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

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KIPPPRA Policy Paper No. 1

November 2000
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Published 2000
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ISBN 9966 949 ** *

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KIPPRA acknowledges generous support from the European Union (EU), the African Capacity Building Foundation (ACBF), the United States Agency for International Development (USAID), the Department for International Development of the United Kingdom (DFID) and the Government of Kenya (GoK).
Abstract

Growth in tea production in Kenya has slowed in recent years. This slowdown is attributed partly to policy reforms in the industry, which reduced government control on providing production, processing and marketing services for smallholder farmers. A major concern in liberalizing the industry is harmonizing the legal framework, adjusting the roles of institutions previously involved in controlling and regulating the subsector to mesh with the policy reforms. This paper outlines the reforms that have been implemented in the smallholder tea industry, the legal framework of operation and the impact of the policies on institutions and production. It analyses the existing legal framework for the tea industry, the delivery of services by the Kenya Tea Development Authority and the on-farm impact of the policy reforms. The results of the analysis attribute the slowdown of the industry to a poor regulatory framework that is not in harmony with privatizing the industry, poor provision of production, processing and marketing services to farmers by the tea authority, poor governance of tea factories, and conflicts and dissatisfaction among farmers.
Acknowledgements

The author would like to thank the following individuals for providing useful comments on this paper; Dr. John M. Omiti, Institute of Policy Analysis and Research (IPAR), Mr. J. M. Omaroro, Head of Planning Division, Ministry of Agriculture and Livestock Development and my colleagues at KIPPRA. However, the author remains for errors and shortcomings in the paper.

Abbreviations

CDC Commonwealth Development Corporation
EATTA East African Tea Trade Association
kg kilogram
KIPPRA Kenya Institute for Public Policy Research and Analysis
Ksh Kenya shilling
KSTGA Kenya Small Tea Growers Association
KTDA Kenya Tea Development Authority
KTGA Kenya Tea Growers Association
KUSSTO Kenya Union of Small Scale Tea Owners
MOA Ministry of Agriculture
MOF Ministry of Finance
OP Office of the President
tonne (metric ton)
TBK Tea Board of Kenya
Contents

Abstract .......................................................................................................................... iii
Abbreviations ........................................................................................................ iv
Contents?

List of Tables and Figures .................................................................................. vi
Executive Summary .......................................................................................... vii

1 Introduction ........................................................................................................ 1

2 Policy Reforms ................................................................................................ 4
  2.1 Deregulating markets and prices ....................................................... 4
  2.2 Institutional reforms .......................................................................... 4
  2.3 Macroeconomic reforms ...................................................................... 5

3 Legal Framework ................................................................................................ 5
  3.1 Institutions prior to liberalization ....................................................... 5
  3.2 Liberalizing the tea industry ............................................................... 9
  3.3 Progress and the impact of liberalizing smallholder tea 11
  3.4 Tea markets ........................................................................................ 17
  3.5 Impact of liberalization on tea farming ........................................... 19

4 Issues and Recommendations ........................................................................ 21

References ............................................................................................................. 25
List of Tables

Table 1.  Tea area, production and average yields by type of grower 1990 to 1998 ................................................................. 3

Table 2.  Average payments to farmers for green leaf according to district ................................................................. 14

Table 3.  Market shares and average prices at KTDA tea market outlet, 1997/98 .............................. 16

Figures

Figure 1.  Proportion of gross sale tea price to different functionaries ......................................................... 12

Figure 2.  Average green leaf tea yields per hectare on small-scale farms, 1990/91 to 1996/97 ......................... 17
Executive Summary

The tea industry has historically been one of the greatest success stories in Kenyan agriculture, with growth in both acreage and production. The remarkable growth is attributed to the supportive role of two key institutions in the industry. First is the conducive investment policy for estates, particularly the non-interference policy of the Tea Board of Kenya (TBK) on producing, processing and marketing. Second is the involvement of the Kenya Tea Development Authority (KTDA) in providing production, processing and marketing services to smallholder farmers. However, successes in developing the smallholder subsector began to slow down in the 1990s. This is attributed partly to the effects of liberalizing the industry.

A major concern in liberalizing the tea subsector is the need to harmonize the legal framework with the policy reforms. In particular, it is necessary to change the legal framework to alter the roles of institutions previously involved both in controlling and regulating the tea trade and in providing it with services to fit well with the new policies. This paper outlines the policy reforms that have been implemented, the legal framework for the policies, and the impact of the policies on institutions and smallholder farms. It also highlights recommendations for improving the subsector.

The major policy reforms are deregulation of markets, institutional reforms and macroeconomic reforms.

- Deregulating markets has led to KTDA liberalizing the provision of services such as extension, processing and marketing. However, wrangles among farmers and other stakeholders have emerged over the new rules, particularly on privatizing KTDA.
Policy and legal framework for tea subsector

- Institutional reforms have been implemented by restructuring KTDA to encourage private competition. However, squabbles that have arisen over KTDA operations and tea factories owned by smallholders have greatly affected subsector performance.

- Removal of restrictions on foreign exchange has allowed exporters to keep most of their earnings in foreign exchange and tea farmers are paid in foreign exchange. However, since most small-scale farmers are paid through KTDA, they have raised complaints over the prices they receive.

The specific laws governing the tea industry are spelled out in the Tea Act (Chapter 343) and the Kenya Tea Development Authority Order established under the Agriculture Act (CAP 318) to control and regulate smallholder tea. Initially these acts and other related ones were based on government-controlled policies. With policy reform towards liberalized markets, some modifications have been made, but they have not yet been done comprehensively.

TBK remains the regulatory body for the industry, and still intact are its restrictive powers over entry and exit into the industry through licensing tea growers and factories. This can create monopolies in providing services to growers.

In restructuring KTDA, efforts are being made to privatize its functions, give more power to farmers in running factories and provide farmers with production and processing services. However, KTDA still dominates in delivering such services as supplying inputs, collecting and processing green leaf, marketing tea and making payments to farmers. It has established itself in the world tea market and can benefit farmers by ensuring easy access to markets. Since liberalization of the sub sector, a parallel system to KTDA has emerged where farmers sell green leaf directly to private factories or intermediaries for immediate payment.
The problems with the KTDA system are poor coordination and supervision of tea collection and processing; uneven distribution of information regarding tea marketing, earnings and transfer of ownership; and significant risks in transfer of ownership, whereby farmers bear the brunt of the risks and costs. The parallel system, on the other hand, lacks the ability to support farmers, particularly to provide inputs, and it exhibits exploitative tendencies because clear rules for contracts between farmers and buyers are lacking.

The major tea market is the Mombasa auction. Major buyers are Pakistan, the United Kingdom, Egypt and the Middle East, but the potential markets elsewhere have not been exploited adequately. Selling tea in bulk without adding value through branding and packaging limits earnings from exports. Estimates indicate earnings could be increased up to six times if this were done.

The average tea yield on smallholder farms has stagnated and sometimes declined due to minimal husbandry, problems with collecting the tea due to poor roads infrastructure, low payments, and politicking among farmers. Controversies about KTDA over its efficiency in delivering services and privatizing it have made the problem worse.

**Recommendations.** The following major issues for developing the smallholder tea subsector in a liberalized economy need attention.

- **Regulating the tea industry.** The Tea Board of Kenya should regulate the industry, as stipulated in the Tea Act (CAP 343), but licensing growers, manufacturing and marketing agencies should be done away with, thus allowing the board to deal only with registration, monitoring and ensuring a level playing ground for all.

- **Providing services by commissioned management agents.** Providing production, processing and marketing
services, previously a KTDA monopoly, should be liberalized to allow many commissioned management agents. However, guidelines must be set to prevent agents from exploiting farmers, such as by a management agency tying its services to a particular tea factory.

- **KTDA ownership.** The tea authority should be incorporated as the farmers’ public company but administered as a commercial entity to act as a commissioned management agent for tea factories. Growers through shareholdings should own tea factories that KTDA owned previously.

- **Financing new factories.** Both the private and public sectors should be encouraged to invest in new factories. The TBK can help in identifying catchment areas for establishment of new factories.

- **Governing smallholder tea factory companies.** A tea factory board of directors who are elected farmers’ representatives should govern public tea factories and oversee the work of KTDA, the management agent.

- **Protecting smallholder interests.** A registered tea growers association completely separate from any management agency such as KTDA should monitor the industry and protect smallholder interests. The current organisations, KSTGA and KUSSTO, do not have the mandate of all farmers and act as rivals even though they are supposed to represent farmers’ interests. The TBK should advise on the rightful organisation to represent the smallholder’s interest in the industry.

- **Tea marketing.** From factory to auction market, tea marketing should be the responsibility of KTDA as a commissioned management agent or of any agent serving a particular factory, to maintain quality control and as an incentive to reduce losses.
Selling and buying. Tea should be sold and bought through auction markets for private contracts, depending on a management agent’s desire. However, the local auction market should continue to be run by the East African Tea Traders Association since it has proved to be the most efficient system of regulating tea buying and selling when compared to direct sales and private individual factory contracts.
1 Introduction

Policy reform, particularly deregulating markets and divesting government from productive activities in agriculture, has become a subject of debate over how it affects agricultural development. Since 1993, trade has been liberalized and institutional policy reformed substantially in the agricultural sector, causing squabbles to emerge in the institutions involved in delivering services to tea farmers. The consequences are mixed trends in tea production.

Historically, the tea industry is one of the greatest successes in Kenyan agriculture. Tea planting and production have expanded rapidly since independence in 1963, from 18,000 tonnes and 21,448 hectares to over 294,170 tonnes and 118,650 hectares in 1998. Smallholders expanded the most; their production rose from a mere 1.7% of the total amount of tea produced to the current amount of 59.7%. In the world market, Kenya produces about 16% of marketed black tea and ranks second after Sri Lanka in tea exports and is the third major tea producer in the world after India, and Sri Lanka.

The remarkable growth in the tea industry is attributed to many factor which include land policy, investment policy, institutional support, and attractive world market prices. The land redistribution policy adopted by the government at independence and completed in the mid 1970s whereby large scale settler farms were subdivided and given to small holders coupled with abolition of the policy that restricted Africans from growing cash crops led to expansion of area under smallholder tea growers. The conducive investment policy for estates, particularly non-interference from the Tea Board of Kenya (TBK) in producing, processing and marketing encouraged tea growing by large scale tea growing. Among smallholders, success is attributed to Kenya Tea Development
Authority (KTDA) involvement in providing extension services and inputs to farmers, collecting green leaf, processing and marketing their made tea. World market prices for tea have been favourable over the years and averaged US$ 1 to 2 per kg of manufactured black tea. Kenyan farmers benefit from the high prices when processing and marketing costs are kept low. However, with a stagnating or declining demand due to competition from other producers in the traditional markets in United Kingdom, Pakistan and the Middle East, significant increases in production will negatively affect prices.

After the phenomenal growth in the decades before 1990, the successes in smallholder tea began to slow down. The average yield per hectare for smallholder farms, for instance, stagnated at about 2500 kg of manufactured tea per hectare and sometimes declined. Yield is currently around 60% or less of estate yields (Table 1). Responsible for this yield stagnation in smallholder tea production is poor husbandry on farms (e.g. low fertilizer use, poor weeding and plucking). Low payments attributed to lower tea quality as a result of poor management of tea collection from buying centres and processing at the factories, and problems with KTDA payments due to high operation costs also lead to low yields. Thus a potential exists of increasing production on smallholder farms using the current area if the above constraints are relaxed.

Liberalisation of the tea industry particularly provision of production, processing and marketing services just as is the case for the whole of the agricultural sector is aimed at removing constraints that limit production. The purpose is to ensure that the agricultural sector continues to play a leading role in poverty alleviation through income generation to the majority of the population and increased export earnings for the country. Thus constraints observed in the smallholder tea industry, which has a big potential in contributing towards the country’s goal of poverty alleviation is of policy concern.
A major concern in liberalizing the tea subsector is harmonizing the laws with policy reform—in particular, changing the legal framework to allow institutions previously controlling and regulating tea to fit in well with the new policies so that smallholder tea production can be enhanced. This paper outlines the implemented policy reforms, the legal framework for the policies, and the effect of the policies on institutions and farms for tea, and it suggests improvements.

2 Types of Policy Reform

The major policy reforms that this policy paper deals with are deregulating markets and prices and making institutional and macroeconomic reforms.

2.1 Deregulating markets and prices

Markets and prices were deregulated to encourage the private sector to play a more important role in producing, marketing and processing agricultural commodities. To achieve this, the tea subsector has been liberalized and government-controlled services such as extension, processing and marketing have been reduced. However, wrangles among farmers and other stakeholders emerged over the new rules published in 1999, particularly on privatizing KTDA.

2.2 Institutional reforms

Institutional reforms were to reduce the government’s involvement in marketing agricultural commodities and allow its marketing institutions to operate like commercial entities and compete with the private sector. These reforms have restructured KTDA to encourage private competition. However, disagreements over operations have arisen between
KTDA and smallholder tea factories, greatly affecting trade performance.

2.3 Macroeconomic reforms

Reforms in macroeconomic policies include removing restrictions on the exchange rate, retaining and remitting foreign exchange, and liberalizing interest rates. Removing restrictions on foreign exchange allows exporters to keep most earnings in foreign currency. Tea farmers may be paid in foreign exchange and operate foreign exchange accounts. However, most small-scale farmers are paid through KTDA, and they have complained about the final prices paid.

3 Legal Framework

The legal framework of general agricultural policies is spelled out in the Laws of Kenya, Agriculture Act Chapter 318. The laws governing tea are the Tea Act Chapter 343 and the Kenya Tea Development Authority Order, established under the Agriculture Act to control and regulate smallholder tea. Initially these acts were based on a policy of government control. With policy reform towards liberalized markets, some modifications have been made but they have not yet been done comprehensively.

3.1 Institutions before liberalization

The Tea Act provides for regulating and controlling the production, manufacture and export of tea, and covers connected matters. The act was enacted in 1960 and has been revised over the years, most recent in 1999. It gives control and regulation of the tea industry to the Tea Board of Kenya. Smallholder tea is supervised by the Kenya Tea Development
Authority, a state corporation established under the Agriculture Act and the Kenya Tea Development Authority Order in 1964. Two private organizations exist in the industry: the Kenya Tea Growers Association (KTGA) represents the interests of commercial tea estates at government or trade discussions, and the East African Tea Trade Association (EATTA) runs the Mombasa tea auction and regulates tea brokers, buyers and sellers.

The Tea Board of Kenya

According to the Tea Act, the Tea Board of Kenya must comprise at least 16 members representing the Ministry of Agriculture, EATTA, KTDA for smallholders, and KTGA for plantations. The Board is a corporate body having perpetual succession and a common seal. It has the power to purchase, sell, lease or otherwise acquire or dispose of and hold movable and immovable property for the purposes of the act. Its major functions are

- licensing tea growers
- licensing tea factories
- regulating, controlling and improving tea cultivation and processing
- controlling pests and diseases
- controlling tea marketing
- controlling investigations and other matters related to the tea industry

The Board is financed by funds collected as cess, which the minister for agriculture in consultation with the Board can impose by notice and gazette. This can be either on manufactured tea or an annual cess on every hectare of land growing tea or both. Cess proceeds are used to cover various functions the board undertakes.
The accounts of the Board are subject to auditing by the auditor general, or by such other person or persons as the minister may appoint. The Board has to produce and lay before the auditor all books and accounts for auditing. The Board has also to submit at the end of the financial year the audited report to the minister for tabling in the national assembly. The Board may, with approval of the minister, invest any funds not immediately required, and it can borrow money to discharge its functions.

The act empowers the minister for agriculture, in consultation with TBK, to make regulations for protecting and promoting the tea industry and carrying out of the provisions of the act. While the regulatory role of the board is necessary to ensure fair play among participants in the industry, licensing tea growers and tea factories is questionable in a liberalized economy. Rather than restricting entry and exit of tea growers and tea factories in the industry, it might be better for the Board to register the growers and tea factories and all other stakeholders, to monitor and enforce contracts among them.

The Kenya Tea Development Authority

Before liberalization, KTDA was exclusively responsible for providing smallholders with planting material, fertilizers and extension services; inspecting and collecting green leaf from their buying centres; and controlling quality, processing and marketing their tea. Farmers owned their collection centres, and KTDA owned and managed leaf collection, vehicles, bags and other equipment through its Leaf Collection Department. It also controlled factory management and tea processing; it marketed processed tea and paid producers.

The smallholder tea factories were private limited liability companies owned by KTDA, smallholder tea farmers, and in some cases, the funding agency, which was mainly the Commonwealth Development Corporation (CDC). KTDA
exercised considerable administrative and financial control over other parties. Although in principle, the tea factories, through the growers’ representatives, were allowed to choose their management agency, strong KTDA presence did not allow any of them to use private agencies. As a result, KTDA management made all decisions regarding collecting, processing, transporting and warehousing tea, and it made all sales arrangements and payments to producers.

The KTDA board of directors formulated policy subject to the provisions of the Agriculture Act, the State Corporations Act (CAP 446) and the Tea Act. Through these acts, the board was subject to control by the Ministry of Agriculture (MOA), the Office of the President (OP) and the Ministry of Finance (MOF). Board members were elected by tea growers to represent tea-growing districts while the permanent secretaries of those ministries represented the government. The minister for agriculture appointed the chairman of the board and the managing director. The mere fact that KTDA was under the control of three government ministries is a reflection of the excessive regulation, which could make it difficult for the board to operate independently. Furthermore, this created an opportunity for conflicts of interests as each ministry could strive to overshadow the other in controlling the smallholder tea industry.

The following divisions undertook KTDA’s daily operations, under the control of the managing director:

- managing director’s office
- technical services
- personnel and administration
- finance
- marketing

Smallholder farmers, although owning the tea factories, did not have any much say on how their tea was collected, processed and sold. KTDA collected the tea, processed and sold it,
received the proceeds from tea sales after the auction and arranged for payments to farmers. The corporation developed a payment system where smallholder tea growers were paid a set monthly payment per kilogram of green leaf delivered in the month. A second payment, or bonus, was made at the end of the fiscal year. The bonus was directly related to the factory's tea quality and marketed tea prices.

The excessive control KTDA kept over the smallholder had its advantages and disadvantages. By ensuring that tea was collected from farms, processed and marketed quickly, KTDA provided the farmers with ready access to export markets. This was reinforced by providing smallholder farmers with supplies and processing facilities, which otherwise could have been very expensive for individual smallholder farmers. However, in recent years, the provision of service has become inefficient because of managerial weaknesses and too much government intervention, which led to high operating costs and therefore, reduced farmer earnings. Furthermore, KTDA’s control over all activities left farmers vulnerable to monopolistic exploitative behaviour.

3.2 Liberalizing the tea industry

Since 1993, changes in tea commerce have moved towards reducing government control in KTDA and privatizing smallholder tea.

The first step in liberalizing the smallholder tea trade exempted KTDA from the State Corporations Act, making the tea authority management no longer answerable to the government, although this exemption was reversed in November 1999. The second step repealed Legal Notice 42 of 1964, which changed Section 191 of the Tea Act, and replaced it with Legal Notice No. 109 of 1997, placing the KTDA board under the control of elected farmer representatives. Other changes made focussed on privation included:
Tea smallholders should own factories by buying KTDA equity and shares.
Tea factory companies would be governed and managed by elected factory company directors.
KTDA’s role was redefined as an agent for collecting and processing tea with control over marketing it.

Major changes to the policy framework for liberalizing the tea industry were published in Sessional Paper No. 2 of 1999, debated in parliament and gazetted as “The Tea (Amendment) Act, 1999 in January 2000. The Sessional Paper focused on strengthening TBK to control and regulate the industry and on restructuring and privatizing KTDA to give farmers more say in tea collecting, processing and marketing through their tea factories.

The government accepted the policy change in principle, based on the policy paper ‘Public Enterprises Reform and Privatisation’ of 1992. Under this change, KTDA will continue to carry out management and development for the smallholder while registered tea growers in the area will be able to own factories through shareholding. The shareholders in each factory will elect members to form the board of directors to run the factory.

Factory companies will be governed by six directors elected by the farmers and three, including the managing director, appointed by KTDA. The factory boards will be responsible for

- procuring goods and services for the factory
- recruiting factory employees
- formulating annual budgets and monitoring expenditures
- collecting leaf and paying farmers
- governing and making policy for factory companies
To facilitate purchase tea factories from KTDA all smallholder tea growers will be allotted ownership shares in their companies according to tea production on their farms.

Despite these measures, which have seen the restructuring of KTDA and tea factory ownership, control of some services, particularly tea processing and marketing and supervising the smallholder tea industry, remain thorny issues.

3.3 Progress and the impact of liberalizing smallholder tea

A recent study (Nyangito and Kimura 1999) outlines the progress and effects of liberalizing smallholder tea. This section relies heavily on the findings from this study.

Organizing and delivering services to smallholder tea farmers

KTDA still dominates in providing supplies, collecting green leaf, processing and marketing for smallholder farmers. However, a parallel system has emerged in which farmers sell green tea leaf directly to private factories or to middlemen for immediate payment. This system has no contractual service arrangement between farmers and green leaf tea buyers; it is only a sale agreement for the green tea leaf delivered to the factory or buying centre. The price farmers receive in the parallel markets, an average of Ksh 6 per kilogram of green leaf, is generally lower than the annual average of about Ksh 22 per kilogram of green paid by KTDA in 1997/98 year. The main advantage for farmers is that they are paid immediately instead of by the monthly or semi-annual payments that KTDA makes.

If the parallel markets are encouraged without clear guidelines on how farmers can be supported, they are likely to lower tea production because they offer the smallholder farmers no input
supplies or services. Benefits to farmers are doubtful because of an inadequate regulatory system of trade. Farmers have no bargaining power, leaving them open to predatory pricing and payment arrangements. Also, the system seems to engender theft of green tea leaves from farms especially at night.

The KTDA system, however, also has major problems:

- Coordination and supervision is poor between farmers and the factory company boards of directors on one hand and the KTDA board on the other, in delivering services to farmers. The problem is worsened by lack of ability of the factory board of directors to deliver these services. Poor coordination and supervision have led to conflict between farmers and KTDA, with the farmers perceiving the directors not wholly answerable to them.

- Information regarding tea marketing, earnings and transfer of tea ownership is unevenly distributed. KTDA has superior access to market information, which puts it unfairly way beyond farmers in bargaining power. No farmer-friendly agreement exists between farmers and KTDA regarding final payment, and farmers think the payments take far too long to reach them.

- Significant risk exists in transferring tea ownership, or property rights, from the farmer through KTDA. Whereas KTDA does not accept ownership of the tea or the associated liabilities, it dominates the processing and marketing and passes all costs to the farmers, who consider some of these costs high.

Selling made tea through KTDA to overseas and local buyers appears to be mutually satisfactory, because the East Africa Tea Trade Association enforces the rules of selling and buying. This time-tested arrangement has made buying and selling between the parties relatively efficient.
KTDA has established itself as a major tea seller in the overseas markets in a closed tea-marketing system among well-known sellers and buyers. This makes it more financially attractive for factories to sell their tea through KTDA rather than directly. However, to dissolve the existing mistrust between KTDA and farmers, transparency on auction prices and marketing charges, including brokerage fees to factory directors, is required.

**KTDA performance**

KTDA’s services to farmers are broadly divided into agricultural services (green tea leaf inspection, collection and field development), factory operations, and selling and distributing made tea. The proportion of the gross sale to various functionaries is shown in Figure 1. The analysis is an average for all the KTDA factories but the amounts paid out to farmers vary from factory to factory.

KTDA’s charges on agricultural services to farmers take only a small proportion, 2%, of the value of gross tea sales, which may be why these services are said to be poorly provided.
Providing agricultural services, such as extension, fertilizer and gunny bags, and purchasing materials for tea processing in large quantities allow KTDA to enjoy economies of scale, and the lower costs for the items can be passed on to the farmers. However, transparent records on charges for these services are essential to avoid conflict between farmers and KTDA. Furthermore, reallocating the KTDA charges for more agricultural services can improve these services and increase tea yields on small farms.

The selling and distribution functions of KTDA are important in determining final tea earnings, and they take 4% of the gross sales. KTDA is the largest single tea-selling organization under one management in the world. It represents 45 factory companies, which account for about 56% of Kenyan tea exports. The volume handled is estimated at about 140 million kilograms annually. Although the tea KTDA handles is regarded as its product, each factory company’s tea is sold separately under its own name. Thus, the price each factory company receives depends on its tea quality, reflecting its own processing and handling standards, which vary from factory to factory.

All the teas that KTDA’s different factories process are marketed through a central system. The marketing division organizes tea transportation from each factory to its central warehouse at Mombasa. KTDA also appoints a broker for each factory. The broker is responsible for auctioning the teas on behalf of KTDA and credits the KTDA account, which in turn pays farmers after taking about 30% of the total value in necessary deductions to cover the tea authority’s expenses and government taxes. The brokers are paid 1% of the total value of the tea sold. This applies to all producers who sell through the Mombasa auction.

Unlike private tea factory companies, where brokers have direct contact with factory managers to advise on tea quality,
brokers have no direct contact with KTDA factory managers except through the head office. This makes it difficult to monitor quality changes and make quick adjustments according to the market needs for each factory. The quality of processed tea is determined by the ability of the factory management to ensure that farmers provide quality green leaves for processing, the leaves are handled and delivered according to the required standards and the processing is done to the best standards possible. Despite this, discussions with brokers indicated that most factory company directors do not understand how the auction works and the importance of tea quality in determining price. Factory company directors need to be educated about quality, price and the auction.

Factory operating expenses constitute 23% of the gross value of sales, the largest cost component. Expenses include manufacturing and processing tea; inland transport and insurance; legal and general insurance; maintenance and depreciation; and loan interest, bank charges and foreign exchange costs through conversion of dollars to shillings and vice versa.

These major expenses reduce payments to farmers, but they are not clearly disclosed. Transparency on these costs can lead to increased understanding of what tea processing entails and therefore reduce conflicts between farmers and KTDA.

In general, factory companies in districts east of the Rift Valley, realize higher returns than factory companies in west of the Rift Valley. The processed tea from factories west of the Rift Valley is said to be of lower quality, possibly because of poor plucking standards and problems in collecting and processing rather than climatic conditions per se (Mukumbu 1993). The average payments for factories in each district are presented in Table 2.
Table 2. Average payments to farmers for green leaf tea according to district (Kenya shillings per kilogram)

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<td>Kakamega</td>
<td>13.90</td>
<td>8.45</td>
<td>10.00</td>
<td>13.50</td>
<td>20.04</td>
</tr>
<tr>
<td>Kisii/Gucha</td>
<td>18.40</td>
<td>8.50</td>
<td>10.50</td>
<td>14.80</td>
<td>19.07</td>
</tr>
<tr>
<td>Nyamira</td>
<td>18.10</td>
<td>8.50</td>
<td>11.24</td>
<td>14.13</td>
<td>20.73</td>
</tr>
<tr>
<td>Mean</td>
<td>19.73</td>
<td>10.50</td>
<td>12.88</td>
<td>14.96</td>
<td>22.32</td>
</tr>
</tbody>
</table>

Source: KTDA annual reports

After the first payment advances, the second payment to farmers is paid from cash retained from the sale of tea. The retained balance is left in banks to earn interest until it is paid to farmers. In some cases, the cash account for factories is not adequate to pay farmers and KTDA is forced to borrow to pay them. The interest on such borrowed funds is charged to the individual factory. KTDA also borrows externally to import the fertilizer supplied to farmers on credit and to construct new factories. The credit is deducted from each farmer’s proceeds over the year. Borrowing by KTDA to finance second payments and to purchase fertilizers, gunny bags and factory investments has raised farmer eyebrows. They claim that KTDA uses the borrowing as an excuse to squeeze them to pay higher and unnecessary interest costs. The KTDA needs to be transparent and inform farmers the nature and levels of these costs.
3.4 Tea markets

The major outlet for Kenyan tea is the Mombasa tea auction, which brings together major tea buyers and sellers, who make open bids through brokers to reach a sale agreement. The tea is sold as a generic product, without branding and packaging to reflect that it is Kenyan tea, despite the fact that branded tea fetches prices six times higher than bulk exports. Although the costs of branding were not analysed in this study, opportunities exist in this which need to be explored.

In addition to the Mombasa auction, KTDA sells tea in the London auction, in direct overseas sales by private contract and through factory outlets for domestic sales. The direct overseas and the London auction sales are coordinated through KTDA’s overseas agents and brokers. But sales through these markets have been reduced because of high cost. Private contract sales are made through arrangements between KTDA and the buyers. Overseas sales (both London auction and direct sales), result on the average a lower proportion of net price than the Mombasa Auction because of higher transportation and shipment costs (Table 3). Sales of KTDA teas outside the Mombasa auction make up only 17% of the total sales, leaving the Mombasa auction as the major outlet for smallholder tea.
The major markets for Kenyan tea are Pakistan, the United Kingdom, Egypt and Middle East countries, which account for 80% of the exports. Although the demand for Kenyan tea is high, the potential in the markets has not been exploited in the Americas, Eastern Europe and Japan. Also, many consumers of Kenyan tea do not know that it is Kenyan because it is sold under brand names of the buying companies or packaging firms in the importing countries. Kenyan tea is bought in bulk for direct sale after packaging or in some cases blended with other teas for sale in consumer markets. Packaging adds value to the tea and the high price pays for the value-adding activities. Kenya loses a great deal from lack of packaging to add value to its tea exports. Countries like Sri Lanka and India have enhanced their tea export markets and earnings in the world market because they package and brand their tea exports.

Previously, packaging tea for the domestic and the eastern and central Africa regional markets was restricted to the Kenya Tea Packers (KETEPA). With liberalized tea marketing, EATTA is encouraging members to package their tea for export. However, this has yet to take off. Limiting this domestic packaging is the lack of incentive for local packers. Tea packaging requires expensive material, which must be imported. The initial capital investment is high, and some

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Table 3. Market shares and average prices at KTDA manufactured tea market outlet, 1997/98

<table>
<thead>
<tr>
<th>Outlet</th>
<th>Market share (%)</th>
<th>A. Av. gross price (Ksh/kg)</th>
<th>Transportation, shipping (Ksh/kg)</th>
<th>B. Av. net price (Ksh/kg)</th>
<th>Net sale price to gross sale price (B/A) (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mombasa</td>
<td>83.12</td>
<td>139.14</td>
<td>2.96</td>
<td>136.18</td>
<td>97.9</td>
</tr>
<tr>
<td>KTDA pool</td>
<td>4.78</td>
<td>144.20</td>
<td>0</td>
<td>144.20</td>
<td>100.0</td>
</tr>
<tr>
<td>Local sales</td>
<td>5.44</td>
<td>113.73</td>
<td>0.57</td>
<td>113.16</td>
<td>99.5</td>
</tr>
<tr>
<td>London</td>
<td>0.05</td>
<td>106.80</td>
<td>26.04</td>
<td>80.76</td>
<td>75.6</td>
</tr>
<tr>
<td>Direct overseas</td>
<td>6.60</td>
<td>150.60</td>
<td>8.03</td>
<td>142.57</td>
<td>94.7</td>
</tr>
<tr>
<td>Total or average</td>
<td>100.00</td>
<td>130.89</td>
<td>7.52</td>
<td>123.37</td>
<td>93.54</td>
</tr>
</tbody>
</table>

Source: Nyangito and Kimura (1999)
exporters reported that local package manufacturers lack the know-how to package tea competitively for the world market. The government needs to reduce import taxes on packaging material and provide tax holidays for tea packers to encourage packaging tea for export. These efforts would increase tea earnings to producers and increase job opportunities in the country over time.

3.5 Impact of liberalization on tea farming

Data from six major tea-producing districts in Kenya indicate smallholder tea production has stagnated or declined (Figure 2). Murang’a and Meru Districts, east of the Rift Valley, have shown the largest decrease in green leaf tea yields—from an estimated average of about 8300 kg to about 6700 per hectare. Kisii, Kericho and Bomet Districts, west of the Rift Valley, have maintained yields at about 5000 kg per hectare. Overall, the average green leaf tea yield on smallholder farms currently

Figure 2. Average green leaf tea yields per hectare on small-scale farms, 1990/91 to 1996/97. Source: Nyangito and Kimura (1999).
averages about 5500 kg per hectare. Declining or stagnating tea yields at about 5600 kg per ha in 1990/91 to 5500 kg per ha in 1996/97 is explained by the low use of inputs, poor husbandry practices, tea collection problems at the buying centres, and payments problems.

Input use is low because farmers believe that the costs of production, particularly fertilizers, are high. This is despite the fact that KTDA provides fertilizers to farmers on credit. But it is common knowledge that some of the fertilizer is not applied on tea. Greater effort from the extension staff is required to educate farmers about the benefits of applying fertilizers according to recommendations since they are important determinants of yields and quality.

Tea collection from farms by KTDA is riddled with the following problems:

- poor road network and lack of coordinated transport which cause delayed collection
- Shortage of gunny bags that lead to congestion at buying centres
- Underestimation of weighed tea leaves by clerks.

The intensity of these problems varies from region to region with the worst hit being tea-growing areas west of the rift valley. However, in general, these problems indicate poor supervision in tea collection by the KTDA. Thus, a strong supervision system for tea collection is required from KTDA or any other management agency.

Tea payments vary from factory to factory and region to region according to tea quality and overhead costs. However, because farmers lack information about why there are differences, complaints have arisen. Transparency on what determines the amounts to be paid to farmers and causes for differences among regions is necessary to reduce the controversy.
Controversies among farmers about KTDA efficiency in providing services and lack of clear guidelines about the roles of KTDA and the government in tea farming have resulted in creation of two farmer groups. The Kenya Small Tea Growers Association (KSTGA), supports the existence of KTDA with its elected factory company board of directors, while the Kenya Union of Small Scale Tea Owners (KUSSTO), is for dissolving KTDA. Politicking is a result of dissatisfaction with producer prices that farmers receive, charges on the inputs that KTDA supplies to farmers, particularly fertilizers, and deductions for construction of new factories. Clearly defined roles for each of the stakeholders in the smallholder tea industry and access to information for all is required to calm the emerging controversies.

4 Issues and Recommendations

The major objective of this paper was to identify how the legal framework for the regulation of the smallholder tea industry fits in with policy reforms to allow for the development of the smallholder tea sub sector. The analysis shows that the current legal framework does not provide clear support for implementation of the policy reforms—liberalisation of the tea industry. This has led to weak co-ordination and supervision of tea collection, processing, and marketing for smallholder tea farmers. Consequently, the recommendations given in this section are aimed at the development of an appropriate legal system to support organisations involved in regulation of the provision of services to the smallholder tea farmers. The recommendations are also aimed at the development of clear

1 Some elements of these recommendations are incorporated in the Sessional Paper (MOA, 1999) on the Tea sub sector
roles and functions for each organisation involved in the delivery of services for development of the smallholder sub sector.

**Regulating the tea industry**

Tea industry legislation in the Tea Act gives adequate framework for regulating the industry but the controls, such as licensing growers, manufacturing and marketing agencies, can create monopolies, which do not fit in well with a liberalized economy and should therefore be done away with.

The Tea Board of Kenya should continue to be the regulatory body for the tea industry with the mandate of registering the stakeholders to keep information about them and monitor their activities to ensure a level playing field for all. The TBK should also monitor the processes of manufacturing and marketing tea and publish comparative data on quality, costs and prices to help enhance the efficiency in tea processing and marketing. The TBK board of directors should be composed of elected representatives of all stakeholders in the tea industry and should include a representative of the ministry of agriculture to represent the government.

**Providing services by commissioned management agents**

Providing planting material, extension services and fertilizers, inspecting and collecting green leaf from farms, processing and quality control, and marketing tea were previously a KTDA monopoly. These services should be liberalized to allow many commissioned management agents, including KTDA, to participate. However, guidelines should protect farmers from exploitation by the agents. These should emphasize tying services by a management agency to a tea factory serving a particular region or clientele, which has a clearly defined ownership (public or private) to avoid conflict. The public
factory company board of directors should supervise the provision of services and determine fees to be paid to the management agency. The fees and services should be clearly spelled out and registered with TBK, the regulatory agency, for the sake of transparency.

**KTDA ownership**

KTDA should be incorporated as a farmers public company to act as a commissioned management agent to provide services to smallholder tea farmers and developing new tea factories. The tea growers should own the tea factories through shareholding. Any government shares existing through KTDA should be sold to tea farmers. The KTDA company should offer services to farmers on a commission. But it should be mandatory that tea factories that have not yet completed repaying their investment loans will operate under KTDA. This rule should also apply to any new factories KTDA has developed. The activities of KTDA as a management agent should be monitored by the TBK and this should be the case for all management agents to countercheck any exploitative activities such as poor provision of production, processing and marketing services by the agents to tea growers.

**Financing new factories**

Both the public and private sector should be encouraged to invest in new tea factories. The TBK can help in identifying catchment areas for establishment of new factories. The KTDA management agency being a public farmer organisation should be used to channel public funds for investing in new factories including loans guaranteed by the government.
Policy and legal framework for tea subsector

**Governing smallholder tea factory companies**

A tea factory board of directors, who are elected farmers’ representatives, should govern public tea factories owned by farmers. The board of directors should oversee the work of the management agent, possibly KTDA, and should remain the policy-making body for factory activities. The members of the board of directors must be tea growers with an adequate education background, say at least form four level or some experience in a managerial position. Selected representatives from the tea factory board of directors should form the KTDA management agency board of directors.

**Protecting smallholder interests**

A registered tea growers association completely separate from any management agency such as KTDA should monitor the industry and protect smallholder interests. The association should be able to monitor the performance of the industry independently through representation on the factory boards of directors and TBK. The agency will need to work closely with the Kenya Tea Growers Association (KTGA) to facilitate development of the tea industry as a whole. Thus there is need to urgently clarify which organisation (KSTGA or KUSSTO) is the rightful representative organisation for smallholders. TBK should advise on this.

**Tea marketing**

Tea marketing from the factory to the auction should be the responsibility of KTDA, as a commissioned management agent, or any other agent serving a particular factory. It is imperative for the processing agency to also deal with tea marketing for quality control and as an incentive to reduce losses. An agreement should be made between the agent, either KTDA or another, and the tea factory board of directors.
setting forth the terms of marketing, particularly with respect to auction agents, timing of payments and charges.

The emerging parallel tea marketing system where tea is sold to middlemen is exploitative and should be prohibited by the TBK. Tea should be sold directly to public or private registered tea factories.

**Selling and buying**

The tea should be sold and bought through auction markets and private contracts, according to each management agent’s decision. However, EATTA should continue to run the local auction market, since it has proved to have the most efficient system of regulating tea buying and selling.

**References**


**Table 1. Tea area, production and average yields by type of grower 1990 to 1998**

<table>
<thead>
<tr>
<th>Year</th>
<th>Smallholders (’000 ha)</th>
<th>Estates (’000 ha)</th>
<th>Total (’000 ha)</th>
<th>Production (’000 tonnes)</th>
<th>Yields (kg per ha)</th>
<th>Smallholder percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Area in ’000 ha</td>
<td>67.00</td>
<td>68.80</td>
<td>72.16</td>
<td>73.11</td>
<td>73.84</td>
<td>78.96</td>
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<tr>
<td>Estates</td>
<td>30.00</td>
<td>31.00</td>
<td>31.34</td>
<td>31.75</td>
<td>32.07</td>
<td>32.36</td>
</tr>
<tr>
<td>Total</td>
<td>97.00</td>
<td>99.80</td>
<td>103.50</td>
<td>104.86</td>
<td>105.91</td>
<td>111.32</td>
</tr>
<tr>
<td>Production In ’000 tonnes</td>
<td>110.00</td>
<td>112.70</td>
<td>99.81</td>
<td>112.53</td>
<td>119.08</td>
<td>138.95</td>
</tr>
<tr>
<td>Smallholders</td>
<td>87.00</td>
<td>90.90</td>
<td>88.26</td>
<td>98.63</td>
<td>90.34</td>
<td>105.58</td>
</tr>
<tr>
<td>Estates</td>
<td>197.00</td>
<td>203.60</td>
<td>188.07</td>
<td>211.16</td>
<td>209.42</td>
<td>244.53</td>
</tr>
<tr>
<td>Yield in kg per ha</td>
<td>1945.30</td>
<td>1981.70</td>
<td>1729.80</td>
<td>1539.19</td>
<td>1612.68</td>
<td>1759.13</td>
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<tr>
<td>Smallholders</td>
<td>3123.80</td>
<td>3184.40</td>
<td>3033.40</td>
<td>3106.45</td>
<td>2816.96</td>
<td>3262.67</td>
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<tr>
<td>Estates</td>
<td>62</td>
<td>62</td>
<td>57</td>
<td>49</td>
<td>57</td>
<td>54</td>
</tr>
</tbody>
</table>

Figure 1. Proportion of gross sale tea price to different functionaries

- Farmer payments: 69%
- Factory and Other expenses: 23%
- Selling and distribution: 4%
- Agricultural services: 2%
- Government tax: 2%
- Farmer payments: 69%
Figure 2. Average tea yields per acre on small scale farms 1990/91 to 1996/97