimum producer prices could no longer be guaranteed.

The reforms did help to stimulate a more competitive milk market and raise milk prices. Those farmers who could sell their milk to private processors benefited in the short run. But liberalisation also led to the near-collapse of KCC, while the new private processors could not cover the shortfall in KCC's processing capacity.

Some of the new private processors collapsed, leaving farmers out of pocket and further reducing processing capacity in the sector. As a result, milk prices fluctuated widely and milk production declined in the 1990s.

Box 3: Overdue: A policy framework for the dairy sector

In 1993, the Kenya Dairy Development Policy was formulated to guide the dairy industry through the liberalised market environment. This policy document has since been revised a number of times (in 1997, 2000 – when it was presented together with a draft Dairy Industry Bill – and again in 2004 and 2005) but never yet implemented or even finalised. In April 2006, it was presented for stakeholder consultation and has currently reached a draft Sessional Paper stage, awaiting presentation to the cabinet.

Political interference

Even as the dairy sector was liberalised, political interference actually increased. In 1987 the government registered KCC as a cooperative under the Cooperatives Act; the farmers' elected governing board was replaced with a government-appointed board. Politicians intervened in the appointment of senior managers. Political appointees included members of the President's family and his political allies.

By the end of the 1990s, KCC's own directors had plundered the company's assets. KCC became so inefficient that it was unable to service its loans with commercial banks. Debts soared. In May 1999, farmers and suppliers sued it for unpaid deliveries. KCC collapsed, unable to pay its outstanding debts to farmers.

Public outcry led the government to arrest and prosecute several of KCC's directors. Not long afterwards, the Kenya Commercial Bank moved in to liquidate and sequester the company's property for an unpaid loan of Ksh. 1.5 billion (USD $22 million). An official receiver was appointed, who issued a tender for the sale of KCC.

A new company was set up, called KCC Holdings, to bid for KCC's assets. KCC Holdings was owned by a small group of powerful politicians and business-people allied to the government and the ruling party, including the then President himself. KCC Holdings acquired KCC's assets for just Ksh. 400 million (USD $6 Million), even though they were estimated to be worth about Ksh. 6 Billion (USD $86 Million).

The 2003 reforms

In 2003, a new government swept to power with a strong mandate for reform. The new government of President Mwai Kibaki was installed in an atmosphere of widespread euphoria and great expectations. The new administration included individuals whose political backgrounds were in the activist movement and other pro-reform groups of civil society.

In the dairy sector, the government launched an initiative to bring KCC back into public ownership and revitalise the industry. KCC was renationalised in June 2003. The repurchase was finalised in February 2005, at a cost of about Ksh. 547 million (USD $7.8 million). The company was renamed 'New

KCC' and a 15-member interim board was appointed to run it. Steps were taken to revive dairy cooperatives and improve KCC's management.

The reforms have been hailed as a major success. There has been a dramatic revival of the KCC, the dairy sector in general and the fortunes of smallholder diary producers in particular. Competition has increased, which has contributed to better farm-gate prices. Nationally, milk processing has risen from 173 million litres in 2002 to 332 million litres in 2005. KCC's daily milk intake increased ten-fold, from 40,000 litres per day in 2002 to 400,000 litres per day in 2006. (See Figures 1 and 2).

The revival of dairy cooperatives has stimulated the development of new businesses such as feeds suppliers and providers of artificial insemination, veterinary, breeding and financial services. Small-scale market traders have been allowed to operate licensed milk bars and transport operations, which were previously considered illegal, and received support from a project to improve hygiene standards.

Explaining the dairy sector reforms

How can we explain the dairy sector reforms? The explanation has to take into account the euphoria and high expectations surrounding the arrival into power of the Kibaki government in 2003. The new government campaigned on a reform platform centred around economic revival, arresting the spread of corruption and preventing further plunder of public resources.

The emphatic election victory provided the government with a powerful mandate for carrying out radical economic reforms and created a tremendous obligation to deliver results. The reforms commanded broad political support both within parliament and outside, which made it difficult for supporters of the previous regime to constrain the reform process.

Farmers were an important part of the political constituency that brought the new government to power. Many dairy farmers supported the reform process because they retained some degree of goodwill and confidence in KCC, which appealed to them because of its cooperative structure.

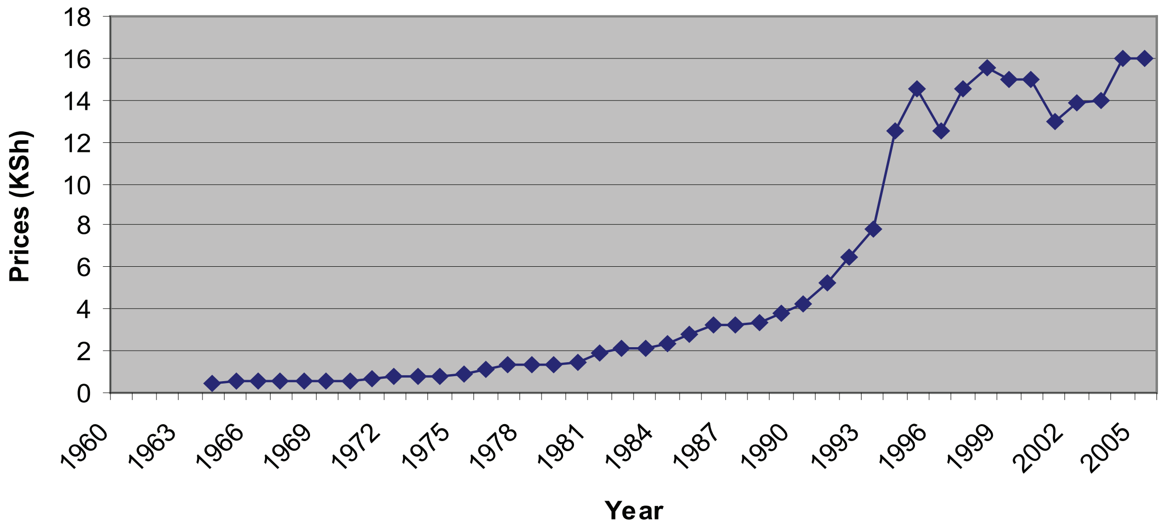
The dairy sector also offered an attractive opportunity for the government to intervene, because of its character as a smallholder-based, commercially oriented sector that was attractive to private investment and offered wide pro-poor benefits through its multiplier effect on the local economy. Intervention in the dairy sector also offered the government an opportunity to be seen to address key social, political and economic needs.

Future challenges

A number of outstanding challenges face Kenya's dairy sector:

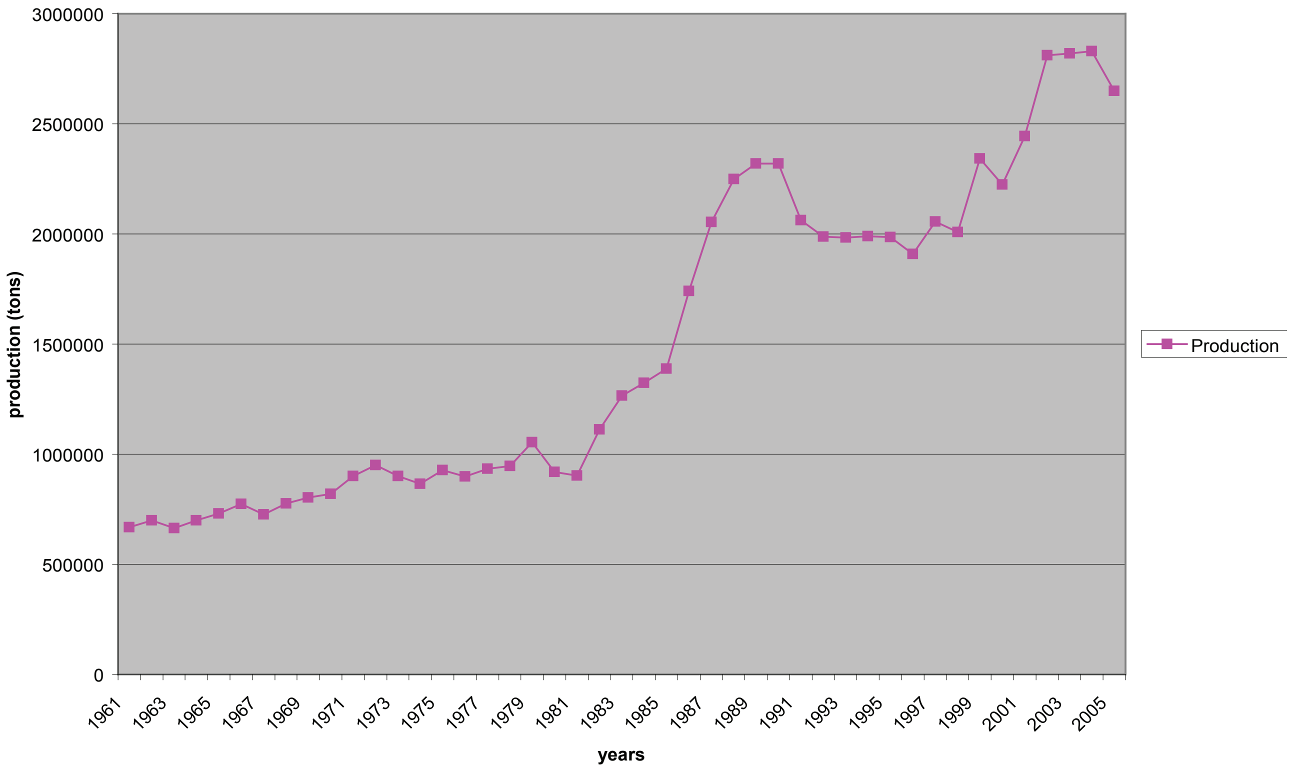
(1) The sector needs help to cope with the seasonality of dairy production and fluctuations between periods of production surpluses and deficits. Kenya has limited capacity to store excess milk. Powdered milk can be stored easily, but KCC is currently the only company capable of converting milk into powder and it lacks the capacity to process all the milk delivered to it. In peak seasons, neither KCC nor the other major

Figure 1: Average Milk Producer Prices (1964–2005)



Source: Statistical Abstracts, various issues

Figure 2: Milk production trends 1961–2005 (tons)



Source: FAOstat

processors can absorb all the milk produced in Kenya.

(2) Kenyan dairy producers face competition from the importation of powdered milk and other dairy products – although this is reducing. Milk should be gazetted as a strategic food commodity, as this would exempt milk from value-added tax and make it more affordable.

(3) Promoting dairy exports to regional markets is a challenge, due to Kenya's high production costs. Accessing regional markets is also restricted by sanitary and phytosanitary standards.

(4) Further work needs to be done to address the problems of accessing reliable supplies of key inputs and services.

(5) Basic infrastructure needs to be improved, notably access roads and cold chain facilities. It is a paradox that poor feeder roads reduce the farm-gate price of milk, and yet the milk cess is not used to fund improvements to the road network.

Lessons

What lessons can be learned from the example of Kenya's dairy sector reforms? In some respects, Kenya's dairy industry has unique features – for instance, dairy is accessible to smallholders, attractive to private sector investment, benefits from high levels of consumer demand, and so on.

Replicating these conditions in another sector may be difficult. However, other factors may be easier to replicate, such as clear goals, political commitment and coordinated action among government ministers, parliamentarians and stakeholders at various levels of the industry.

Another key lesson is the importance of timing. The 2002 elections and the installation of the NARC government, with a strong reform mandate and high expectations of change, provided an especially conducive environment for change. These auspicious conditions have perhaps begun to dissipate since the NARC coalition began to dissolve in 2004. Allegations of interference by political and economic vested interests have resurfaced. Many people fear that the old ways of doing business are gradually returning and that the space for reform has contracted once more.

by Rosemary Atieno and Karuti Kanyinga

correspondence to:
r.atieno@kenyaweb.com
or karuti@south.co.ke

This briefing is based on the Future Agricultures Consortium working paper, 'The Revitalisation of Kenya Cooperative Creameries: The Politics of Policy Reforms in the Dairy Sector in Kenya', which is available from : ***www.future-agricultures.org***