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THE IMPACT OF REFORM OF THE COFFEE INDUSTRY IN
KENYA ON SMALL AND LARGE FARMERS

SATHIA VARQA

THE IMPACT OF REFORM OF THE COFFEE INDUSTRY IN KENYA
ON SMALL AND LARGE FARMERS

SATHIA VARQA

A thesis submitted in partial fulfilment of the requirements of The Robert
Gordon University for the degree of Doctor of Philosophy

This research programme was carried out in collaboration with the Institute of
Development Studies (IDS), of the University of Nairobi, the French Institute
for Research in Africa in Nairobi and The Coffee Board of Kenya

September 2008

Dedication

This thesis is dedicated to my mum for her inspiring words

&

to my dad for his faith in me to achieve academic excellence

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Sathia Varqa

24th July 2008

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Abstract

Underdevelopment is a major problem facing many developing countries around the world. Market mechanisms have increasingly been employed in an attempt to overcome the problem of underdevelopment such as low growth and poverty; however the implementation of market centred policies has raised other problems such as institutional mechanisms and the quality of governance within the institutions designed to implement the market oriented policies. This thesis attempts to throw some light on these problems by investigating the case of liberalisation in the Kenyan coffee industry. The thesis concentrates on the question of the extent to which the liberalisation program sponsored by the International Monetary Fund (IMF) and the Government of Kenya (GOK) has been effective in creating an efficiently functioning market within the coffee sector in particular and the Kenyan macro-economy in general.

The research finds that on the whole the liberalisation program targeted at the coffee sector has failed to take into account the institutional conditions and the extent of state centred features like rent seeking and centralised decision makings powers within the coffee sector prior to implementing the liberalisation program. The resulting market arrangement has therefore adversely affected the program's intended recipients, particularly at the level of cooperative institution where the interests of the small-scale farmers are represented. The thesis will elaborate more on this and relate its findings to the macro-economic view of Kenya.

The conclusion shows that in order for the Kenyan economy to break free from the problems of underdevelopment and to generate sustainable rates of growth, more attention must be given to improving the quality of governance and to developing a credible set of institutions to support and execute market-friendly economic policies. Good quality governance represented by accountability, transparency, rule of law, stability and efficiency appears to be the missing ingredient in making Kenya a successful economy.

Glossary page

ACFC	Agro-Chemical and Food Company Ltd
ADB	African Development Bank
BBC	British Broadcasting Corporation
CBK	Coffee Board of Kenya
CNN	Cable News Network
CRF	Coffee Research Foundation
EAA	East African Airways Corporation
ECLAC	Economic Commission of Latin America
EU	European Union
FHI	Freedom House Index
FOB	Free on Board
GDP	Gross Domestic Product
GNI	Gross National Income
GOK	Government of Kenya
GSP	Generalised System of Preferences
HDI	Human Development Index
ICDC	Industrial and Commercial Development Corporation
ICO	International Coffee Organisation
IDS	Institute of Development Studies
IFPRI	International Food Policy Research Institute
IMF	International Monetary Fund
IPO	Initial Price Offering
KCB	Kenya Central Bank
KCPTA	Kenya Coffee Producers and Traders Association
KCTA	Kenya Coffee Traders Association
KENGEN	Kenya Electricity Generating Company
KMC	Kenya Meat Commission
KNTC	Kenya National Trading Corporation
KP&TC	Kenya Postal and Telecommunication Corporation
KPCU	Kenya Planters and Cooperative Union
KPLC	Kenya Power and Lighting Company
KTDA	Kenya Tea Development Authority
KTDA	Kenyan Tea Development Authority
MCTA	Mild Coffee Traders Association
MPA	Members Payment Account
NCE	Nairobi Coffee Exchange
NGO	Non Governmental Organisation
NPEP	National Poverty Eradication Plan
OECD	Organisation for Economic Cooperation and Development
PRSP	Poverty Reduction Strategy Paper
R & G	Roast and Ground
R&D	Research and Development
SAF	Structural Adjustment Facility
SCIP	Small-holders Coffee Improvement Programme
SDR	Special Drawing Rights (SDR)
SOEA	Society Operating Expenses Account
TI	Transparency International
UNCTAD	United Nations Commission Trade and Development
UoN	University of Nairobi
WB	World Bank
WTO	World Trade Organisation

Chapter 1

Introduction

1.1. The Problem

This thesis is a study on the deregulation of the coffee industry in Kenya which is significant because it illustrates why market oriented policies are not necessarily the best solution in solving the problem of low growth, inefficient production and high levels of poverty. The study on the Kenyan coffee sector illustrates the shift from a state to a market oriented approach to tackling the problem of lack of economic development in general and the problem faced by the Kenyan coffee sector from 1980 to 2004.

1.2. Broader problem of development

The debate about lack of development has generally fallen into two main schools of thought, i.e. state and market centred approaches to development.

Recent literature on development claims that for countries to break free from the problem of underdevelopment, their economic policies should take into account the multifaceted and interconnecting problems of politics, social, individual rights and institutional arrangements in addition to examining the various economic variables (Sen, 1999, Kauffmann, 2005, Rodriguez and Rodrik, 2000, North, 1990, Olson, Sarna and Swamy, 2000, Knack and Keefer, 1995). Kuznets (1966) was the earliest economist to undertake an empirical study on economic growth which subsequently led to new and deeper insight into the connection between economic growth and social structures of the process of development (Kuznets, 1966)

The literature on development acknowledges that the problem of lack of development is more than an economic problem, requiring a more comprehensive look at the role of politics and its function in delivering economic outcomes. Kuznets (1973) argues that to see the problem of lack of economic development as purely economic problem is too simplistic and highlights the aspect of social transformation and innovation to initiate and sustain growth.

Subsequently many writers stated that the role of politics in designing, implementing and evaluating the economic policies is critical for the successful outcome of the development programme. The authors in the field of political economy of development acknowledge that in addition to economic policies, politics have a crucial role to play in facilitating the

process of development (Hayek, 1960). Hayek (1960) argued that market exchange works better than politically engineered state planned economy. Olson (1982) and North (1990) on the other hand explored the effectiveness of the role of political institutions in economic development, Buchanan and Tullock (1962) largely dealt with the role of public choice and the consequence of rent seeking by the political class on economic development. Friedman (1962) also argued that less political intervention is desirable for achieving an efficient allocation of resources, and Sen (1999) argued that political freedom in addition to other rights are essential for removing the major obstacles to economic growth rates. The role of politics on economic development has largely revolved around the extent to which political freedom (democracy) has enabled economic development to take-off.

While the role of politics in the development literature is well recognised, other development aspects such as governance, institutions, social arrangements, education, methods of evaluations and monitoring of development programmes and impact assessments (Kauffmann, 2005, Kauffmann and Kraay, 2002, 2007, Barro and Sala-i-Martin, 2003, Aghion and Durlauf, 2005, IMF: PRSP, 2007) has largely received less attention in the literature on development.

While a number of academic studies acknowledged the broader concept of development, there is still a lack of widespread application of this broader concept in the economic policy framework, particularly among the developing countries around the world, though international institutions like the International Monetary Fund (IMF) and the World Bank (WB) are beginning to push for a broader approach of development by taking into the account the social, institutional and political approach as an integral part of the process of development. This broader agenda on development is largely pursued by these international institutions by imposing conditionality, responsibility and accountability on the developing countries through their various development related funding mechanisms.

The broader agenda on economic development is aimed at reforming not only the economic policies of a country but is also aimed at revamping the overall process of development by taking into account the various interdependency of economic development such as the circumstance of politics, the condition of the institutions, the extent of social arrangements, the attitudes to risk and competition and the level of productive and technological capability for reform. This broader focus on development not only acknowledges the extent of the reform but it also touches on sensitive issues like governance and political competition as part of the economic reform process. Not surprisingly many of the developing countries either skirt the issue of political reform or

attempt to resist some part of the reform process therefore compromising the effectiveness of the shift from state to market based development.

The political resistance to reform is particularly acute among the developing countries where the state is deeply entrenched into the economic development process, particularly through the instrument of state appointed agencies and firms. These institutions often attempt to promote a state sponsored political agenda at the expense of economic efficiency, thereby undermining the potential for higher growth rates and competitiveness in their economies.

On the other hand some developing countries have opted to pursue their economic development using a market centred approach in delivering the economic objective of growth and employment. Under the market centred approach the state is committed to limited intervention in the development process but offers the necessary conditions and stability for private businesses and entrepreneurs to compete, take risk and capture profits within the domestic and international market.

In the next section the state centred approach to development is discussed and some of the critiques of the approach is highlighted before exploring the prevalence of market centred approaches in the contemporary economic policies in most developing countries around the world.

1.2.1. State centred approach

Despite the multifaceted and enormity of the problem of development, the argument is often made that, for developing countries to remove the various obstacles to development and to attain rapid growth rates; political control above any other means is urgently needed in addressing and removing the barriers to development in order to affect growth with minimal social and political interruptions. This means economic development is often pursued under a climate of a politically motivated agenda which gives little or no regard to the other aspects of the development process and the state becomes a dominant player in every sector of the economy. The literature on the impact of democracy on growth is extensive (Lipset, 1959, Barro, 1996, Przeworski and Limongi, 1993, Przeworski, Alvarez, Cheibub and Limongi, 2000, Roll and Talbott, 2001, Sen, 1999, Tavares and Wacziarg, 2001 and Persson, and Tabellini, 2007).

Many developing countries, especially in the 1940s believed that the various aspects to development can be converged and developed through the use of a political approach

such as central planning in order to quickly achieve the much needed objectives of growth and development. The approach of central planning has mainly been undertaken by relying on the state centred institutions to achieve the twin objectives of growth and poverty reduction.

It was widely believed that only a state centred approach could deliver the rapid growth rates that are on a parity with the developed countries of the West. Moreover, it was also common for the newly independent countries to distance themselves from the discriminatory economic policies of the colonial rulers by drafting and implementing autonomous economic development programmes and this was largely undertaken by mixing the indigenous ideas and colonial policy of central planning in every sector of the economy.

The state centred approach of central planning has extensively relied on state financing and management in order to implement an indigenous brand of economic development. The indigenous economic plan focussed on achieving growth through equitable distribution of wealth which was largely denied to the local population during the colonial rule. The newly independent countries were quick to change their laws, policies and political structures in order to legitimise their nationalist agenda in pursuit of an indigenous economic development plan. The state centred central planning approach was based on the idea that state power and economic planning were needed to urgently tackle the domestic problem of development. The belief was that the state had the legal duty to intervene in the functioning of the economy by influencing the behaviour of the producers and consumers through regulations, policies and controls if it were to improve the livelihood of the population.

In most developing countries, the state had a mandate, to play a dominant role in diagnosing, planning, investing and executing the economic development programmes with the aim of achieving rapid economic growth and reducing poverty rates. More on this will be discussed in the chapter on literature review.

The flagship policies under the state centred approach to development included policies such as: import substitution, industrial protectionism, price controls, currency controls, regulatory controls and the state owned and managed enterprises together with state sponsored institutions to regulate and implement the economic policies (ECLAC, 2007) (Roxborough, 1979). These policies were extensively implemented through a state run central agency with the aim of achieving the objective of the state, i.e. in lower poverty and increasing growth. Though the state centred policies were well intentioned in

delivering the economic aim of growth and poverty, by and large many developing countries seem unable to achieve sustainable growth rates and reducing poverty levels. Some of the reasons cited in the literature for the failure of the state centred solution in delivering the planned economic programme included poor political and economic institutions, the lack of investment, the lack of efficiency and the highly distorted price and output particularly in the agricultural sector (Schatzberg, 1987, Langdon, 1981, Sandbrook, 1993, Bates, 1992).

The problem of distortion in the economic management resulted in severe impediment to economic growth in the long run, particularly in attracting technology, increasing investment and in generating capital to achieve the economic potential of the country.

The criticisms of the state centred approach as a means for generating autonomous and sustainable growth rates were becoming more evident in the developing countries especially in the early 1980s and, as a consequence, there was a re-examination and re-evaluation of the state centred solution in its ability to deliver the promises of growth. The criticisms of the state led to an examination of alternative method of development and it came mainly from writers like Milton Friedman (Hunt, 1989) and others associated with the Chicago school of economics.

In the next section a brief overview of the market centred approach is presented by discussing the approaches, the flagship policies and some critique of the approach.

1.2.2. Market centred approach

As the state central planning approach to development proved to be ineffective in producing growth and reducing poverty, attempts were made by state governments and funded by the international institutions in reviving the fortunes of the developing economies by separating the entrenched role of state from the process of economic development. This involved freeing the economic sectors from state control in order to allow for free and unfettered functioning of the market.

According to the market centred approach, decisions over prices, production and consumption would automatically be achieved by the market if the bureaucratic decision making and state interference were to be removed from the economic development process. It was believed that by liberalising the economic sectors from government control and regulation, the role of politics would be reduced and efficiency in production would be improved. Hence by the late 1970s, many of the developing countries had either

undergone massive reforms or had acknowledged that the political approach had not been very effective in delivering the economic objective of growth and poverty reduction.

The shift in the approach to development in most developing countries in the late 1970s led to the abandoning of many of the inward looking economic policies in favour of liberalisation policies particularly from the 1980s onwards. The overarching market centred approach was to liberalise the economic sectors from regulatory control particularly with reference to the way economic decisions of production, prices and investments are made. The shift to liberalisation was aimed at making the economy to be outward oriented, competitive and free from economic control, particularly by applying to the neoclassical principles of free market economy.

It was also widely believed that by liberalising the economy many of the previously state controlled sectors would become competitive, profitable, productive, efficient and innovative. The motivation for liberalisation was also intellectually supported by the vast body of literature on neoclassical economics during the 1980s and augmented by international bodies such as the IMF and the WB.

The IMF, WB and the World Trade Organisation (WTO) became the leading crusaders of liberalisation around the world in the 1980s and more intensely in the 1990s. Of these three international institutions, the IMF became the fervent propagator, facilitator and financier of the liberalisation programme by subscribing to the neoclassical principles of growth around the developing world (Stiglitz, 2002), (Meseguer, 2006). However in this thesis the role of IMF is assessed together with the role of the Government of Kenya in affecting the liberal reform policies.

The support for the role of the free market in the formulation of economic development policies opened the way for the emergence of an ever increasing number of private sector firms and foreign and domestic investments in the economies of the reforming countries. The rise in the private sector was complemented with a lesser role for the state in the management and regulation of the economic sectors.

By the 1980s the momentum to liberalise had taken off and policies such as unfettered price movement, competition, privatisation, floating exchange rate, deregulation, capital and labour mobility, low cost to starting business, free trade, transparency and choice become the hallmark of the market oriented approach to achieving growth and prosperity.

Most of the IMF programmes implemented in member countries were broadly aimed at cutting red tape, eliminating controls and cutting fiscal spending. This was largely done by legislating policies to reduce the size of public sector, liberalising trade policies and by promoting transparency particularly within the public sector services. The elimination of regulatory and policy controls was also aimed at attracting the much needed flow of technological innovation and value-addition in the domestic economy. How deregulation impacts on economic development will be discussed in detail in the next chapter.

These typical IMF policies espoused in the neoclassical economic approach were largely initiated under the guidance and financing of the IMF and supported by the WB and other donor countries. As the neoclassical economic programme gained momentum in the 1980s and 1990s, a period of radical economic change swept throughout the developing and developed world. By the 1980s the market oriented economic approach had become pervasive within the economic sectors of the developing countries and institutions like the IMF and the WB had made significant impact in helping developing countries to institute further liberalisation of the economic sectors.

Furthermore, many of the developing countries were becoming more integrated into the world economy by opening their economies to international trade and dismantling the remaining controls on trade like tariffs and quotas (Stiglitz, 2002). The integration of developing countries through international trade was demonstrated by significant reduction in tariffs and the elimination of quotas, particularly in the terms of trade between the member countries of regional trade blocks (WTO, 2006). The opening of the economies was aimed at increasing domestic growth rates by competing on the world market and less on domestic markets only.

The aim of liberalisation was to liberate the economic agents and allow for efficient functioning of the market, which implies that political influence would be limited and even eliminated from the economic development process in general. Therefore under the liberal market conditions, opportunities for rent seeking and extraction would no longer be readily as available as under the state run economy (Giavazzi and Tabellini, 2005).

In most developing countries however the opportunities for rent seeking depended more on the extent of quality of governance within the institutions rather than on the extent of economic freedom (liberal market) within the country. In other words, liberalisation does not automatically lead to disengagement of the political class from the process of economic development; rather the burden of reforming the institutions is dependent on the level of political commitment in ensuring good quality of governance is reflected within the

institutions of the country (Kauffmann, Kraay and Zoidi-Lobaton, 1999a, 1999b, 2002, Kauffmann and Kraay 2002, 2007, Kauffmann 2005, North 1990).

Institutions such as free press which allow for the free flow of information, a justice system which guarantees the ownership of private property and intellectual rights, parliamentary institutions which legislates market-friendly policies, and a liberal political party competition are some of the few necessary institutions in addition to liberalisation which can help make the functioning of the market economy effective in delivering efficient economic outcomes.

Many of the countries that underwent the liberalisation process, particularly among the developing countries, failed to establish some or all of these institutions in a credible and sustainable manner, and as a result, the implementation of the liberalisation programmes was often compromised, and the outcomes fell short of the intended objectives. This will be looked at in detail in Chapter 6 on the impact of liberalisation on the coffee sector in Kenya.

Given the coffee sector was highly regulated in Kenya by the state institutions during the colonial and post-colonial period, the investigation into how these institutions responded to the process of deregulation offers an insight to the controversies and tensions in the shift from state central planning policies to market oriented approach of economic development.

In the next section, we list the specific aims and objectives of the thesis by considering the controversy over the market centred approach, particularly on the small scale coffee growers in Kenya.

1.3 The case of Kenya

The study over the shift from a highly state regulated to a market centred approach will be examined by exploring the impact on the small scale coffee growers. The discussion on the coffee sector and the shift from a state to a market centred approach will locate this study within the broader argument on economic development and its application to Kenya.

1.3.1. Aim and objective of the thesis

The aim of this thesis is to study the deregulation of the coffee industry in Kenya by illustrating that liberalisation and markets are necessary but not sufficient to bring about development but that good government and appropriate political institutions are also required.

In this thesis, the impact of liberalisation on economic development is considered by investigating the effectiveness and the responses of the institutions in delivering the intended economic objective of the liberalisation programme. This will be done by considering the case of Kenyan coffee industry from the period of 1980 to 2004.

Although the literature on development amply demonstrates the tension between political and economic approaches to development, it has to a large extent ignored the impact of liberalisation on economic development, particularly under the conditions of poor quality of governance within the agricultural institutions, principally in the case of the Kenyan coffee industry. Therefore the contribution of thesis will help bridge the gap in the body of knowledge on liberalisation and development.

The four specific objectives of the thesis are:

- (1) to identify and describe the problem of economic development among the developing countries with particular reference to the case of Kenya;
- (2) to explore the tension between liberalisation and economic development by considering the case of Kenya;
- (3) to investigate the Kenyan coffee sector and how this has been influenced by the political economy of Kenya; and
- (4) to consider the extent to which the coffee sector, particularly the small scale farmers has been impacted by the process of liberalisation at the micro and macro level in Kenya.

These four objectives shape the way in which the thesis examines the arguments from the literature and its analysis, findings, and conclusion. In the next section, we list some of the reasons for selecting the coffee sector before setting out the argument and structure of the thesis.

1.3.2. Coffee industry

The Kenyan coffee industry has been chosen for this study for several reasons. With reference to global trade, the coffee industry demonstrates an uneven pattern of consumption and production between the developed and developing countries. About 90 percent of global coffee production takes place in the developing countries of the Southern hemisphere, while consumption takes place mainly in the developed North which mostly has well developed consumer based economies. This offers an interesting perspective on the economic relationship between Kenya and other developed countries in terms of the duality and unequal structure of development (Ponte, 2001). Furthermore coffee is the second most valuable traded commodity in the world after oil which demonstrates the importance of coffee commodity to the Kenyan economy and its relationship to the developed metropolitan countries of the West (Ponte, 2001).

In addition coffee was and is still one of the most regulated commodities in Kenya with heavy state involvement, especially during the colonial years and the early period of Kenyan independence, therefore by studying the coffee sector, we can explore the strategies used by the state appointed institutions to control the coffee sector and consequently investigate the problems related to deregulation of the sector. The analysis on the influence of these institutions on the coffee sector helps to show the extent of rent seeking and rent extraction activities by the state and other related agents within the coffee sector in particular and illustrates its implication to the economy. This also offers an idea on the extent to which the politics of Kenya influences the most lucrative sector in Kenya.

Another reason for selecting the coffee industry is that coffee producing countries in Africa produce only a small share of the global export market, but it has to rely on the coffee commodity for a very large proportion of their export earnings. The dependence on coffee export revenues for the African countries represents an important contributor to the national income and employment in addition to other primary commodities that the majority of the African countries produce. As a result of the importance of coffee to the economy the coffee producing governments have often treated coffee as a strategic commodity in using political control to exercise its influence mainly over coffee revenue and coffee growing land. These controls were often exercised under the guise of laws and policies, purportedly to maintain the quality of coffee and to increase export revenues (Ponte, 2001).

1.4. Argument

The examination on the impact of liberalisation on economic development is a more general problem faced by many developing countries, particularly in disentangling political control from economic development programmes. The subject of liberalisation is crucial to developing countries like Kenya in which agriculture constitutes a major contributor to the economy. This is because agriculture based economies like to be self-sufficient in producing food and be less dependent in importing food from other countries, mainly because sufficient food supply is a necessity to feed domestic population before it is exported. As a result countries like to be in control of their agricultural policy and food production without being subjected to market and other external terms and policy prescriptions.

Also the volatility of agricultural prices and production can have a pervasive impact on the livelihood of the whole population and as a result of any changes in the pattern of household consumption and production, as a result states like to be in control of the agricultural sector and are hesitant in letting the market forces control it.

Furthermore land is a politically sensitive issue in Africa where land is one of the most important commodities in demonstrating the political and economic power of the owners. In addition African countries were largely afflicted by the problem of colonisation, exploitation and extraction of land resources which inevitably invokes memories of economic and political exploitation when issues of land reform are mooted. The volatile nature of political and social reaction to the issues of land reform in many of the African countries is a particular concern to the programme of liberalisation which if not handled sensitively can have a large scale political, social and economic impact on the whole population.

One of the main approaches in which agriculture and land reforms are pursued in most of the developing countries is through the use of political controls as opposed to applying free market policies on land allocation and agriculture production and prices. Political approaches such as centrally appointed body in diagnosing, drafting, implementing and evaluating the functioning of the agricultural sector has often had a political bearing, such as reforms that favour a section of the political supporters or reforms that attempt to punish a certain group of political opponents. The main point is that often agricultural policy reforms in many developing countries are not free from politicians' influences like rent seeking and rent extraction.

In the case of Kenya, the years of political control over the economic sectors have resulted in political power becoming deeply ingrained within the agricultural system and therefore any changes to the way the resources are allocated have been politically and economically very costly.

It is argued in this thesis that one of the costs of liberalisation is the extent to which poor governance had exacerbated within the Kenyan political and economic institutions. Poor governance prior to and after liberalisation had increasingly been manifested in Kenya in the form of corruption which has gradually descended into the state and private institutions which has produced adverse effect on economic outcomes like incompetence and inefficiencies in the management of political institutions.

It is also argued that inefficiencies, particularly within the state institutions are reflected through bloated employment and hasty implementation of law and policies without due attention to concerns of accountability and transparency. Most of the problems of governance concerning accountability, transparency and corruption in Kenya are demonstrated in the third most important sector of the Kenyan economy, i.e. the agricultural sector, and specifically within the smallholder coffee growing activity.

The main argument of this thesis is that liberalisation programmes within the coffee sector of Kenya have largely focussed on the neo-classical free market economic policy prescriptions with little or no attention to the institutional arrangements and conditions faced by the beneficiaries of liberalisation prior to implementing the programme of liberalisation. The early results from the liberalisation in the coffee sector appear to show that the effects have not been particularly successfully. The transition to liberal market economics appears to be plagued with various problems within the sector. This has resulted in a disappointing set of outcomes such as increase in the cost of processing of coffee and a decrease in the share of income received by the farmers. The discussion in the Chapter 5 and 6 will identify why the process of liberalisation has been met with limited success and offer analyses on the overall impact of liberalisation on the coffee sector and subsequently on the economic growth of Kenya before and after the IMF led liberalisation programme. This will be done by analysing and interpreting the qualitative and quantitative data from the primary and secondary source of data.

1.5. Structure of the thesis

The arguments in this thesis are divided into three sections. The first section consists of a literature review chapter and a chapter on methodology. The second section discusses the organisation of the coffee production in Kenya, the macro-level evidence on the impact of the liberalisation reforms, and the micro-level evidence based on the qualitative findings. The final part of the thesis consists of the conclusion.

The literature review in Chapter 2 examines the existing material on the subject of development. This chapter offers a comprehensive coverage on the theories, policies and application of development problem. It reviews the problem of underdevelopment facing many of the developing countries around the world and presents the state and market oriented responses and criticism of the policies to the problem of development. The Chapter on methodology (Chapter 3) focuses on the approaches used in justifying the source of data and the techniques employed in analysing the data to support the arguments presented in this thesis.

The second section of the thesis focuses on the Kenyan coffee sector and its importance to the Kenyan economy. It discusses the structure of the coffee sector during the colonial and post colonial period before highlighting some of the problems emanating from the regulatory regime during the post colonial period and ends by describing the main changes in the coffee reform implemented in 2002. The two other chapters in this part are devoted to presenting the macro-level secondary data (Chapter 5) and cross-examining the macro-level data with the micro-level data gathered from the qualitative interview.

The discussion on the findings takes us back to the underlying question of the thesis on the tension in the shift from centrally planned approach to free market economy in delivering the economic objective of growth and development. In this chapter (Chapter 6) the state of the Kenyan economy is considered before and after the process of liberalisation and assessment is made on the outcome of the liberalisation programme.

In the final chapter (Chapter 7) the arguments of the thesis are drawn to a conclusion. This is done by summarising and synthesising the arguments and findings in response to the problem of underdevelopment in Kenya and in developing countries in general. This chapter also identifies some of the other areas for further research within the subject area of the political economy of development of Kenya.

Chapter 2

Literature review

2.1. Introduction

The aim of this chapter is to explore the literature on economic development in order to clarify the nature of state and market oriented analyses of underdevelopment, and their policy responses to the problem of underdevelopment and to explain some of the gaps in the market centred approach that have led to the rejection of government institutions in managing the economy.

The review will set the liberalisation of the Kenyan coffee economy in the context of the economic problems faced by the developing countries and the challenges faced by those countries and the subsequent response of liberalisation to these challenges. This will be done with reference to the main aim of the thesis.

In the following section, we review the economic development problem as identified in the theory and the various aspects to the theory.

2.2. The general problem of economic development

The current debate on economic development emerged in the 1940s after the economic disruption caused by the Great Depression in the 1930s and the 2nd World War from 1939 to 1945. Early writers on the theories of economic development include Rosenstein-Rodan, Lewis, Nurkse, Rostow, Myint, Myrdal, Libenstein, Hirschman and Bauer (Hunt, 1989, pp. 46). These writers offered various theoretical perspectives on economic development which were intended to throw light on the nature and causes of economic backwardness of the countries around the world. The theories also broadly identified the principle of cumulative causality by taking into account the process of interaction of individuals within the social system and the expectation and re-action of the economic actors to the changes of the economic variables.

In the post-war years the Keynesian economist Kaldor (1961) was the first to question on why countries or groups of countries were able to grow in succession while others failed despite similar factor inputs. He also questioned on why convergence in per capita income across the world failed to materialize and why countries exhibited medium to long term accelerations or decelerations in their growth path (Kaldor, 1961).

The availability of new data and tools had intensified the investigation into this old but still very important and relevant problem on development. In addition to Kaldor (1961), Romer (1986) is also credited as the first to bring the theoretical and empirical research together in investigating the problem of economic growth using cross country data, according to Larrain (1989).

The general problem of economic development was viewed as structural problem of growth or/and as lack of capital for fuelling economic growth. Social scientists have attempted to categorise the various development theories using a framework of perspectives (Chenery, 1975), (Killick, 1978), (Seers, 1979), (Love, 1980), (Kitching 1982), (Chilcote and Johnson 1983) for reviewing the state of development theories particularly in assessing its effectiveness on growth rates (Hunt, 1989). The categorisation of the theoretical work on development led to the emergence of two dominant theoretical perspectives in the 1940s and 1950s. They are: (i) structuralism and; (ii) expanding capitalist nucleus.

In the following section below, we review the general problem of development as categorised according to these two theoretical perspectives and discuss in more detail the different theories in order to explore the main characteristics of the economic development problem and the various interconnections between them. The review of the theories will help the reader to locate the economic problem and the economic conditions faced by the developing countries, particularly in the Sub-Saharan African region within the context of this study.

2.2.1. The structuralist perspective

The structuralism perspective originated largely from the economic conditions in Latin America in the 1940s. The structuralism focused on the distinct structural problems of a developing country when it is locked with the development prospects of an industrial country.

The study by the Economic Commission of Latin America (ECLA) on the problem of dependency in Latin America in the 1950s was the first critical approach to the problem of structural underdevelopment in the economic development literature. The structuralists observe that the continuing export of primary products from low income countries to high income countries will deteriorate the terms of trade between the two groups of countries and this will lead to substantially different production structures between the two countries. The structural economic problem is sometimes known as Prebisch-Singer thesis, after Raul Prebisch and Hans Singer but other writers like Kuznets (1966) was also highly influential in contributing to structural development thesis.

Prebisch and Singer (Prebisch, 1960) (Singer, 1950) independently arrived at the same conclusion by asserting that primary commodity exporters (mainly developing countries) tend to import less and less for a given level of exports and therefore they recommend that primary commodity exporting countries diversify their economies or depend less on the export of primary commodities.

Prebisch-Singer argue that the deteriorating terms of trade faced by many of the primary commodity exporting countries as the main cause for the structural economic development problem of the developing countries which make these countries to fall into a state of dependency on the developed country. According to the structuralist school, it is the conditions of unequal trade and the state of dependency which impedes the potential for growth and development in most low income countries.

Kuznets (1966) in his book on *Modern Economic Growth* (1966) suggests that special attitudes are required to make the structural change. He summarises these attitudes as secularism – referring to aspiration to attain material wealth, egalitarianism – denial of inborn differences and human beings and nationalism – capacity of the state to provide stability with an elite dedicated to modernisation.

Kuznets (1966) argues that the successive shifts in the attitudes of the sectoral attachment of the labourers associated with high labour mobility will result in structural shift of the general economy to a higher capacity to perform. In this way structural shift emerges as an important strand of modernisation.

2.2.2 The expanding capitalist perspective

According to Hunt (1989), the expanding capitalist nucleus perspective is largely associated with the economic characteristic of Western Europe and North America.

Rostow (1960) and Lewis (1954) are grouped as the main writers on the subject of expanding capitalist nucleus. The expanding capitalist school view the economy as a dualistic structure, consisting of a large subsistence sector dominated by family farming and a small emerging capitalist sector using wage labour. From this premise, Lewis (1954) develops much of his analysis on economic development by arguing that savings are small not because people are poor but because capitalist profits are low. Lewis (1954) emphasised that capitalist profit provides the stock for savings which can then be made available for capitalists to borrow and invest in the economy. Rostow (1960) identified the Five Stages of Growth doctrine which an economy is likely to go through from traditional to a modern

industrial economy. The five stages include: traditional society; pre-conditions for take-off; take-off; road to maturity and; age of high mass consumption (Rostow, 1960). These five stages were set as markers for defining the characteristics of an economy progressing towards an expanding capitalist nucleus stage. The analysis by Lewis and Rostow includes many similar characterisation of the economy.

These characteristic includes: the use of per capita income (GNI) as the main indicator for measuring growth rates; the focus on the transformation of a traditional, stagnant, subsistence based economy into a dynamic, capitalist, wage-labour; the consideration that the abundant supplies of labour in the traditional sector as the starting point for any policy measures; the recognition that the key determinant of growth is the rate of capital formation, which in turn depends on the share of savings and; recognising the important role played by the capitalist/entrepreneurial class in capital accumulation because these members have a higher propensity to save and invest (Hunt, 1989, pp.62 – 63). According to the school of expanding capitalist nucleus these characteristics tend to explain the domestic supply-side conditions (capital accumulation, employment, wages, savings) that constraint growth and development in the developing countries.

These two perspectives according to Hunt (1989), embodies the general problem of economic development, the author claims that in each of these perspectives, various conclusions have emerged on the causes and constraints to development and the consequent condition in which the economy is locked in. In addition the theory of development has produced several variants of development theory which includes among others: (i) the theory of unequal exchange; (ii) the theory of dependency in development and; (iii) the condition of underdevelopment as a consequence of the dependency structure of development.

2.3. Underdevelopment

The study of economic underdevelopment within the subject of development gained prominence in the 1950s and early 1960s following the publication of the ECLA report on the interconnection of trade patterns between the developed and developing countries around the world.

The study on the causes of underdevelopment and dependency structure of economic development has largely been explored by studying the extent of duality and the interconnection between the developed (metropolitan) and developing (peripheral) countries around the world. Underdevelopment is a term used in the development literature to refer to

a state of development where a country is subjected to conform to an international and internal structure which makes it dependent on another country for expansion and development (Santos, 1970).

Santos (1970) argues that the inter-connection between developed and developing economies through trade locks the developing country into a state of dependency, where the dominant ones, the developed country can expand and be self sustaining while the other (the developing country) can only do this as a reflection of the expansion in the developed economy. As a result of this, the process of development in the developing country becomes dependent on the changes in the more advanced developed country. While the developing country develops its economic sectors, its structure and potential is largely dependent on the state of the developed country, which as a result impedes the autonomous development of the developing county and traps it into a state of underdevelopment which subsequently weighs down the development prospect of the developing country. According to the literature, the defining feature of underdevelopment (Baran, 1957) is that the surplus produced in the developing country are often and increasingly transferred to high income countries which are generally considered as the centre of capitalism with advanced banking and other financial infrastructures compared to the developing country financial infrastructure. The 'surplus' referred to in the literature refers to wages, interest payments on loans and repatriated profits among others. It appears that transfer of surplus is the main feature that locks a developing country into a state of underdevelopment thereby impeding its autonomous development.

The analysis on underdevelopment according to the argument developed above was first pioneered by Baran (1957), which is based on the following proposition:

- a) Economic growth entails investment in new production
- b) The value and composition of net investment depends on the size and use of actual economic surplus
- c) The surplus value is the difference between what is produced and what is consumed
- d) The size and use of the surplus value is influenced by the social structure within which the production process takes place.

(Baran, 1957)

The views of Baran (1957) were later supported in the work of Frank (1967) in which Frank characterises the process of underdevelopment as:

- a) Expropriation of surplus from the many to the few
- b) Polarisation of the capitalist system, both within and internationally into metropolitan and peripheral states

(Frank, 1967)

According to Baran (1957) and Frank (1967), the transfer of surplus from the low income to high income countries is a major cause of inequality in the world system and they argue that this inequality would continue through the international trade system even as some low income countries had acquired political independence. According to the literature the inequality in trade is particularly acute among the developing countries in the Sub-Saharan African region in terms of trade and transfer of resources (Marshall, 1985). The analysis on the relation between low and high income countries with reference to transfer of surplus was examined and discussed by Larrain (1989) by classifying the structures of economies into 'central' and 'peripheral' countries. The purpose of the classification is to study the problem of underdevelopment by using capital as a criterion. Leys (1975) also uses the same methodology as Larrain (1989) but applies a different term to classify the duality, i.e. 'metropolitan' and 'periphery' instead of 'central' in referring to metropolitan countries.

Larrain (1989) argues that the peripheral economic system is mainly characterised by its export sector which largely aims to serve the needs of the consumers in the advanced metropolitan economy through export and advanced processing of primary commodities, while production and primary processing largely takes place in the peripheral country where there is little or almost no focus on the development of goods for the consumer market in the peripheral economy. According to the literature on underdevelopment, a metropolitan or central economy refers to an economy which has a developed consumer and producer market and furthermore extends its economic power over a developing country, particularly in securing primary commodities for the purposes of expanding the production base of the metropolitan economies (Baran, 1957), (Frank, 1967).

According to the literature on development, the productive and consumption forces within a metropolitan economy is largely determined by the distribution of income between wages and profits within an economy, whereby wages are considered as the main source of demand for mass consumption and the level of profits as the main source of savings and investments (Larrain, 1989). According to Larrain (1989), the cumulative causation between

these variables is what expands the production possibilities and increases the growth rates in the metropolitan economies.

The literature on development according to Larrain (1989) claims that the activities initiated by the metropolitan economies in the peripheral countries are based on two motives that are related to the argument of unequal trade and they are: (i) to secure better returns for their capital and; (ii) to obtain cheap raw-materials and foodstuffs from the periphery.

It is claimed in the literature by Baran (1957), Frank (1967) and Larrain (1989) that firms from the metropolitan countries are attracted to invest in peripheral countries because of the lower cost and higher returns on capital compared to the production costs in the home country. Foreign firms from the metropolitan countries are particularly attracted to invest in the peripheral economies in order to take advantage of the prospect of lower cost in the form of wages and lax regulations in the production of goods and services in the peripheral countries. Wages in the peripheral economies are lower than in the metropolitan countries because of the low skill base of the workers and the weak bargaining power of the workers as compared to the workers in the metropolitan economy who enjoy higher wages and better protection of labour rights (Emmanuel, 1972).

In addition, Emmanuel (1972) also argues that the peripheral economies find themselves in a weaker position to bargain for greater levels of domestic investments and high-end skilled jobs, instead of jobs created at the lower end of production that requires low levels of investment in skills, research and innovation in the manufacturing sector. Moreover the technology and the expertise used in extracting, processing and marketing primary commodities are highly protected by the foreign firms in order to maintain the competitive edge in trade and distribution network.

The protection of intellectual and patent rights enjoyed by the firms in the metropolitan countries over their products, technology and distribution gives the metropolitan countries an added advantage over the peripheral country in maintaining the unequal exchange system and according to Frank, Wallerstein, Emmanuel and Amin cited in Larrain (1989, pp.114) and Bertocchi and Canova (2002), this exacerbates the problem of underdevelopment.

Furthermore the low cost of labour and the weak bargaining power of the workers in the peripheral economy offers a better returns on the capital for the foreign firms in the peripheral country when compared to investment made in countries where the labour costs is higher and the bargaining power of the workers are stronger. As a result peripheral economies are a

natural target for foreign firms, mainly from metropolitan economies in exploiting them on wage cost differential (Emmanuel, 1972).

According to Emmanuel (1976), Amin (1980) and Kohler (1999) imperfect competition in the international labour market is the root cause of unequal exchange between metropolitan and peripheral economies as demonstrated by the disproportionate amount of surplus transfer from backward peripheral to developed metropolitan country. This is confirmed by writers such as Emmanuel, Marini, Singer, Presbich and organisation like the Economic Commission of Latin America (ECLA), (Larrain, 1989, pp. 129).

It is claimed in the literature that an essential feature of underdevelopment is the large concentration of the economy in the agriculture and other primary commodities sector. As a result of the narrow base of development, there is a tendency for high levels of open and disguised unemployment particularly within the agricultural sector in the rural areas, therefore making it difficult for industrial firms to attract and absorb labour equipped with the right skills and experience and to integrate them into the modern industrial sector. As a consequence it is a common practice for private firms to hire foreign workers on higher wages to undertake complex technical and managerial tasks, particularly in the high-end of advance industrial sector. Furthermore according to Sarkar (1957), the over-crowding of peasants in the agriculture sector also acts as a drag on development in the peripheral economies. For example the pressure of population on land is responsible for the large uneconomic size of land holding leading to reduction in yields due to difficulty of crop rotation, high cost of farming, indebtedness, absentee landlordism and many other land related problems (Sarkar, 1957). It is claimed by Easterly and Levine (1997) that developing countries, particularly in the Sub-Saharan Africa manifest these factors which have conditioned their economies to the state of dependency and underdevelopment.

According to the ECLAC, analysis, the solution to the problem of underdevelopment was to pursue industrialization through import substitution policy as a means to reducing the transfer of surplus. It is stated in the literature of ECLAC that the policy of import substitution among the developing countries was focussed on promoting domestic industrialisation by limiting or removing competing imports through the use of quotas and tariffs (Larrain, 1989).

In the next section a review of the state, followed by the market oriented responses to the problem of underdevelopment are considered and presented below.

2.4 State and market oriented responses to underdevelopment

It is claimed in the literature that to solve the economic problem of underdevelopment, state intervention was credible not only in Latin America but also in many other developing countries in Africa which faced similar economic problems. The economic policies of Tanzania, Sudan, Ethiopia, Mali, Zambia, Ghana, Mozambique and other developing countries in the 1950s, 1960s and 1970s mirrored that of the ECLAC economic policy prescriptions in their response to the economic woes of dependency faced by these countries. Below are descriptions of two main approaches to development used largely between 1950s to the 1990s.

2.4.1 State oriented response (1960s to 1970s)

The economic development agenda in most countries in the 1960s and 1970s was characterised by state intervention in creating employment, in directing and managing growth sectors, in imposing import substitution policies, in distorting prices through subsidies and tariffs, in curtailing foreign competition, in imposing currency controls and in instituting a range of other inward looking policies.

The import substitution policy was the hallmark of the state centred response to the problem of underdevelopment among the peripheral countries. The import substitution policy which was first adopted by the ECLAC was soon followed by other developing countries in the 1950s and 1960s as a solution to the problem of foreign dominance in their economies.

The United Nations Commission for Asia and the Far East (1960) and the World Bank also endorsed the ECLAC import substitution policy by publishing studies that focussed on planning methods and techniques for promoting industrialisation mainly by protecting the domestic sector from foreign competition and encouraging the state to play an active role in the economy (Roxborough, 1979). According to Roxborough (1979) the typical economic response among the developing countries in order to extricate themselves from the condition of underdevelopment is to either (i) pursue industrialisation through import substitution by protecting the domestic industries and manipulating the exchange rates in order to stimulate export growth or/and to (ii) engage in trade between the peripheral countries, thereby creating economic cooperation between the peripheral group of countries (Frank, 1967).

The import substitution policy refers to economic development strategy which aims to replace import of goods from the metropolitan countries with domestic production with the hope of resolving the problem of dependency. It was claimed by aid agencies and international

funding organisations that in order to protect the development of infant industry, developing countries must pursue a policy of import substitution (Baran, 1957), (Frank, 1967).

The protectionist policies such as tariffs, quotas and regulatory controls were widely used to restrict the import of foreign goods with the hope of promoting the domestic base of the economy by mimicking the industrial structure of the advanced metropolitan country. It was believed that in order to support the policy of import substitution developing countries must have their own large scale manufacturing and capital goods sector within its domestic economy. This inevitably called for extensive state intervention in investing and creating large industrial conglomerates to support and implement the policies of import substitution and industrial development during the period 1940s up to the 1970s (Baran, 1957), (Frank, 1967). Many economists in the developing countries saw the role of the state as crucial in funding and managing the import substitution policies, especially when private funding was scarce and indigenous entrepreneurship at low levels in the early post colonial period.

The strategy of state intervention through investment in the economic development process was also widely accepted among the developing countries during the popular spread of the Keynesian school of economic thought during the 1940s and 1970s. The Keynesian Theory of Growth which places great importance on the effectiveness of aggregate demand as the main driver of economic growth particularly at the time of economic downturn or when recovery is delayed and unemployment is persistently high was well suited to the nationalist politicians of the newly independent countries who clamoured for greater state involvement in the economic development process.

The Keynesian growth theory positioned the importance of the role of the state over the private sector in stimulating the levels of output and employment, particularly through the manipulation and acceleration of aggregate demand in the macroeconomic policy framework. The Keynesian economic policy aimed to raise the market for output, profit and business optimism through injection of fiscal stimulus largely through government appointed state institutions and agencies.

Most notable of these state institutions are the commodities, transport, utilities and currency boards. These state institutions were mandated to fulfil government policies on price, output and the extent of market coverage in every sector of the economy (Tangri, 1999) (Roxborough, 1979). In addition to committing to a large wage budget, the developing countries, particularly the newly independent African countries were also engaged in extensive spending to create large infrastructure network to support the expanding economy, particularly in the urban centres of the country (Tangri, 1999). The policies on price, output

and market coverage was mainly designed to create some sort of planning in managing the economy.

For example the policy on price control was largely aimed at creating stability and certainty in the pattern of production and consumption in the agricultural sector of the economy. According to the literature the price controls were instituted in order to ensure that the farmers received a stable price throughout the year despite the changes in weather and international markets conditions. Often the state regulatory body would act in buying the agricultural goods from a central monopoly or bureau and pay the farmers a fixed price for their produce. It is claimed in the literature by Tangri (1999) that the state assumed the responsibility of purchasing the agricultural commodity with the aim of creating an efficient redistribution system.

Regulatory controls on quality, quantity and supply were also subjected to an assortment of state policies. It is stated in the literature (ECLAC, 2007) that by legislating and enforcing on the quality and quantity of goods, mainly from the agricultural sector, high prices can be fetched. It was common among the developing countries, particularly during the post colonial period of the 1950s and 1960s to adopt such regulatory controls in governing the production and export of agricultural commodities (ECLAC, 2007).

It was claimed by some writers that for the state centred policies to be effective and successful, state appointed regulatory agencies must be established to implement and regulate the proper functioning of the market within the designated sectors of the economy (Tangri, 1999) (Roxborough, 1979). This means that the economic institutions had to control and regulate the exchange of goods and services within a legislative framework (ECLAC, 2007). Therefore the economic and political institutions within the country had to function closely in order to implement and evaluate the economic policy outcomes. It was clear to the nationalist politicians that, the control over the economic institutions offered them the leverage to control the revenue policy and the channel for influencing political and economic policy matters (Tangri, 1999).

This meant that in addition the main political institutions such as the legislative body, the Office of the President and the various Ministries other institutions had to be appointed to govern the numerous economic sectors. These economic institutions consisted of commodities board, economic planning departments, currency boards, utilities board, transport boards, agricultural growers associations, cooperative associations and a host of other institutions that made up the bureaucratic structure of the state and was made responsible for implementing the detail policies with reference to quality, price and output.

For example in Nigeria the government acquired controlling shares in the oil and gas sector in order to influence its operation. In Ghana the government acquired majority equity in gold mines, banks, insurance agencies and aluminium and timber corporations. In Zimbabwe the Mineral Marketing Corporation was set up to regulate the foreign controlled mining sector. In Kenya the Agricultural Finance Corporation was set up to assist the Africans to acquire credit to develop the formerly white settler farms. The Kenya National Trading Corporation was set up to help Africans enter commerce. The National Construction was established to help Africans to enter the construction field which was dominated by the European companies prior to the 1960s (Hornsby and Throup, 1998). These are some of the few examples of how the state had attempted to use its powers in creating the various institutional channels for implementing the state oriented policies. In addition to implementing the detailed state oriented policies, these public institutions also provided employment to many of the indigenous population in the post colonial period.

According to Tangri (1999), the state institutions were also largely responsible for increasing the state budget on employment and other overheads, escalating regulatory controls, impeding economic growth of the market and making the state authorities to treat the institutions as a 'honey-pot' for extracting benefits and rewarding political loyalist through these institutions. Tangri (1999) claims that state enterprise comprise of a large proportion of state spending in creating and maintaining their survival in addition to implementing state centred policies. Tangri (1999) estimates that African countries spend in the range of 10 to a high of 40 percent of their GDP on state enterprises in a period of one financial year. Furthermore the publicly owned enterprises were also major borrowers from the international credit system (Tangri, 1999) therefore trapping the institutions into large deficits and high debt servicing, particularly when mismanagement and inefficiency in implementing the state centred policies became rampant in the Sub-Saharan African countries in the 1980s. According to Kaufmann (2005), although state spending in the public sector was aimed at generating employment and furthering the centrally planned policies, it was the poor implementation of those policies that was the problem.

It is claimed by writers such as Kaufmann (2005) that effective implementation of state centred policies crucially depended on the effectiveness of endowing good quality of governance such as transparency, accountability, competency, stability and compliance of rule of law within the institutions. According to Ulubasoglu and Doucoulia (2004, p.2) 'institutions are the established rules and organs that drive the production atmosphere which can influence both productivity and effective implementation of state policies'.

The effects of political, civil and legal arrangements on the economic growth have been extensively explored in cross-country empirical work by several writers (Barro, R 1996, 1997, 1999, Helliwell, 1994, de Haan and Siermann, 1995, 1998, de Haan, and Sturm, 2003, North, 1990, Hodgson, 1988) and many others. These writers argue that poor level of governance within the institutions have been one of the main reasons for the adverse implementation of the state centred policies in delivering the economic objective of growth and development.

As a result of adverse level of governance within these institutions, the state crafted policies were often inconsistent and unreliable which made the policies susceptible to highly politicised and centralized economic markets (Rowley, 1998, Tangri, 1999); this was particularly pronounced among the developing countries in Africa. For example developing countries in Africa could not consistently implement import substitution policies and finance the development of domestic industries because of the lack of resources, skills and incentives in delivering the stated objective of price stability and redistribution. As a result, the managers in the institutions often had to resort to political channels to maintain their jobs and justifying the operation of their institutions (Tangri, 1999).

According to Tangri (1999) the priority of state institutions was first to meet the political pressure of the state and then only attempts were made to address the economic problem of the respective sectors once the political pressure have been meet. The political pressure is manifested by committing institutional finances and loyalty to political causes and assenting to state oriented policies of protectionism and monopoly.

Rowley (1998), (2000), claims that one of the major political and economic activities to arise from the intense interaction between the state institutions and the political is the proliferation of adverse quality of governance within the state and private institutions among the developing countries, particularly in the Sub-Saharan African countries where incidences of rent creation and extraction are widespread, among the ruling political oligarchs who had inherited the political and economic institutions from the colonial rulers.

According to Tangri (1999) and Rowley (1998) (2000), the adverse interaction between government and economic institutions is one of the main reason for the poor quality of governance within the institutions in the Sub-Saharan African countries today and they argue that the poor quality of governance is largely reflected in the extensive rent seeking and rent extraction activities of their economies.

According to Buchanan (1980, pg.3) rent is defined as part of the payment that is received by an owner of resource 'over and above that which the resource could command in the alternative use'. Evans (2003) defines rent seeking as following.

The basic thesis of the theory of rent-seeking is that people, acting individually or as interest groups, seek to manipulate political and legal processes with the objective of creating a legal and institutional environment which enables them to extract transfers of wealth, outside the normal processes of voluntary market exchange, from other people in society. In essence, rent-seeking groups seek to acquire, through statutory and/or legal privileges, the power to restrict the quantities supplied of particular goods or services, thereby acquiring for themselves the monopolistic power to set prices for those goods or services above those that would prevail in openly competitive or contestable markets. The resultant wealth transfer is known as an 'economic rent' because it derives from an asset with especially valuable characteristics which, in this case, is the exclusive, politically or statutorily based power to set prices significantly above corresponding competitive market prices. (Evans, 2003, pg. 2)

It is argued in the literature of political economy that in economies where the state plays a dominant role in the process of development, there will be ample opportunities for the political class to use rent creation and rent extraction practices in their policies (Buchanan and Tullock, 1962), (Coolidge and Rose-Ackerman, 1997), (Krueger, 1997).

It is claimed by Buchanan and Tullock (1962) that state appointed institutions act as ready made channels for governments to manipulate and extract the various rent transfers in the form of monopoly profits, bribes, credits, foreign exchange rations and others in order to maintain the status quo of the structure of development.

It is claimed in the literature by Rowley (2000) that the state centred approach to the problem of underdevelopment failed to work because the excessive rent extraction activities within the economy had deteriorated the quality of institutions and consequently failed to halt the obstructionist policies of import substitution and controls which had impeded the efficient allocation of resources by distorting and misleading prices and market signals.

Tangri (1999) claims that the guaranteed price system administered in many developing countries during the 80s and 90s, often led to over-production of certain commodities and under-production of others. This inevitably distorted the unfettered functioning of price and production signals within the economy. The distortion of price and production was particularly acute within the agricultural sector which was subject to cyclical supply and demand under the conditions of weather vagaries and price expectations. Such uncertainties made any fixed price guarantees to distort the market and make production inefficient.

Meseguer (2006) explains that the subsidisation policy also had the tendency to exacerbate state spending and expenditure plans which had serious implications on inflation and interest rates. It was not uncommon for developing countries that pursued a state centred approach to development to be mired in fiscal indiscipline, currency devaluation and balance of payment crises. Such consequences were familiar among the developing countries that vigorously subscribed to the Keynesian economic policies in the 1940s.

The failure of centrally planned state policies, particularly in Africa was well catalogued by Tangri (1999). Tangri (1999) claims that in Niger and Togo net deficits were roughly 4 percent of GDP in the early 1980s as a result of excessive state spending in the central state institutions. In Cameroon subsidisation of losses equalled roughly 7 percent of GDP in the early 1980s and in Ghana total operating deficit of state owned firms amounted to over 3 percent of GDP. This was equivalent to total government spending on education, health and social welfare. In Zimbabwe subsidies to loss making enterprises totalled 14 percent of GDP and in Ethiopia industrial public policy was shown to have low economic efficiency (Tangri, 1999). In Kenya the state grain marketing enterprise National Cereals and Produce Board had accumulated debt of over 5 percent of the country's GDP (Tangri, 1999), the Kenya National Trading Corporation was also mired in controversies over the tenders for goods and services to firms with dubious companies and with total disregard to procedures, which amounted to millions of dollars of losses (Tangri, 1999). Public transport companies in Kenya often faced difficulties in increasing the fares to match any cost rises because of political pressure to keep the cost low, and marketing boards were often made to sell commodities at well below the costs. Subsidies were often paid by the state to absorb these costs. However when the state fails to do so, large losses are incurred (Tangri, 1999). By 1980s, state ownership of economic institution was associated with poor performance and large debts (Tangri, 1999).

In addition to the catalogue of failures by the state institutions, Tangri's (1999) literature also claims that the problems of overstaffing within the institutions was another common factor which had contributed to the poor performance of the public enterprises. For example the Ghana Cocoa Marketing Board employed over 130,000 people who handled crops less than half the size of crop handled efficiently by 50,000 employee twenty years earlier (Tangri, 1999, pg. 24). In Kenya, the Coffee Board of Kenya (CBK) had employed about 800 staff in its institution; however after a series of re-organisation it now totals just 81 (Kenya European Commission, 2004).

Critics of a state centred approach to development mainly point to the import substitution policy which was funded by the UNCTAD and the WB in the late 1970s to having had

harmful consequence on the ability of the local manufacturers to compete and innovate. Critics argue that as a result of the policy of insulation, local manufacturers and entrepreneurs failed to develop the skills to compete internationally and seek new markets. According to Erixon (2003), the import substitution policy facilitated by the aid programme had isolated and damaged the economy of the developing countries with inefficient producers and uncompetitive prices.

Erixon (2003) claims that an increase in the importance of state owned enterprises in developing countries like Kenya and others in the 1970s with the aid and support from the WB soon became an arena for endemic corruption and rent seeking among the state authorities. As a result Erixon (2003) states that the series of aid flows and policy recommendations on nationalisation had impeded the effectiveness of state institutions in improving and developing good quality of governance which subsequently resulted in conditioning the developing countries particularly the Sub-Saharan African countries on aid dependence.

Tangri (1999), Rowley (1998) and the IMF (PRSP, 2007) claim that the attempt to bring rapid economic development through state centred approach has not only weakened the capacity of the domestic institutions and the quality of governance within it but it has also entrenched the dominant role of politics within the process of economic development which had made these countries to be dependent on aid and isolated them from developing competitive and innovative industries. Some of the consequence of the political influence within the state approach to development will be explored in detail by considering the case of the Kenyan coffee sector in the chapter on analysis.

The literature review on state oriented response to the problem of underdevelopment appears to suggest that not only had the developing countries failed to break out from the cycle of underdevelopment but the policies had also weakened the capacity of the institutions in implementing the subsequent corrective policy measures.

As a result of the assortment of economic problems and the poor outcomes from the state centred approach to development, particularly among the developing countries; there was an urgent need for re-examining and re-evaluating the state approach around the developing world in about the 1980s, and this resulted in the shift from state oriented to market centred approach as an alternative to the solution of underdevelopment.

2.4.2 Market-oriented responses

The market oriented policies that were developed to respond the problem of underdevelopment can be summarised as liberalisation, stabilisation and privatisation of the market. The arguments of market centred approach is that the state centred approach to the problem of underdevelopment has not been effective in generating the much needed autonomous and stable growth rates because of the excessive regulatory controls in state central planning, import subsidisation and restrictive private enterprise which made the state to be the dominant economic player while limiting the free movement of factors of production. The limitation on the free movement factors of production made the state to be inefficient in making decisions over allocation of resources through a centrally planned bureaucracy. The ineffectiveness of the state central planning led to the development of alternative perspective that concentrated on market approaches. The market approach was seen as an alternative to the state central planning approach to the problem of underdevelopment however the market approach went too far and ignored the aspects of institutions and governments in achieving the solution to the problem of underdevelopment. This thesis will explore the aspect of institutional failures in implementing the market approach.

According to Nonneman (1996) there are four explanations for the spread of market oriented response to the problem of underdevelopment around the world during the 1980s. They include (i) those who focus on the perceived failures of the previous state centred policies; (ii) those referring to the inequality in the international environment; (iii) those that draw attention to the domestic policies (Nonneman, 1996, p.31) and; (iv) the emergence of the neo-liberal revivalism in the 1980s.

Of the four the first and the last explanation has gained currency among academics, economist, international institutions and politicians around the world. The merits of market oriented policy as a response to the problem of underdevelopment is mainly espoused in the neoclassical economic growth theory first published by Solow in 1956. The failures of central planning run by the state institutions subsequently led to the shift in economic policies that was more liberal in decision making, particularly to do with allocation of resources and mobility of resources.

The literature on neo-classicist economics cite that the start of the neo-liberal revolution in the United States, the United Kingdom, the former West Germany, Canada and Japan in the beginning of 1980s, created the political space for the neo-classicist to reinvigorate their economies by revamping the role of the state in the process of economic development (Hunt,

1989, Nafziger, 2006) and institute the path towards state policy reforms in these major economies of the world.

The key principles that are embodied in the neoclassical school of development according to Hunt (1989) are, firstly, a belief that economic inequality is a major source of incentive and as a result the backward or peripheral economies would strive to improve themselves by responding to this incentive. Secondly the neoclassical approach attached a very high value on the level of personal freedom in the political and economic domain of a country and thirdly the neoclassical economists believed that the free market generally allocates resources more efficiently than it can be achieved by the government, and this is demonstrated by the extent of economic freedom and the degree of mobility of labour and capital in achieving efficient utilisation of the resources within an economy (Hunt, 1989, pp. 316).

These three key principles were considered as the core neoclassical economic principles and they are largely reflected in the economic development policy of developed and developing countries around the world.

The development of the neoclassical model can be traced back to the 1960s, when it was first developed by writers such as Solow's (1956), Swan (1956) and Cass (1965). Of these, Solow growth model (1956) was the most cited in the literature on neoclassical economic growth models in illustrating the theory of growth in the long run.

Essentially the Solow (1956) model describes that the supply side growth rate of an economy is determined by the amount of the labour force growth rate and the increase in the labour productivity. In the model, the gain made from labour productivity is calculated from the increase in the capital to labour ratio. Hence the increase in the ratio reflects the extent to which technology improvement has taken place. In addition to the ratio of labour to capital, the amount of savings was also considered critical in the Solow model.

The neoclassical Solow model demonstrates that growth is dependent on an increase in the level of savings which in turn is dependent on the increase in the ratio of capital to labour, therefore by increasing the quantity of labour supply through less regulation and more mobility and by boosting additional labour productivity through shift in technology and innovation, the economy's long term trend of constant growth can be raised (Boltho and Holtham, 2000). Unlike the Keynesian which was one of the main state oriented approaches to development, the Solow model gives minimal attention to the intervention of the state in development policies.

In addition to the Solow model, other writers like Romer (1986), (1987), (1989) and Lucas (1988) modified the Solow model by including growth determinants like the rate of technology and labour progress into the growth model. Romer (1986, 1987) and Lucas, (1988) demonstrated how an open economy can be crucial in absorbing science, technology, human capital and innovation in the process of economic development.

The endogenous neoclassical growth model as it was known, demonstrated that market policy measures which aimed to increase the combined factors of innovation and accumulation can be powerful in explaining the sustainable rates of growth across the countries in the world (Boltho and Holtham, 2000) as opposed to a closed economy that protects the domestic industries from competing, innovating and learning from rivals.

Central to neoclassical economic belief is that the efficient functioning of the market coupled with minimum state intervention was a recipe for achieving efficient allocation of resources. This entailed decentralisation of the market away from central state planning and the functioning of price mechanism without any sort of distortions. The argument for free market and unfettered price was strongly argued by writers such as Friedman (1962) and Hayek (1988). They argued that by decentralising the market and releasing the power of the unfettered market pricing, the economy will spontaneously generate proper incentive structure for voluntary human interactions.

According to the literature, economic freedom was considered crucial for the making and functioning of a competitive market economy, and this was to be harmonised with individual freedom which was critical in discriminating between the different producers. Economic and consumer freedom in decision making was considered fundamental for the efficient functioning of the incentive structure within the free market (Hunt, 1989).

The literature on neoclassical economics refers to the process of decentralisation and deregulation of the state run economies as 'privatisation'. The programme of privatisation was pursued in order to create independence of the enterprises from state control with the appropriate conditions for the efficient functioning of price and incentive structure. Privatisation and deregulation quickly became the hallmark of economic policy prescription in solving the economic problems of underdevelopment, particularly in the 1980s.

Moreover, the high income members of the Organisation for Economic Cooperation and Development (OECD) were also largely supportive of market privatisation, and in promoting a range of other neoclassical economic positions (Friedman, 1962 and Hayek, 1988). Furthermore neoclassical economic policies dominated the thinking and policy proposals

among economists at the international and regional institutions at the IMF, the WB, the Asian Development Bank and the African Development Bank, particularly in the 1980s (IMF Website, various years), (Meseguer, 2006).

During the 1980s and 1990s, the economic development agenda was characterised by the advocacy of market oriented reforms which included adjustment of public expenditure priorities and financial liberalisation were aimed at fixing the lax fiscal discipline and tightening the Keynesian style state expenditure (Nafziger, 2006, pp. 149).

Also reforms targeting exchange rates were intended to bring the volatility of exchange rates in line with the open market currency and not by pegging or controlling currency movements through currency control boards. On international trade and foreign direct investments, the IMF reforms were addressed particularly on removing quota and tariff controls and offering incentives to firms to invest and compete within a liberal market setting. Labour market rules were relaxed in order to encourage firms to compete with each other in the hiring of labour using wage pricing. Policies and laws that previously gave protection to the state controlled firms were now subject to deregulation and exposed to the market economy. These liberal market reforms were packaged by the IMF and implemented in the developing countries under the so called 'Washington Consensus'. The typically list of policies under the Washington Consensus included the following:

1. Privatisation of state owned enterprises
2. Liberalisation of price control
3. Liberation of trade policies
4. Liberalisation of exchange rate controls
5. Diversification away from the agricultural sector
6. Reduction in civil service
7. Cut in fiscal spending
8. Promotion of transparency

(IMF Website, various years), (Meseguer, 2006)

These policies were considered as the best response to the problem of underdevelopment and lack of economic growth. The central planning policies in controlling prices, trade, production and exchange controls, particularly through the state owned enterprises was now beginning to shift towards a Washington Consensus espousing the main eight policies above.

By the 1990s, economic policies in the developed and developing countries were increasingly based on the principles of neoclassical economics with less state intervention, more outward orientation, greater economic openness and increased mobility of resources through better allocation of resources in the economic development programmes. The policy direction in the developing country by the early 1980s was now completely opposite to state oriented response of Keynesian style state intervention and the inward looking policies which was omnipresent in the 1950s, 60s and 70s (Meseguer, 2006).

According to Meseguer (2006), the IMF policies was seen as solution to many of the problem of state central planning policies. Hardoy (2002) argues that during the 1980s the IMF was perceived to be the most credible international economic solver, because of its ability to offer mediation between credit institutions and the country in need of loan agreement, particularly when the country in question is facing severe economic difficulties. It was also widely accepted in the 1990s and reinforced during the Asian financial crisis in mid 1990s that the only the IMF had the most influence in affecting the internal fiscal and monetary policies of the country it is assisting to develop. According to Hardoy (2002) the fiscal and monetary restraint combined with exchange rate devaluation remains the hardcore policies of the IMF in the reforming member countries. The IMF liberal economic policies were not only perceived as the correct economic solution but it was also viewed as the only alternative to problem of lack of development and dependency among the majority of the developing countries in the world. The perception and the subsequent acceptance of IMF prescribed economic solutions spread the influence of IMF to most developing countries from the mid 1970s to about mid 1990s.

Table 2.1 below shows the spread of neoclassical style economic policies under the IMF from the period of mid 1970s to late 1980s. During this period about 70 developing countries had either signed up to or implemented IMF neoclassical policies in some form into their economic sectors.

Table 2.1 Countries under IMF agreement from 1973 to 1987

No.	Country	Years under IMF	Share of years under IMF
1	Panama	1980-81,1983-87	0.47
2	Chad	1987	0.07
3	Yugoslavia	1973-86	0.93
4	Zaire	1976-86	0.79
5	Haiti	1974-1976, 1978-86	0.86

6	Senegal	1979-87	0.60
7	Togo	1979-87	0.60
8	Malawi	1979-86	0.53
9	Mauritius	1979-86	0.53
10	Morocco	1980-87	0.53
11	Costa Rica	1980-87	0.53
12	Turkey	1978-85	0.53
13	Ivory Coast	1981-87	0.47
14	Somalia	1980-86	0.50
15	Mali	1982-87	0.40
16	Gambia	1977-81	0.67
17	Liberia	1979-83	0.45
18	Honduras	1979-83	0.33
19	Mexico	1983-87	0.33
20	Niger	1983-86	0.29
21	Zimbabwe	1981-84	0.27
22	Dominican Republic	1983-86	0.27
23	Guatemala	1981-84	0.27
24	Brazil	1983-86	0.27
25	India	1981-84	0.27
26	Hungary	1982-85	0.29
27	Tanzania	1980-82	0.23
28	Barbados	1982-84	0.21
29	Belize	1984-86	0.75
30	Western Samoa	1983-85	0.60
31	Ethiopia	1981-82	0.18
32	Tunisia	1986-87	0.13
33	Nepal	1976-77	0.18
34	Egypt	1977-81, 87	0.40
35	Solomon Islands	1984	0.50
36	Guinea-Bissau	1987	0.09
37	Mozambique	1987	0.10
38	Zambia	1973-74, 1976-87	0.93
39	Philippines	1973-81, 1983-87	0.93
40	Jamaica	1973-74, 1977-87	0.87
41	Israel	1978-85 1974-77	0.27
42	Kenya	1975-78, 1980-86	0.73

43	South Korea	1974-76, 1980-87	0.73
44	Madagascar	1977-78, 1980-87	0.67
45	Sierra Leone	1977-82, 1984-87	0.67
46	Sudan	1974-75, 1979-85	0.64
47	Chile	1974-76, 1983-87	0.53
48	Peru	1977-80, 1982-85	0.53
49	Romania	1975-78, 1981-84	0.57
50	Central African Rep.	1980-81, 1983-87	0.47
51	Argentina	1976-77, 1983-87	0.47
52	Burundi	1976-77, 1986-87	0.26
53	Gabon	1978-79, 1986-87	0.27
54	Guinea	1982-83, 1986-87	0.27
55	South Africa	1976-77, 1982-83	0.27
56	Ecuador	1973, 1983-87	0.40
57	El Salvador	1973, 1980-83	0.33
58	China-PR	1981, 1986-87	0.20
59	Uganda	1980-84, 1987	0.40
60	Bangladesh	1974-76, 1979-83, 1985-87	0.79
61	Pakistan	1973-75, 1977-78, 1980-83	0.60
62	Sri Lanka	1974-75, 1977-81, 1983-84	0.60
63	Mauritania	1977-78, 1980-82, 1985-87	0.53
64	Myanmar	1973-75, 1977-79, 1981-82	0.57
65	Thailand	1978-79, 1981-83, 1985-86	0.47
66	Bolivia	1973-74, 1980-81, 1986-87	0.40
67	Guyana	1973, 1976-77, 1979-82	0.47
68	Congo	1977, 1979-80, 1986-87	0.33
69	Ghana	1979-80, 1983-85, 1987	0.40
70	Uruguay	1973, 1975, 1981-87	0.60
71	Nicaragua	1973,1979	0.13

(Source: Hardoy, 2002, pp.46-47)

According to Hardoy (2002), it was widely accepted among the development economist at the IMF and WB from the mid 1970s onwards that the effective response to the problem of economic underdevelopment should be the market centred approach based on the neoclassical economic principles.

Related to economic openness is the extent of economic freedom or the degree of mobility of the factors of production like labour, capital and technology within the domestic market in absorbing the related benefits that arise from foreign investment and technology. The literature claiming the link between economic freedom and growth is indeed abundant. The theoretical support for the positive relationship between growth and economic freedom has been forcefully justified by growth theorist like Romer (1986) and Lucas (1988).

Writers like Barro and Sala-i-Martin (2003), Grossman and Helpman (1991) and Romer (1992) also show that economic freedom can significantly impact on growth particularly through technological change. According to de Haan and Sturm (2003) the capacity to absorb and translate new technology and other benefits in expanding the productive capacity is dependent on the extent to which domestic and foreign firms enjoy the degree of economic freedom to compete and innovate. These findings are in complete contrast to the state oriented economic policies of protectionism and import substitution which promotes insularity from foreign firms as practised by the developing countries from the 1940s up to the mid 1970s.

Additionally a substantial amount of literature demonstrates that liberalisations on a range of macroeconomic sectors like finance, trade, industrial, banking, labour, institutions, and others have made many positive contribution to economic growth of a country (Friedman, 1962), (Hayek, 1988), (Sachs and Warner, 1995), (Wacziarg and Welch, 2003), (Edwards, 1998), Harrison (1996) and (Krueger, 1997). Also Christopoulos (2007) and Levine and Renelt (1992) demonstrate that movements towards openness of an economy increases the growth performance of both non-OECD and OECD countries through changes in foreign direct investment and export variables.

With reference to African countries Sachs and Warner (1995) find that openness to international markets has resulted in faster growth for Mauritius and Botswana compared to other African countries. Similarly Ghana, Guinea-Bissau, Guinea and Uganda have also experienced higher levels of growth more recently as they opened their economies to the international market. Sachs and Warner (1995) argue that the findings on openness and growth in Africa do not support the evidence that market oriented pro-growth reforms do not work in Africa.

However the literature on development shows that in spite of the implementation of the neoclassical growth policies as advocated by the market economist such as the IMF and the WB in the 1980s and 90s, many developing countries are still struggling to generate the expected rates of growth and deliver the much needed boost in development (Dreher, 2005,

Rodrik, 1999). Not surprisingly there are also large amounts of criticisms in the literature on the strength of neoclassical economic policy on growth, particularly on the way and the timing of the implementation of the liberalisation programme.

Some of the reasons for the criticisms according to the neo-classicist is that the economic policies of liberalisation and open market with free movement of labour, capital and information was often taken as carte blanche solution for all economic problems with little or no regard to issues such as institutions, regulations, transparency, accountability and enforcement of contracts between and among businesses and states (Stiglitz, 2000, 2005, Jilberto and Mommen, 1996, Nonneman, 1996). It is also argued by Spence and El-Erian (2008) that the market approach was too 'formulaic' and was not context specific and time specific but was rather offered a single blueprint for policy. He also argues that the Washington Consensus needs to be reconsidered and the role of institutions reassessed before growth is delegated to the private sector (Spence and El-Erian, 2008) through the market approach. As a result one of the major impediments to the proper functioning of a liberal market is the way governance within the state and economic institutions operated in implementing the neo-classical policies of growth.

2.5 Governance and institutions

According to Kauffmann (2005), governance within institutions that are either undergoing or implementing the process of liberalisation can make a crucial difference to the intended outcome of the liberalisation programme. The problems of governance within the institutions implementing the liberalisation programme are particularly acute among the developing countries in the Sub-Saharan African economies and this is well documented by Tangri (1999), Rowley (2000), Anke, Fosu and Bates (2006) and acknowledged in the recent NEPAD (2001) report (New Partnership for African Development). Although there are widespread variation in the method of measurement of quality of governance, the literature on liberalisation shows that even when there are institutions set in place to handle the programme of liberalisation, the quality of governance within the institutions can make a critical difference to the outcome of the programme (Kauffmann, Kraay and Zoidi-Lobaton, 1999a, 1999b, 2002, Kauffmann and Kraay, 2002, 2007, Kauffmann 2005).

However authors like Rodriguez and Rodrik (2000) appear not to be convinced on the available evidence that economic openness and growth are positively related. Additionally Greenway and Morgan (1997) in a study on trade liberalisation and growth in developing countries in the 1980s and 1990s show that liberalisation leading to market oriented policies seems to have been associated with a decline in growth. These writers argue that openness

alone does not bring higher growth rates, according to them other factors like institutions and rule of law are also needed to translate openness into higher growth rates.

When investigating the effectiveness of IMF policies to delivering growth in the 98 programme countries from the period 1970 to 2000 Dreher (2005) shows that IMF programme actually reduces growth rates when their endogeneity is taken into account. He shows this using the regression technique of pooled time-series with averages of five years (Dreher, 2005). He concludes that with respect to the "primary objective of growth" (Camdessus, M, 1990 in Dreher, 2005, pg. 18) the paper shows the IMF programme has been a failure when considering the countries and the period covered.

Some of the main reasons highlighted for the failure of market oriented policies, particularly among the developing countries are related to political resistance and adverse policy environment which restraint the reform programme. According to Nonneman (1996) the entrenchment of political interest in the economy particularly during the era of state oriented development have made political influence to proliferate and create the network of patronage and clientele between the political and industrial class thereby making any reform efforts costly and protracted. Nonneman (1996) argues that in such cases the neo-liberal policy prescriptions are the least bad starting point for reforming the state of the economy.

According to Nonneman (1996) this is because a system with high concentration of political intervention in the economic development process lacks the institutional prerequisites and attributes of good governance for an autonomous and incorrupt bureaucracy to deliver the separation between economic development and political interference (Nonneman, 1996, p. 22). According to Nonneman (1996) the politicisation of the economic market is most often manifested in the form of manipulation of laws and policies in order to extract rent and rent related activities during the process of liberalisation.

Furthermore, Stiglitz (2004) deals with other broad areas that can have a negative impact on the domestic sector of the economy when the process of liberalisation is in motion. According to Stiglitz (2004, p.473) these broad areas are interrelated and work their way through when the domestic economy is opened to the global economy through market oriented policies.

The summary of the arguments by Stiglitz (2004) includes job creation, whereby with liberalisation, old jobs in the protected industries are eliminated before new jobs are created. With liberalisation, resources tend to move from low productivity areas to zero productivity, therefore creating mass unemployment. According to Stiglitz (2004) this only tends to increase the incidences of poverty. Stiglitz (2004) argues that investment in labour market

often takes place after and not prior to the liberalisation of the labour market and this cannot be guaranteed, thereby increasing uncertainty. As a package measure to liberalisation, the tightening of monetary policy can often lead to a rise in interest rates in order to rein in the inflation rates, this makes borrowing and investing particularly unattractive for the private enterprise to undertake in creating employment and increasing productivity.

In addition with liberalisation, the surge of capital into and then out of the country imposes a very high transaction cost on the system and on the economy in terms of volatility of capital movement and disruptions to the domestic financial system. According to Stiglitz (2004), given the risk to jobs and investment, the liberalising country are often encouraged to hold reserves by borrowing from the international financial institution which are then subjected to high interest rates, consequently this will increase the debt of the liberalising country with adverse effect on growth, employment and investment.

Related to the market oriented policy of liberalisation is the problem of capital flight associated with financial liberalisation. Stiglitz (2004) argues that the rapid inflow and outflow of capital may have an adverse affect on the economy. The liberalisation of the capital market can increase the net outflow of capital if the liberalising country does not quickly put in place the necessary capital controls in place. According to Stiglitz (2004) the rapid privatization of the previously state owned enterprises in many of the developing countries often led to a few oligarchs to pick valuable state assets at prices lower than it would have been valued. These oligarchs, who tend to lack the political legitimacy and scrutiny in buying these assets, are then faced with a choice when the capital market is liberalised of either keeping their money in the domestic economy where the possible election of new government will question the privatisation or take the money out to foreign bank where it is secure according to Stiglitz (2004).

Furthermore the market oriented policies of the financial sector can lead to the loss of the independence of monetary policy (Stiglitz, 2004) in the liberalising country. The loss of monetary policy through the capital market liberalisation can be a costly affair if the monetary policy lacks the ability to institute capital controls, particularly among the developing countries because of the dependence of the economy on the sensitive movement of capitals. The failure to impose capital controls can trigger high interest rates, forcing many firms to go into debt, which in turn increases the cost on the domestic banks and governments in addressing the legacy of the debt. All of these can have an adverse effect on the future of growth.

Market oriented policies to underdevelopment has also often led to the loss of national financial institutions when competition forced the mega mergers between banks which reduced the extent of competition between the banks in offering lending opportunities to smaller and medium enterprises. This has made competition among the smaller banks difficult under the highly concentrated banking sector. Depositors would naturally be attracted to the larger banks that offer attractive interest returns than the smaller domestic banks. As a result the larger banks which are often foreign controlled have greater influence in changes in the structure of the economy than the domestic banks.

Finally the critics of neo-classical economic policy argue that globalisation can often trigger social turmoil if the implementation of the liberalisation programme does not take into account the social impact of liberalisation programme. A good example of this is the social impact of liberalisation in Indonesia in the aftermath of the East Asian currency crisis which led to contractionary fiscal and monetary policy. The policy restraint was followed by the IMF prescribing the cutting of fuel subsidies which caused the purchasing power to decline and unemployment to rise and as a consequence invigorated the political and social turmoil and caused the population to descend into anarchy and subsequently overthrow the political regime which had been in power for more than three decades destabilized the years of economic stability. In the case of Indonesia the liberalisation programme had undermined the long held social cohesion and consensus which delivered modest growth rates through the state centred approach (Stiglitz, 2004) though not without its problems.

It appears that these reasons are interconnected and are particularly pervasive among the developing countries in the Sub-Saharan Africa more than anywhere else in the world. According to Stiglitz (2004) liberalisation of the economic sectors does not automatically result in growth, stability, and prosperity as advocated by the IMF and other writers, instead each the economic development problems faced by the developing countries are different and hence it requires careful diagnosis and not carte blanche implementation of neoclassical set of economic policies.

It appears from the literature that the state and market centred policies to the economic problem of underdevelopment have not brought the intended promises of growth and development as promised in each of these approaches.

2.6. Conclusion

This chapter explored the literature on economic development which shows that the two main approaches to underdevelopment, state and market centred policies does not guarantee the developing countries of breaking free from the cycle of low growth and dependency.

Under the state centred central planning approach to development, production of goods and services was determined within the structure of political order, giving rise to state focussed solutions for all the economic problems which subsequently led to politicisation of the economy and creation of rent seeking opportunities. This was discussed with some reference to Keynesian growth policies where the state played a dominant role by intervening in investing and creating the infrastructure to deliver economic objectives such as employment, investment, production and price stability. The Keynesian economic policy of demand management was widely accepted as *carte blanche* in the many developed countries particularly from mid 1930s up to the mid 1970s.

It is claimed in the literature that though these policies were effective in generating employment and in stimulating growth within the targeted sector of the economy particularly in Latin American and Sub-Saharan Africa, these policies nevertheless resulted in resounding failure (Tangri, 1999).

The literature shows that the structure of development through the representation of state appointed institutions and centrally planned policies were more conducive to the spread of rent and rent related activities than in generating sustainable growth rates which eventually weighed down on the prospect of growth (Rowley, 2000, 1998).

The second approach adopted by developing countries following the re-examination of the state oriented policy was the market oriented approach. The market oriented approach was favoured and supported by many writers on neo classical economics from the mid 1970s onwards. The neo classicalists considered the market centred policies as significant explanatory for successive economic growth rates among the developed and developing countries (Solow, 1956, Swan, 1956, Cass, 1965). The market oriented approach which is located within the neoclassical theory of economic growth was extensively applied by the IMF and the WB in prescribing economic policy solutions to the problem of allocation, utilisation and distribution of resources among the developing countries facing the problem of underdevelopment.

The economic solutions favoured by neo-classicalists typically involved a dominant role for the private sector and a minimal role for the state in intervening in the economy. The implementation of neoclassical economic policies has been the cornerstone of reform in many developing countries in the 1980s and 1990s. Although liberal economics is the most favoured approach, the literature shows that liberalisation of the economy does not automatically translate to higher growth as advocated by neo-classicist writers.

According to the literature this is largely because developing countries are forced to liberalise without proper institutional conditions in place. The institutional conditions and good quality of governance are needed in order to manage and execute the market friendly policies within every sector of the economy (Kauffmann, Kraay and Zoidi-Lobaton, 1999a, 1999b, 2002, Kauffmann and Kraay 2002, 2007, Kauffmann 2005, North 1990).

The literature claims that because the extent of political influences within the economic sectors were so pervasive during the years of state centred approach the association between politics and economic sectors have made the process of shifting from state to market approach an onerous task.

It is also argued by the critics of the market that the deeply entrenched political interest within the economic institutions over the many years can make the process of liberalisation to market policies to be susceptible to politicisation of the economic markets and thereby undermine the objective of liberalization (Dreher, 2005).

According to the neo-classical writers on development, many of the challenges faced by the developing countries today are to do with institutions, governance and other appropriate arrangements in implementing the sets of liberalisation within the various sectors of the economy.

It appears from the literature that as more and more developing countries are repositioning their policies from state to market approach to development in pursuit of economic development, the debate on institutions and the determinants of good institution is also gaining currency in the literature on development (Kauffmann and Kraay 2002, 2007, Kauffmann 2005, North 1990).

In this thesis it is the institutional aspect that will be considered by studying the case of the Kenyan coffee industry and by arguing that in order for the liberalisation of the Kenyan coffee sector to be successful institutions must be in place prior to designing and implementing the

terms of liberalisation as shown in Chapter 1. This is crucial for the liberalisation programme to be successful in generating the expected market oriented outcomes.

In the next chapter, we consider some of the methods and techniques that will be used in addressing the question of liberalisation and its impact on the Kenyan coffee sector.

Chapter 3

Methodology

3.1. Introduction

This chapter explains the method and techniques used in this research. The first part of the chapter presents the research approach used in relation to the aim and objectives of the thesis; the second part discusses the interview questions used in this thesis; the third part identifies the secondary sources of data used and the fourth part discusses the qualitative and quantitative methods used to identify and extract the main themes and findings from the primary and secondary data sources. In addition, the existing method of assessing the impact of the IMF programme on economic development is reviewed and some discussion on why the particular analysis method is selected in this thesis is presented before drawing the chapter to a conclusion.

The qualitative data are mainly gathered from the primary source, i.e. interview and the quantitative data are gathered mainly from the secondary sources i.e. statistical sources. The details of secondary and primary source of data used in this research are discussed in this chapter.

3.2 Time period under study

The period of study considered in the study of the Kenyan political economy of development is from 1980 to 2004. The period is selected because during this period Kenya had undergone changes in its political systems from multi party to single party and then to multi party again. The changes in the political system also reflected changes in the economic policy from colonial style central planning to state central planning and then followed by gradual economic liberalisation. Table 3.1 below shows the different political system and leadership in Kenya from 1963 up to present day.

Table 3.1 Political systems of Kenya

Political system	Period	Presidency
Multi-party	1963 to 1978	Kenyatta
	1978 to 1982	Moi
Single-party	1982 to 1992	
Multi-party	1992 to 2002	Kibaki
Multi-party	2002 to present	

The changing nature of the political structure in Kenya helps to explain the extent to which the political factors influence the state and market policies and their impact on the various institutions in delivering the much cited goal of growth and poverty reduction.

The next section below is devoted to a brief discussion on the interview data which is used to explore the aim and objectives of this thesis with reference to the political economy of development of Kenya. This is done by undertaking a series of interviews with the various respondents in Kenya. More on this is discussed below.

3.3. Interview data

The primary data for this thesis is collected by face to face interview. The primary data is needed to verify and support the argument, debates and controversies identified from the secondary sources. The primary data offers an insight to the subject in detail by linking the effects of liberalisation on the economic development within the specific sector from the individual and organisational perspective. The interview questions are aimed at collecting views and comments directed on liberalisation and institutions and the role of politics on the economic development of Kenya. The lists of questions and the agreement forms used in this research are attached in Appendix 1 of the thesis.

The qualitative data from the interviews offers more than analysis of numbers; it offers meaning and explores the issue with a personal experience unlike the secondary statistical data (Silverman, 2000). In this research the candidate used the qualitative method for evaluating the impact of liberalisation on the economy. The evaluation is aimed at elucidating and understanding the internal dynamics of the coffee sector operations from the top policy makers, the coffee growers and other stake holders in the industry (Patton, 1987, pp 26).

The collection of primary data involved collaboration with three institutions in Kenya. This was to enable the data collector to access the sensitivity of data and to seek help in accessing and making appointments with the members of the sample group. The three collaborating institutions are: (1) the Institute of Development Studies (IDS) which is part of the University of Nairobi (UoN); (2) the French Institute for Research in Africa which is part of the French Embassy in Nairobi and; (3) the Coffee Board of Kenya (CBK). Partnership with these three Nairobi based institutions was established before the data collection process began in August 2005. The links were established through recommendation from colleagues and fellow researchers at research conferences and meetings.

In total 23 face to face interviews were undertaken. The sampling technique that best described the collection of primary data in this research is purposive sampling.

Patton (1990) identifies 15 different purposive sampling cases under non-random sampling in qualitative research and they are:

1. Extreme or deviant cases
- 2. Intensity**
3. Maximum Variation
4. Homogeneous
5. Typical cases
6. Stratified purposeful
- 7. Critical case**
8. Snowball of chain
9. Criterion
10. Theory based
11. Confirming or disconfirming
12. Opportunistic
13. Random purposeful
- 14. Politically important**
15. Convenience

In this research I will use: (i) intensity; (ii) critical case; and (iii) politically important cases of purposive sampling because it best captures the characteristics of the sample considered in this thesis.

Intensity cases are samples that are information rich that manifest the phenomenon intensely, but not extremely. For example cases such as good/poor and above/below average. Critical cases are samples that allow logical generalization and the full application of information to other cases, because if It is true in one case It is likely to be true in all other cases. Politically important cases are samples that attract attention to politically sensitive cases. This research mainly falls into the domain of politics, economics and liberalisation hence it directly attracts politically sensitive sample cases (Patton, 1990).

The set of characteristics that were considered when short-listing the sample group are: unbiased views; high probability of reliance; consistency; reflects detail; demonstrates role

of decision makers; gives an idea on the potential for circumventing the law and gives some idea on the beneficiaries and losers from the decision making process in the coffee sector. The aim of selecting a purposive sampling technique is to reflect these characteristics. These characteristics act as parameters of the population and are used to select the sample case carefully on the basis of the characteristics. This method of sampling technique is supported by Denzin and Lincoln (1994).

The participants listed below reflect all of the characteristics described in the purposive sampling technique discussed. The sample participants and their role include:

- a) Policy makers in the Ministry of Agriculture in charge of agriculture, land and coffee reform issues. These included three representatives to the Secretary of the Ministry of Agriculture. The three interviewees were involved in the negotiations between the Kenyan Ministry of Agriculture and the IMF, therefore offering detailed insight to the terms and conditions of the coffee reform issues.
- b) Senior official within the Coffee Board of Kenya charged with dealing with small and large scale coffee farmers. The senior officer has a wealth of experience in visiting and explaining to the farmers the benefits of coffee reform, in particular to the small holders. This officer was instrumental in organising and arranging interview sessions with the coffee small holders in the rural and outskirts of Kenya.
- c) Coffee traders who buy coffee at the Nairobi Coffee Exchange (NCE) for export purposes. I had the opportunity to interview two coffee traders, both of whom have been involved in coffee trading for more than 10 years in Kenya. They buy coffee from the NCE and then re-export it to European countries like Germany and the UK. The traders are Kenyan registered companies who engage in the weekly auction in the NCE.
- d) Small scale farmers from the Kikuyu background who have had experienced farming coffee in the pre and post liberalisation period. I met about 7 small scale farmers in their local farming area in the outskirts of Nairobi. The farmers showed me their farming area and the machinery and tools used by them in their day to day activity. These farmers offered rich insight into the impact of change of policies during the rule of President Moi and then later by President Kibaki. These farmers were all affected by the various policies under both the leaders in Kenya.
- e) Large scale farmers from a Kikuyu background – who have had experienced farming coffee in the pre and post liberalisation period. This large scale farmer was located about 40 kilometres outside of Nairobi. During the three hours visit to this farm I had the opportunity to speak to the owner and the manager of the farm. The manager of the farm also took me for a tour of the farm and showed me the

- f) Kenyan government official who deals with coffee marketing and export related issue at the international level. I met this official based in the Kenyan Embassy in London several times and had the opportunity to speak and discuss with him some of the details of Kenyan government marketing strategies for the promotion of Kenyan coffee. This official eloquently described the ethnic politics involved in the Kenyan coffee sector.
- g) Academics involved in the political economy research of Kenya. I had met two academics at the Kenyan Political Economy conference in Oxford University in the UK and I had maintained good regular contact with them. One was from the Institute of Development Studies of the University of Nairobi and the other was from the French Institute for Research in Africa, both based in Nairobi. In my visit to the these two institutes I interviewed the research associates on the political economy of Kenya and a researcher on the ethnic politics of Kenya based within the French Institute for Research in Africa.
- h) Officials working in the Nairobi Coffee Exchange (NCE) who are able to give their opinion based on quantitative data. I met and interviewed the head of the research team within the NCE. The researcher also shared and showed me the data on the weekly coffee auction transaction that takes place in the NCE. The head of the research also explained the type of farmers who seek for information on the transaction and those who don't.
- i) Coffee marketing agents that are involved in dealing with local coffee cooperatives and large estate farmers. I interviewed an agent from the KPCU who have been with the organisation for about seven years; therefore he was able to explain the type of policy changes initiated by KPCU and highlight some of the type of resistance expressed by the farmers towards the changes. The other agent that interviewed was from Thikka Coffee. This agent has been in the coffee business for more than 10 years and was able to offer plenty of observation on how the coffee sector has changed in Kenya.
- j) Senior member of the Ministry of Cooperative who handles cases of local cooperative before and after the process of liberalisation of the coffee industry. I interviewed this officer as he was the personnel in charge of registration and deregistration of coffee cooperatives in Kenya. The senior officer was able to explain some of the reasons behind the formation and dissolution of coffee cooperatives.

- k) Business organisation dealing with input material to the coffee sector in particular. I briefly interviewed the manager of a machinery shop that sells coffee processing equipment. This shop was located within the KPCU building and given KPCU is the largest marketing agent and the oldest coffee farmers association, the KPCU building is regularly frequented by all types of coffee farmers, be they of Kikuyu ethnic group or other ethnic groups, small or large farmers or whether they are part of the cooperative or not. Therefore the manager of the shop was able to offer interesting views on the type of farmers that seek different terms and conditions on payment.
- l) Bankers dealing with coffee sector and other small business credit facility. The two bankers I interviewed have been dealing with credit applications from coffee farmers for about 6 years and they were able to explain how the commercial banks have gradually changed their terms in offering credit facilities to the farmers. The bankers were also in a credible position to offer interesting trends on how small scale farmers are often penalised with interest repayment rate because of their weaker bargaining power compared to the large scale farmers.

The participants listed above were either representing themselves, their organisation or the government of Kenya (GOK). They can be categorised into the following category: politics; interest groups; civil servants; farmers; academia; and the private sector. Each of these participants represents a rich set of characteristics identified in this study and can therefore help to minimise any extreme biases or errors when aggregating and analysing the qualitative views.

Each of the interview sessions lasted from an hour to two hours. As a general rule it was decided that any interview under half an hour is unlikely to be valuable (Robson, 2002). In some cases the interview was longer than expected. This was because the interview exchange was taking place while the interviewee was presenting a demonstration or was giving answers while on a tour of the factory or the farm. In all instances it was the interviewer who brought the interview to a closure and terminated the exchange.

The interview exchange was recorded in a mini recorder and transcribed later. The interviewer undertook three pilot interviews in order to ascertain the sequence and the validity of the questions in fulfilling the research aim (Bouma and Atkinson, 1995). All the interview questions and the interview exchanges were conducted in English. The aim of the pilot run was to elicit data and minimise any disruption and wasteful interview exchanges (Bouma and Atkinson, 1995).

The feedback from the pilot stage of interview revealed that some of the questions were closely related to each other while others contained 'leading' elements in it. After taking into account the feedback from the pilot interviews, the interviewer modified the interview schedule by eliminating some questions and adjusting the sequence of the questions.

All of the questions were open ended so that wide range of issues within the subject of politics, economics and liberalisation can be covered freely. The use of closed ended question with a fixed scale is not suitable for this research. This is because a closed ended questionnaire does not help capture the details, the personal experience and perception of the stakeholders explored in this research.

The perceptions may include things like, feeling of optimism or pessimism on the prospect of the industry, signs of favouritism from the state for certain sector of the population, risk of corruption, general outlook of the government policy, view on the institutions and in addition an open ended questionnaire allows the respondent to explore sensitive information freely without closed or fixed format in answering the questions. All of these allow the information gathering process to be valuable and not passive with the respondent merely ticking boxes in a pre-set option format. Added to this, since the sample group in this research is small in size but rich in characteristics, the objective should therefore be to obtain an in-depth qualitative data (Baxter and Hughes, Tight, 1996) and not an extensive breadth of data. Therefore only open ended questions can reveal the rich qualitative data required to fulfil the research aim and objectives in this research.

Unlike the closed ended questions, the coding categories of open ended questions have to be decided after the interview process. This is in order to see the range of answers produced from the questions posed. Open ended questions takes longer to collect and analyse than closed ended questions. However open ended questions yield richer data than closed ended. Open ended questions also help sustain rapport and stimulate the participants to thinking and arguing in defending their answers (Ackroyd and Hughes, 1992). This is crucial in this research because of the need to find the interconnection between economics, liberalisation, politics and the coffee sector institutions.

Each question that is posed to the respondent contains only a single idea which may mean it only requires a single response. However the interviewer should be flexible to allow the respondent the freedom to express and relate other points that maybe relevant to the research aim and objective of this study.

Although short questions are desirable, priority was always given to clarity when developing the questions. The use of economic jargon was minimised and preferably avoided, instead ideas were presented in a simplified fashion. In short when designing the questions in this study, the following was taken into account:

- a) Clarity of questions
- b) Avoidance of double barrel questions
- c) Competence of the respondents to answer
- d) Relevance of the questions
- e) Brevity and clarity of the question
- f) Avoidance of negative terms
- g) Avoidance of biased terms

These factors are also highlighted by Babbie (1995) as vital features in developing questionnaires.

The interview data was validated in two ways. The first is by presenting to the interviewee a release form declaring that the interview exchange did take place at the time, date and venue. Here the interviewer and interviewee would both sign the memorandum before the start of the interview. Second, since the interview is recorded it can be used to verify the validity of the data should there be any ambiguity in the data analysis and interpretation. The release form is attached in Appendix 2 of this thesis.

Upon successful primary and secondary data collection, the data is then analysed to identify meaningful trends and themes in order to fulfil the research aim and objectives. The next section describes how the qualitative and quantitative data from primary and secondary source is analysed.

In order to investigate the research problem relating to development and liberalisation we need the relevant secondary data to assess the impact of liberalisation on the economic development in addition to the interview questions. The quantitative data is therefore used to support the arguments and supplement the research findings from the qualitative data source. The sources and type of secondary data will be discussed in detail in the next section.

3.4 Secondary data

The secondary data in this thesis are mainly gathered from statistical publications, specifically from: the African Development Indicators for the year 2003; the World Bank and IMF online databases; reports, specifically from the Assessment of the Value-Adding Opportunities in the Kenyan Coffee Industry by the European Commission and; the Kenya Economic Survey published annually by the Government of Kenya (GOK).

The World Bank which is in charge of providing finance and advise to developing countries mainly on the subject of poverty contains the best source for statistical data relating to development and growth. Cross country data on macroeconomic variables are available from the World Bank database website portal.

The IMF which is the international institutions responsible for ensuring the stability of the international monetary and financial system is also the foremost organisation that offers technical and financial assistance to member countries that are undergoing economic transition to liberalisation. The IMF is also extensively involved in sponsoring economic liberalisation policies to member countries that request for its help. The IMF statistical and technical data on its 184 member countries are available from the IMF portal on Data and Statistics website. These secondary sources consist of all the necessary quantitative data in order to develop the argument and comparisons between the economic position and indicators of Kenya and other developing countries over the period from 1980 to 2004.

Other statistical data that will be used to support the arguments in this thesis includes the Human Development Index (HDI) which is published by the United Nations, and the Transparency International (TI) which is the world authoritative statistical literature on addressing corruption worldwide. The TI contains data on corruption perception and a comparative listing of corruption worldwide. The data from HDI and TI forms the discussion on the social and welfare position of Kenya and its people. The purpose of exploring the social and welfare state of Kenya is to identify and support the argument that economic problem is not purely an economic problem but rather a wider problem that afflicts the generality of the population and bears a cost on them. The data from HDI and TI offers a credible source of reference to this argument.

Freedom House Index (FHI) is another reputable survey that is widely acknowledged in credible academic journals as an authoritative source for worldwide surveys on the subject of civil liberties and political rights (Dreher, 2004). The index on civil and political rights is the most commonly used indicator for discussing the level of freedom in a country with

reference to the state of social affairs in a country and its relevance to the economic development. The purpose of using the Freedom House Index surveys in this thesis is to support the argument that political and civil rights freedom does have an important link to the level of economic development, especially through the various institutional channels. In order to support the argument that curtailment of political freedom does have an impact on the institutions, we use the FHI survey to demonstrate this.

The statistical data from the secondary sources discussed above are extensively used and analysed in supplementing the arguments from the qualitative secondary and primary data, particularly those relating to the subject area of politics, economics and liberalisation.

Most of the secondary qualitative data are gathered from published academic journals that are available in hard and electronic format. The electronic copies are mainly available from the Science Direct database website. Other valuable websites sources includes the United Nations, the IMF, the WB, WTO, Human Rights Report, The Economist, the BBC, CNN and the Kenyan Daily Nation news and other reports and articles. All of these sources contain many references to the developing countries, Sub-Saharan Africa and Kenya. All of these sources are updated and available on the internet.

In order to investigate the Kenyan coffee sector and how it is influenced by the political economy of Kenya, specific secondary qualitative reports and articles on the coffee industry will be gathered from the Coffee Board of Kenya and the Kenyan Ministry of Agriculture. In order to support or refute the claims from the interviews with the sample group, data from the published academic articles and report from the International Coffee Organisation is also consulted.

The table in Appendix 3 presents all the electronic and non-electronic sources of quantitative secondary data used to develop and support the arguments in this thesis. Though the list of variables identified in the Appendix 3 contains differing characteristics, methodology and data collection techniques in measuring and reporting the respective indicators, what they all have in common is the connection to the arguments in this thesis. In the next section a brief description on how the qualitative and quantitative data is analysed and developed into an argument is presented below.

3.5. Data analysis

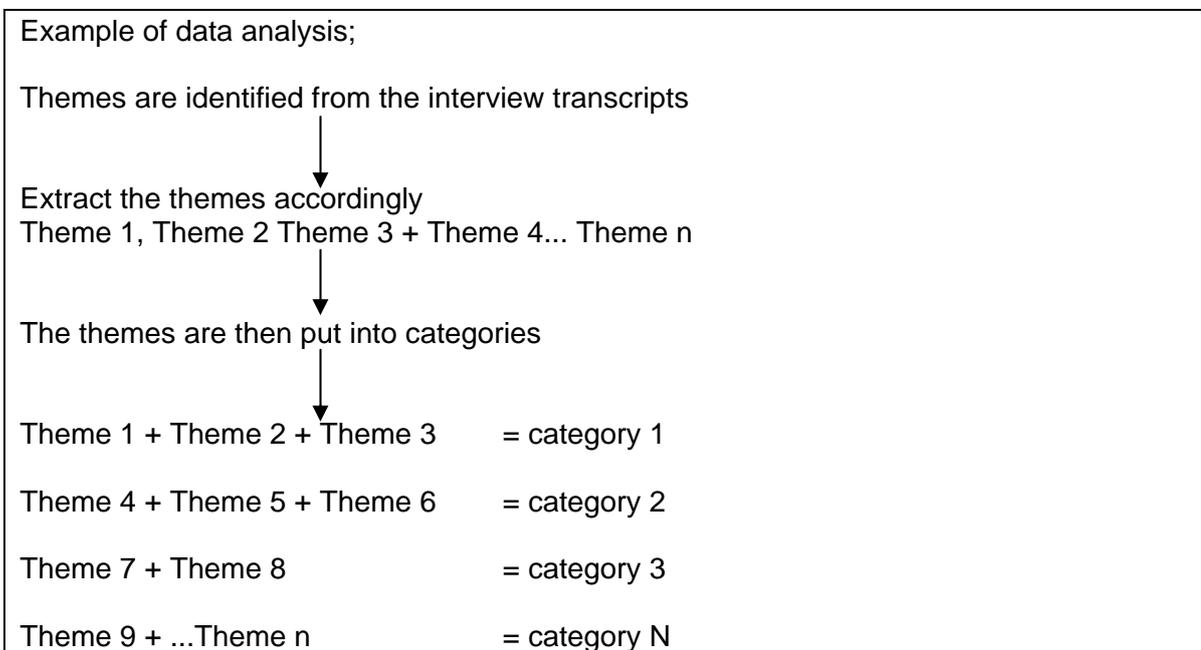
The qualitative data are mainly drawn from the interview sessions and the quantitative data drawn mainly from statistical reports are analysed using different techniques and they are discussed below.

3.5.1. Qualitative data analysis

The qualitative data are analysed by identifying the key themes emerging from the set of interview data. This is done using the N-Vivo 2.0 software package. These themes are then used to trigger N-Vivo to extract the themes from each of the interview transcripts. The technique used by N-Vivo is by extracting and labelling the source of the theme so that it can be traced to the original interview transcripts.

The collated themes are then aggregated into several categories. These categories form a template (matrix) for arranging other data (like secondary qualitative and quantitative data) into the relevant sections of the template. See table 3.2 below for summary of the data analysis technique.

Table 3.2 Summary of how data is analysed



Category 1	Category 2
Theme 1 Theme 2 Theme 3	Theme 4 Theme 5 Theme 6
Category 3	...Category N
Theme 7 Theme 8	Theme 9... Theme n

(Source: Author generated)

Table 3.2 above offers a structured way of analysing qualitative data. This process of analysis is based on data reduction and interpretation (Marshall and Rossman, 1999). This structure also helps to analyse other qualitative data that may not have emerged from the interviews. The matrix methodology represents the main tool for analysing qualitative data. The matrix structure helps to keep the analysis coherent and comprehensive. The various sections of the matrix are also used as sub-sections in the data analysis chapter.

Since most data in this thesis are of a qualitative nature, the various texts forming sentences and paragraphs in the interview transcripts contains relevant and irrelevant pieces of raw information. In order to extract only the relevant points, the themes have to be identified. The relevance of the data is validated against the research aim and objectives as set out in this thesis. Therefore the views expressed at the interview stage can be analysed without losing any of the essential elements in it. This is the best way to analyse the qualitative data because it offers structure, meaning, and coherence and helps bring convergence among the constituent themes from the interview data. In other words this methodology allows the analysis to take place by discovering the underlying meanings and patterns of the interview exchanges (Babbie, 1995).

3.5.2. Quantitative Data Analysis

The quantitative data in this research are analysed using descriptive statistics (Ackroyd and Hughes, 1992). Quantitative data is analysed using Statistical Package for Social Sciences (SPSS) software version 13. Quantitative data from secondary sources like the Human Development Report, IMF Data and Statistics, World Bank report, Transparency International and other statistical data are analysed using the SPSS software package.

Descriptive statistics is used to summarise and present the data in visual charts.

According to Dreher (2004, pp. 8-9) there are three main principle methods used in evaluating the effectiveness of an IMF programme in countries where the IMF programmes are implemented. These methods are:

(1) Before - after analysis – This is a straight forward method which compares the economic growth before the IMF programme has been approved and after the approval of the IMF period. The differences in the value of the economic growth are then attributed to the programme. The criticism of this method is that it treats the participation of the IMF programme as exogenous. In fact in almost all cases the participation of a member country is usually as a consequence of some economic crisis and not otherwise.

(2) Using control group – This method evaluates the IMF impact on growth by comparing the growth rates in countries with and without IMF programmes. The problem of using this method is in identifying the suitable control group that is in the same initial position. Also the IMF programmes are specifically designed to suit the requirement of member countries and the programmes are not distributed randomly.

(3) The third method is regression analysis – This method is effective when the variables that affect the outcome of the model are taken into account and the variables are separated to test the effects of IMF's advice and compliance with conditionality from the IMF money. By using regression analysis endogeneity of the IMF's related variables are taken into account. Studies by Przeworski and Vreeland (2000) and Barro and Lee (2001) have used this technique and the effectiveness of this method is acknowledged to be the most promising according to Dreher (2004).

In this thesis, the analysis is done using qualitative data. The regression method will not be used in this thesis because it is more relevant to analysis using quantitative data set. However the use of regression method by other writers are mentioned and summarised in the table below.

In this thesis, the method of interview will be used to assess the impact of the IMF programme on the economic growth of Kenya, covering the period from 1980 to 2004. This is done with reference to the set of coffee sector macro variables. The details of the macro variables and its relevance to the coffee sector are discussed in the next chapter. However other methodologies of assessment are also presented in Table 3.3 below.

Table 3.3 below from Dreher (2006, p.773) presents a summary of the writers and the different methodologies they have adopted in their research when assessing the impact of IMF on economic growth.

Table 3.3 IMF and Economic Growth

Study	Period	Number of Programs	Number of Countries	Effect on Growth
Before-After				
Reichman and Stillson (1978)	1963-72	79	n.a.	Increase
Connors (1979)	1973-77	31	23	None
Zulu and Nsouli (1985)	1980-81	35	22	None
Killick (1986)	1974-79	38	24	None
Pastor (1987)	1965-81	n.a.	18	None
Killick, Malik and Manuel (1992)	1979-85	n.a.	16	Increase
Schadler et al. (1993)	1983-93	55	19	Increase
Evrensel (2002)	1971-97	n.a.	109	None
Hardoy (2003)	1970-90	460	69	None
With-without				
Donovan (1981)	1970-76	12	12	Increase
Donovan (1982)	1971-80	78	44	Decrease
Loxley (1984)	1971-82	38	38	None
Gylfason (1987)	1977-79	32	14	None
Faini et al. (1991)	1978-86	n.a.	93	None
Hardoy (2003)	1970-90	460	69	None
Hutchison (2004)	1975-97	455	25	None
Regression-based				
Goldstein and Montiel (1986)	1974-81	68	58	None
Khan (1990)	1973-88	259	69	Decrease
Doroodian (1993)	1977-83	27	43	None
Conway (1994)	1976-86	217	73	Increase
Bagci and Perraudin (1997)	1973-92	n.a.	68	Increase
Bordo and Schwarz (2000)	1973-98	n.a.	24	Decrease
Dicks-Mireaux et al. (2000)	1986-91	88	74	Increase
Przeworski and Vreeland (2000)	1970-90	465	135	Decrease
Barro and Lee (2001)	1975-99	725	81	Decrease
Easterly (2002)*	1980-99	107	107	None
Butkiewicz and Yanikkaya (2003)	1970-99	407	n.a.	Decrease
Hutchison (2003)	1975-97	461	67	Decrease
Hutchison and Noy (2003)	1975-97	764	67	Decrease
Nsouli, Mourmouras, Atoian (2003)	1992-2000	124	92	None

* This study focuses on IMF and World Bank programmes

(Source: Dreher, 2006, pg. 773)

Chapter 4

Governing the Kenyan coffee sector

4.1. Introduction

This chapter is going to explore the political economy of coffee production in Kenya by setting the development of the Kenyan coffee industry in the context of the Kenyan economy and the global coffee market. It shows the way in which state oriented and market oriented approaches were mobilised in the development of the sector from the colonial period up to the present day in order to illustrate how the state centred institutions and policies affected the development of the coffee sector from the 1980s up to the year 2000 when reforms were introduced to address the long-established and well-institutionalised patterns of action within the sector. This chapter will highlight some of the problems rooted in the highly regulated structure of the coffee industry from the colonial period up to the reforms in 2001, and identify some of the changes to the way the coffee sector and farmers are structured and organised under the IMF liberalisation programme.

4.2. Background to Kenyan coffee

Coffee is the second most valuable traded commodity after oil in the world (International Coffee Organisation: ICO, Website). In 2006, the global coffee export was worth about USD 9 billion, supporting about 25 million coffee growing families in about 50 countries around the world (*The Economist*, January 25th 2007). Global coffee sale accounts for over USD 75 billion in retail sale annually (ICO, Website).

Coffee is the most important natural resource of Kenya and Kenya is the largest producer of the finest Arabica coffee in the world (Akiyama, 1987 and ICO, 2006). This is attributed among others to its excellent climatic and soil conditions which are appropriate to coffee growing. Arabica is a higher quality mild coffee than Robusta. Robusta is priced lower and its quality milder than Arabica. Brazil is the leading producer of Arabica and Robusta coffee combined together in the world (ICO, 2003). Other main coffee exporters of Arabica and Robusta includes Colombia, Costa Rica, Ethiopia, Ivory Coast, Indonesia, Peru, Guatemala, Uganda, Mexico and more recently Vietnam (ICO, 2003).

Kenyan coffee production is almost exclusively concentrated in producing Mild Arabica coffee. Coffee was also the first commodity from Kenya to be exported to the global market started by the British traders during the colonial period in the late 19th century

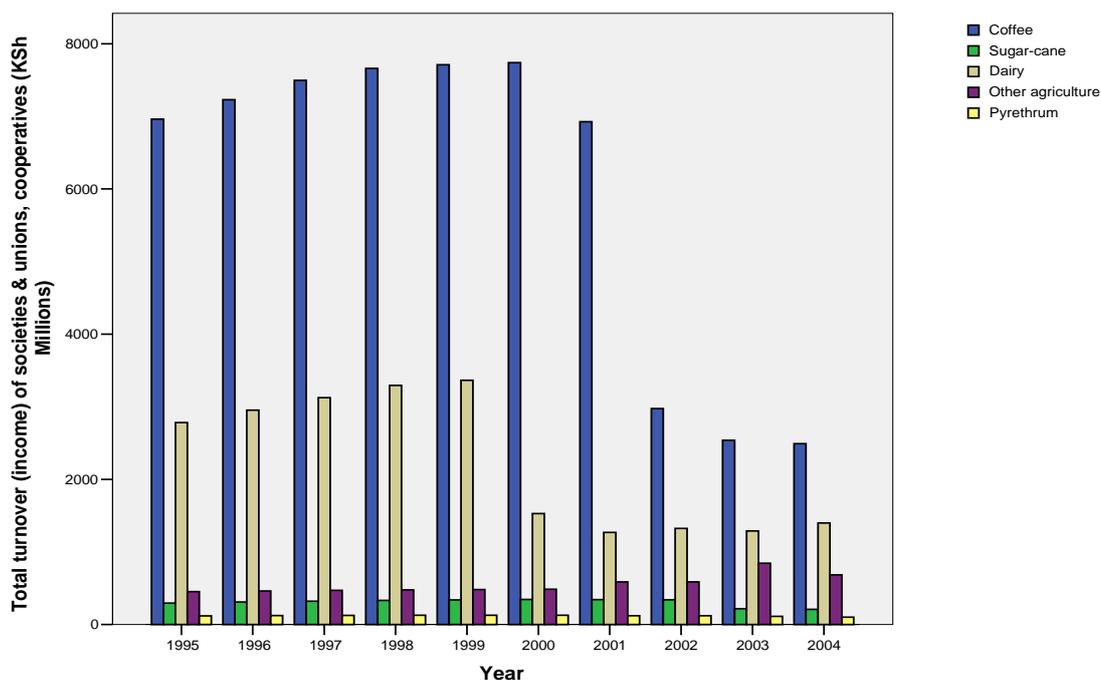
(Leys, 1975). The prosperity of the settlers in Kenya during the colonial period largely depended on coffee growing and trading to the lucrative European markets in the 1900s (Leys, 1975). The coffee sector also provided employment to millions of indigenous Kenyans, especially to the ethnic Kikuyus as labourers in the settler controlled coffee farms.

Coffee production in Kenya is split between smallholders and large estates. Smallholders produce about 60 percent and estates about 40 percent of the total production. Coffee and other agricultural products are processed and marketed through a network of local and regional cooperatives throughout Kenya. In 2005, about 5.6 million people are members of cooperatives and about 20 million Kenyans either directly or indirectly derive their income from the cooperative movements (International Co-operative Alliance, 2006).

A cooperative society is a collection of many small cooperatives. It is compulsory for coffee small holders in Kenya with less than five acres to become a member of local cooperative. In 2004 there are about 500,000 small scale coffee producers in Kenya (International Co-operative Alliance, 2006). Prior to the coffee sector reform in 2001, there was only one marketing agent: the public owned enterprise Kenya Planters and Cooperative Union (KPCU) which was the monopoly provider of marketing and milling to the coffee sector (CBK, various years).

The importance of coffee to the Kenyan economy in terms of income, employment and export is illustrated in Table 4.1 below which shows the amount of turnover received by each of the major agricultural cooperative societies in Kenya from 1995 to 2004 (Kenya Government Statistics, 1996 to 2005). Evidently the coffee cooperative is the largest recipient of income among the agriculture sector cooperatives, though the decline in turnover since 2002 has become more pronounced for all commodities. Figure 4.1 below illustrates coffee is the most lucrative sector in terms of turnover within the agricultural sector of Kenya; therefore any major policy shifts in the coffee sector will have a major impact on the coffee sector and the economy in general.

Figure 4.1 Total turnover of cooperatives, unions and societies (1995 to 2004)



(Source: Kenya Government Statistics, various years)

The bulk of the coffee produced by the small and large estate farmers in Kenya are exported to foreign markets of the European Union and North America. These countries prefer Kenyan coffee for its 'acidity' taste and are therefore willing to pay a premium price for it. Countries like Japan and US do not value 'acidity' of the Kenyan coffee so much, hence are less willing to pay premium for Kenyan coffee (Akiyama, 1987), though this maybe changing with modern blending methods.

Apart from coffee, Kenya also produces other agricultural products like tea, sisal, sugarcane, horticultural products, corn, wheat, rice, pineapples, pyrethrum, dairy products, meat and meat products, hides and skins. Tea and coffee are the two most important agricultural exports crops of Kenya (International Food Policy Research Institute, (IFPRI, 2004). Fruit and vegetable exports are also increasingly gaining importance, i.e. four fold increase in constant dollar terms since 1974 (IFPRI, 2004). Despite the competition from other export commodities, quality coffee has always been associated with Kenyan premium Arabica coffee in the global market.

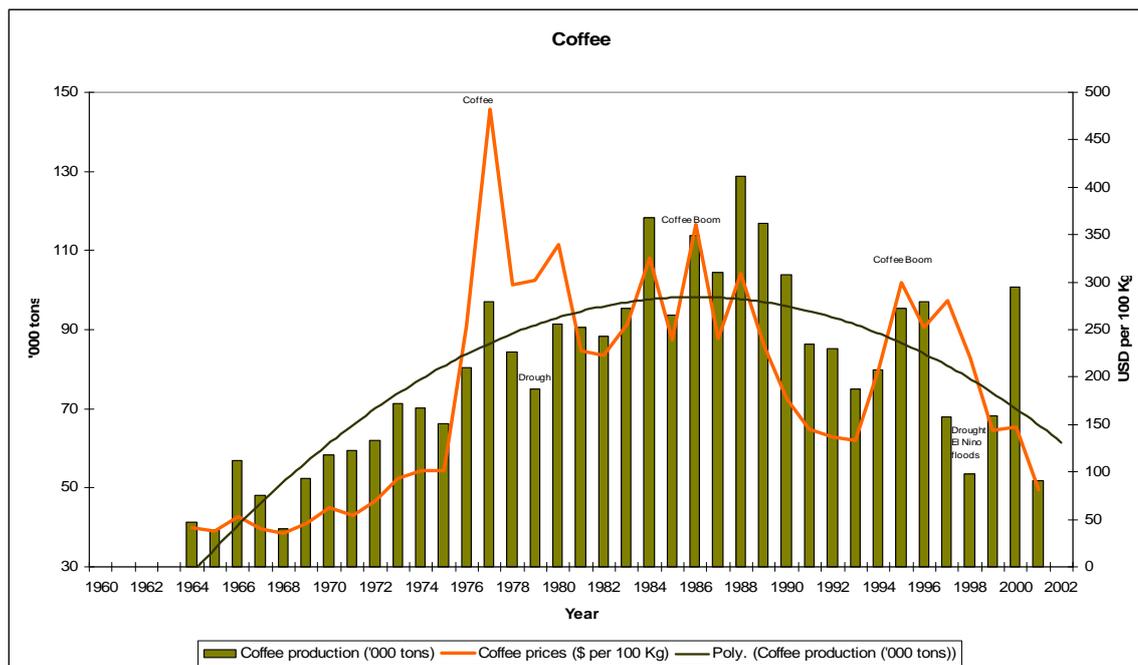
Figure 4.2 below shows Kenya coffee production from 1960 to 2002, the coffee boom from 1976 to 1979 significantly contributed to the rise in revenue and income of coffee farmers in Kenya. The main cause of the boom was the frost in Brazil which damaged the coffee tree crop which created a supply shortage but did not destroy the tree stock altogether thereby increasing the price of coffee in Kenya in the short term. The boom allowed the Kenyan economy to achieve a very high level of coffee export revenue from

this windfall (Bevan, Collier and Gunning, 1987). Neither the peak prices of 1987 nor the tax free enjoyed by the coffee growers and traders in the later period ever returned the level of export revenue gained from the 1976-77 peak period.

On the other hand, the coffee boom also signified the extent to which the Kenyan economy was exposed to the changes in the world coffee market and to weather vagaries. After nearly 40 years of independence, the Kenyan economy is still heavily dependent on the agricultural sector, with the coffee sector playing a significant part with about 10 percent of total export earnings, in 2000, and 6 percent in 2001 (Karanja and Nyoro, 2002), therefore increasingly subjecting the fortunes of the Kenyan economy to the changes in weather and world prices for generating revenue, employment and in maintaining the trade balance.

In 1987/88 production of clean coffee was at 130,000 tonnes, however during the 1990s production averaged only 77,514 tonnes (Karanja and Nyoro, 2002, page 5). The decline in production was significant among smallholders falling by 47 percent in the 1990s period (Karanja and Nyoro, 2002). The decline in production among the smallholders is a major 'quality reputation' problem because it is the smallholders who produce the best quality coffee measured by the price it fetches at the international market, which help influence the premium price for the Kenyan coffee brand. In the next section the history of coffee production in Kenya is discussed in order to identify the elements of policy developments within the state sponsored institutions of the Kenyan coffee sector from the colonial days up to reform years in 2000. By tracing the development of the policies we are able to discern the extent to which poor policies are responsible for the poor performance of the Kenyan agriculture in general and the coffee sector in particular.

Figure 4.2 Kenya coffee production – 1960 to 2002



(Source: Legovini, A (2002) Kenya: Macro Economic Evolution Since Independence, pg. 43)

4.3. Establishment of coffee production in Kenya

Cultivation of coffee in Kenya began around 1896 when white settlers established plantations in locations where the native Kenyans, mostly the Kikuyus ethnic group, were employed as indentured labourers. Coffee farming was an exclusive economic privilege of the colonial settlers. Africans were not allowed to grow coffee for commercial purposes (Hornsby and Throup, 1998, Killick, 1983). The repressive colonial policy was aimed at keeping the locals out of the most lucrative sector of the economy.

Coffee marketing under the colonial government was controlled by a range of institutions, the chief of which was the Coffee Board of Kenya (CBK) established in 1933 by the GOK.

In the case of the CBK, the institution was empowered to issue licenses for the growing of coffee in designated areas, to authorise coffee dealers, to approve the operation of coffee marketing agents, coffee millers, auctioneers, warehouseman and coffee packers. In addition to these duties the CBK also regulated coffee quality and promoted the industry at the international export market.

The extensive role undertaken by the CBK at the time of Kenya's independence was aimed at controlling the economic activities of the sector and to directly influence the

sector through a top down approach with policies and regulations streaming from the Ministry of Agriculture to the CBK, the KPCU and finally to the producers through a series of networks of local and regional cooperatives.

Through this top-down approach the government could keep tab of the changes within the sector, apply policies and monitor performance and attempt to institutionalise political elements within the institutions and other public sector agencies.

The establishment of the CBK was followed by the acquisition of a coffee estate in the Ruiru region in 1944, with the aim of converting it into a private research station where experiments of input fertilizer and cross breeding could take place. This research and development programme was an attempt to institutionalise the R&D activities of the industry in addition to improving the Kenyan coffee yield. This research station gradually evolved to become the Coffee Research Foundation (CRF).

In addition to the CBK, the CRF was now supporting the expansion of the coffee sector through institutionalised R&D. The CRF was funded through an ad-valorem levy on the sale of coffee. Today the CRF is still being funded by 2 percent levy on the coffee auction proceeds (Kenya European Commission, 2004). In addition to auction proceeds, other sources of funding come from government and consultancy services offered by the foundation.

One of the major support networks which proved crucial for the expansion of the coffee sector was the amalgamation in 1954 of the coffee milling factories into a network of factories under a single operator called the Kenya Planters Cooperative Union (KPCU), (Kenya European Commission, 2004).

The KPCU was the first commercial institution established to serve the interests of coffee farmers from across the country. The KPCU members consisted of small, large, European and non European coffee farmers. KPCU is an institution owned collectively by all coffee farmers, whether small or large estate operators (CBK: Coffee Traders Licensed Dealers, 2007). The purpose of KPCU was to offer cost effective processing of coffee and to auction the processed coffee on behalf of the farmers. This was done by pooling the coffee produced from the various parts of the country and processing it at designated local KPCU processing stations. By doing this economies of scale were achieved and the high quality of Kenyan coffee maintained.

The link between CBK and KPCU was sanctioned in the Kenyan legislation from the colonial period and it continued up to 2000. The legislation gave the CBK the right to control and manage the activities of KPCU, particularly in managing the payment system and in controlling the physical flow of coffee. The CBK acted as middleman between KPCU and the farmers in collecting and distributing the payments and in maintaining the administrative details of payments and debts of the farmers (Ponte, 2001). Historically the CBK managed and regulated the running of the KPCU and its various roles. The overarching function of CBK was to regulate, manage, research, process, and to be the guardian of the Kenyan coffee production and quality. The CBK's role was indeed extensive in the period from colonial rule up to the early 2000 (Kenya European Commission, 2004).

The KPCU board of directorship at the time of its establishment in the 1930s was dominated by colonial settlers, however since 1952 the dominance of the white settlers gradually weakened and the indigenous power gradually increased in farming and institutional decision making (Pendergrast, 2001). This was done by progressively increasing the number of local African farmers on the CBK board with the corresponding rise in the coffee production from among African small holders (Kenya European Commission, 2004).

As coffee production, processing facilities and payment networks expanded, so too were the benefits enjoyed by the multitude of the new small-scale farmers. The Kenyan colonial government in the pre-independence years was crucial in building and facilitating the support institutions by protecting and promoting the standard of the Kenyan coffee.

Though the institutional support network of the coffee industry was expanding to make the sector more efficient, the colonial policy of prohibiting the locals from growing coffee was maintained, though about 15,000 Africans were growing it illegally (Pendergrast, 2001) in a move to defy the British economic policy and political rule in Kenya.

The opposition to the British colonial policy was so intense that it spilled into one of the most violent conflicts in Kenya since the British occupied Kenya in the late 1800s. In 1952 the disenchanted indigenous Kikuyu labourers rebelled against the British colonial government in what came to be called the Mau-mau rebellion. The Mau-mau rebellion was also a violent expression for greater mass political participation for the indigenous Africans in the future direction of Kenya. The rebellion was put down by the British colonial government after almost two years of conflict and negotiation. By the end of the rebellion

in 1954, the detention camps and prisons held about 150,000 indigenous people (Pendergrast, 2001).

As a result of the discriminatory labour market policy and the consequences arising from it, the British colonial government commissioned a report to address the grievances of the indigenous Kenyans with respect to their economic and political rights. One response to this discontent was a policy shift to allow Kenyans to enter the world of capitalist organisations. The report largely devised by the then Assistant Director of Agriculture, RJM Swynnerton was called 'A Plan to Intensify the Development of African Agriculture in Kenya', published in 1954. The report is better known as the Swynnerton Plan (Schatzberg, 1987). The Plan was designed to: (i) create a class differentiation, with rich peasants cultivating cash crops such as coffee, tea, and pyrethrum; and (ii) to provide the essential economic fundamentals by integrating the Africans, especially the ethnic Kikuyus more fully into the capitalists system (Throup, 1987. pg. 42). This was to be achieved through the redistribution of land plots from the control of white settlers to the natives and by giving farmers individual title to their land, so that they could use them to access credit facilities. The essential part of the Swynnerton plan was to sub-divide the large plots of coffee farms from the colonial settlers into smaller plots for redistribution to the indigenous farmers.

The colonial government accepted the recommendation made in the Swynnerton Plan and prepared for the implementation of transferring the freehold land titles to the Africans. The aim was so enable the title holders to borrow from commercial banks or from government on security of their titles (Leys, 1975) for investment and other business undertaking in the coffee sector. All of this preparation was done by establishing the necessary institutions and extensive consultation prior to the political independence of Kenya in 1963. The Swynnerton Plan was the first British sponsored document in preparing and enabling the African small holders to participate in the cash economy by using modern technology. The Swynnerton plan can be identified as the first official document which set out the role of Africans in the future monetized economy of Kenya (Hornsby and Throup, 1998).

The Swynnerton Plan was also the first document that took into account the economic rights of the local population in the most important sector of the Kenyan economy. Many locals, particularly the Kikuyus took advantage of their newly derived rights by growing coffee in small and large coffee estates (Throup, 1987). In addition to being coffee farmers, the Africans were also taking part in the management and marketing of coffee. Indigenous coffee traders began to emerge to take part in the booming coffee sector and

there was a momentum from the nationalist movements to control every aspect of the sector, ranging from growing, processing to exporting. The emergence of the coffee farmers began to show the weakening of the economic power of the colonial rulers in Kenya.

As the number of indigenous coffee farmers increased, the coffee governing body CBK exercised stricter rules governing crop husbandry and coffee quality standards. The planting of coffee was restricted to authorised persons and to specific number of coffee trees. Although the recommendations of the Swynnerton Plan was to open free and fair access of farming to all indigenous Africans, the Plan was nevertheless used as a 'rent' in controlling the coffee sector in terms of who and how much one gets to grow. Throup (1987) argues that ethnic identity mattered a great deal in the decision over land redistribution and the permission on who can grow coffee.

Following the publications made in the Swynnerton Plan, other African coffee producing countries which were under the rule of France and Britain followed the recommendations made in the Swynnerton Plan. Economic and political inequities and forced labour and racism which were prevalent in many of the large coffee estates of Uganda, Ivory Coast, Angola and Belgian Congo was now being taken away from the colonial settlers control to the European powers (Pendergrast, 2001) and were now sub-divided and sold to the local population.

The pattern appears that: first the colonial settlers ostracise the indigenous population; then rebellion takes place; and after investigation and recommendation by an independent body the local population would be allowed to integrate and take part in the pre-independence colonial economy before granting them full political and economic rights.

Although in 1954 some 15,000 indigenous Kenyans were already growing coffee illegally in tiny plots of land (Pendergrast, 2001), the implementation of the Swynnerton Plan allowed the full and unfettered access to the indigenous Africans in the coffee growing sector. The Swynnerton Plan also gave legal recognition to the existing indigenous coffee farms and recommended the expansion of the small scale coffee production sector into new geographical areas.

During the colonial period only large coffee estates competed commercially and there were no commercially competitive small holders in the coffee market however with the publication of Swynnerton Plan many of the sub-divided large estates became commercially attractive, thereby offering employment and income opportunities to

thousands of families and support services. The White Highlands area which was previously monopolised by the settlers was now opened and support services like processing and research were now extended to the smallholder peasants. In 1963/64 the area under small scale production was only 13,000 ha, but with increasing subdivision and redistribution of large plots of land, the small holders area gradually grew to around 38,000 ha and in 1996 it was up to around 120,000 ha (CBK, 1996), though the average coffee yield from the small holders had declined since 1999/2000.

The controlled expansion of the coffee sector during the colonial period saw the massive expansion of small holder coffee production and the establishment of marketing cooperatives with a corresponding rise in the number of processing and payment facilities.

The importance of maintaining the coffee quality and keeping the cost low was paramount especially during the expansion phase in the post Swynnerton Plan, because many of the newcomers to the industry (local Africans) in the domestic market were still undergoing a steep learning curve, and in addition the lack of infrastructure development in terms of roads, technology, and cooperative banks justified the need for a single institution like the KPCU to bring together the various coffee farmers and the disparate versions of coffee quality under one institution without compromising the growth of the sector (Killick, 1983).

On this basis KPCU was granted the monopoly status over the processing and purchase of coffee from all the coffee farms in Kenya and it remained a monopoly support service provider to the sector from about 1954 up to 2000 (Kenya European Commission, 2004). Today KPCU continues to be a dominant force in the processing, marketing and selling of coffee despite the liberalisation, though KPCU is still owned by the farmers, the management of KPCU is no longer under the authority of the CBK with the onset of coffee reforms in 2001 (Kenya European Commission, 2004).

The opening of coffee farming to the local population did not weaken the market power of the already established large coffee estates run by the settlers, instead the entry of small scale coffee holders only helped to expand the range of support services in addition to CBK, KPCU and CRF (Killick, 1983). Other institutions like the Co-operative Bank, the Union of Banking Sections, the foreign and local dealers emerged to seize the commercial opportunities by offering lending and investment financial products (Johnson, Malkamaki, Wanjau, 2005). Facilities and advice on stock management was also offered and consolidated under the rules of the CBK.

Although the colonial settlers practised economic discrimination within the Kenyan coffee sector, they nevertheless played an instrumental role in institutionalising the structure of coffee production in Kenya from the 1900 to about mid 1950s. However on the consumption side, neither the colonial coffee growers nor the post-colonial economic policy targeted the expanding domestic market (Kenya European Commission, 2004).

The limited participation of the indigenous population in the capitalist economy can partly be blamed on the limited development of coffee consumption in Kenya during the 100 years of British colonial rule in Kenya. Instead of expanding the domestic consumer base, the demand for coffee came exclusively from the non Kenyan market, namely from Britain, Germany and other metropolitan markets in the West. The Germans were the main importers and processors of the Kenyan coffee, while the British were the main consumers of the Kenyan coffee during the colonial period. Germans continue to be the main importers to the present day. The expansion of the coffee sector in Kenyan was mainly based on the potential of the foreign market and not so much based on the consuming power of the local market. There was little or almost no coffee sold in the domestic Kenyan market. The little that was consumed was restricted to the British and other European expatriates in Kenya. As a consequence the domestic market was never exploited nor was it considered as a potential coffee drinking mass market.

The lack of attention to developing the domestic coffee drinking market during the early days of colonial rule has made it challenging for the introduction of coffee in the domestic market today, this is because of the more established taste preference among Kenyan consumers for tea. Also tea was and is still cheaper to grow and process than coffee therefore tea was sold at a much lower price than coffee. Also the tea sector did not face the same level of discrimination in labour participation as in the coffee sector; as a result tea was also grown by the locals for the purpose of domestic consumption (Pendergrast, 2001). The majority of Kenyan growers sell their coffee to the lucrative overseas markets in order to recoup the high domestic cost and to make a decent profit. According to one large coffee farmer, the foreign market is just too lucrative to be foregone. It was only in recent years under the 2001 coffee sector reform, when the potential for domestic consumption was raised and some strategies were laid out for attracting the domestic market.

At independence in 1963, most of the economic sectors developed by the colonial powers were inherited by the Kenyan post independent regime with some changes in the economic structure of the sectors. However the monopoly state operating firms in the utilities, agriculture and banking sector remained and the state centred policies were

simply modified to incorporate the indigenous philosophy. In the next section a review of the Kenyan coffee sector and some the consequences of maintaining the policies and structures in the post independent regime is presented.

4.4. Kenya and coffee in the post independent regime

The political independence achieved by the Kenyans offered an opportunity to the GOK to define its national economic development in its own way but abandoning some of the colonial policies (Schatzberg, 1987, Leys, 1975). Some of the British policies that were abandoned by the post colonial government at independence are the discriminatory labour market policy, the hut taxes, the monopoly over the use of land, the illiberal access to credit and the limited participation of locals in politics (Schatzberg, 1987).

At independence the post independent regime made concerted effort to Africanise the whole of Kenyan economy by opening employment and other commercial opportunities to local Kenyans (Schatzberg, 1987). These changes were undertaken through direct government intervention in the political and economic structures of Kenya. It was done with the aim of overthrowing the inequitable and discriminatory economic and political characteristics of the colonial government and to establish an indigenous based African values. Concepts such as the Harambee movement (a self-help movement), the Nyayo philosophy of love, peace and unity which stressed the need for leaders to take a personal interest in the welfare of ordinary people, and slogans like 'Uhuru na Mashamba' and 'Uhuru na Kaz' which translates to 'freedom with land' and 'freedom with work' respectively were invoked in the national development plan (Schatzberg, 1987). These values were identified with freedom from colonialism and Kenya's self confidence in creating and promoting opportunities for all.

One of the defining characteristics of the newly independent Kenya was the way politics was used to influence the economic sectors within the country (Leys, 1975, Anderson and Throup, 1985, Langdon, 1981 and Lonsdale, 1986). This was done mainly through the public institutions that served the interest of the primary commodity producers (Langdon, 1981). Though the public institutions were collectively owned by the farmers, the management of these institutions were usually under the patronage of the government of the day. The employees in these institutions were considered public servants and their duties mainly involved managing the day to day operation of the respective economic sectors. The institutions were wholly financed from government funding and employment in it was highly sought after given the scarcity of private sector jobs during the early post colonial days. The public institutions acted as a channel for the political elite to reward

supporters and to extract other political and economic benefits. The survival of these institutions also depended on the patronage of the government through its funding and policies for the sector (Tangri, 1999, Burrows, 1975). In most cases, monopoly rights were granted to a single operator to serve and regulate the respective economic sector. The monopoly was also to ensure that the government can use the institutions as a mouth-piece for announcing policies and ideas.

The granting of monopoly rights to single operators to serve the multitude of producer's was not unusual in many developing countries, including Kenya. In Kenya the monopoly marketing boards were established to support the marketing and processing of commodities like coffee, tea, cotton, pyrethrum, tobacco and wheat. In the case of the coffee industry, the control over the sector were mainly exercised by the CBK which had the power to grant the power to license a monopoly service provider in processing, packing, auctioning, and exporting of coffee (i.e. KPCU) (IFPRI, 2004).

Institutions like the marketing boards in the African colonies were justified on the grounds of stabilisation of producers' and the sector's income (Cardenas, 1994). One of the major policies to improve smallholder agriculture development in the post independent Kenya was the establishment of local and regional cooperative systems for marketing and provision of credit and inputs. All small holders were compelled to register with a local cooperative structure for processing and marketing of their coffee (CBK: Coffee Traders Licensed Dealers, 2007). All of the small holders were legally bound to be members of the KPCU institution on the grounds of sharing and reducing cost.

Though KPCU was a farmer owned institution, it was made more accountable to the Ministry of Agriculture than to farmers. Although the public institutions were called public corporations and public enterprises because of the commercial going concern, in reality many of these institutions operated more as government agencies in their day to day operation. The newly independent GOK were enthused not only in establishing the institutions but was also in legislating assortment of laws, policies and regulations governing the operation of the institutions.

It appears that the regulatory structures which seemed to work before independence were not effective in the post colonial period and this is largely because of the way power is managed in the newly independent Kenya. The literature demonstrates that the nationalist leaders in the post independent Kenya had not altered the political and economic structures in Kenya but the way political power was used to manage the economic sector had drastically changed in the post independent period. One of the major instruments

through which the newly elected government attempted to control the economic sectors of independent Kenya was through the use of regulatory powers. In the section below some of the specific regulatory controls in the coffee sector are explored in detail.

4.5. Problems in the coffee sector – post colonial period

One of the main ways in which the coffee sector was regulated in Kenya was by fixing price and output quota through central planning. This control policy resulted in an adverse outcome to the sector and consequently led to abandonment of central planning measures in the economic development of Kenya (Tangri, 1999, Karanja and Nyoro, 2002).

Often farmers tend to expand their production beyond the gazetted area when coffee prices are high and subsequently substitute coffee to other crops when coffee prices are low (Karanja and Nyoro, 2002). This did not only make the regulation of coffee production and prices ineffective, but it was also detrimental to the quality of coffee that was produced because of the cross use of land for different crops, made coffee plants yield lower quality cherries (Karanja and Nyoro, 2002). Added to this, the channels of communication between the central institutions and the farmers were not highly developed for the farmers to respond to the predetermined price and output information in timely fashion. As a result often the farmers over-produce when the global prices are low and under-produce when the global prices are high (Kenya European Commission, 2004). As a consequence the farmers were not able to enjoy the best prices offered by the global coffee market (Karanja and Nyoro, 2002).

The reason for the failure of CBK to control the production of coffee despite the highly structured top-down approach is mainly because, producers and institutions had conflicting incentive structures (Kenya European Commission, 2004). The farmer's incentive was to respond to prices and maximise their gain but the institution incentives were to respond to bureaucratic procedures of stable production and prices. Nevertheless the aim of both the agents (producer and institution) was to ensure that the farmers get the best deal for their coffee which in turn depended on the production of best quality coffee. In the chapter on literature review, it was shown that the argument to realise efficiency, growth and stability; what was desirable was less regulation and greater decision making power to the private producer and better quality of governance within the institutions in serving and supporting the needs of the private producer ((Karanja and Nyoro, 2002, Kenya European Commission, 2004)

In the case of the Kenyan coffee sector, the post colonial institutions that were inherited had all the ingredients of good management, but when the sector was opened to the local farmers the state had over ambitiously attempted to control the development of the sector with over arching rules and policies governing the sector (Leys, 1975). The control exercised by the coffee sector state institution especially in implementing rules over price, production, coffee planting area, licensing and monitoring had subjected the institution to restrain itself to regulatory controls instead of creating an enabling condition for the sector to thrive (Tangri 1999). According to literature on governance, poor governance is manifested by lack of transparency, poor regulatory control, lack of accountability, political instability and ineffectiveness (Kaufmann, 2005).

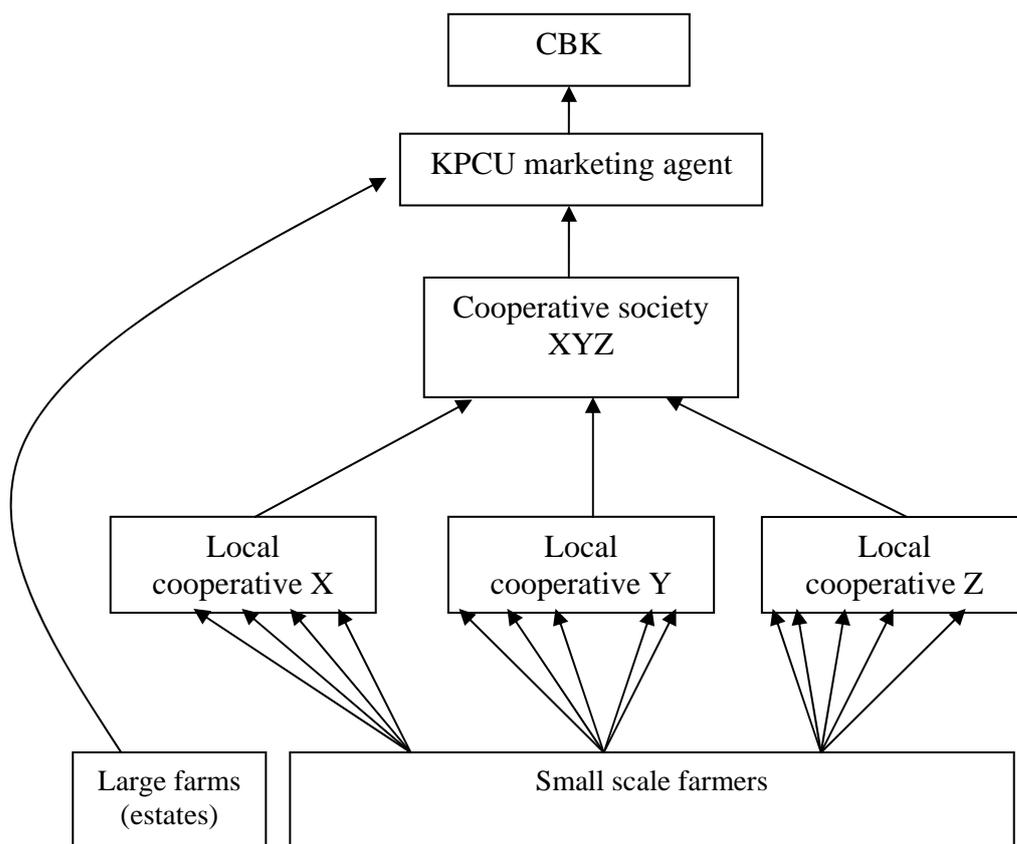
What is clear is that although the coffee sector was opened to all types of farmers to grow in Kenya since the implementation of Swynnerton Plan in 1955, there was still considerable government influence under the newly elected GOK in regulating, processing and selling of coffee (Schatzberg, 1987). The GOK though no longer subject to the colonial policy, but was nevertheless constricting the growth of the sector through myriad of regulations and controls. This was mainly done through the CBK institution.

From the early days of independence to the mid 1990s, there was widespread acknowledgement that the regulations on production and maintenance of quality were not helping the sector to grow and that the sector must be liberalised to achieve its growth potential (CBK, 1996). As a result, the 1933 Coffee Act was revised in 1997 to allow for agricultural reform and a special legislative supplement was published in 1999 to support these reforms.

The reforms were aimed at fitting the coffee marketing rules within the liberalised marketing policies. These reforms allowed the primary processing factories to undertake more advanced processing like milling and sorting at various locations thereby decentralising the production capacity within the limited scope of the liberalisation programme (CBK, 1999).

The deregulation of the production system that Kenya went through in the form of liberal formation of cooperatives is an important aspect of liberalisation programme since the sector was inherited from the colonial government. Figure 4.3 below shows how the small scale coffee farmers are linked to each other and how they are connected to the marketing agents in Kenya before the major changes took place in 2001.

Figure 4.3 Supply chain - small scale farmers and marketing agent (prior to 2001)



(Source: Author generated from discussion with Deputy Commissioner of Cooperative, 2005)

The marketing structure displayed above was established during the colonial period in Kenya and the expansion of the sector has largely been in the increase of small scale farmers in the post independent period. Although cooperative membership is compulsory but not all smallholders are connected supported by the cooperative structure. The expansion of the local cooperative facilities since independence in 1963 had helped to link about 75 percent of the smallholders into a network of cooperatives by 2001 (Mwega and Ndung'u, 2002). This network of cooperatives is the main support infrastructure for the majority of the small holders in farming, and selling their coffee.

The integration of the smallholders into the network of cooperatives have largely been for the purposes of: accessing credit facilities; purchasing input materials such as fertilisers at a discounted rate; processing and storing of the coffee bean and; transporting the partially processed coffee to the marketing agents for secondary processing, grading, packing and

auctioning. In addition, the local cooperatives also act as a network through which state policy and regulations are often channelled to its farmer members, therefore the local cooperative is an influential institution in affecting the way the farmers undertake their business. Crucially the management and operation of the local cooperatives can be significant in explaining how it affects its members and the consequences faced by the sector as a whole.

The inherited coffee structure had all the elements in linking the disparate farmers together in a series of network groups but as the number of small scale farmers increased, the ability of the pre-colonial coffee structure to meet the challenges of payment, physical movement of coffee, expanding market opportunity and most importantly managing the cooperative institutions had gradually become less effective.

Major reforms were addressed in the late 1990s and reforms were legislated in 2001 and subsequently implemented in 2002, to fix the deep rooted institutional problems at the local, regional (local and society cooperatives) and national (marketing agent) level.

The findings in this thesis illustrates that local cooperatives are a significant prize in the local coffee production under the liberal market condition. The governing of local cooperatives was often taken as a mechanism to reward and build patronage in the coffee producing geographical areas. The reward and patronage is largely manifested through excessive job creation which inflates the overhead cost and compromise on the efficiency in serving the farmers. In addition the findings also show that most of the problems faced by the smallholders can be related back to the years of lack political leadership in creating conducive environment for the sector to thrive, particularly in the run up to the liberalisation in 2002.

The adverse political conditions is reflected in the coffee sector mainly in the way the local cooperatives and other coffee related institutions have mismanaged the challenges faced by farmers in terms of production, competition, innovation, management and research and development. As a result of the mounting institutional problems within the sector a raft of reforms were introduced to revive the sector. The detail findings on the implementation and outcomes arising from the reforms are discussed in detail in the chapter on Analysis.

In the next section, we review the literature on the various coffee sector institutions and explore some of the ways in which the problems within the institutions have affected the prospects of the sector in Kenya.

4.5.1. Politicisation of the economy – coffee sector

Although Kenya is a premium producer of Mild Arabica coffee in the world, it appears that there is widespread discontent among the majority of its stakeholders in the management of the coffee sector (Karanja, A and Nyoro, J, 2002). This has particular consequences on the development of the coffee sector and on the general economic development of the country. This is because the coffee sector generates income, employment, commerce, foreign exchange revenue and offers opportunity to millions of farmers in pooling and sharing of resources in the production of this global commodity.

Coffee and politics in Kenya are closely inter-related as in most other coffee producing countries. A French coffee importer noted “coffee is a political problem as much as an economic one” (Pendergrast, 2001, pg 226). The case of Kenya is no different. The political influence on the coffee sector in Kenya has mainly been exercised through the institutions using policies and law.

The coffee sector institution particularly the CBK was consolidated by the newly GOK at independence with a mandate to safeguard and promote the sector under the direction of the state (Dresang and Sharkansky, 1975, Kenya Economic Survey 1995 - 2000). This was done in order to maintain the existing network structure, including the marketing agent and local cooperatives so that the stakeholders in the coffee sector can continue to be under the influence of state.

In addition to the CBK and the KPCU, the following institutions also play an important role in the development of the coffee industry of Kenya at present:

- 1) The Ministry of Agriculture
- 2) The Ministry of Cooperatives
- 3) Local cooperatives
- 4) Nairobi Coffee Exchange (NCE)
- 5) Coffee Research Foundation (CRF)
- 6) Mild Coffee Traders Association (MCTA)
- 7) Kenya Coffee Traders Association (KCTA)

However in most cases these public enterprises have become a major source of rent creation and rent seeking in the process of economic development in the many developing countries, including Kenya (Dresang and Sharkansky, 1975, Tangri, 1999, Cardenas, 1994) Often the fortunes of the sector and public institutions dealing with the

commodity closely follow the changes in the political domain that occurs within the country.

It is stated in the literature that these public institutions form the channel through which policies and legislations are discharged (Karanja and Nyoro, 2002). The development prospect of Kenyan coffee industry depends significantly on the effectiveness of the institutions mentioned above.

The Ministry of Agriculture has controls over the CBK, the CRF, the export, the infrastructure of distribution and generally over the protection of the industry and the producers (Kenya European Commission, 2004). In addition, the Ministry of Cooperatives has controls over the registration and formation of the coffee cooperatives and societies that supports the industry. All matters relating to the organisation, election, and disputes within the co-operative societies are dealt with by the Ministry of Cooperatives (Kenya European Commission, 2004).

The NCE is a recent addition to coffee sector. The NCE's role is to sell coffee, and disseminate data on the selling price and quantity of coffee auctioned at the NCE. The data is mainly distributed to local and international media group for publication in their trade commodity pages (CBK, 2007).

The MCTA is an association which represents the interest of the coffee dealers in the NCE. The MCTA has been in existence since the colonial period. The MCTA is the pioneer association of the coffee dealers in Kenya. Its function is to adjudicate conflict between the dealers and sellers by expressing a single voice on matters pertaining to the interest of coffee dealers (Kenya European Commission, 2004). The MCTA is funded by the registered dealers with the NCE. The importance of MCTA in representing the interest of the dealers has weakened over the last four years. This is because of the rising discontent among the dealers in its services and the failure of the association in effectively communicating the changes and advantages within the sector. More generally, the inefficient management has weakened the effectiveness of MCTA as a powerful voice for the traders.

As a result of dissatisfaction among the dealers, they have setup a rival organisation under the banner of Kenya Coffee Traders Association (KCTA). The KCTA performs similar functions to MCTA in representing the interest of the dealers, adjudicating conflicts among the stake holders and, in addition it also provides funding for the management and running of the NCE.

These support institutions have all been increasingly seen as channels through which individual and party political agenda are promoted; political clients groomed; rent extracted; and loyal supporters rewarded. In order to legitimise the operation of these institutions, these institutions are endowed with certain powers granted to them by the Parliament. This argument is supported by Tangri (1999).

The way power is managed within these institutions determines the extent of the quality of governance within these institutions (Tangri, 1999). In addition to the internal operation of the institutions, the relationship between the public institutions and politics also does matter. This is because the quality of the public institution depends on the rules made by the political representatives in serving the needs of the specific economic sector. In the case of Kenya the autocratic political structure during the 10 years (1982 to 1992) and in the subsequent years has not resulted in any significant pieces of legislation in addressing the challenges faced by these public institutions, particularly with reference to governance within the coffee related institutions.

As a result, many of the institutions associated with the coffee sector have ended up with bloated deficits, increased debts, ballooned workforce, poor service delivery and obsessive promotion of sectoral interests. All of these problems impeded the ability of the institutions in delivering the objective of price and income stability through the redistribution policies.

Typically when institutions fall under the control of central governments, underpayment to producers occur (Cardenas, 1994). Underpayments were particularly widespread in Kenya after its independence. Underpayment occurs because politicians and officials serving as members on the institutions have different preferences to the producers, in using the institution for redistribution purposes (Cardenas, 1994). Politicians especially in a weak democratic political structure as in Kenya often attempted to over-rule the official mandate of achieving price stability by pocketing the revenue or profit from the sale of commodity for political purposes, thereby transferring economic profits into political gain.

In the case of Kenya, public corporations were often seen by politicians as a source of 'honey pot' for extracting revenue (Dresang and Sharkansky, 1975). This is because public institutions offer opportunities to the political class to manipulate the policies and laws in extracting gains, whether It is in the form of revenue (taxes, levy, etc) or by appointment of political supporters to the office of public institution.

Officials serving on the institutions on the other hand collude with the politicians by complying with the manipulated laws often by transferring part of revenue to the politician's pocket. Politicians in return safeguard their income transfer by appointing loyal members onto these boards. The reciprocal favouritism displayed by politicians and members of the board are some of the signs of patronage-client network of relationship. Such relationships if it proliferates can affect the economic efficiency and the prospect of development in general and the sector in particular (Kaufmann, 2005).

In a study by Dresang and Sharkansky (1975) on Kenya, the authors find that in a weak democratic political structure, the sequence of political change and public corporations to be closely related to each other. The study by Dresang and Sharkansky (1975) is particularly interesting given the study between public corporations and political change was undertaken immediately after the colonial period in Kenya.

The study considered the Kenya Meat Commission (KMC) in detail and other corporations like Kenya Tea Development Authority (KTDA), Industrial and Commercial Development Corporation (ICDC), Agricultural Finance Corporation, Agricultural Development Corporation and the East African Airways Corporation (EAA) briefly. These bodies were selected because they represented broad characteristics of economic activities, and political problems (Dresang and Sharkansky, 1975, pp.165). Some of these bodies are no longer in operation now.

The study concluded that public corporations were an integral part of the political process in Kenya. The study shows how the political and economic elites were synonymous up to a point and then commercial wealth and political power diverged into separate hands and then back again to an era of congruence (Dresang and Sharkansky, 1975, pp.165). Although this study was undertaken in 1975, the consequence of poor management and years of neglect are beginning to show now, as these institutions go through the strain of reform programmes. For example in an article published in September 1999, the following excerpt from a leading daily paper summed up the characteristics between politician (patron) and directors (client) of public institutions in Kenya.

...the typical profile of a managing director of a parastatal in Kenya is one of a big-headed individual who concentrates on evolving and maintaining patronage relations with powerful politicians. They are always willing to commit resources in ostentatious things such as shows and fund-raising meetings, which allow them to win awards and get the opportunity to be photographed with president...

(Daily Nation, September 28th 1999)

Patronage-client relationship had permeated almost into every institution in Kenya during the 10 years of single party rule in Kenya from 1982 to 1992 and then from 1992 to 2002 under multiparty rule of Moi (Tangri, 1999). This is largely done by using ethnic and money politics as a dominant strategy for the government to maintain and maximise its power.

In the case of the coffee sector, the local cooperatives whose responsibility include making decision over allocation of credit, investment, processing cost and contracts were largely undertaken by manipulating the laws and policies of the local cooperative institutions. This was done by allocating credit to farmers based on the effectiveness of lobbying as opposed to need. Investments were made mainly for the sake of creating jobs as opposed to meeting productivity needs and contracts with supporting services like transport and fertiliser suppliers were established largely based on ethnic alliance as opposed to cost considerations (Tangri, 1999, Karanja, A and Nyoro, J, 2002). As a result the processing and other overhead cost margins were largely determined by non-economic factors which weighed down on the efficiency of local cooperatives.

The dominance of non-economic factors such as ethnicity, patronage, political support, lobbying and others were exacerbated by the neglect and lack of political leadership, particularly during the period of Moi. The collective impact of inefficiency and lack of political will to reform the sector decimated the prospect of the industry for almost 20 years (1982 to 2002). This is one of the reasons why the CBK, the regulator itself was immersed in mismanagement and bloated workforce.

The failure to support the sector had resulted in the neglect and deterioration of the institutions within the sector. In addition, the autocratic political structure instituted by Moi from 1982 to 1992 weakened the functioning of democracy and made the coffee sector institutions to succumb to rent extraction activities at the local and national level.

It appears from the literature, that the lack of political will in cleaning up the sector had done a lot of damage to the prospect of the Kenyan coffee industry especially during the rule of Moi from 1982 to 2000 and this is elaborated in Hornsby and Throup, 1998, Brown, 2001, Foeken and Dietz, 2000 and Human Rights Watch, 1999). President Moi and his political class had little incentive in supporting the coffee industry which was mainly controlled by the Kikuyus in the pre and post independent period in Kenya. The years of Moi presidency was symbolised by neglect of the coffee industry because it was controlled by the Kikuyu ethnic group who did not share the same extent of loyalty as the presidents own ethnic identity. As a result of the poor leadership in the coffee sector,

mismanagement of the coffee institutions had become widespread over the years and it is still reeling in recovery.

The accumulation of the problems within the CBK came to a boiling point in the late 1990s when it was reported that the CBK was embroiled in mismanagement and misappropriation of the CBK finances. The audit on the allegation of corruption noted that the level of corruption in CBK was helpful to the collapse of the coffee sector of Kenya. The audit entitled "Mismanagement and Misappropriation of Resources in the Coffee Board of Kenya" noted that during 1998-99, nearly USD 185,000 was channelled to the directors and senior managers. By January 2000, eight board officials were fired over accusation of misappropriating USD 8.6 million, of which three of them were charged with stealing USD 177,142 from funds intended for small scale coffee farmers (Daily Nation, 21st November 1999).

By the end of the 1990s, it was clear that the lack of political support had undermined the prospect of the Kenyan coffee industry, especially with reference to the quality of governance within the institutions. In the next section we explore some of the key differences in the old and new regime within the Kenyan coffee sector.

4.6. The Coffee sector reforms

The aim of the Coffee Act 2001 was to liberalise the coffee sector and reduce the problems of political interference within the sector. This is done with the purpose of liberating the individual farmers' right in choosing to join a local cooperative and by dismantling the monopoly rights of the service provider. The overarching purpose of dismantling the monopoly service provider was to improve the quality of governance within the institutions in the hope that it will improve the income prospect of the farmers (IMF & Kenya PRSP, 2005).

The liberalisation of the coffee sector began in earnest in every coffee growing district and provinces in Kenya in the 1980s. These programmes were identified as SCIP I (Small-holders Coffee Improvement Programme) and later SCIP II implemented in the 1990s. These reform projects were supported by the IMF and WB institutions by providing financial and technical assistance to the CBK in setting up the administration to speed up the payment system from the CBK to the farmers. The main aim of SCIP I and SCIP II were to improve the time taken for the farmers to receive their payments. Although the reform programme initially proved to be a success, it was nevertheless not sustained because of lack of external funding. Since the termination of the SCIP projects in the mid

1990s there have been no reform programmes targeted at the coffee sector until the year 2000.

The Coffee Act 2001 marked the first attempt to overhaul the coffee sector with the full support of the Kenyan government. This act superseded the Coffee Act Cap 333 Laws of Kenya which was legislated in 1933. The pace of implementation of the Coffee Act intensified in 2002 when the new government of Kenya was elected into power. The new act mandates the private firms to play a greater role in the coffee sector and aims to reduce the role of the state in the sector by freeing the market in line with the neoclassical economic policy principles.

The reforms aimed at the coffee sector were first contained in the Poverty Reduction Strategy Paper (PRSP) launched by the IMF in collaboration with the Government of Kenya (GOK) in October 2000.

The broad aim of the PRSP is to tackle the twin objective of economic growth and poverty reduction. The PRSP is part of a long term vision (1999 – 2015) of the GOK under its National Poverty Eradication Plan (NPEP) in meeting the objective of these twin objectives.

Under the NPEP various programmes and frameworks have been developed and implemented to achieve these two objectives. Under the agriculture and rural development category, the PRSP research paper identified the potential of the agriculture sector to the Kenyan economy and commended the need to increase agricultural production so as to increase the income of the farmers (IMF: PRSP, 2000). With reference to the coffee industry, the PRSP identified that improvement to the institutions, specifically among the smallholders is urgently needed to make the marketing system for smallholders become more efficient and organised (IMF & Kenya PRSP 2005).

The assistance offered by the IMF to the GOK, included financial package and a set of reform policies. The financial assistance and the policies were aimed at reforming the various aspects of the inefficiently run state centred approach of central planning and decision making in the economic management of the country.

According to the IMF official 'the assessment of the PRSP is jointly undertaken with staff of the World Bank. The assessment on the impact of improving the institutions for farmers is largely qualitative, based on economic reasoning and experience...' (Email communication: Public Affairs Division, 2007). The objectives of poverty reduction strategy

as addressed by the GOK and the IMF is therefore generally to reform the agriculture sector and specifically to improve the marketing and market access of the agricultural commodities with the sole objective of increasing the share of the final sale that farmers receive (IMF & Kenya PRSP 2005).

The key changes addressed in the coffee sector in order to tackle the problem of governance within the institution as addressed in the new Coffee Act 2001 as described in Kenya European Commission (2004), Karanja, A and Nyoro, J (2002) and Kenya PRSP (2005) were the following:

1) Restructuring the membership and remit of the Coffee Board of Kenya

Prior to the reform, the Board consisted of growers and traders and several government officials. In addition to regulating the industry the CBK was also the marketer and handler of farmer's cash. The staff number was approximately 800 people.

Under the present arrangements the role of the CBK has been changed to that of regulator only. The CBK now acts to promote the production, processing and marketing of coffee instead of doing it itself. The Board now consists of 16 members, representing growers, traders, marketing and government authorities. The membership is skewed towards the interest of the small scale producers. The staff members now total just 81 people.

2) Dismantling the KPCU marketing agent monopoly

Under the previous coffee regime, all processing, packing, and marketing was done by KPCU. KPCU was part of the CBK. KPCU was a giant monopoly servicing the coffee sector.

However under the new regime, there are now two main commercial millers in addition to the KPCU competing to offer services to the small scale farmers. These three companies are licensed by the CBK.

3) Setting up of special funds to assist the farmers

Prior to 2002, no specific finance facility was available except through the Cooperative Bank servicing all agricultural cooperatives. With liberalisation, special provision is made for the setting up of the Coffee Development Fund for the sustainability and affordability of credit to the sector.

4) Proposing to establish another research institute to complement the existing one
Under the previous arrangement the Coffee Research Foundation (CRF) was governed by the CBK. Its workforce totalled 800 people. The CRF was funded through the CBK.

With the onset of liberalisation, the CRF has been established as a separate company. The funding is paid directly through research levy from the auction proceeds. The CRF workforce now totals just about 200 people. A new research body called the Coffee Research Institute is proposed. Its aim is to primarily research marketing and value-adding opportunities.

5) Liberalising the right of farmers in joining and setting up of cooperatives

Prior to 2002, local cooperatives can only be setup with the consent of the Ministry of Cooperatives. It is compulsory for smallholders with coffee growing area of less than 10 acres devoted to coffee to become members of cooperatives. All cooperative societies must deal with the KPCU for the processing and selling of their coffee at the auction.

The liberalisation gave the farmers the freedom to set up local cooperatives without the consent from the Ministry. The criteria for setting up a cooperative have been eased. A coffee area granted estate status has been decreased from ten to five acres. This is mainly to allow the smaller estates to enjoy coffee growers with greater than five acres to enjoy independence in their marketing and selling strategies. The changes in the acreage qualified more smallholders to enjoy the status of estate and consequently the number of smallholders declined. However smallholders continue to operate within the network of cooperatives by pooling and sharing resources together. Given the freedom to the smallholders to set up cooperatives, an increasing number of smallholders has broken-free from a larger cooperative to form a smaller unit. Each cooperative is free to contract with any one of the three marketing agents.

6) Liberalising the auction exchange

Under the previous coffee regime, the auction system was governed by the CBK. It also acted as the collecting agent of the proceeds from the sale of coffee and to disbursing the payment to the farmers through the cooperatives (smallholders) and directly (estate) to the farmers. The auctions were run by the Kenya Coffee Auction Ltd.

With the onset of liberalisation the auction system is now managed by the Nairobi Coffee Exchange as an independent body funded directly from the sale of coffee. The NCE is now managed by the newly established Kenya Coffee Producers and Traders Association (KCPTA). The marketing agents are free to choose their own auctioneers.

7) Increasing the scope for innovation

Prior to liberalisation of the coffee sector, there was no provision focussed on increasing innovation in the sector. The coffee sector was highly regulated, rigid and restricted in its operation.

The literature on the coffee development in Kenya demonstrates that the public institutions in Kenya inherited and expanded by the post colonial regime particularly those relating to the coffee sector had been weighed down by years of rent seeking and extraction. Therefore these key changes were identified and implemented in order to tackle the years of rent seeking and extraction problem within the sector.

The Coffee Act 2001 offers a good deal more freedom to the industry than any other Acts since 1933. This new freedom has been enshrined in the newly liberalised Coffee Act with the overarching aim of liberalising the individual farmers and giving them the right to choose with whom they want to do business within the liberalised marketing structure. However there is also plenty of evidence to suggest that the liberalised environment had actually weakened the structure and players in the market, especially the farming community who are dependent on the long established local co-operative networks as viable economic units. More on this will be discussed in the chapter on Analysis.

In a speech to the agricultural sector at the Central Kenya Agricultural Show, the newly elected President of Kenya remarked that 'We want to re-activate interest in agricultural shows, as genuine forums of interaction between Government and the farmers, industrialists and traders'. He went on to say 'The Central Province economy has been driven by agriculture, agri-based industry, horticulture and trade. The growth of these sectors in the last fifteen years has been hampered by poor infrastructure, lack of credit, lack of access to markets, corruption and mismanagement' (President Mwai Kibaki's Speech 2003).

The 2001 coffee reform is the first attempt by the GOK in partnership with the IMF and the WB to collectively address and reform the coffee sector as a whole, particularly relating to the seven areas identified above. The macro and micro findings from the reform programme are discussed in Chapter 5 and 6 respectively.

4.7. Conclusion

The GOK had used a state regulated approach in managing the development of the sector in the post independent Kenya by continuing to depend on the institutions like the CBK regulatory board and the KPCU monopoly service provider. The use of these institutions in managing the sector gradually expanded as the number of coffee farmers increased following the implementation of the Swynnerton Plan in 1954.

The increase in the participation of the small holders in the coffee production and other related services were integrated within the cooperative structure which was partially established during the colonial period. The cooperative is a decentralised institution which connects many small scale producers to a centralised marketing agent which provides facility for the producers to undertake secondary processing, packaging and exporting.

At independence in 1963, the coffee sector of Kenya was under the dominance of the state regulatory controls. The control over production, quality and price were mainly implemented through the various coffee related institutions in the coffee sector. As the number of coffee producers, dealers and suppliers increased gradually, the state and its regulatory powers have increasingly viewed the coffee related institutions, particularly the CBK and the KPCU as a institutions for extracting economic and political benefits. The interaction between government and the institution had intensified especially from the period of independence in 1963 up to the year 2000. The two main reasons for this are: (i) the policy of Africanisation which the new GOK implemented in order to increase the representation of Africans within the public institutions of Kenya and; (ii) to demonstrate the ability of the independent GOK to design and promote policies for the benefit of all Africans and not just to benefit the settlers living in the lucrative coffee growing enclaves.

The use of the coffee institutions for promoting government centred policies and for rent extracting purposes, particularly during the period of the rule of President Moi had increased the entrenchment of politics into the various economic sectors, and this is clearly manifested in the coffee sector of Kenya. Therefore in 2001, the GOK under a new presidency and with the support of the IMF and the WB through financial, technical and policy assistance attempted to reform the sector from years of state control.

Chapter 5

Analysis from secondary sources

5.1. Introduction

The aim of this chapter is to identify and present data relating to the impact of liberalisation from secondary sources cited in the Chapter on Methodology. The purpose of presenting the secondary data is to examine the extent to which the changes in the coffee sector have impacted on the Kenyan coffee farmers at a macro level. The assessment of the macro level impact from the secondary data will then be cross examined at a micro level using the primary data in the next chapter on findings. The analysis from secondary sources will pull together all the references to the impact of liberalisation on the broader Kenyan political economy of development and the analysis will focus on the state of the coffee sector within the broader Kenyan political economy of development. By undertaking a cross examination between the secondary and primary data, we will be able to identify if the comments made from the interviews are supported at the macro level and if it is then to what extent it is supported.

This chapter is divided into three parts. The first part will briefly outline the programme of liberalisation in Kenya, and this will be followed by an examination of the impact of liberalisation on the Kenyan coffee sector. The final part will draw this chapter to conclusion.

5.2 Background to liberalisation

The mounting economic problem in the early 1990 led to one of the most expensive reform programmes in Kenya. Kenya received the highest disbursement from the IMF than any other years; the amount disbursed was approximately 100.47 million worth of Special Drawing Rights (SDR) (See Appendix 4 for more details on SDR). However the single party rule from 1991 to 1993 under which repressive style of political governance led to Kenya's worst economic performance since independence despite the substantial financial assistance. During these three years the political regime of Kenya was dominated by extensive patronage and rent seeking within the public enterprise and state institutions. These are reported in Hornsby and Throup, 1998, Brown 2001, Foeken and Dietz, 2000 and Human Rights World Report, 1999). During the period of three years (1991 – 1993) growth stagnated, agricultural sector shrank and inflation recorded almost 100 percent rise. As a result of the repressive political rule and the mounting economic mismanagement donors suspended their aid and stopped all assistance to Kenya as a sign of reprimand (Karanja, A and Nyoro, J, 2002, Tangri, 1999).

After three years (1991 to 1993) of stalled reforms, Kenya began to embark on a series of reforms in about mid 1993 as a result of worsening economic conditions. The reforms included the appointment of new minister of Finance and a governor for the Central Bank of Kenya, elimination of price controls, removal of foreign exchange controls, privatisation of an array of state owned enterprises, reduction in the number of civil servants and the introduction of tight monetary and fiscal policy (IMF, 2006, Hornsby and Throup, 1998).

However the series of IMF funding for the Poverty Reduction and Growth Facility was suspended in 1997 because of the failure of the GOK to maintain the reforms and to curb corruption (IMF, 2006).

These reforms were largely funded by the IMF and the WB. However the failure of the GOK to meet its commitments on governance and poverty at a macro level again led to the suspension of lending and technical assistance from the IMF and WB in 1997. Although the previous economic reforms were in place, the GOK failed to implement further reforms especially in the area of governance in addressing growth and poverty levels. The stalled reforms were also a sign from the IMF and WB at its displeasure on the way the adverse conditions under which the political elections had taken place in the multiparty elections of 1997.

According to Hornsby and Throup (1998) as governance in the state institutions deteriorated, political influence became more pervasive in the economic sectors particularly in the two key petroleum distributions - Kobil and Kenyan National Oil Company (Kenol) but was also widespread in state run companies like Air Kenya Aviation Ltd, Wescon Ltd and ABC Foods Ltd (Hornsby and Throup, 1998). In addition the rise in default loan payments to the state banks particularly to the Kenya Central Bank (KCB) led to mounting economic troubles with rising unemployment and rapidly rising prices. The use of these institutions to extract political benefits led to an increasing demand from the opposition Members of the Parliament, Non Government Organisations (NGO) and the civil society in particular to demand for greater democratic rights and more accountability from the government.

As a result the GOK was forced to institute further reforms in late 1999. Following the resumption of reforms, IMF and WB continued its funding in 2000. However the reforms especially in the setting up of anti corruption authority were considered not credible by the IMF and it was declared unconstitutional in December 2000 by the international bodies (IMF, IMF, donor countries). As a result the IMF and WB again suspended their reform programme for the third time. Efforts to restart the reform programme were not successful until the election of new government under the leader of Kibaki in December 2002.

Mwai Kibaki who took over the Presidency resumed cooperation with the IMF and WB and enacted a range of anti-corruption, ethics and economic crimes acts to clean up the state institutions and strengthen the quality of governance. Following a new wave of reforms the IMF approved a three-year funding of USD 250 million for the Poverty Reduction and Growth Facility programme in early 2003. In addition a commitment of USD 4.2 billion was also made by other donor members in November 2003 (CBI, 2005).

Almost the entire utilities and commodities sector in Kenya which was previously under the control of the GOK was set for privatisation and total state divestiture. They include the electricity sector which was previously under the state run Kenya Power and Lighting Company (KPLC), the agricultural commodities sector which was previously regulated by state appointed institutions like the Kenyan Tea Development Authority (KTDA), the Coffee Board of Kenya (CBK) and National Cereals and Produce Board, Mumias Sugar Company and many others. In addition to the divestment policies, the GOK has also undertaken steps to substantially reduce its holding within the state appointed institutions.

Table 5.1 below provides a list of some of the organisation that were either privatised or that are currently undergoing privatisation in Kenya.

Table 5.1 Main state enterprises that are privatised or facing privatisation in Kenya

Services	Comments
Kenya Postal and Telecommunication Corporation (KP&TC)	Completion of the privatization of Telkom Kenya and the commercialization of Postal Services
Kenya Railways	Concessioning of Kenya Railways
Kenya Ports Authority	Concessioning of the Container Terminal and other non core services of the Port to convert Kenya Ports Authority into a land lord port
Kenya Power and Lighting Company	Privatization of electricity distribution through Kenya Power and Lighting Company
Kenya Electricity Generating Company	Privatization of Kenya Electricity Generating Company (Kengen) through an Initial Price Offering (IPO)
Pipeline services	Privatization of Kenya Pipeline
Commercial Bank	Privatization of Kenya Commercial Bank
Reinsurance Company	Privatization of Kenya Reinsurance Company
Mumias Sugar Company	Privatization of Mumias Sugar Company through IPO and if necessary sale of a portion of shares to a strategic investor and privatisation of Chemelil Sugar Company
Agro-Chemical and Food Company	Privatization of Agro-Chemical and Food Company Ltd. (ACFC)
Kenya Airports Authority	Involvement of private sector in Kenya Airports Authority through the award of concessions
Nairobi Water Department	Involvement of private sector in the Water Department of the Nairobi

Kenya National Trading Corporation	Privatization of Kenya National Trading Corporation (KNTC) through liquidation
Paper Mills	Privatization of Pan African Paper Mills
Portland Cement Company	Privatization of East African Portland Cement Company through sale of shares on the Nairobi Stock Exchange
Coffee Board of Kenya	Restructuring by reducing workforce, divesting the organisations role, function and structure.

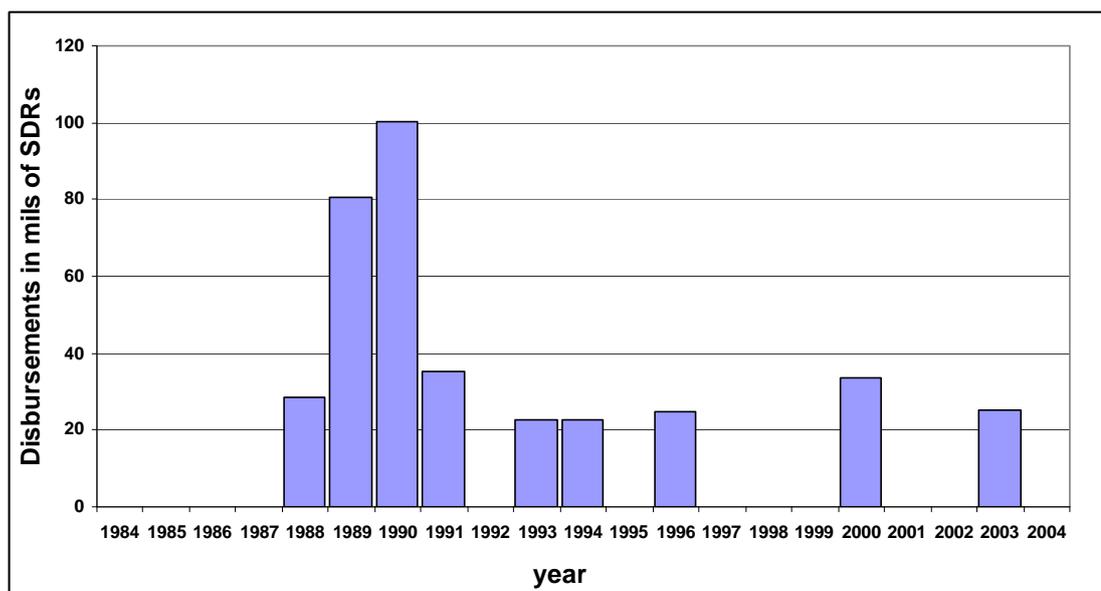
(Source: Essential Action, 2001)

The series of liberalisation programmes identified above were aimed at reducing the fiscal deficit of the state, increasing the scope for the market, attracting new investment into the sector, improving government management by reducing the size of civil servants and expanding the role played by the private sector in delivering efficiency and innovation within the sectors. These features were identified as some of the key reasons for liberalising the various economic sectors of Kenya (IMF: PRSP 2000, 2005). The shift from state to market oriented approach to development was viewed as the best strategy by the GOK and the donor countries for breaking out from the cycle of underdevelopment faced by Kenya since its colonial days.

The strategy to shift from state to market centred approach was also widely supported by institutions such as the WB, the IMF and donor countries as a favourable course of action in achieving higher growth rate and lower poverty levels (IMF: PRSP 2000, 2005). However the flow of funding from the IMF to the GOK has been intermittent, as shown in Figure 5.2 below.

The period under consideration for this study is from 1980 to 2004. Figure 5.2 below presents the years and the amount of disbursement received by Kenyan from the IMF. The intermittent funding from the IMF is largely attributed to breaches of conditionality by the GOK as described above.

Figure 5. 2 Kenyan transactions with the IMF



(Source: IMF, 2006, Transaction with the Fund)

Although the funding from IMF to Kenya was intermittent, Kenya nevertheless continued to depend on the IMF funding for growth and stability.

The lack of funding and adverse weather conditions in the form of drought and the energy and water rationing from 1997 to 1999 led to a contraction of the Kenyan GDP from 1.8 percent in 1998 to 1.4 percent in 1999 (IMF, 2000). As a result of this the GOK made numerous reforms to impress the IMF to resume its lending which was later suspended in 1997.

The IMF resumed its lending to Kenya in 2000 to help Kenya see through the drought impacted economy, however lending was suspended again in 2001 when the GOK failed to sustain the reforms instituted in 2000 (IMF, 2006). Despite the good weather conditions favouring agriculture production and rising demand in the world market for agriculture commodity, poor macro economic management and chronic levels of corruption (TI, 2003 and 2005) crept back into the economy made worse by political infighting and political rent seeking within the state institutions (Hornsby and Throup, 1998). These political problems became an impediment to attracting sustainable private sector investment (IMF, 2006). The table in Appendix 5 summarises the period under which Kenya participated in the IMF programme with the respective programme and the period in which it did not.

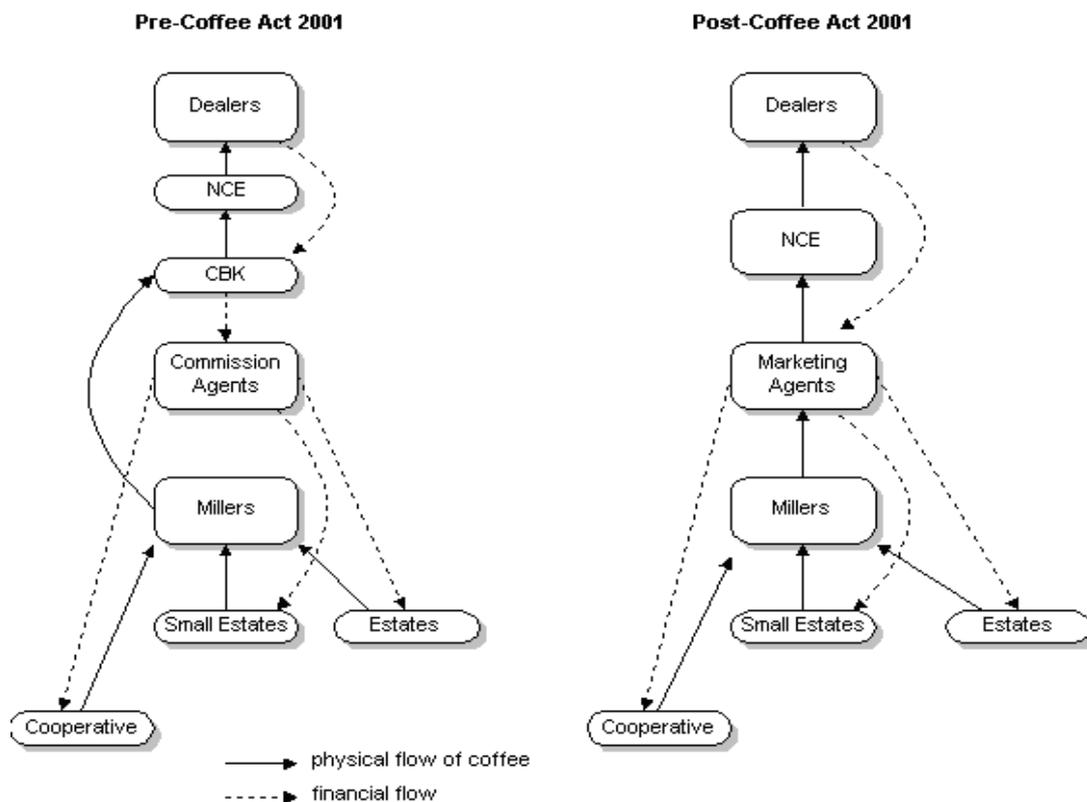
Of the many economic sectors the major sector to have undergone the changes from the liberalisation programme is the coffee marketing regime. In the next section below, a more

specific discussion on the old and new policies in the coffee sector will be considered using the secondary data identified in the methodology chapter.

5.3 Marketing structure – old and new

In order to recognise the changes within the coffee sector of Kenya particularly within the local cooperatives institutions, one must appreciate the marketing structures involved in the coffee sector of Kenya. Figure 5.3 below shows the interconnection between the various institutions in the coffee marketing structure in the pre and post coffee act of 2001. The various changes in financial and physical flow of coffee from pre to post 2001 are discussed below.

Figure 5.3 Coffee marketing structures



(Source: Kenya European Commission, 2004, Part 2-page 124)

Small estates are distinguished by estates according to the location and the availability of infrastructure surrounding the small estate region. Under the pre 2001 Act farms that are below 10 acres are categorised as small holders, however some of these farms were located in area that is isolated from other small farms, therefore making it difficult and expensive to be part of a local cooperative, therefore these small holder farms were categorised as small estates. Small estates operate as an independent farm similar to

estates. Under the post 2001 Act, smaller estates were continued to be recognised as small independent farm operators.

With the implementation of the liberalisation programme in 2001, institutions such as Commission Agents and the CBK are no longer part of the new structure. The Commission Agent which was previously charged with processing payment on behalf of the CBK and the farmers is now superseded by the marketing agents. Under the previous regime the Commission Agent was responsible for collecting the payment from the dealers through the CBK and who then disburses it to the producers. The Commission Agent was a support institution and was an integral part of the bigger CBK institution though it had separate responsibility within the structure. Under the liberalised structure there are at least three main marketing agents which operate and undertake the work of the Commission Agents in Kenya. The marketing agents purchase coffee from the farmers, undertake the secondary processing at their various milling stations and sell coffee on behalf of the farmers at the weekly auctions in Nairobi. Under the liberalised arrangement the dealers pay directly to the marketing agents who will then disburse the payments to the producers, thereby bypassing the CBK. The removal of Commission Agent was aimed at speeding up payments and reducing payment 'leaks' in the system.

A detailed examination on the extent to which this has been achieved and the reaction of the farmers to the new payment system will be analysed and discussed in the next Chapter.

Prior to liberalisation there was only one miller in the coffee sector (CBK: Coffee Traders Licensed Dealers, 2007). The KPCU was a farmer's organisation primarily offering services such as secondary processing and selling of the coffee on behalf of the farmers. The purpose of having a monopoly service provider was to achieve economies of scale and thereby increase the returns to the farmers, particularly to the small scale farmers who had to bear higher cost of production than the big estates (CBK: Coffee Traders Licensed Dealers, 2007).

The establishment of a monopoly service provider under the colonial regime was therefore justified on financial reasoning and on this basis it was continued under by the post colonial regime (Kenya European Commission, 2004). However with the expansion of the coffee sector and the increasing demand placed by the coffee producer on KPCU, the ability of KPCU as a monopoly institution began to be jeopardised (CBK: Coffee Traders Licensed Dealers, 2007).

In order to make the liberalisation of the coffee sector more effective in serving the needs of the farmers, small scale farmers were also given the freedom to form cooperatives and make choices in contracting with marketing agents, in deciding over investments matters and in setting-up of processing and other incidental prices (Kenya European Commission, 2004, CBK: Coffee Traders Licensed Dealers, 2007). However the freedom offered to the small scale farmers have failed to encourage the small scale farmers in achieving the expected economies of scale, instead the farmers have split into further smaller units, thereby increasing their processing cost and decreasing the level of profits received by the individual farmers. The reasons for this according to the IMF is that the farmers were keener to have administrative control over the physical flow of their coffee rather than gaining a little more profits at the expense of delegating the ownership of their coffee to a bigger cooperatives.

In Figure 5.3 the Post Coffee Act 2001 flowchart shows that the farmers in the local cooperatives which make up the collection of small-scale farmers form the link between the smallholders to the marketing agents and subsequently to the central auction in Nairobi. The cooperatives pool together their resources to offer facilities and services like pulping of the coffee cherry, drying (mechanically or sun-dried) storage of the dried parchment and transport of coffee parchment to the centrally located marketing agents milling factories for advance secondary processing which includes hulling, grading and packing (Kenya European Commission, 2004, CBK: Coffee Traders Licensed Dealers, 2007). The marketing agent offers all of these services to cooperative society at a fee. Each cooperative has management committees to manage and oversee these services. However as described, many of the small scale farmers instead of pooling their resources and coffee output together have decided to split into smaller administrative units thereby increasing their control over the physical flow of the coffee under the liberal environment rather than using the liberal environment to increase their income (Kenya European Commission, 2004, CBK: Coffee Traders Licensed Dealers, 2007).

Under the previous regime the smallholders within a jurisdiction come together and form a cooperative with the consent of the Ministry of Cooperative, however under the present system, the smallholders can form their own cooperative without the need to inform or seek the permission of the Ministry of Cooperative (CBK: Report of the Task Force on Liberalisation and the Privatisation of the Coffee Industry, 1996). Under the pre-2002 regime it was compulsory for all smallholders to undertake primary and secondary processing with their registered local cooperatives.

However under the new Coffee Act 2001 the small-holders still go through the cooperatives structure, but they are now allowed to form their own cooperatives within a geographical

jurisdiction without the permission of the Ministry of Cooperative (Kenya European Commission, 2004). Under the current reform there is no limitation on the numbers of cooperatives that can be established within a geographical region, as a result the number of local cooperatives have increased rapidly, so has the problem of management within the cooperatives (Kenya European Commission, 2004).

With liberalisation of the coffee sector in 2002, two additional marketing agents, Socfinaf and Thika Coffee Mill have been competing intensely with the previously state monopoly of KPCU. The liberalisation of the marketing agents and the cooperatives has caused many cooperatives to split from the giant cooperatives and cross-over to different marketing agents in the hope of better service at a lower cost.

Table 5.4 below shows the milling capacity of KPCU, Socfinaf and Thika Coffee Mills and other private millers under the newly liberalised Kenyan coffee sector.

Table 5.4 Milling capacity

Company	Number of Mills	Installed Capacity (tonnes)
KPCU	8	108,000
Thika Coffee Mills	1	48,000
Socfinaf	1	*24,000
Private Millers		30,000
Total		210,000

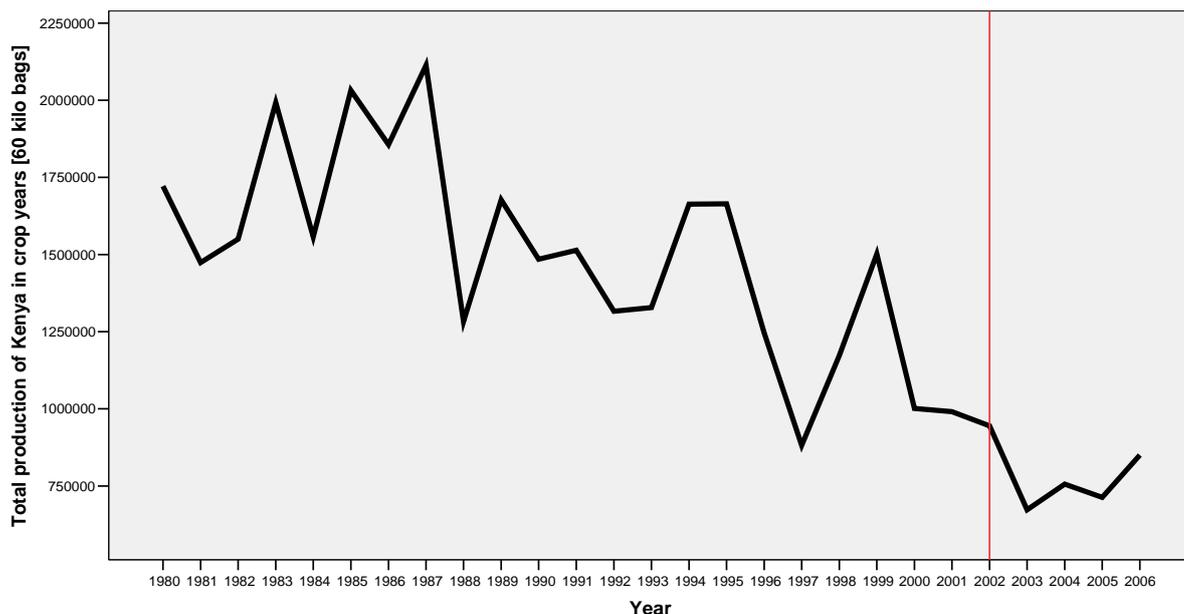
Note: * as of end 2003.

(Source: Mission estimate: Kenya European Commission, 2004)

5.3.1 Price and production

As described in the last chapter, Kenya enjoys one of the best coffee prices in the world. Figure 5.5 below presents Kenyan coffee production from 1980 to 2006. Figure 5.5 shows coffee production has been on a declining trend over the last 26 years, the liberalisation programme introduced in 2002 (marked by a red vertical line) has not made significant impact in reversing this trend.

Figure 5.5 Kenya coffee production 1980 to 2006



(Source: ICO, 2007)

The trend in coffee production in Figure 5.5 shows that since 2002, the year after the IMF policies were implemented, coffee production have continued to be on a declining trend.

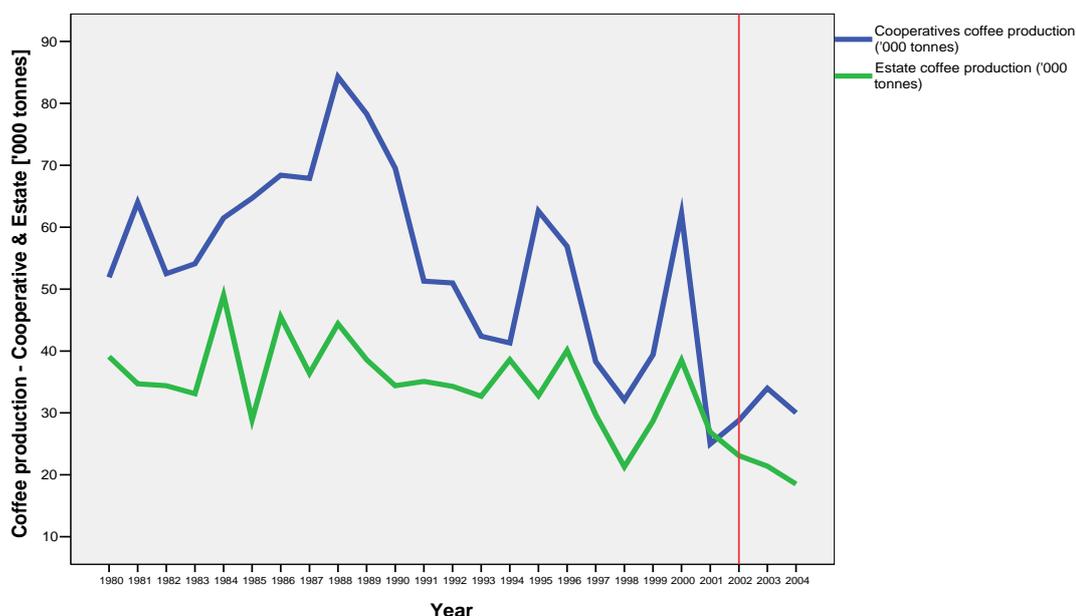
When considering coffee production between the cooperative and estate from 1980 to 2004 in Figure 5.6, the co-relation between the two was 74 percent. This shows that cooperative production and estate farm production follow a close trend thereby implying that the changes in the way the cooperative sector production will have some impact on the estate sector production

Increasing sub-division of estate farms into smallhold in the early 1980s has increased the number and the need for local cooperatives stations to service the many emerging small hold farmers. The greatest gap in production between the two (small and estate) was recorded between the years 1987 to 1989. The rise in production during this period was mainly because of the boom in world coffee prices, making smallholders to substitute from other crops to coffee.

In 2000/2001, the year before the IMF liberalisation was implemented the cooperatives sector output declined to the point where it matched the output from the estate sector. The outlook in 2001 a year prior to implementing the liberalisation programme had created many uncertainties among the smallholders which caused many small scale farmers to suddenly scale down on production in anticipation of the changes in the sector. However the decline in

production in the estate sector had been gradual. Production between the two sectors diverged again in the years following the implementation of the liberalisation programme. See Figure 5.6 below showing the year when the production between the small and estate farmers equalled each other in 2001 and the year when the liberalisation was implemented, which is marked by a vertical red line.

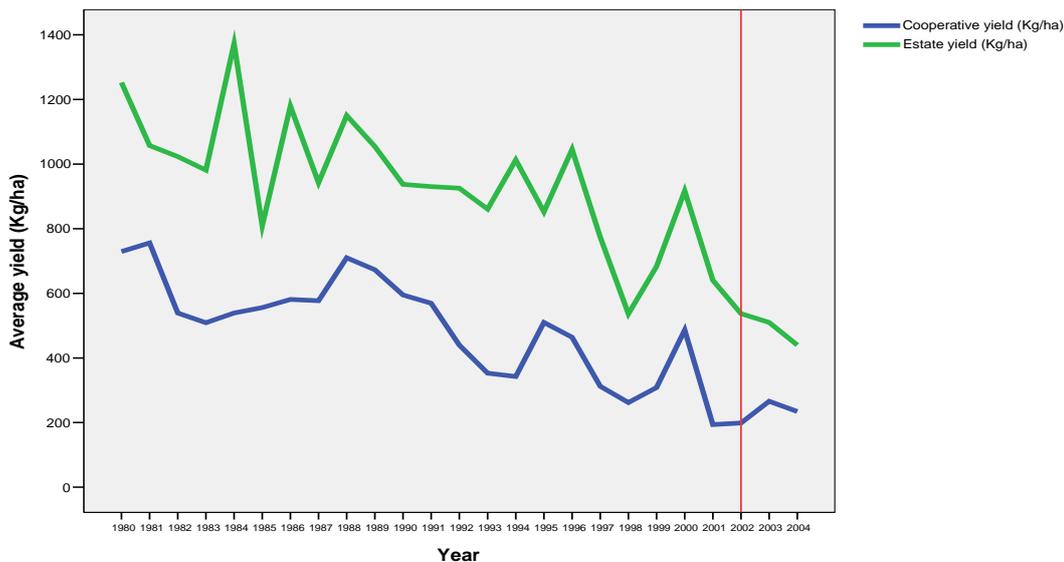
Figure 5.6 Cooperative and estate coffee production 1980 to 2004



(Source: CBK Statistics, various years)

As coffee production between estate and smallholders declined, the overall trend in the average use of land devoted to growing coffee also tended to be decline. Figure 5.7 below shows the average yield of coffee between cooperatives and estate in Kenya from 1980 to 2004 to be on a declining trend.

Figure 5.7 Trend between cooperative and estate average yield in Kenya (1980 to 2004)

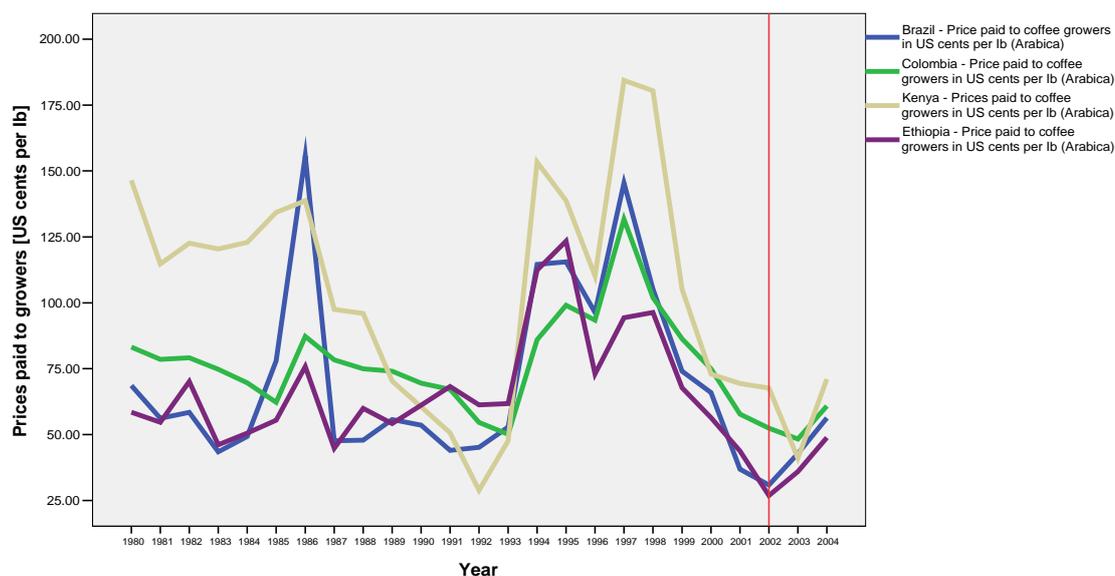


(Source: CBK Statistics, various years)

It can be concluded from observing the coffee producers in Figure 5.5 and the average yield of coffee between the cooperatives and estates in Figure 5.7 that things became worse after 2001.

Although under the present arrangement, Kenyan coffee output has not increased, the Kenyan coffee farmers have continued to be one of the highest recipients of average coffee growers' income when compared to other major Arabica coffee producers in the world. Figure 5.8 below shows the comparison of prices paid to coffee growers in the four Arabica coffee producing countries.

Figure 5.8 Prices paid to coffee growers in Kenya, Brazil, Colombia and Ethiopia (1980 to 2006)

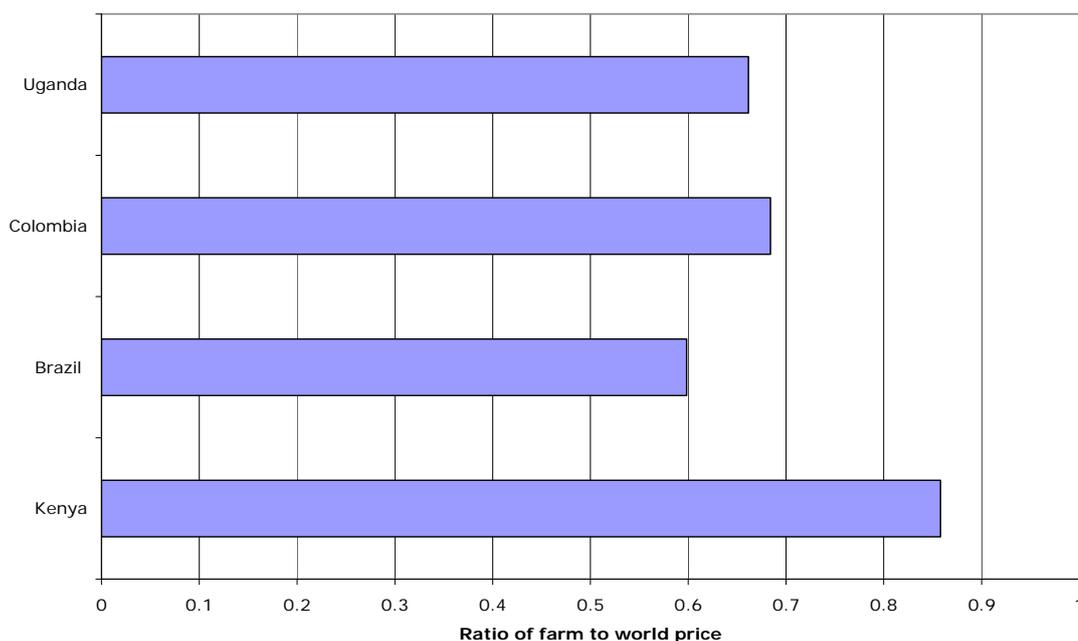


(Source: ICO, 2007)

This shows that the trend in coffee prices received by the coffee farmers in the top four coffee producing countries follow a similar pattern particularly for the period from 1992 to 2004. Figure 5.8 also illustrates the prices fetched by the Kenyan coffee producers to be the highest in the world and this is mainly because of the premium quality of Kenyan Arabica coffee and the willingness of the international traders to pay prices above the prices of other coffee origin. When comparing between small and large coffee producer in Kenya, the small scale coffee growers produce one of the best quality coffee in the world.

When comparing the producers' share of world prices, Kenya emerges as the top country where farmers receive the highest share of world price among the top four countries selected from Coe (2006). These four countries were selected from Coe (2006), because they showed to have the highest farm to world price ratio for the period from 1996 to 2002. In this study we considered the four countries (Kenya, Uganda, Colombia and Brazil) and found Kenya to record the highest farm to world price under the period 1980 to 2004 (Coe, 2006). This is demonstrated in Figure 5.9 below.

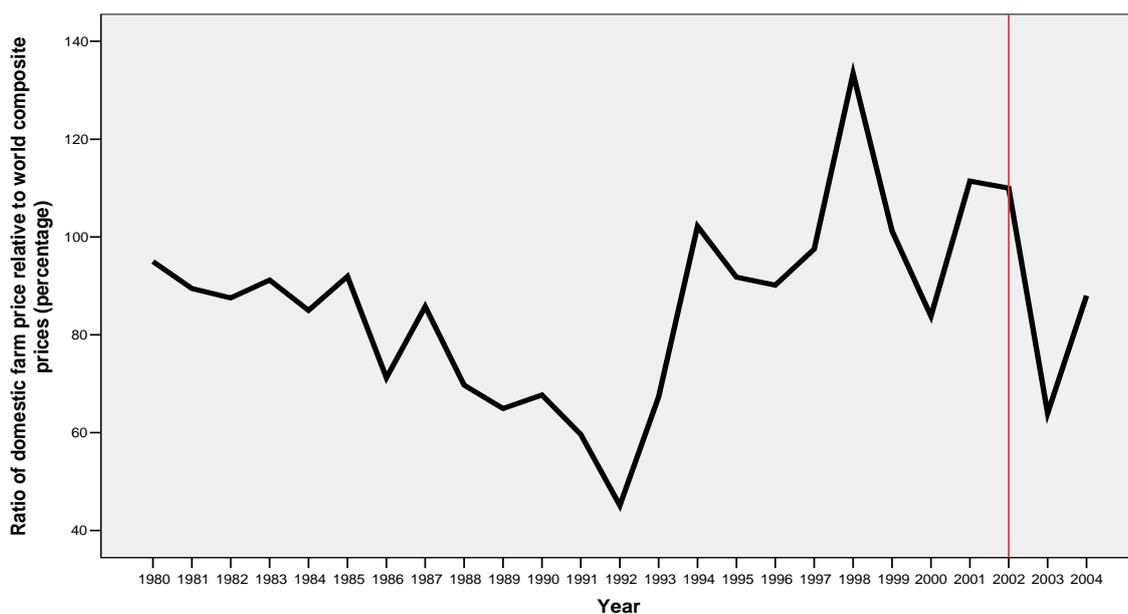
Figure 5.9 Average producer share of world price by country (using time series data from 1980 to 2004)



(ICO, 2007)

However when observing the ratio of Kenyan farmers to world price over the period from 1980 to 2004, the story appears to be different. Figure 5.10 below shows a decline in the trend in the ratio of farm to world price received by Kenyan farmers, particularly from the period 2002 when the IMF liberalisation programme was first fully implemented.

Figure 5.10 Trend in ratio of farm to world price



(Source: ICO, 2007)

The trend shows the farm to world price is on a downward path particularly from the year 2002 when the programme of liberalisation was first fully implemented. The fall in payment is especially drastic since liberalisation was implemented in 2002. In the space of one year the ratio of price received by the domestic farmers fell from 1.10 cents to 0.64 cents per pound of coffee in one year (ICO, 2007). The decline of 0.46 cents per pound is the largest fall since 1992 when the coffee sector was still largely under state control. Although the trend began to recover in 2004, there were no signs of sustainable recovery because of the lack of stable policy environment that offered clear benefits from the process of liberalisation.

One of the often quoted explanations for the decline in the ratio of price received by the Kenyan farmers is the high cost faced by Kenyan coffee producers. According to the Kenyan European Commission (2004) report, the high cost faced by the producers is mainly at the stage of primary processing at the cooperative level. More discussion on cost and its implication at the macro level is discussed in section 5.3.3 below. More on how the decline in the share of world price impacts on the morale of the Kenyan farmers will be cross-examined from the interview data in the next chapter.

The chart in Figure 5.10 above shows that the trend in the ratio of farm to world price has been declining particularly from the period when liberalisation was implemented in 2002, suggesting that the liberal market environment has actually increased the cost of operation and reduced the levels of profits earned. The rise in the cost of operation has not only been purely in terms of rising input cost but also in terms of rising cost of capital. With the implementation of liberalisation, the problem of waiting period for the farmers to receive their payment has not improved but has only added additional stages in the payment systems.

In the next section, the views from the farmers and the dealers who act as middle man will be examined and analysed with reference to the problem of payment to farmers.

5.3.2 Payment to farmers

One of the main reasons for liberalising the coffee sector and allowing more marketing agents to enter the sector is to bring competition and with competition it was expected better services will be delivered to the small and large coffee farmers. However one of the most contentious issues, as the coffee sector expanded over the years was the time taken for the farmers to receive their payments from the dealers via the marketing agents.

There is no distinction in the payment structure between small and large scale farmers in Kenya, however mismanagement and lack of accountability in the payment system often

makes small scale farmers suffer more than the estate farmers. Estate farmers on the other hand are able to use their resources to recoup their money quicker than the small scale farmers. The small scale farmers neither have these resources nor the management skills at the local cooperative level to promptly recover their money from the sale of coffee.

According to the auction rules, once the coffee beans are auctioned, the buyers (trader/dealers) must make their payment to the sellers (marketing agents) within seven days, who would then disburse the payments to the farmers, however the payment from the marketing agents to the producers often fail to reach the farmers in good time. This is not because of the delay in payment from the traders/dealers but rather the delay in the disbursement of the payment from the marketing agent to the farmers. Table 5.11 below shows the timeline of payment to coffee growers at different levels of activity. According to the European Commission Kenyan Report (2004) the bulk of funds are received from the marketing agent 11 to 28 weeks after the delivery of cherries to the cooperatives.

Final payments to the cooperatives however can take up to 12 months after the delivery of cherry at the local cooperative factory station though this can vary from cooperative to cooperatives. Also the final payment is usually made at the end of the financial year, which acts as a natural cut off point for payments (Kenya: European Commission, 2004, part 2 – page 47).

Table 5.11 Timeline of payment to coffee growers

Activity	Time From Delivery (weeks)	
	Minimum	Maximum
Delivery of Cherry to coop		
Primary Processing	2	4
Storage	4	8
Milling	5	20
First Auction	9	26
Final Auction	15	52
First Payment	11	28
Final Payment	17	54

Source: Mission estimates.

(Source: Kenya European Commission, 2004, part 2 – page 47).

The European Commission Kenyan Report (2004) noted that the delay in payment has been an ongoing problem from the days of state control and the liberalisation programme has not eliminated or improved the problem. Any delay in payment to the farmers, will inevitably

impact on the efficiency of the sector, in the next chapter the views of the farmers on this issue are gathered and analysed.

5.3.3 Cost of processing

The cost of primary processing for estate sector in Kenya is much more competitive than the cooperative sector. In the past the high cost of primary processing in Kenya was compensated by high export prices received by the farmers. However under the current market conditions and structure, the Kenyan smallholders are at a disadvantage compared to those of Colombian and Costa Rican producers. This is because the Kenyan producers are now facing increasing cost and therefore profit margins have steadily declined largely because of the rising cost of processing.

However the advantage of selling coffee directly by bypassing the central auction system means that the farmers can cut out on the commissions and levies that the farmers are subjected to pay in the internal marketing structure. Under the present liberalised structure, Kenya is still a high cost producer compared to other coffee producers in Africa and Latin America. Table 5.11 below shows the marketing cost comparison between Kenya, Colombia and Costa Rica for 2001/02. The data shows that marketing cost in Kenya to be the highest with USD 0.71 per-kg.

Table 5.12 Marketing Margins, 2001/2002 (USD per kg)

	Kenya	Colombia	Costa Rica
FOB	1.73	1.30	1.38
Transport	0.05	0.03	0.04
Exporters Costs	0.13	0.08	0.03
Levies	0.06	0.12	0.02
Milling	0.08	0.03	0.21
Milling Margin and Costs	0.08	0.06	0.12
Primary Processing (including transport to mill)	0.31	0.06	
Implied Producer Price	1.02	0.91	0.96
Grower Price % FOB	59%	70%	69%
Marketing cost	0.71	0.39	0.42

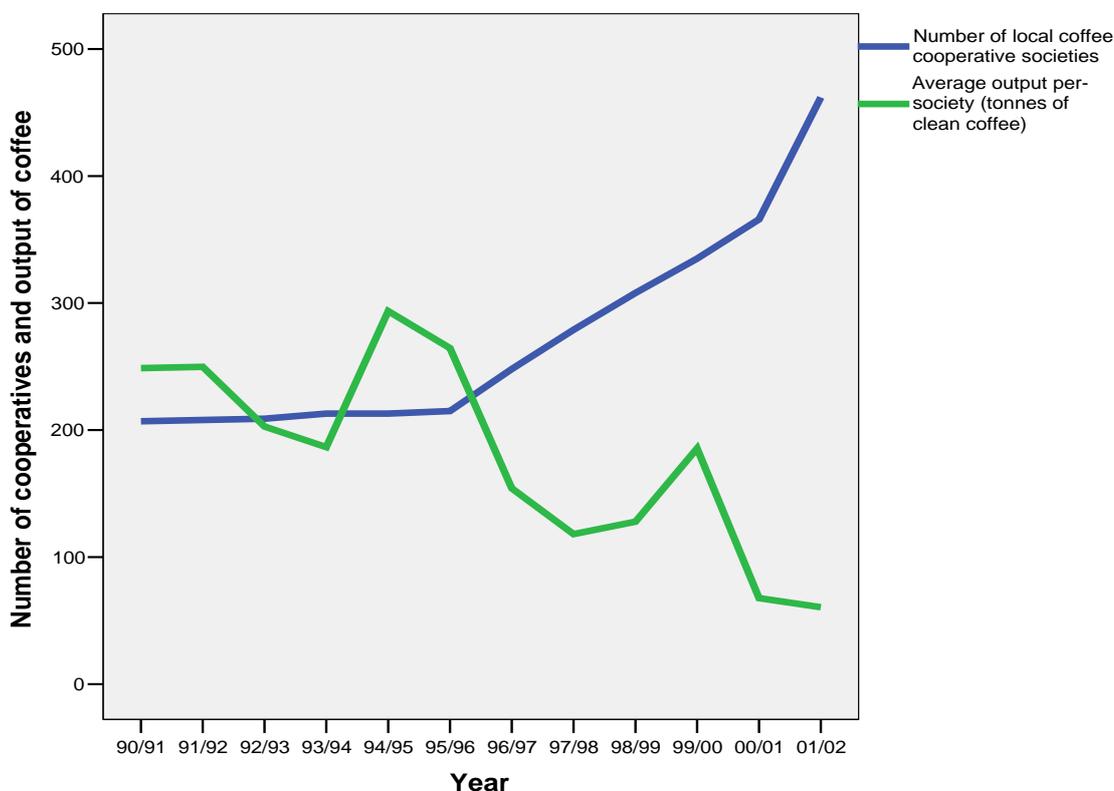
Notes: Costa Rica – Milling includes primary processing.

(Source: Kenya European Commission, 2004, part 3, p.141)

One of the reasons for the rise in the marketing cost of the Kenyan producer is the increase in the number of local cooperatives that have split from the larger cooperatives to form their own institutions in order to exercise their economic freedom in choosing the marketing agents that they want to do business with thereby increasing their freedom of choice at the expense of rising cost of processing.

Figure 5.12 below shows the increase in the number of coffee cooperative societies, especially from 1995/1996 when the coffee sector was partially liberalised and in 2002 when the sector was fully liberalised. With the implementation of the IMF liberalisation programme in 2002, the few remaining barriers to splitting from larger cooperative were eliminated in the hope that this would give the smallholders the freedom to associate among a smaller number of smallholders to pool their resources together and exercise their bargaining power. The chart below shows the increase in the number of local coffee cooperatives over the period from 1990 to 2002. Figure 5.12 shows that while the number of coffee cooperative societies rose, the average output per-society have been declining especially from 1997/1998 onwards.

Figure 5.12 Number of cooperative societies and average output per-society



(Source: Coffee Board of Kenya: Annual Report, various years)

According to the marketing agents, economies of scale are particularly easy to achieve if the small scale farmers cooperate and deal as one large unit with the marketing agents, instead of splitting into smaller cooperative units, which makes their processing cost high. The high costs of processing have a greater impact on the smallholders than the large estate farmers because of the lower volume of coffee produced and high input cost incurred by the smallholders.

Despite the liberalisation of coffee processing, the cost of primary processing at the cooperative level remains extortionately high. Cost remains a major constraint in the internal marketing chain with salaries and maintenance cost ranking the highest at the cooperative level. The operating cost forms a very important incentive for the growers to continue to produce the best quality coffee.

In comparison to Kenya, the cost of primary processing is lower in Colombia mainly because of its marketing structure. In Colombia, growers process their own cherry on the farm like that of Kenyan estate farmers, however in Kenya smallholders who produce the majority of high quality coffee has no choice but to process their coffee through the cooperative system unlike in Colombia where the growers are largely independent. Similarly in Costa Rica growers bring their coffee to a central washing station where coffee is pooled and processed together, however according to the European Commission the cost of processing in Costa Rica is kept lower by a combination of : (i) competition between the processors (called 'beneficios') competing for farmers coffee and; (ii) legislations which allows easy entry of new millers into the market without the need to be linked to a local cooperative in some processing activities. (Kenya European Commission, 2004)

Table 5.14 below presents the operating cost faced by smallholders in Kenya. According to the Kenyan European Commission mission study, despite the competition between the processors (marketing agents), the cost of processing remains high as before the liberalisation programme when other ancillary costs are taken into account.

Table 5.14 Cooperative Operating cost

	Ksh/kg clean coffee	% of Total
Salaries	3.09	15%
Casual Labour	2.67	13%
Processing Materials	2.24	11%
Repair and Maintenance	3.20	16%
Bank Charges	0.53	3%
Interest	2.13	11%
Committee Expenses	1.07	5%
Training/Education	0.80	4%
Fuel/Electricity	0.45	2%
Other	4.10	20%
Total	20.28	

(Source: Kenya European Commission, 2004, part 2 – page 78)

The four factors that determine the costs of running a cooperative society in Kenya are: (i) volume of coffee that's passing through a factory, which ensures a high level of capacity utilisation; (ii) the quality of cherry, ensuring good conversion ratios cherry/clean coffee; (iii) proficient management and; (iv) a manageable level of debt (Kenya European Commission, 2004, part 2 – page 78). In the next chapter these four factors will be cross examined using the interview data.

5.3.4 The international market

Another major area of coffee liberalisation is the opening of an alternative opportunity for the coffee producers to sell their coffee directly to the international market instead of relying on the marketing agents to sell on their behalf.

It was expected that by granting greater freedom to the coffee producers, they can circumvent the marketing agents and sell their coffee directly to the international coffee dealers and thereby cut the middle man costs and capture larger profit.

According to the available statistics the export of coffee from Kenya has traditionally been dominated by foreign traders. Under the present system, there are about 109 buyers or traders registered with the CBK (CBK, 2007), however only around 40 or so traders actively participate in the weekly auctions by buying coffee in the Nairobi Coffee Exchange, Nairobi. Among the few traders, about seven dealers dominate the market with purchases ranging

from 4.4 percent to 10.3 percent of the overall market in 2002/03 (Nairobi Coffee Exchange Data, 2004), the remaining 90 percent of the dealers tend to purchase smaller quantity of coffee irregularly from the weekly auction.

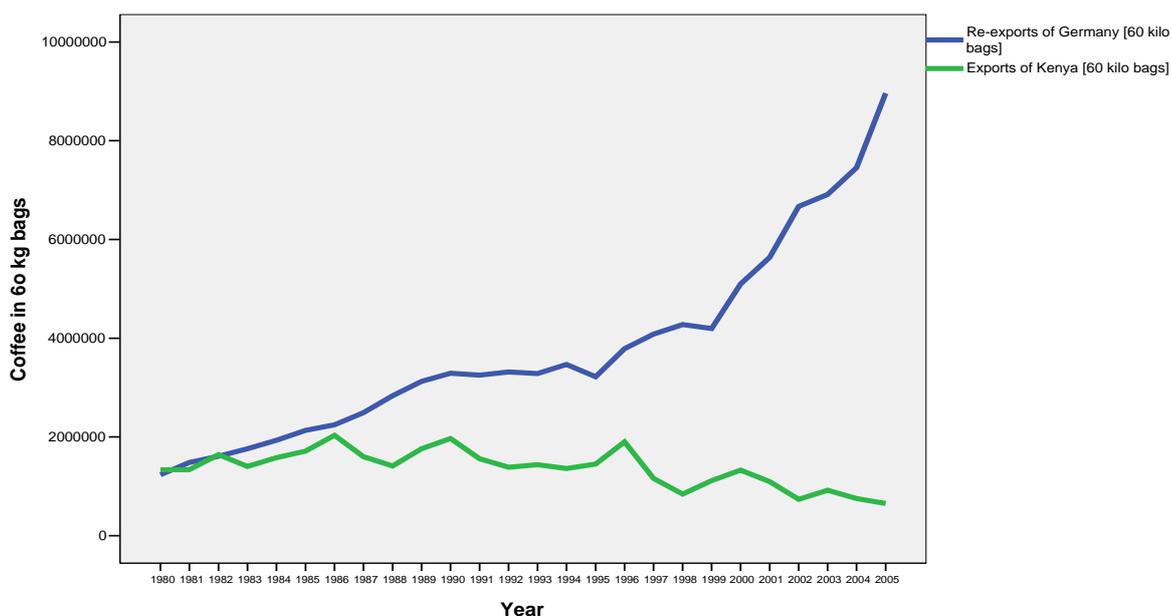
One of the main reasons for the dominance of few players in the market is the requirement of large financial capital (CBK, 2007). Large capital is required because payments to the auctioneers must be made within seven days of agreeing to buy. The capital requirement is one of the main reasons why there are a limited number of domestic players in the market. Often dealers representing multi-national corporations are backed up by large multi-national banks in providing capital with which the dealers outbid the small players at the auction (Nairobi Coffee Exchange Data, 2004).

In addition to the capital requirement, the other reason for the high concentration of foreign buyers in the auction market is the established and proven export market for marketing of their coffee (Kenya European Commission, 2004). Often dealers representing large multinational corporations have an established network of international supply chain to undertake advance processing and to re-export the retail ready product. Traditionally Germany has been the largest importer of Kenyan coffee. This also means the distribution network and processing facilities in Germany have been well established over the years, offering great potential to the dealers to exploit the market.

Exports of Kenyan coffee to the European Union and the United States of America (USA) are also considered lucrative markets for the dealers. Germany, USA and other EU countries are considered lucrative because of the domestic and the re-export market potential undertaken by the large roasters and blenders in these countries (Coe, 2006).

Figure 5.15 below shows the wide divergence between Kenyan coffee export and Germany's re-export of coffee from 1976 to 2005. Data from 1997 to 2001 shows that Germany is the largest importer of Kenyan coffee, particularly for its highly valued acidity taste. The availability of capital, storage facility, expertise in processing and packaging, market access and efficient management makes Germany a major global player in importing, blending and re-exporting coffee around the world.

Figure 5.15 Export and Re-export of coffee (1980 to 2005)



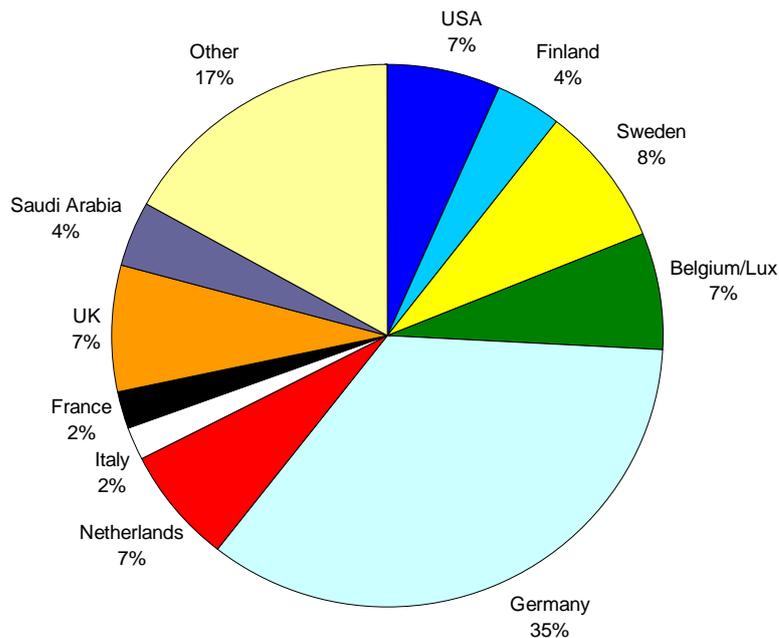
(Source: ICO, 2007)

In addition to Germany, the other countries that highly value and traditionally import Kenyan coffee are the United States, Sweden, Netherlands and the UK. See Figure 5.16 pie-chart below for the Kenyan coffee export markets from 1997 to 2001. All of the importing countries are industrial countries where the technology for innovation in blending, marketing and distribution are well established in comparison to the coffee exporting countries, like Kenya. The multinational firms in these countries are also well managed, have established distribution networks with the wholesalers and retailers and have built reputable brand names for their coffee products over the years.

It is expected by the Kenyan Ministry of Agriculture that with liberalisation, the Kenyan coffee sector will create indigenous Kenyan coffee multinationals which will invest in branding and innovation and ultimately penetrate the international market and compete with other leading brands in the world.

In the next chapter the re-action from the indigenous and international coffee dealers from the importing countries like Germany and UK will be analysed and assessed with reference to the potential of the Kenyan coffee sector in creating indigenous multinational firms.

Figure 5.16 Kenyan coffee exports by market 1997 to 2001



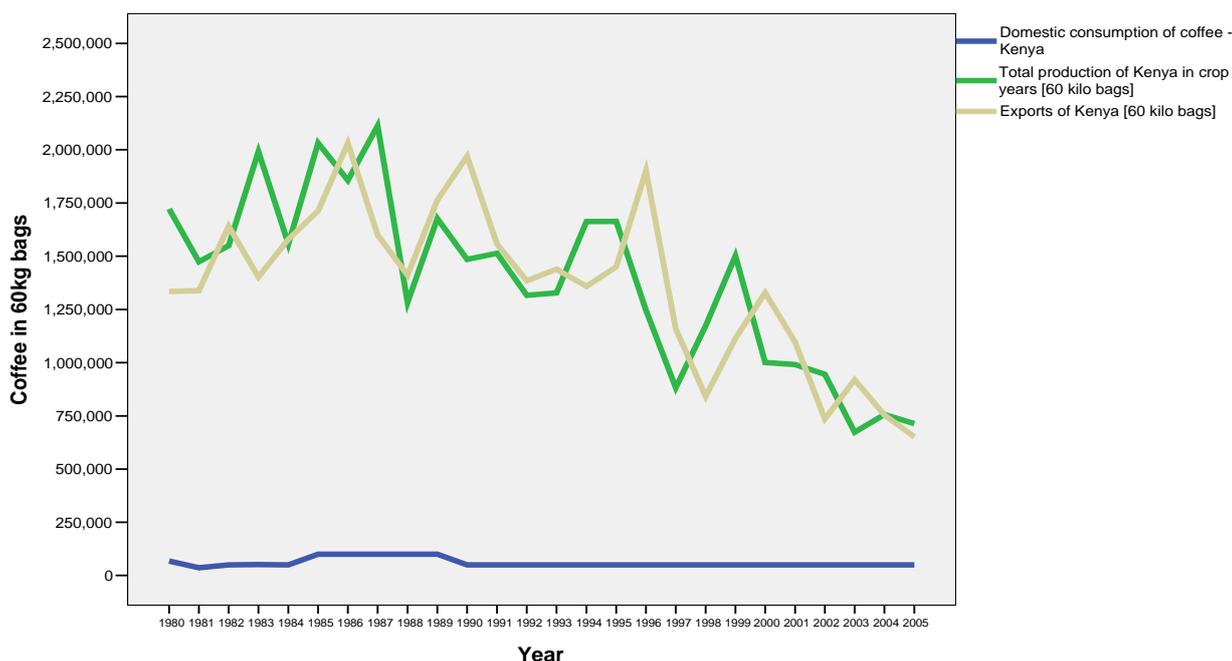
(Source: Kenya European Commission, 2004)

5.3.5 Innovation

Related to increasing the economic freedom of the producers in selling coffee to the international market is the increasing attention devoted to creating innovation for the coffee sector under the liberalisation programme. Under the act, it is expected that competition among the marketing agents will spur the sector into undertaking innovative method of adding value and finalising the export of coffee as a retail ready product to the international retail market.

At the moment very little of Kenyan coffee is processed for domestic consumption. See Figure 5.17 below for the divergence between Kenyan coffee production, export and domestic consumption.

Figure 5.17 Kenya coffee production, exports and domestic consumption movements (1980 to 2005)

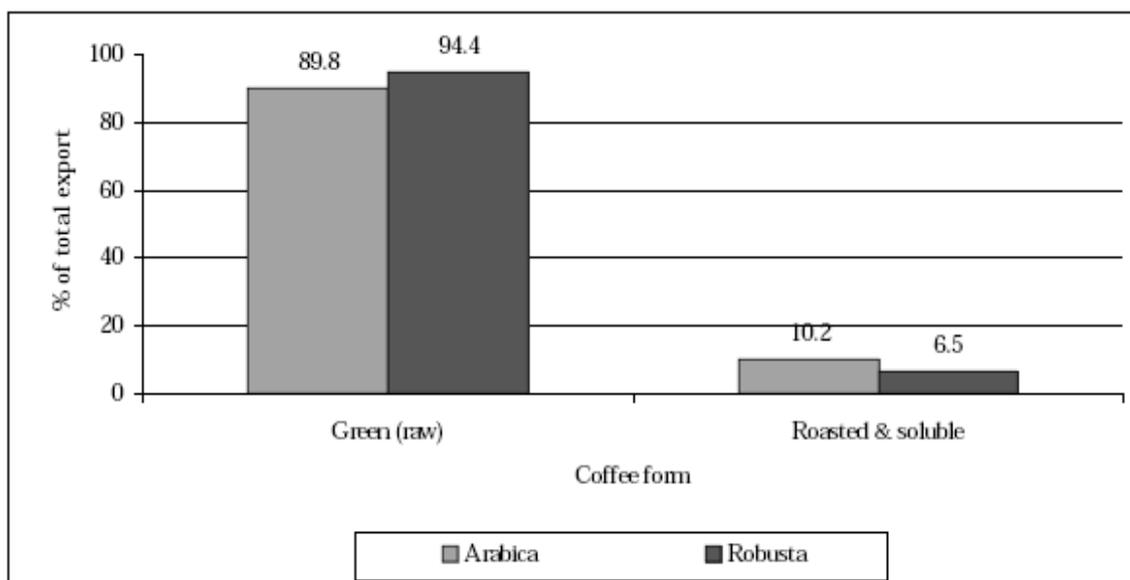


(Source: ICO data, 2007)

Historically the bulk of Kenyan coffee is exported to the international market in green-bean form for the blending and processing of coffee into different flavours using coffee from other countries before it is packed and distributed to the Western supermarkets for lucrative profits (Kenya European Commission, 2004). With liberalisation the GOK and the IMF expects more investment to take place among the marketing agents and estate farmers in adding value opportunities within Kenya as opposed to merely exporting it as a raw commodity good to overseas markets.

Figure 5.18 below shows that about 95 percent of world coffee is exported in the green bean form with 6.5 percent in soluble and about 10 percent roasted where Kenya accounts for about 1 percent of global coffee production and 2 percent of the value of global exports (Kenya European Commission, 2004).

Figure 5.18 Global coffee exports, 2000/01



(Source: ICO Statistics in Karanja, A and Nyoro, J, 2002, page 15)

The premium acidity quality of Kenyan coffee allows the international roasters to define and create unique taste according to the preference of the consumers in specific markets. The ability of the roasters to switch between origins using Kenyan coffee as a premium demonstrates that the international roasters are in a more powerful position than the domestic Kenyan coffee roasters in creating and maintaining coffee consumers internationally.

According to the Kenyan Ministry of Agriculture with the liberalisation of the coffee sector, Kenya can also be like Germany in developing the technology and expertise in adding value and exporting coffee to the world market as an end retail product.

The attempt to roast and blend Kenyan green bean is aimed at branding Kenyan coffee as a single origin product for the international market consumers. The branding and blending of 100 percent Kenyan coffee is also aimed at lifting the share price received by the farmers and minimising the cost of intermediaries like bank charges, dealers commission and shipping cost.

At present there are only about 13 registered domestic roasters catering for the local market as demonstrated in Table 5.19 below. Very little of the processed coffee is exported to retailers and wholesalers around the world. The majority of the processed coffee is sold

domestically. It is expected with liberalisation more domestic firms will take part in innovation in roasting and blending within Kenya using the premium local Arabica coffee blend.

Table 5.19 Registered Roasters in Kenya 2002/2003

	Registered Capacity (kg)
Stevkham Enterprises	24,000
KPCU Coffee Exporters	150,000
Raki Investments	240,000
Malaika Coffee and Tea	1,080,000
C.Dorman	960,000
Kenya Nut Company	1,200,000
Mwangi Coffee Exporters	30,000
Kwacha Coffee	500,000
MA Pandit & Co	261,000
Bico	500,000
Cejo Investments	288,000
Central Impex Enterprises	2,400
Nairobi Java House	75,000
Total	5,310,400

Source: CBK.

(Source: Coffee Board of Kenya, 2004)

Although the desire to increase the economic freedom and create a conducive environment for innovation to take place is laudable, these attempts are not without challenges, at a macro level trade barriers appear to be the main barrier in addition to other domestic challenges.

The tariff on the import of green bean coffee in the three major coffee consuming regions (EU, US and Japan) is set at zero with the tariff rising for processed coffee. Of the three regions, Japan imposes the highest tariffs with the Most Favoured Nation (MFN) tariffs at 16 percent for Roast and Ground coffee and 13 percent for soluble coffee, while Generalised System of Preferences (GSP) tariffs are set at 10 percent and 9 percent, respectively. However there are no tariffs imposed on Kenyan coffee when imported into the United States (Kenya European Commission, 2004).

Table 5.20 below shows the tariff rates imposed by the European Union (EU) on roast and ground (R&G) and soluble coffee that is imported from outside the EU. More on how the local Kenyan dealers and agents view the tariffs under the liberal market condition will be discussed in the next chapter.

Table 5.20 EU Coffee Tariffs

	Green Coffee	R&G	Soluble
Tariff Codes	090111 090112	090121 090122	210111
MFN	0.0%	7.5%	9.0%
GSP	0.0%	2.6%	3.1%
ACP	0.0%	0.0%	0.0%

(Source: Kenya: European Commission, 2004, part 1, page 39)

5.4 Conclusion

The conclusion from the secondary quantitative analysis is that the reforms of 2001 did not work as they were intended. The macro-data and discussion presented in this chapter are in reference to some of the main changes identified in the Kenyan coffee sector under the Coffee Act 2001. The macro data on the Kenyan coffee sector shows that coffee is an important commodity to the Kenyan economy in terms of export crop, employment and foreign exchange revenue earner. The data also shows that Kenyan coffee is highly valued in the international market and it often fetches a premium price over coffee from other countries. The Kenyan farmers also fetch the best price in terms of domestic to world coffee price when compared to farmers from other main coffee producing countries. However the monopoly activities within the coffee sector, particularly from the post colonial period have impeded progress in the sector. The monopoly service provider KPCU and the regulatory regime of CBK has largely produced adverse outcomes in delivering efficiency and profitability to the farmers in the sector, particularly during the 1990s, when political influence was pervasive in all state institutions including the coffee sector. As a result of this, reforms within the coffee sector was pursued in 2001 and implemented in 2002, the macro-data shows that the liberalisation of the sector has increased the number of local cooperatives and reduced the average output of coffee yield. In addition, the data also shows that the freedom given to the small scale farmers has increased the cost of processing and the outlay of running local cooperatives.

As mentioned in the beginning of this chapter, the IMF assessment on the Kenyan coffee sector liberalisation programme is based on qualitative and quantitative assessment. The quantitative assessment in this chapter is cross-examined with the qualitative assessment from the interview data in the next chapter.

Chapter 6

Analysis from the interview

6.1. Introduction

The aim of this chapter is to cross-examine the secondary data presented in the last chapter against the primary data gathered from the face to face interview. The qualitative data are gathered from a set of 23 face to face interviews. The purpose of the interviews is to draw the perception and views of the stakeholders on the liberalisation programme from their own experience rather than from aggregate data. The discussion in this chapter is data driven with the themes covering the merits of liberalisation and the problems of liberalisation with particular reference to the case of Kenyan coffee industry. This chapter is organised by briefly re-stating the restraints faced by the growers and other stakeholder in the coffee sector and by analysing the re-action of the stakeholders to the changes following the liberalisation of the sector.

6.2 The restraints

The argument for liberalisation presented by the IMF and the GOK is to transform the coffee sector from an inefficient to cost-effective producer and to subsequently lead to higher income and higher ratio of world to farm price received by the farmers. Some of the inefficiencies identified in the coffee sector from the interviews include:

- i) long delays in payment to the farmers
- ii) monopoly of public enterprises in processing and selling of coffee
- iii) lack of transparency in identifying the reserve and selling price realised at the auction market
- iv) high input cost due to the monopoly of the public enterprise in importing fertilisers, machinery and other input materials
- v) lack of innovation in the industry
- vi) low levels of morale amongst coffee producers
- vii) an ever increasing number of smallholders substituting coffee for other crops in the same plot which drives down the quality of the coffee yield eventually leading to lower prices

According to the GOK, the IMF and the World Bank (WB), the solution to these problems was to liberalise the sector in the hope that freedom, mobility, choice, and innovation would be increased and the producer's income improved. The hypothesis according to the IMF was

that by freeing the coffee industry from institutional constraints, coffee production and grower's morale in the sector would be increased. The aggregate data on the Kenyan coffee sector shows that liberalisation has not transformed the sector and there are still numerous impediments to improving the efficiency of the coffee market.

The research participants' views and the secondary data show that farmers' income has not improved, the morale amongst the farmers has not been revived and the institutional inefficiencies have multiplied since the liberalisation programme was implemented. These views are explored in detail in order to ascertain the extent and the ways in which the participants' experiential accounts throw light on the outcome of the policy change.

Among the interviewees considered in this research are: coffee farmers; staff at the Ministry of Agriculture and the Ministry of Cooperatives, officials at the Coffee Board of Kenya, chairman of a coffee interest group, managers of coffee mills, bankers, journalist, coffee traders and a diplomat. In addition to the face to face interviews, I also undertook field visits to: the Thika Coffee Mill, Kenya Planter Cooperative Union (KPCU), the Coffee Board of Kenya Liquoring lab, small and large coffee farms, the Inland Revenue, the French Institute of Economic Research, and the Institute for Development Studies (IDS) of the University of Nairobi. On average an hour and a half was spent with each interviewee. Most of the interviewees were willing to participate and answered most of the questions at varying level of depth.

There is a general acceptance among the interviewees that the liberalisation programme has an important influence on the coffee sector in particular and the economic development of Kenya in general. The questions from the interview schedule were designed to elucidate the extent of this impact in the coffee sector.

The response from the respondents on the changes will be discussed in detail in the rest of this chapter and the themes to emerge from the interviews includes accountability, input cost, democratic space, finance, corruption, infrastructure, institutions, integrity, trade, liberalisation, local cooperatives, payment systems, cost, taxes, and transparency.

6.3 The reforms and its impact

The main findings from the interviews are discussed below with reference to the liberalisation of the coffee sector and by making some reference to the secondary data discussed in the previous chapter. According to interview participants; the reforms made no big difference to improving efficiency in the coffee sector but they were instead keener to highlight the

problems relating to management of the cooperatives and the marketing regime in general, and of the inefficiencies and corruption which had resulted from the liberalisation programme. It is also interesting to note that the coffee growers were not demanding for more liberalisation in response to the inefficiencies in the sector but were more concerned about identity and power associated with the local cooperatives. In other words the growers were not looking for institutional change to give them better markets; in fact, they sought to avoid markets through direct dealing and by constructing new sales outlets through local processing and domestic markets. In the section below a fuller experiential account of the interview participants are analysed and presented with reference to liberalisation of the sector.

6.3.1. Cooperatives

The most significant finding from the interview data is the way the cooperatives operated and re-acted in governing the small scale coffee production in the post coffee sector liberalisation in Kenya. The small scale producers who are responsible for about 60 percent of coffee production re-acted to the problems within the cooperatives by seizing the opportunities offered by liberalisation by exiting from the cooperatives and forming new cooperative associations instead of transferring their membership to another. This reflects the localised nature of the cooperatives in responding to the problems of the cooperatives which resulted in inefficient economies of scale and costly marketing network.

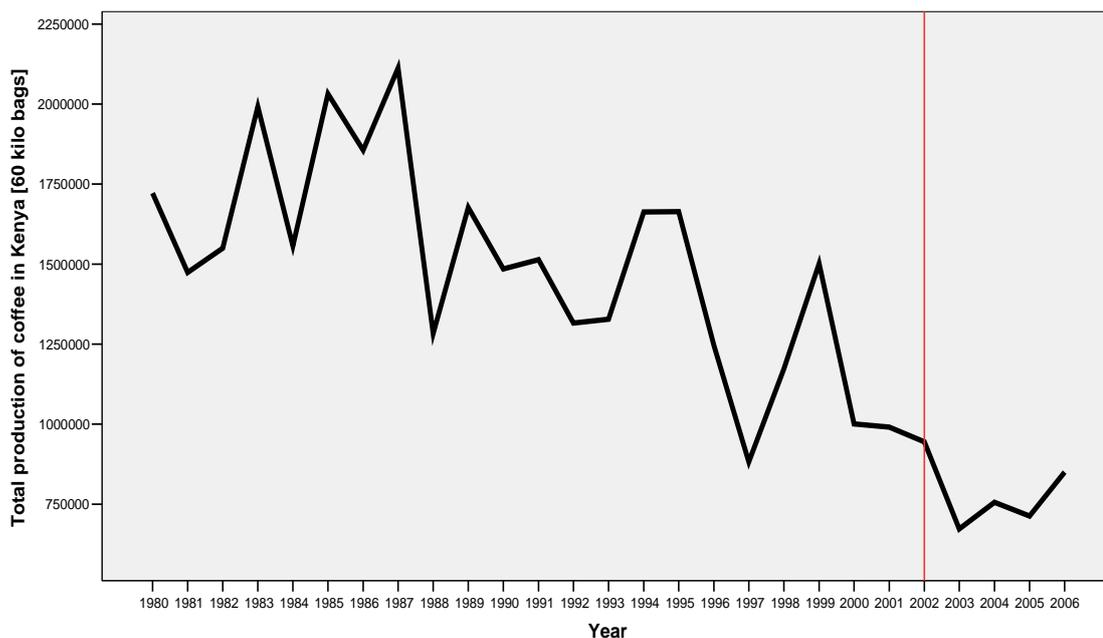
From the conversation with the farmers and officials in the coffee sector, it appears that the programme of liberalisation to increase the freedom of the market has not particularly been favourable to the coffee sector as a whole. This is because the liberalisation has given the farmers, especially the small scale farmers the freedom to sub-divide their cooperatives into smaller groups in order to exercise bargaining power and choice but this freedom has not helped to improve the efficiency in the sector.

According to the interview conversations with the CBK officials and farmers, the breakdown of local cooperatives into smaller groups offered opportunities to split and form smaller local cooperatives the chance to exercise their power in deciding over a range of issues such as jobs, identifying and appointing suppliers, appointing marketing agents, deciding and setting processing cost charges, appointing transport service providers, making investment plans and decisions, authorising borrowings from financial institutions and other administrative budget decision at the local cooperative level.

When probed on the details of internal wrangling, some of the small scale farmers cited that they split from the larger cooperatives more for reasons of management power and less for economic reasons. According to the farmers in a smaller set up, the local cooperatives have greater influence over the election and control of its members onto the committee board. The members can therefore exercise their power effectively in influencing their decisions in budgeting, planning, investment and employment. Also in a smaller cooperative, the committee members who are elected to manage the cooperative resources can be called to account more frequently and with less bureaucracy. In a larger cooperative where there are many registered farming members, the extent of influence of individual farmers to influence and lobby the committee members over the decision, especially on which marketing agents to use for secondary processing can be less persuasive. The small scale farmers claim that in a larger cooperative there is a lack of accountability from its committee members towards its farmer members except once a year at the Annual General Meeting.

A senior official in the Ministry of Cooperative lamented that the lack of proper orientation and induction for the small scale farmers in the newly liberalised cooperative institution has been one of the major factors for the rise in sub-division among the cooperatives and decline in coffee production from the peak of production in the mid 1980s to recent years. The rise and fall in coffee production from 1980 to 2006 is presented below in Figure 6.1 showing a decline in the trend of coffee production over the last 26 years. According to a senior official in the Ministry of Cooperatives the method of liberalisation has so far not brought the intended results to the sector as promised by the neo-liberal market enthusiast. The officials argue that the farmers who made up the cooperatives were not clearly informed of the purpose, the advantages and the consequence of the liberalisation process. In short the beneficiaries were not inducted to the likely benefits and risks prior to the process of liberalisation.

Figure 6.1 Kenya coffee production 1980 to 2006



(Source: ICO, 2007)

The breaking of cooperatives into smaller groups means there is now greater competition from the marketing agents to solicit their business. The three marketing agents differentiate themselves by offering varying levels of processing capacity and services as shown in the previous chapter.

According to the small scale farmers the competition from the marketing agents to solicit business from the cooperatives can sometimes be intense, and money politics play an important role in soliciting business from the cooperatives. This view was widely supported by small scale farmers and confirmed by an official from the marketing agent and a senior officer at the CBK.

According to a senior officer in the Ministry of Agriculture, the liberalisation of the sector is driving the three main marketing agents to chase too little coffee from the multitude of the small units of sub-divided local cooperatives. Hence marketing agents have had to resort to tactics beyond pricing and costs in order to attract their clients. These tactics include: bribing the local cooperative board members to sign deals with them; tactics to destabilise the local cooperatives and; offering attractive financial credit without clarifying the implications to the local cooperatives.

It appears from the interview data that despite the presence of many small local cooperatives and the few marketing agents, the small scale farmers are unable to use their economic

power to control the behaviour of the marketing agents. From the interview data, it appears that the economic power of small scale farmers is weakened with the increase in sub-division and their inability to organise and command the market as a collective entity is less powerful.

The officials in the Ministry of Agriculture acknowledge that with only three marketing agents and many small scale farmers and few large estates the market cannot be termed very competitive. The CBK had licensed many marketing agents to operate in the market since the liberalisation in 2002, however there are only three that are commercially competitive at the moment. The Chief Liquorer of the CBK reckons that in four to five year period when there are more marketing agents, competition among the agents will help drive down cost, increase coffee output and deliver efficiency in the sector. The Chief Liquorer also agrees that the small scale farmers must become more competent and united in order to seize the opportunities presented under the liberal agenda.

According to Mr. Musiyimi who has been in charge of coffee cooperatives for many years, liberalising the cooperatives had led to anarchy, rise in cost, too many lenders, mismanagement, leadership wrangling, endless debates on the concept of liberalisation and large amount of financial losses in the cooperatives.

Mr.Musiyimi elaborated by giving an example of a case where there a cheque for 1 mil Ksh was written to three people without any audit backing and soon there were no goods and the money had disappeared. Mr.Musiyimi stated that such cases frequently occur but this was the largest amount of money that his Ministry had to investigate. This case was supported by another official in the same Ministry who is in-charge of registering agriculture cooperatives. The official stated that liberalisation had also affected the relationship between government and the cooperatives. Previously the government had made provision for the cooperatives in its annual budget. However when it was liberalised, the budget provision for cooperatives ceased to exist. According to Mr.Musiyimi, the lack of government funding to support the administrative and infrastructure cost had also adversely affected the cooperatives institutions during the liberalisation period.

The independence of the local cooperative also means that the committee members of the cooperative are no longer accountable to the Ministry of Cooperatives for their decisions and actions. According to Mr.Musiyimi, previously the Ministry had the provision to take the cooperatives to the court for breaking the codes of the constitution but not under current regulatory free environment.

According to the Thika Coffee Mills Managing Director, the disunity and sub-dividing of the local cooperatives is a major impediment to the coffee sector performance in Kenya. He expressed that Kenyan coffee sector is operating below its potential and this is because of the lack of efficiency in the sector at the moment, particularly relating to the increasing sub-division of the local cooperatives. The specific problems arising from sub-division of the local cooperatives includes: rising cost and debt, mismanagement and delays in payment and deteriorating quality of the governance. These are discussed in the next sub-section.

The officials in the Ministry of Agriculture admit that the move to disestablish the state monopoly to perfectly functioning market oriented structure may take many years to come and mistakes are bound to happen. They also admit neither them nor anyone in the industry will know in advance of the precise outcome of liberalisation programme in terms of the number of marketing agents that the industry will attract or the percentage increase in coffee output that the sector will enjoy under the liberalised environment. According to them the IMF sponsored liberalisation programme is the best way forward in repositioning the competitive edge of the Kenyan coffee industry and they believe that it is entirely for the market to decide the path to efficiency and profit.

According to the officials in the CBK in addition to perfecting the market mechanisms, the other factors that have an impact on the future performance of the coffee sector includes: (i) the efficiency of local cooperatives; (ii) tax regime; (iii) domestic market; (iv) knowledge of the market; (v) infrastructure development and; (vi) empowering the farmers to take advantage of the liberalised environment.

i) Rising costs and debt

According to a well respected local coffee dealer the increasing sub-division has increased the costs of local cooperative and as a result their profit margin has dropped. The decline in the farmers income is demonstrated in the ratio of price received by the Kenyan coffee farmers to world coffee price in the last chapter. Figure 5.9 showed a sharp decline in the proportion of world price received by the Kenyan farmers especially since the programme of liberalisation was implemented in 2002. Although some of the dealers argued that the decline is partly to blame on the world market, they nevertheless agree that rising cost at the local cooperative level is a better explanation for the decline in the farmer's income. The farmer's interviewed in this research also support the argument that overhead and other administrative cost at the local cooperative level have cut into their profit.

All the of three marketing agents (KPCU, Socfinaf and Thika) agree that they have the capacity and potential to cut costs, however they blame the local cooperatives who are unable to unite into a large cooperative body in order to take advantage of the economies of scale offered by the marketing agents.

Although there are more cooperatives now which are able to access credit then prior to liberalisation, it also means that servicing the debt has become a major part of the cost for the new cooperative. According to Karanja and Nyoro (2002), the loan repayments can significantly reduce the income payments to the farmers.

According to an official in the KPCU marketing agent, since liberalisation, the increase in the number of cooperatives has led to a substantial increase in the number of loans to the farmers through the local cooperatives, thereby making debt a long term concern for the small scale producers. According to the secondary data reported in the last chapter, 11 percent of cooperatives operating cost is spent on paying interest charges to the lenders (Kenya European Commission, 2004). An official in CBK cited that though liberalisation has increased the freedom of the farmers, it has also substantially increased the financial risk to the farmers and their local cooperatives. According to Karanja and Nyoro (2002) the coffee cooperatives owe the Cooperative Bank around Ksh 782 million in total, of which Ksh 550 million is written off as bad debts.

Most of these debts have been rising since the partial reform programmes were first put into place in the mid 1990s. The reforms opened the opportunities to the cooperatives to operate as independent bodies by allowing them to borrow capital to purchase the necessary facilities. Table 6.2 below shows the amount of loans owed by the coffee cooperatives as at January 2002.

Table 6.2 Amount of loan owed by Coffee Cooperatives in 2002

	Name of Society	Amount (Ksh.)
1	Kahuhia Fcs Ltd	46,893,800
2	New Mugoiri (Under Liquidation)	2,257,338
3	Kigetuiini Fcs	508,341
4	Kamacharia Fcs	123,176,183
5	Mbari-Kianjo Fcs Ltd	10,863,002
6	Rwaikamba Fcs	122,127,257
7	New Kiriti Fcs Ltd	40,968,001
8	Kiriti (Under Liquidation)	1,533,522
9	New Weithaga Fcs	106,154,020
10	Iyego Fcs Ltd	91,635,140
11	Kangunu Fcs Ltd	26,712,969
12	Kiawanduma	4,899,979
13	New Gatari Fcs	57,972,402
14	Mirwagi Fcs	4,053,673
15	Mikaya Fcs	49,093,304
16	New Kiboi	1,300,000
17	Kanyenyaini Fcs	12,620,721
18	Kiru Fcs	23,280,006
19	Wamugoiri Fcs	34,643,628
20	New Murarandia Fcs	21,557,666
	Total	782,250,952

(Source: Karanja, A and Nyoro, J, 2002, page 40)

A senior official with the CBK elaborated that liberalisation had worked well for big business that were well prepared to seize the opportunities and face the commercial risk but had not worked so well for small scale producers. Given most coffee in Kenya is produced by small scale producers, this has adversely affected the coffee sector by increasing cost and reducing production. According to a senior CBK official the decline in small scale coffee production is a serious problem in the long run because, the decline of the small scale producers means the yield of quality coffee is set on a declining trend which will subsequently have a negative impact on the Kenyan coffee prices and reputation. Another impact from the rising cost according to the official is that many small holders tend to substitute coffee plants to growing other crops which also has negative impact on the yield of coffee plant quality.

According to most small scale farmers in the Kiambu district, the exit of the coffee farmers from the sector has mainly been for political and cost reasons. Although coffee prices were high during the period of 1980 to 1988, agriculture as a whole did not expand compared to the decade 1970-80. In fact agriculture as a whole declined from a growth rate of 5.33 percent in the decade 1980-1990 to 3.66 percent in the decade 1980-1990. The following decade of 1990-2000 was the worse period for the Kenyan agriculture, recording a growth of merely 0.66 percent in the ten year period (Legovini, 2002).

The small scale farmers often recall and compare the lucrative coffee days of 1977 to 1979 when coffee prices were at their peak, with prices fetching about USD 1.58 to 2.00 US dollars per-lb when local cooperatives were run efficiently. The farmers attributed the high prices then to shortage of world supply of coffee and to the favourable and enabling domestic policies that promoted the agricultural sector. It is also argued that in the first fifteen years after Kenyan independence, coffee was largely farmed in large estates as opposed to small scale farming method. This helped to keep the cost low and efficiency to be achieved in short space of time. Small scale farming method has now flourished with the intense sub-division of large estates into smaller plots.

However from the interview exchanges It is clear that the large estate owners though not happy with the rise in cost and the decline in prices are nevertheless better prepared and organised in reducing costs and increasing productivity by using technology and efficiently budgeting their finances. The small scale farmers on the other hand are less able to shield themselves from the rise in costs and fall in production of coffee variables. It appears that the small scale farmers do not enjoy a similar level of autonomy as the large estate farmers in meeting and dealing with the cost and risks.

Related to the problem of rising costs from the sub-dividing of the cooperatives is the protracted wait faced by farmers to receive their payments from the sale of their coffee. In the section below the comments from interview respondents are analysed and presented.

ii) Payment problems

The problem of delay in paying the farmers was first acknowledged in the early 1990s, and immediately afterwards reform programmes were put in place to address and fix the problem. The reform programme was called Special Coffee Improvement Programme (SCIP II). Under SCIP II a special project called the 'Improved payment system' (IPS) was implemented in the 1990s. The objective of the programme was to alleviate the payment problems and to reduce the coffee societies operating expenses by and to eliminate the various payment stages involved, thereby expediting the payment to the farmers and improving their profit margin.

Under the IPS programme, the cooperative societies will have two accounts, a members payment account (MPA) and society operating expenses account (SOEA). The MPA is a record of coffee proceeds for payment to the cooperative members (smallholders) and the SOEA records funds for society operations. The ratio between the two was initially set at MPA = 70 percent and SOEA = 30 percent with a gradual reduction to 20 percent towards the end of 1990s. By the end of the project in 1998, about 70 societies were rated as 'best

managed having achieved a member payment rate of 82 percent' (Karanja, A and Nyoro, J, 2002, page 36).

However with full freedom granted to the local cooperatives under the 2001 liberalisation programme, the problem of delay of payment has recurred. According to the official in the Ministry of Cooperative, the increase in the number of local cooperatives has increased the problem of payment to the farmers. Under the liberalised structure the dealers pay the marketing agents who then disburse the payments to the local cooperative who subsequently pay the farmers.

Almost all of small scale farmers who took part in the interviews expressed dissatisfaction over the long waiting period involved in receiving their money from the point of delivery to the sale of coffee at the auction. Often in many cases, the small scale farmers do not even know the price at which there is coffee sold let alone knowing they are due for payment. However large estate scale farmers on the other hand are able to track down the physical movement of their coffee and know the exact selling price of their coffee immediately after the auction. This is mainly because estate farmers are better organised and equipped with technology and skills in efficiently gathering and disbursing information.

As a result of the increasing sub-division among the local cooperatives, there are now many local cooperatives which are networked into the payment structure of the sector which inevitably puts pressure on the capability of the marketing agents in disbursing the payments to each cooperative timely and accurately.

According to a credible business literature in Kenya, the Kenya Coffee Traders Association (KCTA) which acts as a coffee interest group, it alleges that the KPCU lacked leadership towards its farmer members (Business Week, 24th February 2004). The vice chairman of the KCTA who is also the Managing Director of Taylor Winch Coffee Limited, which is a leading coffee dealership, demands that KPCU explain to the farmers what it has done with almost USD 1.3 million worth of coffee bought by Taylor Winch in 2003 at the Nairobi coffee auction. The Managing Director continued his criticism by arguing that the money paid to KPCU at the auction had not reached the farmers. He questioned the ability of the government minister to address the core problem within the industry, which is: cooperatives failing to provide the mandated services of efficient payment to its members. This view is widely supported by the smallholders, marketing agents and coffee dealers. The problems of payment and misappropriation still dogs KPCU after almost five years of liberalisation. According to the Managing Director of Taylor Winch, 'Coffee does not belong to cooperative or the government. It belongs to the farmer and its business. Cooperative and the government

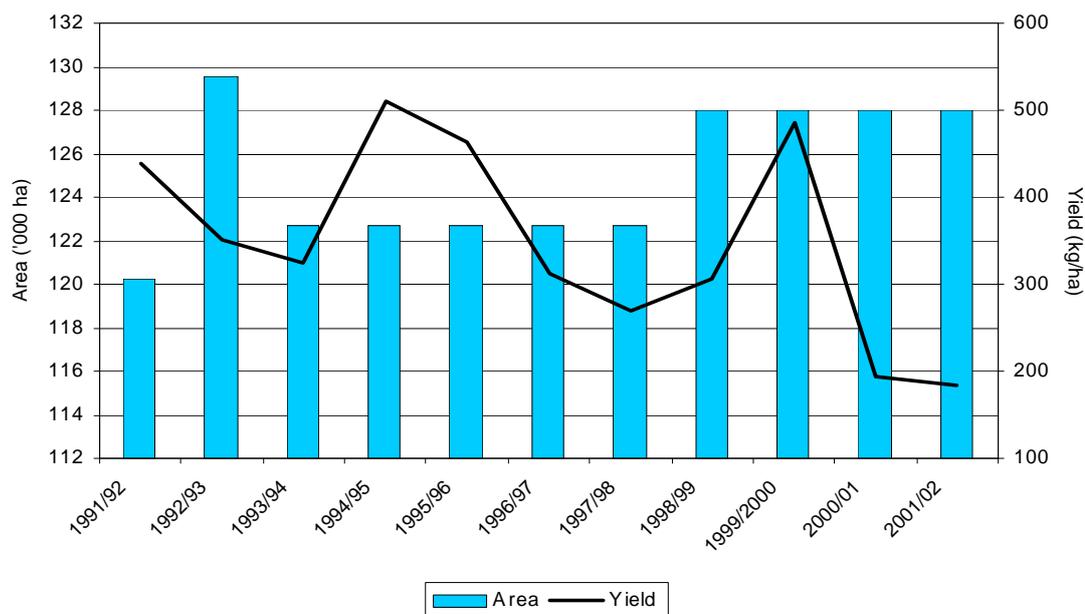
should just provide services, (Business Week, 24th February 2004). The Managing Director claims that too many cooperatives are weighing down the efficiency of the system in achieving good service to the farmers.

It is not unusual to come across small scale farmers who express grievances on the lengthy time taken by the marketing agents to pay them, in some cases more than 12 months which has resulted in many farmers either leaving the sector or had substituting to growing other crops. These are usually bananas, maize, and pineapples. As a result of mixed breeding of coffee with other crops, as mentioned the yield of coffee quality will deteriorate and subsequently fetch lower prices.

When asked why the delay in payment is a recurring problem especially affecting the small scale farmer, the farmers blame the incompetence of the cooperatives. Most small and estate farmers direct their blame at the KPCU. When the same question was directed to a KPCU official, the official acknowledged that there have been many cases of delays not because of the payment system but blames the local cooperatives for much of the delay in disbursing the money to the farmers. According to an official in one of the marketing agents, 'the payment system has created a lot of distrust among the small holders'.

According to CBK the area under smallholder coffee during the last 10 years, was approximately 120,000 hectares devoted to coffee. However, with the problem of delayed payment, increasing cost, poor cooperative management and low prices there has been both a reduction in the area under coffee and the abandonment of coffee farms in some areas. The aggregate data in Figure 6.3 below suggests that average yields of smallholders have fallen from a peak of 500 kg per hectare in 1999/2000 to just under 200 kg per hectare in 2001/2002.

Figure 6.3 Smallholder Area and Yields



(Source: Kenya European Commission, 2004, part 2 – page 61)

Although the problem of payment system was addressed in the new Coffee Act, there appears to be little positive feedback from the small scale farmers on the benefits of the new system. Not surprisingly the decline in the area and yields has negatively impacted on the small holder coffee production over the years. If the problems of late payment persist, the coffee produced by small holders will continue to decline. According to the marketing agents this decline must be urgently addressed because it is the smallholders who produce the best quality coffee which gives Kenyan coffee the world reputation it deserves.

The problem of long waiting period for payment also means that the farmers who have incurred high input cost had to wait four to six years before being able to recover these costs and make a profit. Undoubtedly many smallholders expressed cash flow problems in managing their investment and purchasing decisions. As a result of this many smallholders used credit facilities with their respective cooperative societies to stay in business and sustain their business on a short term basis. The delay in payment also adds to the mounting interest on borrowing which makes smallholder business particularly costly in servicing the debt and making a profit in the long run.

According to one of the estate farmers although the payment system is now re-organised under the 2002 liberalisation, it still contains fundamental flaws. These flaws are not only to do with the delays in payments but also associated with transparency in the handling of farmers' coffee bean and money. According to a well respected coffee estate owner reports

of cases of 'missing' coffee bags are not uncommon, especially when it is handled by the KPCU marketing agents.

A local coffee dealer who took part in the weekly coffee auction acknowledged that although the payment system is now revamped, it is still a 'leaking system'. He described the system as having too many loop holes that need fixing, referring to the payment flow from buyer (dealer) to the marketing agent and then from the marketing agent to the cooperative to be disbursed to the small scale farmers. According to him enacting a new payment system does not solve the problem. He stated that the inherent inefficiency in the payment system cheats the farmers of their hard work. According to an official in KPCU, he acknowledged that his organisation has problems in handling the payment to the farmers because of the lack of cooperation from the cooperatives and the mismanagement on the part of the cooperatives in managing their finances. He stated, often the payment from the marketing agents to the cooperatives are pocketed or under-declared by the authorities at the local cooperative level. According to the second top official in the Ministry of Cooperative charged with devising policies for the cooperatives the local cooperatives and KPCU have failed to negotiate an agreeable payment arrangement for the sake of the farmers.

According to the official in the Ministry of Cooperative, the payment problems experienced by the smallholders have been especially intense in the last two years. The official states that the government cannot just step in and cancel its license or reduce the powers of KPCU or the local cooperatives, because KPCU is owned by the farmers and the local cooperatives is a collection of farmer organisation and as such revoking their registration licenses would jeopardise the farmer representation and income.

According to two smallholders who operate about 40 miles out of Nairobi, they reckon that KPCU is desperately using political strategies to maintain their existing contracts with the local cooperatives as the number of small holders sub-divide and expand. When probed on this remark, they elaborated that KPCU have been losing a lot of business with the emergence of Scofinaf and Thika Coffee Mills into the market, and as a result KPCU have been campaigning by bribing the cooperative directors to sign-up or at least maintain their processing contract with them.

According to the smallholders, the attempt to buy-off the decision makers in the cooperative institution has had a very detrimental effect on the perception of the coffee sector in Kenya and beyond. According to a senior banker in Nairobi; the bank has been instructed by its headquarters in the United States not to offer any lending facilities to the coffee farmers

because of its reputation for mismanagement and internal wrangling which could affect its loan repayment.

From the interview data, what is apparent is that the payment problems have been an ongoing issue for many years and attempt to reorganise the payment structure under the Coffee Act 2001 has not improved or given impetus to increasing the morale among the coffee farmers. Related to the problem of payment is the deteriorating level of governance as small scale farmers attempts to exercise their bargaining power aloof from larger cooperatives. This will be discussed in detail in the next section.

iii) Governance

It appears from the interview data that non-transparency and incidences of corruption have increased the inefficiency of the market operation within the smaller cooperative even when competition is introduced into the sector.

According to the participants in the interviews, almost all of them acknowledged that Kenya faces a serious problem of corruption within its institutions. Literature on corruption and governance demonstrate that quality of governance has a robust effect on economic growth (Barro, 1997), (Knack and Keefer 1997a), (Knack and Keefer, 1997b), (Mauro, 1995), (Svensson, 1998), Kaufmann, (2005). These were extensively explored in the chapter on literature review. In this section we explore the qualitative impact of the cooperative institutions on the coffee sector with reference to the quality of governance in Kenya.

Participants in this interview acknowledged that incidences of corruption which were left unchecked for the last 10 years in the previous government (1992 to 2002) had over the years become so pervasive and penetrated into most institutions in Kenya, including the lucrative coffee sector, especially within the institution of its local cooperatives. According to a Kenyan diplomat the two main reasons for the rise in corruption in Kenya are: (i) the intensity of political control over the economic sectors prior to 1990 and; (ii) the opportunities for corruption with the onset of liberalisation in just past 1990. The diplomat who is based in London said that the onset of liberalisation in the mid 1990s has opened the doors to politicians and buyers of the nationalised industry to profit from the opportunities of liberalisation.

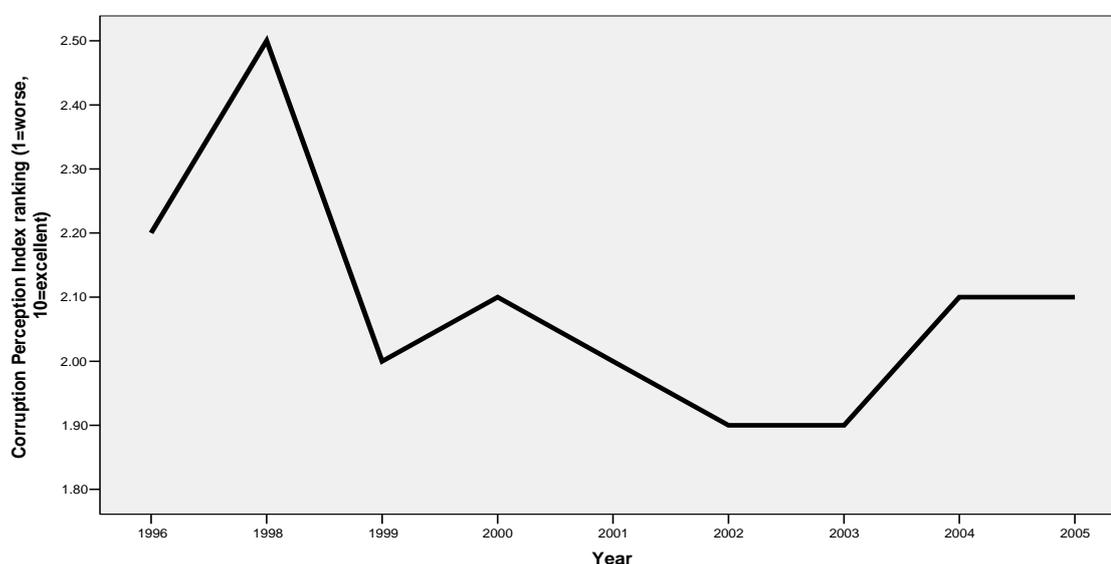
The diplomat stated that when KPCU and its monopoly services network were dismantled, it was often the managers and directors who were serving under the previously state institutions that would buy the newly privatised organisation. According to the diplomat the

transfer from state to private ownership was often not transparent and entangled with corruption in the selling of the state enterprise to the private owners.

The comments from the diplomat and other interview participants on the state of corruption in Kenya, particularly within the local cooperatives are supported by the poor score received by Kenya from Transparency International ranking.

According to the Transparency International survey on corruption for Kenya from 1996 to 2005 (1 being worst for corruption and 10 being excellent) the score for corruption in Kenya has never risen above 3. In fact Kenya has only managed an average score of 2 from 1996 to 2005 as demonstrated in Figure 6.4 below.

Figure 6.4 Kenya - Corruption Perception Index ranking (1996 to 2005)



(Source: Transparency International, Kenya 1995 to 2005)

According to TI ranking the score for Kenya is worse than most of the developing countries in the world. The incidences of corruption in Kenya have been on the rise with the intensification of the liberalisation programme targeting the various sectors of the economy. According to the Transparency International Kenya Bribery Index (2006), bribery costs Kenyans about USD 1 billion each year and yet more than half the population live on less than USD 2 per day (Kenya Bribery Index, 2005).

According to the qualitative data, the cases of corruption in the coffee sector of Kenya have mainly been found in the institution of local cooperatives. According to the Managing Director of Socfinaf marketing agent the coffee cooperatives are the main impediment to the growth

of the coffee sector in Kenya at present. This is supported by the aggregate index score received by the local cooperatives in Kenya published in 2005 (Kenya Bribery Index, 2005).

According to the diplomat, the privatisation of the state monopoly did not produce any significant changes in terms of efficiency of service, speed of payment and innovation in processing and this is largely attributed to the way the organisation is managed and the remnants of state ownership still lingering in the private organisation.

The diplomat described that the impact between politics and economics is not particularly restricted to developing countries. What is interesting in the case of Kenya is that, the extent of political impact on the economic performance of Kenya had been significant. The diplomat admitted that governance has an important influence in the way the institutions deliver its services in Kenya because of the lack of well developed private sector with elements for achieving efficiency, low cost, high profit and being innovative. The poorly developed private sector according to him had put increased pressure on the state sector to offer most of the basic services, thus opening opportunities for advancing cronyism in the state institutions. The many years of state regulated economic development programme has been a disincentive to the private sector. According to the diplomat, the role of the state over the years has crowded-out the private sector in developing the aspects of governance that can deliver good management and commercial acumen. The results from M'Amanja and Morrissey (2005) support the argument that government investment has crowded-out the private sector investment in Kenya. The study focuses on the relationship between public and private investment in Kenya from 1964 to 2002. Some of the possible reasons for the crowding-out include competition for resources from the public sector that tends to substitute rather than complement the private sector investment. Other reasons include the excessive protection granted by the GOK to domestic firms since independence which over the years had added an adverse environment for competition to thrive (M'Amanja and Morrissey, 2005).

The diplomat remarked that in any institutions where the government is the appointing authority, there will be political biases and cronyism and this includes Kenya and its coffee sector. He stated that Kenya had to recognise this through the hard way and in the end Kenya had no option but to resort to liberalisation. He also mentioned that without liberalisation, there will be lack of accountability and the Kenyan economy would continue to be locked in a state of underdevelopment, therefore the GOK had no choice but to liberalise the local cooperatives even though the institution in Kenya were not familiar with the notion of how good governance can deliver good results.

He noted that at present Kenya is still in the process of transition from government managed to liberal based economy. According to the diplomat, although these external institutions had good intentions, they failed to follow up the demands of the reform or offer the necessary safeguards on how to go about the reform agenda. This argument is supported by all of the interview participants in this research. They argue that the lack of institutional capacity and conditions had failed to deliver the intended outcome on the liberalisation programme, including the local cooperatives of the coffee sector.

The Deputy Commissioner of the Ministry of Cooperatives, who is in-charge of the coffee cooperatives agrees that most liberalisation and reform programmes in Kenya are donor driven. Every time a donor driven programme stops abruptly, laws had to be enacted to maintain or protect the programme from collapsing altogether. This means the programme now has to come under the wing of the government and this would now potentially create the opportunity for political interference in managing the sector in question. It also means that most of the resources are devoted to maintaining the liberalisation programme rather than improving the elements like good governance and management in the newly privatised institutions.

The diplomat and the Commissioner agree that the increasing sub-division of local cooperatives have deteriorated the quality of governance within the coffee sector. The interview data shows that the attempt to achieve higher returns and better service through sub-division has not yielded the best outcome; instead the respondents argue that small holders should be improving the various elements within the institutions in order to achieve better efficiency and higher returns.

The Managing Director remarked that liberalisation is good for the economy because it will help lift the coffee sector out from lacklustre performance. However he feels that the problems within the cooperatives are slackening the whole process. A very senior official in the Ministry of Cooperative echoed the views of the Managing Director.

Officials in the Ministry of Cooperative are adamant that despite all the problems of governance, mismanagement in the local cooperatives, the government will not renege on its commitment. This is because the trend is to liberalise and the aim is to generate value for money in the competitive open market. The Officials stressed that even if this means learning from expensive mistakes.

Although the problems of the cooperative institution at first appear to be diverse and disparate, what they all have in common is: (i) the inability of the farmers to engage effectively as a collective body in influencing their economic circumstances; (ii) the

incapability of the farmers in seizing the opportunities opened up by liberalisation and; (iii) the failure of the institutions to effectively extend the benefit of liberalisation to its intended recipients. It can be argued that these three problems are inter-related and deeply rooted in governance.

Given the recurring complaints in the local cooperatives and the cost implications, it appears that the majority of the growers in this interview are keener to avoid the traditional market structure rather than address the inefficiencies. The most favoured and talked about alternative method of selling among the interview respondents was the method of selling partially processed coffee directly to international dealers and fully processed coffee to retailers, thereby circumventing the traditional auction market.

In order to undertake this, the liberalisation programme offered the provision for the small and large estate farmers to undertake domestic processing and value adding within the shores of Kenya. The aim of the policy was to offer a choice to the producers between direct selling and using the auction market in generating higher income for the farmers. In the section below a detailed analysis on the re-action of the growers and other stakeholders to this choice is considered and presented.

6.3.2. Direct selling and innovation

The direct selling of coffee is an idea that is much touted in the newly liberalised coffee environment. The idea of selling coffee directly to the domestic and international buyers by circumventing the auction system is one of the key aspects of the liberalisation programme sanctioned by the Ministry of Agriculture taskforce in June 2003.

A senior official at the largest marketing agent (KPCU) expressed that with the implementation of the direct selling of coffee, farmers will be able to exercise 'choice' when selling their coffee. If the coffee prices at the auction are depressed the farmers will have an alternative window to go to and if the prices at the auction are attractive then the farmers can choose to sell through the auction. According to a senior official, the purpose of giving the farmers the opportunity of second-window is to exploit the premium price potential of Kenyan coffee internationally. This may mean higher income for the farmers, increase in coffee production and greater popularity of Kenyan origin coffee blends.

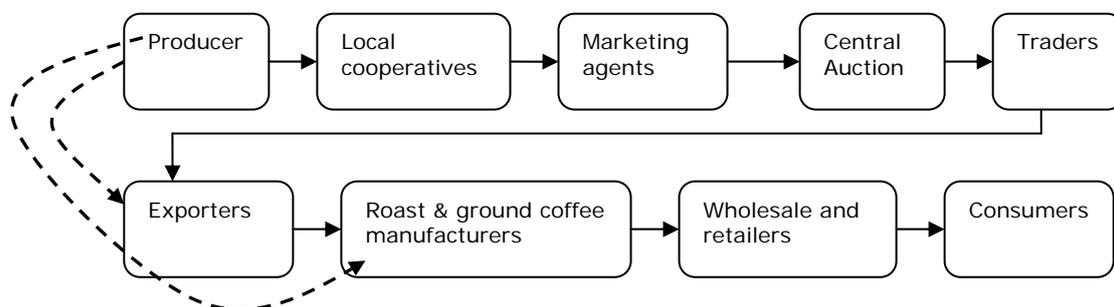
Prior to the liberalisation coffee were sold through the weekly central auction system managed by the Nairobi Coffee Exchange (NCE). This meant that the only route through which Kenyan coffee is sold to the domestic and international market is through the dealers

who bid for them. The central auction method has been the preferred method in the Kenyan coffee industry since the colonial times. Supporters of the auction system, who are mostly the dealers argue that the auction system is the most open and transparent method for discovering the market price for coffee.

The diagram below shows the existing structure of flow of coffee from the stage of production to the consumer. The stages from production to trade are undertaken within the shores of Kenya, with the central auction playing a crucial role in determining the price and quantity of coffee was sold for the Kenyan and the world market. Under the present system all coffee producers must bring their coffee to the central auction through one of the three marketing agents in order to export their coffee.

The proposal to sell coffee directly is most likely to take place from the point of production straight to exporters or the manufacturers, thereby skipping the chain of flow to the local cooperatives, marketing agents, the central auction and traders. This is shown by the dotted arrow in Figure 6.5 below.

Figure 6.5 Input-output relations



At present there are three sellers known as the marketing agents who compete for coffee from about 462 cooperative societies (Karanja and Nyoro, 2004) and there are over 109 registered buyers or dealers as they are known in Kenya (CBK, 2007). The marketing agents are licensed by the Coffee Board of Kenya (CBK), to process, grade, and pack and sell the raw coffee on behalf of the smallholders and large estates through the auction market.

There are two main advantages for the smallholders and large estate farmers in using the marketing agents to sell their coffee as opposed to selling their coffee directly. They are: (i) marketing agents can offer the services of processing, analysing, grading and finalising the green bean coffee for sale at a cost lower than doing it privately at one's own farm.

This is mainly because of the cost advantage enjoyed by the marketing agents in processing a larger quantity of coffee as opposed to processing a smaller quantity and; (ii) the ability of the marketing agents to offer a central venue by bringing the buyers and sellers together helps to create transparency, competitive price discovery and ready made market for the coffee.

By offering the service to process, analyse, grade and pack the green bean coffee according to regulated Kenyan standard, the unique Kenyan coffee quality can be maintained. It also means that monitoring of coffee standard by the regulator is made easy. Given that there are only three service providers at this stage, the government can also easily influence the sector by using a top-down approach. This is done by using legislations and policies between government and the marketing agents.

It appears that under the current auction and marketing structure, the Kenyan coffee farmers are relatively better off than coffee farmers from other countries when considering the price received by the growers. This is demonstrated in the charts in the previous chapter.

When probed on what is wrong with the present marketing structure that makes the farmers yearn for another option despite enjoying the best prices in the world, the farmers argue that inefficiencies in the local cooperatives have made cost to rise and potential for improvement in prices to decline. It is because of these reasons that the farmers are keener to circumvent the established structure and exploit the freedom of the market through direct selling. According to secondary sources when cost is taken into account, Kenyan growers receive only 59 percent Free On Board (FOB), while Colombian and Costa Rican growers receive 70 and 69 percent respectively, making Kenya comparatively a high cost producer. In addition the farmers to a greater extent the CBK officials lament that under the current system, few financially powerful foreign traders are dominating a large chunk of the market and this is impeding the role of domestic traders in buying, marketing and promoting Kenyan coffee both domestically and internationally.

The dominance of foreign traders according to the CBK official is impeding the innovation in the domestic coffee sector therefore they argue that the alternative method of selling coffee will release innovation among the small and large estate farmers in addition to growing coffee for export purposes only, like marketing and research.

The inefficiencies highlighted by the interview respondents include the following list which are related to some of the aspects discussed above.

- (i) the current system is ridden with leaks in the payment system
- (ii) the present marketing structure takes too long for the smallholders to receive their payment
- (iii) the present system is not transparent in terms of the physical flow of coffee and income to the farmers.
- (iv) under the present system the local cooperatives have a monopoly for the primary processing and payment to the smallholders, this has led to increasing wrangling among the cooperatives
- (v) under the present system, the marketing agents and traders have a greater say and influence than the coffee growers in policy making and identifying new markets.
- (vi) in the present structure local cooperatives are riddled with governance problems within the institutions.

These are some of the inefficiencies within the present structure that makes the option of a second window very attractive to the coffee producers in Kenya. However not all respondents agree that by liberalising the selling method everyone will be better-off and the inefficiencies fixed. The idea of selling coffee directly to the international market is well supported and favoured by the coffee producers, especially the large estate owners. This is in contrast to dealers (exporters) who express scepticism over the idea of farmers being able to sell coffee directly.

The dealers argue that the lack of established marketing infrastructure for the farmers can be a barrier to selling coffee directly. In addition the dealers are keen in keeping the status quo division of labour, where the growers concentrate on growing coffee and dealers concentrate on buying and selling it onward.

The dealers who act as intermediary think that the competitiveness of Kenyan coffee in the international markets will be damaged if the growers sell coffee directly to the international foreign market and by-pass the dealers. According to the dealers the second window will mean that Kenyan coffee will not reach the full marketing and price potential it deserves. They state that the answer to the inefficiency in the sector is to address and fix it rather than by-pass it by creating another window for selling of coffee.

According to the one large estate farmer the opening of the second option will automatically allow the Kenyan smallholders and estate farmers to invest and expand production to facilitate processing of coffee on their farm site instead of processing at one of the three nationally licensed millers. The farmers argue that this will help to reduce the high cost of transport and advance processing.

The idea that estate farmers can sell their coffee directly to the international blending factories by evading the intermediaries (dealers) may appear to be an interesting and low cost option relative to auction however the challenge is to first find the market to sell their coffee and then offering a competitive world price. According to an estate farmer, this requires incredibly strong commercial acumen which may take years to develop and cannot immediately be achieved through liberalisation.

Another estate farmer remarked that the option of selling coffee directly also means that the farmers are no longer solely dependent on farming techniques to increase their production but in addition they also have to engage in commercial enterprise and compete with well established multi national firms that specialise in the selling of coffee to the high end lucrative markets and well established high street coffee chains and like Starbucks, Costa Coffee, Coffee Republic and Nescafe.

The enthusiasm expressed by the estate farmers in selling their coffee directly by circumventing the auction does not appear to be shared universally among the small scale farmers. From the interview exchange, some smallholders are content to market their coffee through the existing network of cooperatives. The three main reasons for the lack of enthusiasm on the part of the smallholders in using the alternative method of selling of coffee are cost, marketing and capital.

In my field visits to about three small farms, the local cooperative does not appear to have the skills or the expertise in exploring the international market opportunities. Added to this, is the complexity faced by the cooperatives in establishing or competing with the already existing distribution of coffee supply network. In fact smallholders agree that selling of coffee directly to the market is of greater incentive than selling it through the central auction system, however they also agree that this requires concerted and significant investment in international marketing effort which inevitably leads to higher cost and greater risk than the farmers are facing now.

None of the farmers who took part in the interview were clear if the role of the cooperatives will completely disappear if the majority of the small scale farmers choose to

sell their coffee through the second window. However what is evident is that the role played by the cooperatives will be reduced from its present day function and the inefficiencies within the system will not be tackled but will be ignored.

The Deputy Commissioner of the Ministry of Cooperative, who is in charge of the coffee cooperatives, expressed optimism that second window option for the cooperatives and estate farmers would empower their role from merely producers to coffee traders. He expressed that the removal of marketing agents from handling of farmers' coffee and money will greatly enhance the position of the farmers. He said 'what you are selling is yours'. This means the marketing agents do not process, pool and sell the coffee on behalf of the farmers, instead the farmers will be undertaking their own processing and selling directly to the final domestic and international market. This also means that the dealers will no longer be able to use their financial power to command the price of coffee that farmers receive through the central auction system.

Understandably the dealers do not welcome the proposed 'second-window' because it reduces their influence as middle man. The owner and manager of Josra coffee dealer, Joshua Ngeera reckons that the second-window will kill competition. He maintains that the best way to sell Kenyan coffee is through open competition and argues that the central auction system is the best way for bringing together the demand and supply of coffee in the domestic and international market. Asked about the inefficiencies in the present system, he recognised that there is a problem and noted that the best way is to solve them through concerted effort with the help of the government.

The auction system according to Mr. Negeera is not only good for Kenyan coffee producers but it is also the best method for discovering Kenyan coffee prices internationally. According to him the Nairobi Coffee Exchange offers predictability to traders all around the world on the quality and price performance of Kenyan coffee though the method of bringing the coffee to the auction is associated with some inefficiency.

It appears that under the liberal selling market, the large estate farmers will benefit more than the small scale because the small scale farmers and their local cooperatives lack the resources to exploit the market even though they produce better and higher quality coffee than the estate farms. The estate farmers on the other hand are better positioned well resourced and efficiently managed to take advantage of the direct selling opportunity. The Kiamara Estate which I visited in Kiambu district, about 40 miles out of Nairobi was managed by a full-time farm manager and about four office personnel. The offices were well maintained and equipped with reasonably good technology and facilities.

In my interview with the estate farm owner, Mr. James Karugu expressed optimism and enthusiasm on the potential of selling coffee directly to the international market without going through the central auction. He admitted that he would seize the opportunity the next day if it became available. The confidence of large estate owners to tap into the international markets using the second-window opportunity is detectable. Large-scale farmers appear to be more prepared to take risk and invest in marketing opportunities in order to increase their production capacity both in terms of acreage and production efficiency.

The small scale farmers on the other hand have limited farm acreage in order to expand their production, have limited access to finance and information in tapping into domestic and international markets and are largely risk averse. Despite these constraining factors the small scale farmers are more ready to exploit the advantage of selling coffee directly to the domestic and international markets by avoiding the auction system. The small scale farmers desire to take part in the alternative means of selling coffee is largely because of the frustration they had to bear under the current auction and payment system. This finding is interesting given that the small scale farmers are keener to avoid the auction system and look for new sales outlets and local processing rather than address the inefficiencies of the local cooperatives.

All of the small scale farmers interviewed were very optimistic of the long term benefit of the second window choice. However none of the small scale farmers were able to clearly articulate a strategy or a plan on how the second-window option would help to increase their sale by penetrating into the domestic and international market out with the auction system.

Although the opportunities emanating from selling coffee directly without the dealers in between appears to be promising, it however still lacks details on how it is going to impact on the small scale farmers. This is a serious cause for concern especially when small scale farmers produce about 60 percent of the total coffee in Kenya (CBK, 2006). In addition to being responsible for the bulk of production, the small scale farmers are also responsible for producing the best quality coffee as mentioned and this in turn offers income and employment opportunities to a range of support services. The support services include cooperative society administrators, transport service providers, specialist in liquoring services, engineers handling the processors and grading machines, the on site research services and many others. Therefore the direct selling option which the small scale farmers are clamouring for could be viewed as a strategy to avoid addressing and

fixing the problems of inefficiencies in the many sub-divided small scale local cooperatives in the sector.

In addition to increasing the freedom of the producers in choosing how to sell their coffee, it was also expected that the liberalisation of the sector will cultivate innovation in processing and marketing of Kenyan coffee as a global brand. From my interview exchanges the respondents were keen in speaking about innovation and how it can stimulate the sector to become more competitive like the tourism sector in the country. The respondents also hoped that innovation through competition could be the answer to the problem of inefficiency in the system at the present. The discussion below explores the responses from the producers and other stakeholders with reference to the policy of achieving innovation within the Kenyan coffee sector and this can address the inefficiencies within the system.

'Value-addition' or innovation is one of the most spoken about subjects within the coffee sector in Kenya since the implementation of the Coffee Act in 2002. The term value-addition is used to refer to the processing, blending and exporting of Kenyan coffee as a final product to the international markets.

The theme of value-addition can be studied by dividing it into two parts. They are: (1) adding value by processing and packing 100 percent Kenyan coffee as a single origin brand and; (2) Kenyan firms blending Kenyan coffee with coffee origins of different countries and exporting them as a final product from the shores of Kenya.

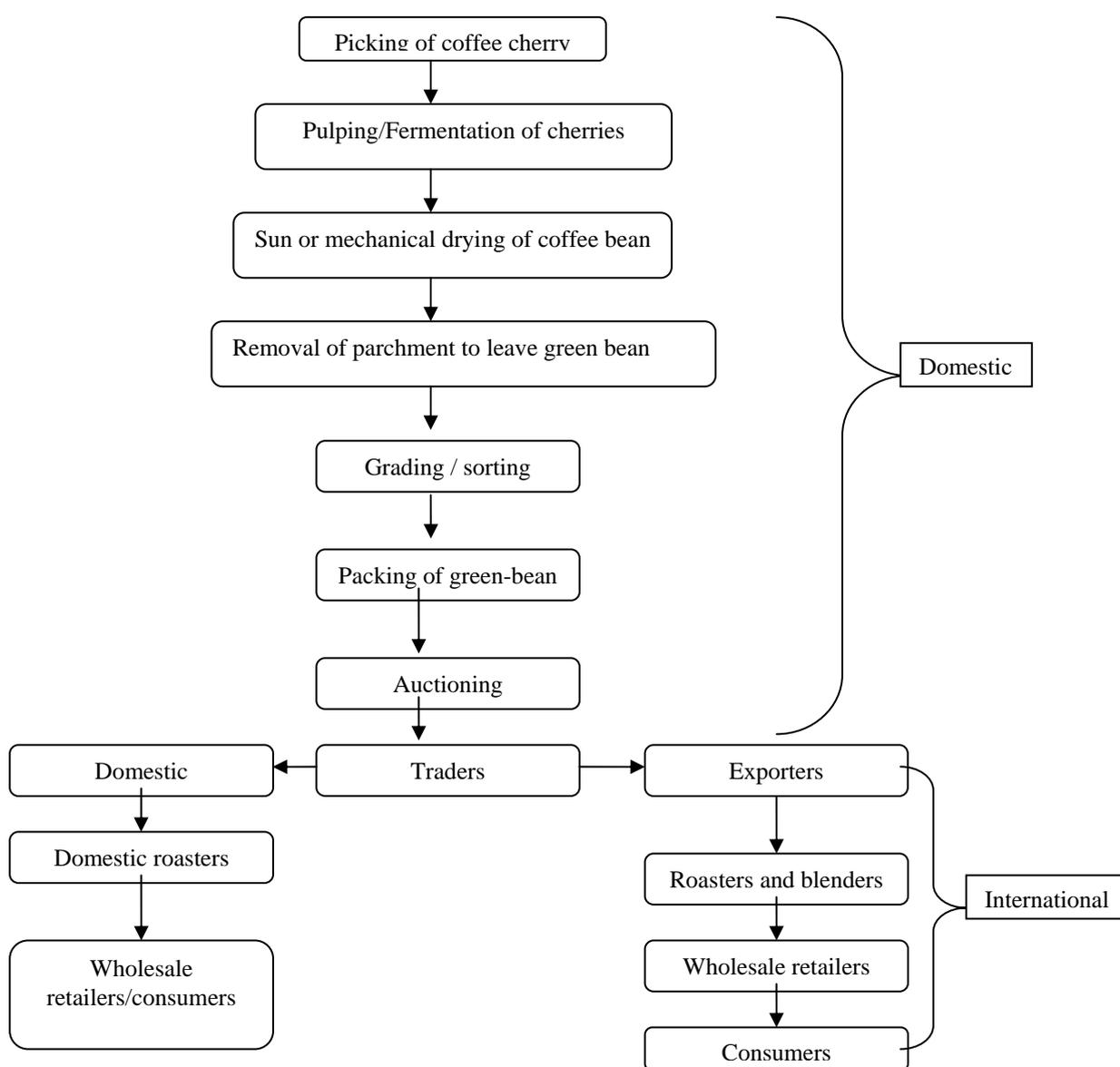
The concept of marketing Kenyan coffee as a single origin product has been expressed with mixed enthusiasm among the coffee farmers and other stakeholders within the coffee sector. At present Kenyan coffee is exported in the form of green beans to international roasters and blenders for final processing and then to be sold to the wholesalers and retailers.

Dealers in the NCE argue that coffee of single origin, especially 100 percent Kenyan blend is not competitive as it only commands two percent of the global market when compared to other coffee brands. In addition to this, coffee dealers argue that Kenya does not consistently produce enough high quality coffee throughout the year for it to be 100 percent single origin producer. Furthermore the dealers argue that the inefficiencies in the local cooperatives are too widespread and costly to solve before Kenya can embark on any sort of innovative programme in the sector.

In order to appreciate the extent of innovation that the respondents are talking about, Figure 6.6 below is presented to show the various stages involved in the processing of coffee before its ready for consumption.

At each stage of processing, value is added to the coffee bean. The idea of adding value to Kenyan coffee simply means extending the processing of Kenyan coffee within the borders of Kenya until coffee is ready for final consumption. At present the primary processing takes place within Kenya and advance processing takes place outside of Kenya, mainly in the city of Hamburg, Germany. The idea of liberalisation is to offer the opportunity to the domestic and international firms to process and export Kenyan coffee as a final product to the domestic and international retailers.

Figure 6.6 Stages involved in the processing of coffee – picking to consuming



(Source: Author generated)

When inquiring on the inefficiencies inherent at the various stages involved, the respondents argue that the CBK and the Ministry of Agriculture feels that investment in research and development will help the sector innovate and competition will force the growers and processors to address and fix the various inefficiencies at the different stages of processing. For example not all local cooperatives have the facility to mechanically dry coffee after the process of fermentation, as a result the wet coffee parchment has to be transported to a another location, which means higher transport cost and negative impact on coffee bean quality. The next stage of processing, i.e. removing of coffee parchment which is undertaken at one of the three marketing agents again includes transportation of the bean to another location. In the process of movement from one point to another, the farmers argue that sometime their coffee goes missing or the weight of the coffee is reduced or the weight does not match the recorded amount.

The CBK and the Ministry of Agriculture argue that all of these inefficiencies will continue to persist until the Kenyan coffee sector begins to experiment, innovate and replicate the success of value addition from Germany and other importing countries. In order to do this, the officials strongly believe that a domestic consumption base must be created, so that the coffee related firms have the right incentive to undertake investment and innovation in the sector.

It can be argued that given the estate farmers are better equipped and more willing to take risk in business investment than the cooperatives, there may be a tendency for estate farmers to reap the benefit from innovation in the sector quicker than the smallholders. According to the officials in the CBK this is very likely to happen because the estate farmers are well positioned financially and technologically than the small scale producers.

Although none of the interview participants mentioned the possibility of inequality in receiving the benefits of innovation between the small and estate farmers there is very strong possibility that the inequality in investment, production and management might exacerbate the already inefficient system that is largely unfavourable to the small scale farmers. None of the officials in the CBK or the agricultural economists at the Ministry of Agriculture appear to be aware that the different levels of initial conditions between the small and large scale farmers can have an impact on their future prospects.

However the agricultural economists at the Ministry of Agriculture are aware that Kenya is not alone in liberalising to innovate and create domestic and global coffee brands. Kenya like other coffee producing countries with the exception of Brazil has struggled to innovate and establish unique coffee brand within the domestic local mass market let alone a

global brand. This is because of the various unaddressed problem within the sector particularly to do with costs and governance of the sector.

In addition even if the coffee sector is successful in innovating and addressing the various inefficiencies there are two main barriers to exporting ready processed Kenyan coffee to the international market according to the officials in the Ministry of Agriculture and they are: (i) tariff barriers from importing countries and; (ii) access to the international retail market.

The tariffs for importing ready processed Roast and Ground (R&G) and soluble coffee was presented in the last chapter. The officials in the Ministry of Agriculture and those in the CBK strongly disagree with the notion that developing countries are asked to liberalise but tariffs imposed by the developed countries in Europe still remain. They argue that the liberalisation of the Kenyan coffee sector will make little headway if the developed countries in Europe continue to obstruct the import of Kenyan retail ready coffee into Europe. The officials argue that institutions like the IMF and WB push the developing countries to liberalise their economy before they are ready to do so and are then faced with restriction in expanding their market. The officials in CBK argue that the restrictions to international trade do not only impede the expansion of the sector but also obstructs the free movement and exchange of technology and marketing techniques in improving the coffee sector in particular and the economy in general.

The second barrier to exporting Kenyan coffee as retail ready product is the challenge of penetrating into the competitive and lucrative Western market. The CBK officials argue that penetrating the Western retail market means having to aggressively market Kenyan coffee in order to break into the highly competitive supply chain distribution network and brands like Nescafe, Kenco and Maxwell House. This means high capital investment must be accompanied with long term strategy in achieving the aim of exporting retail ready products from Kenya. The officials accept that this should be a long term strategy but were not able to present a concrete marketing plan to penetrate into the international market. When asked why the CBK and the Ministry is keen to speak about international market and innovation when there are many unresolved issues at the domestic level, the respondents argue that these problems will always be present and only by opening the sector to domestic and international competition can the inefficiencies and the lack of infrastructure facility can be fixed. The small scale farmers also respond in similar vein, arguing that exposing the sector to the market will at least help improve the high cost of taxation, levy, transport cost, processing and grading cost and other statutory charges highlighted in the last chapter.

Despite many of the challenges identified by the policy makers, the Kenyan coffee growers, especially the estate farmers exude confidence in regenerating the sector through world class innovation.

The first major report into the value adding opportunity in the Kenyan coffee industry was published in April 2004 by the Agrisystems Limited at the behest of the European Commission (Kenya European Commission, 2004). The recommendation of the report on exporting coffee as a final product is that: (a) access and (b) marketing can be a difficult task in competing with established brands. The report also goes on to say that attempts should be made to enter the market but this should be done on a trial basis rather than by wholesale purchase of roasting facility.

It is recommended in the report that the Kenyan green coffee is initially delivered to established roasters within Kenya for them to roast and package on behalf of the Kenyan firms and then to export them to the international market. According to the report this strategy will minimise the development and operating costs of the innovation process and thereby reduce the risk and inefficiency in the system.

The ambition to sell Kenyan coffee as a final product is enthusiastically supported by the chairman of the Mild Coffee Traders Association (MCTA), the chairman of the association suggested that Kenyans are capable of doing what the international traders are doing by blending Kenyan coffee with other cheap coffee in order to sell them. He was also supportive of value-addition by arguing that the strategy to sell Kenyan coffee as a final product will boost the free market economy of Kenya, and limit the interference of the state in running the coffee sector and thereby minimise any inefficiency arising from it. He argued that Kenya and other developing countries should look at ways of diversifying the export of primary commodities and devoting more energy to the development of final products by adding value and quality domestically before exporting them to the world market.

He gave the example whereby India has started producing anti-retroviral drugs and has gradually made a name for its medical capability in the world. Likewise the chairman of the MCTA argued that Kenya should exploit its premium coffee reputation and sell coffee directly without leaving the Kenyan borders. According to him Kenyan coffee makes up about 10 percent and the rest 90 percent is usually made up of cheap coffee grades from countries like Papua New Guinea, Indonesia, Vietnam, Colombia and India to make up coffee brands in the supermarkets around the world. According to the MCTA chairman, there is a great scope for Kenyan farmers and processors to tap into the reputation of the

Kenyan coffee. However the challenge of penetrating and competing with the Western and Northern European market remains to be surmounted.

The liberalisation of the coffee sector was meant to give the cooperative institutions, the marketing agents and traders the power to compete and bargain through the market mechanism, in the hope that the market will eradicate the problems of high transaction cost, inefficiency and declining output. However the Coffee Act 2001 was itself responsible for some of the newer problems in the newly liberalised market structure. These include wrangling among the cooperative societies; competition among the liberalised marketing agents to solicit cooperative clients often by corrupt means and the increasing sub-division of the cooperative societies into smaller ones thereby increasing the cost of processing. Although the intention of the IMF and the WB is to eradicate inefficiency and high cost in the domestic coffee sector through competition, the producers on the other hand were more concerned about identity of their cooperative than efficiency. This is reflected in the cultural values of the producers when they reported that the marketing agents did not compete for customer by offering higher prices than their competitors, but by bribing the cooperative directors, therefore It is not surprising that the marketing agents and producers did not share the WB's assumption that competition would help increase growers return. It appears that the growers weren't looking for institutional changes to give them better markets but they sought to avoid markets and attempt to sell their coffee through new sales outlet, i.e. direct selling and local processing.

In the next section, the main findings from the analysis are drawn to conclusion by taking into account the qualitative and quantitative statistical data and its relevance to liberalisation and the coffee sector in Kenya.

6.4. Conclusion

The findings from the qualitative and quantitative analysis reveals that the liberalisation of the coffee sector has adversely affected the Kenyan coffee growers in terms of grower's income, production, morale and the future outlook of the industry. Although Kenyan coffee growers receive one of the highest proportions of domestic to world coffee price among the coffee producing nations, they are nevertheless facing a downward trend when observing the changes in the proportion of the price received by the Kenyan farmers over the period from 1980 to 2004. In addition to this, the findings also reveal that both the smallholders and the estate farmers overall production of coffee has been declining and this is attributed largely to the way coffee institutions, particularly the local cooperatives operate in serving the needs of the farmers.

It can be concluded that the impact of liberalisation felt by the coffee farmers can largely be linked to the years of neglect, underinvestment and mismanagement of public and state enterprises during the state centred approach to economic development in Kenya during the 1980s. The consequent implementation of the liberalisation programme in 2002 was meant to address and improve the way the sector operated however given the coffee sector was immersed in a range of macro-economic problems for more than a decade, it took the IMF and the GOK several attempts to reform and put into practice the terms of liberalisation. It was only in 2001 when the coffee sector reform was instituted in the legislation, the ailing sector began to be re-invigorated.

The overarching purpose of the reform of the coffee sector was to bring competition and to limit the direct interference of politics in the coffee sector. This was to be achieved by improving the institutions, specifically by serving the interest of the smallholders through market competition (IMF: PRSP, 2000 and 2004). In order to achieve this objective, the 2001 Coffee Act was enacted and implemented in 2002.

The findings and analysis shows that the fall in production of coffee and the decline in the proportion of domestic to world price received by the farmers can partly be attributed to the IMF reform programme of liberalisation which increased the freedom of the farmers to come together or to split into smaller local cooperatives without properly considering the consequences of such actions. The interview findings in this thesis shows that in most cases the farmers exercised their freedom to mobilise based on non-economic reasoning. As a result the institutional condition and the quality of governance among the cooperative institutions deteriorated and this was exacerbated by the lack of political will and leadership, particularly from the period 1990 to 2002. The splitting up of local cooperatives

had increased cost, made corruption pervasive and encouraged poor leadership in addressing and resolving the institutional problems within the industry. As a result of these problems many farmers are keener to exploit the alternative method out with the existing market structure. The respondents are keener to avoid the liberalised market when they notice inefficiency instead of demanding institutional changes to give them better markets and prices.

In the next section a summary of the qualitative and quantitative findings are presented with reference to the programme of liberalisation.

6.4.1 Summary of analysis and findings

The qualitative and quantitative data gathered and analysed in this thesis revolve around the problems within the new and the old structure faced by the small and large coffee farmers in Kenya. The findings and analysis from this thesis can be summarised as below:

- i) The IMF and the GOK liberalisation of the coffee sector have created more adverse conditions for the coffee sector to prosper. Liberalisation caught the farmers by surprise. This is proven by the lack of understanding on the part of the recipients especially among smallholders, who failed to see the long term benefit who instead resorted to breaking away from the long held structure of cooperative with the purpose of creating a power base and identity.
- ii) The power base allowed: the setting up of a new committee membership to govern the institution; to exercise independent decision making; offered negotiating powers with the marketing agents; created opportunity to pool and share resources to increase and improve the farming standards; and enabled access to credit facilities. However in smaller cooperatives these powers are enjoyed at a higher cost than the larger cooperatives.
- iii) The freedom given to smallholders to set up their cooperatives seem unproductive in reducing their costs. The rise in the cost experienced by the small holders have subsequently led to reduction in the production of coffee among the smallholders which in turn have made competition among the three marketing agents intense in chasing their coffee in order to increase their profit.
- iv) The intensity of competition among the cooperative societies to sign up with one of the marketing agents have increasingly led to corrupt tactics among the marketing agents and the cooperative institutions who offer and receive kick backs from the committee

members. This is done to induce the cooperatives to sign up with the marketing agents. Such practices have negatively impacted on the quality of governance like accountability, competence and transparency, particularly at the local cooperative level.

v) The liberalisation of the coffee sector, has not improved the decreasing trend in the ratio of domestic to world prices received by the Kenyan farmers. The trend from 1990 to 2004 shows a declining rate over the period. This is a worrying trend among the smallholders because it is the smallholders who produce the majority of quality Arabica coffee in Kenya, hence any fall in production among the smallholders can have a destructive impact on the quality and reputation of Kenyan coffee.

vi) Enthusiasm for innovation – the stakeholders in the coffee sector are enthusiastic about innovation. The main strand of innovation spreading around the sector is the value adding opportunity in the sector. The momentum for innovation has been received with excitement among the farmers, the marketing agents and the government but less so among the traders. This can be interpreted as an opportunity for the producers and the marketing agent to escape from the years of inefficiencies and the problems of local cooperatives. The traders who act as middlemen for the foreign subsidiaries may lose out if Kenya begins to add value by blending Kenyan coffee with coffee of other origin and export them as final consumer product to the retailers. Its not surprising therefore that the traders are eager to identify the various inefficiencies in the coffee structure system and its weakness in undertaking innovation. However there are also other barriers to innovation which includes: tariff barriers; distribution network; market opportunities; cost of machinery and the technology for blending and packaging.

vii) Under the present structure local cooperatives are riddled with governance problems within their institutions. Liberalisation has allowed the splitting of co-operative. Splitting is a very expensive exercise. The cooperative society debt per-farmer will rise, production will decline and cost will rise. The next chapter offers a conclusion to the whole thesis by making references to the aim objectives of the thesis.

Chapter 7

Conclusion

7.1. Introduction

The argument in this thesis is that freeing the coffee industry from institutional constraints would result in an increase in productivity and higher returns to the growers. The arguments were set out by discussing the issue of economic liberalisation and economic development. This was done by making references to the economic liberalisation programmes as set out by the IMF for improving the economic development of the developing countries, particularly in Kenya. Particular reference was made to the agriculture and rural development category by identifying the objectives and the specific targets for the coffee sector. The general theme of reform in the coffee sector is to improve the marketing and market access for farmers in the coffee sector. According to the IMF and the GOK, the purpose of reforming the coffee sector is to increase the share of the final sale that farmers receive (IMF: PRSP, 2000). The IMF and the GOK stressed in their consultation paper that in order to reform the coffee sector improvement to the coffee sector institutions specifically among the smallholders is urgently needed. (IMF: PRSP, 2000 and 2004). The need is urgent because it is the smallholders who produce the best quality coffee compared to the large estate holders. Therefore any negative impact on the smallholders can have severe consequences on the reputation of Kenyan coffee and the prices fetched by Kenyan coffee throughout the world. In addition the failure to reform can result in the loss of employment and income to millions of Kenyans who depend on the coffee economy.

Prior to discussing these problems in detail in the subsequent chapters, the thesis explored the literature review on the tension between state and market oriented approaches to achieving economic development. This was done exploring the literature on the history and the main writers on development. The two main theoretical schools to emerge from the history of development are the: (i) structuralist who argue that the problem of lack of development is because of the unequal international trade pattern and; (ii) expanding capitalist growth who argue that the lack of capital formation as the main cause for the lack of development among the developing countries in the world.

According to both of these schools, the general problem of development was identified as underdevelopment which was weighing down on the prospect of autonomous development.

The literature review delved into the concept, the structure, the characteristics and the analysis on underdevelopment according to the two main writers on underdevelopment

(Baran, 1957, Frank, 1967). The review of the literature on underdevelopment also explored the two most widespread policy responses to the problem of underdevelopment. They include (i) the state oriented and; (ii) the market oriented response to the problem of underdevelopment. In discussing these approaches, the typical flagship policies were highlighted and the leading theories such as neoclassical and Keynesian economics that inform these policies were identified. The literature review chapter ended with criticisms of the state and market oriented policies toward the problem of underdevelopment and set the context for a more detailed study on the case of Kenya and its coffee sector.

The persistent poor level of governance has only increased the opportunity for the state to create and manipulate the multitude of laws and policies for the purpose of extracting rent. Excessive rent seeking has weighed down on the economy and worsened the domestic political and economic structure of the developing countries, particularly in Sub-Saharan Africa, and this can be demonstrated by studying the case of the Kenyan coffee economy.

The aim of the methodology chapter is to offer an in depth discussion on the approach used to meet the aim and objectives set out in this thesis. The aim of the thesis is to study the impact of liberalisation on the coffee sector of Kenya, particularly on the small and large estates. To this end a list of four objectives was set out. The approach used in fulfilling the aim and objectives this thesis are: (i) dissect the emerging themes from the literature on economic development; (ii) discuss the themes in separate chapters by making reference to the case of Kenya and its coffee industry; (iii) identify the qualitative and quantitative primary and secondary data related to the aim and objective of the thesis; (iv) analyse the findings with the aim of answering the research problem and; (v) conclude the findings with reference to the aim and objectives.

7.2 Summary of part 2

The chapter on governing coffee production was dedicated to discussing the evolution of the coffee sector in Kenya. This was done by exploring the development of the coffee sector since the colonial period up to the present day. Most of the discussion on governing the coffee sector was focussed on the post independent regime and on the supporting institutions inherited by the post colonial rulers. The colonial legacy was not without its problem; part of the review in this chapter was devoted to examining the problems, particularly those arising from the regulatory regime implemented by the post colonial rulers in Kenya. As a result of the persistence of these problems, particularly within its institutions the coffee sector had to endure adverse outcomes in terms of inefficiency, governance and rising cost.

The accumulation of all of these political and economic problems led the IMF in collaboration with the GOK to embark on a series of reforms by aiming to liberalise the economic and the political sectors of the country. General reform programmes within the state and public owned enterprises in Kenya were first addressed by the GOK with the assistance of the IMF in 1990s. The overarching aim of liberalisation was to free the economy of Kenya, particularly in the agricultural and the utilities sector from any direct political control so that rent creation and rent extraction opportunities can be minimised. This also meant the regulatory regime and its inward policies had to be deregulated and the role of the market promulgated.

The liberalisation of the Kenyan economy in the 1990s was supposed to mark the beginning of a new era in the development prospect of Kenya. During this period the IMF sponsored liberalisation programme did not always go smoothly. The flow of funding and other forms of assistance from the IMF and other bodies were not only irregular but was also characterised by distrust and hostility between the IMF and the GOK. The failure of the GOK to keep up its reform commitment particularly in monitoring and tackling the problems of corruption was one of the main sticking points between the IMF and GOK. The conflict between politics and market were particularly intense during the two decades (1982 to 2002) of single party rule.

When considering the coffee sector the problems included: mismanagement and poor governance at local cooperative levels; the increasingly slow payment to the farmers; the decline of the small scale farming area devoted to coffee growing; the dominance of the foreign subsidiary in the auction market; the rising input cost; the poor flow of information between the marketing agent and farmers; the monopoly of the KPCU marketing agent; lack of accountability from the CBK to the farmers and the over-lap of the role of CBK as regulator and distributor of farmers income.

The cumulative effect of these problems over the period of two decades (1980 to 2000) weighed down on the morale of the coffee farmers, especially among the small scale producers. Small scale farmers blamed the GOK for the pessimistic outlook and the decline in production and income among the coffee producers during the period.

During this period the politics of Kenya was characterised by lack of political leadership in addressing the core problems within the coffee sector. More generally the performance of Kenyan economy was also set on a deteriorating trend. The economic performance of Kenya can be summarised as going through the stages of high growth (1963 to 1983) followed by stagnation and decline (1983 to 2003). Although some of the targeted sectors were successfully privatised over the period from 1990 to 2001, questions remained over the method and the consequences of the reform.

Despite the early enthusiasm for reform in Kenya, it was only in the late 2001 with the election of a new government that the programme of liberalisation was given a fresh impetus to go forward. In terms of the coffee sector, the reforms were finally fully implemented in 2002 with the enactment of Coffee Act 2001. Since 2002 the Kenyan coffee industry has undergone numerous changes and challenges however the effective implementation of the reform programme was dependent on the credibility of institutions in seeing through the series of the reform programmes aimed at the various sectors.

When assessing the case of the Kenyan coffee sector and its related institutions, the IMF and the GOK led the reform programme by liberalising the institutions such as the regulatory board, the marketing agents, the local cooperatives servicing, the Coffee Exchange and the coffee selling structure.

One of the major changes to face the coffee sector under the Coffee Act 2001 is the freedom of the local cooperative institution to establish and dissolve themselves. Prior to the Coffee Act 2001, small scale farmers must seek the permission of the Ministry of Cooperative before forming a cooperative. This change is crucial because, it now gives small scale coffee farmers within a geographical region to group together and form themselves into a cooperative thereby allowing them to pool and share resources together without belonging to a larger cooperative. The aim of giving the small scale farmers the independence to break-away from the bigger cooperation is to force the cooperation's to be cost efficient, to be competitive and to increase their bargaining power in the liberalised coffee sector. The findings in this thesis show that this has not been achieved.

Although low coffee prices and drought are partly to be blamed, the findings in this thesis show that the deteriorating quality of governance in the coffee sector institutions and the lack of government determination to reform the sector are the two main reasons for the failure in reviving the optimism and production of the coffee sector.

Some of the other challenges are identified and discussed in the chapter on findings and analysis. This is done using the methods and methodology presented in chapter three of the thesis.

When assessing the IMF PRSP paper for the coffee sector, the improvement in the institutions of the coffee sector has not been achieved based on the examination of the qualitative data. Additionally the objective of increasing the smallholder farm-gate price has also not been achieved according to the quantitative data analysed and presented in the findings chapter.

Although the trend in the ratio of farm to world price appears to be rising from its lowest point in 1992 but by 1999 the trend has reversed and was on declining path. The full implementation of the coffee reforms in 2002, failed to arrest this decline. In fact the ratio fell from almost 100 cents per-pound in 2002 to just above 0.60 cents per-pound of coffee. This is a fall of almost 40 percent in the ratio of farm to world price experienced by the Kenyan farmers in a single year (2002 to 2003).

The fall in the ratio of the farm to world price follows the fall in the coffee prices received by coffee growers in Kenya and other coffee producing countries. However in the case of Kenya, this is made worse by the poorly executed IMF and GOK liberalisation programme on the coffee sector. This is substantiated and discussed in detail in the findings and analysis chapters using qualitative and quantitative data.

So what are the main changes to have impacted the coffee sector in Kenya? The summary of findings from the qualitative and quantitative analysis shows that small scale producers have been losing their position as premium coffee producers since the full implementation of the IMF and the GOK led reforms. This is manifested by: the increasing subdivision of smallholder coffee cooperatives which has led to a steady increase in the cost of coffee processing; the widening disparity between small and large coffee estates in achieving efficiency; the pervasive problems in transaction between marketing agents and smallholders; the over-concentration of traders among the few foreign subsidiaries that drives out local traders, which is crucial for re-investment in the domestic coffee sector; the lack of domestic consumption of coffee in the local market which impedes growth and; a lack of clear strategy in the sector for innovation and marketing as a single origin product.

The quantitative findings show that: there is a very high correlation between domestic coffee grower's price and world price, however the co-relation shows that smallholder and estate production moves in the opposite direction to the ratio of domestic to world coffee price. This is explained by the quantity of supply of coffee to the world market, as the total supply of world coffee rises, we expect the prices to be depressed as demand remains unchanged in the short- run. Given that smallholders produce more coffee than the estate farmers, the former will depend more on the structure of the cooperatives to process and sell their coffee than the latter. Hence the problems within the cooperatives will have a major impact on the majority of coffee producers in Kenya.

7.3 Conclusion

The findings and analysis in this thesis show that although the IMF liberalisation was well intended in fixing the economic problems faced by Kenya, the same level of determination and aspiration were not shared by the GOK consistently over the period of implementation. As a result of this the coffee sector failed to appreciate and seize the opportunities presented in the liberal market economy. The coffee growers especially the small scale farmers saw the process of liberalisation as an opportunity to increase their bargaining power at a higher cost and lower output, therefore the newly derived bargaining power within the free market has not delivered significant positive impact on the small scale producers.

It can be concluded from the analysis of the qualitative and quantitative data that what matters is not whether it is the market or state oriented policies that are used to respond to the problem of underdevelopment but rather It is the extent of the quality of governance within the institutions of government, business chambers, trade union, judiciary, the press, commodities and utilities board, etc which supports the implementation of the state policies that makes a crucial difference in reforming and improving the performance of the respective sectors and the economy in general.

The contribution in this thesis has demonstrated that the implementation of a liberal market agenda as a carte-blanc response to the problem of underdevelopment has not helped to remove the various impediments to the problem of economic development. This is because in most developing countries the issues of governance and institutions still largely remain unaddressed. It can be concluded from the literature review that most developing countries had opted for the market oriented response without giving extensive consideration to the necessary initial conditions prior to implementing the market style liberalisation programme. In the case of Kenya the programme of liberalisation was undertaken without taking into account the extent of the deep seated political and rent seeking problems within the institutions prior to implementing the reforms. It can be claimed that for liberalisation to be successful, institutions should be in a position to prioritise the finances, absorb the ideas and translate the terms of liberalisation into concrete programmes of action. This thesis has demonstrated that good quality of governance and credible set of institutions might hold the key to freeing developing countries from the bane of underdevelopment.

7.4 Further research

It would be interesting for future researchers in the political economy of development in Kenya to explore the relationship between the IMF sponsored liberalisation and its impact on other commodities in addition to coffee. As discussed in the previous chapters, a substantial part of the Kenyan economy, i.e. 25 percent of GDP, is dependent on agriculture, therefore the effectiveness of the IMF liberalisation programme should be assessed on the performance of the various aspect of the agricultural sector in addition to the coffee sector.

The commodities that future researchers might want to consider assessment includes: tea, cotton, meat, sugar, dairy and others. The results from the assessment may suggest the extent to which Kenyan politics have influence over the most important economic sectors in the country. It could also highlight some of the political methods in influencing the sectors.

Future researchers may also want to undertake comparative studies between the different commodities and identify if the terms and conditions of the reform had impacted on the commodities differently. It is evident in the literature that the result of externally imposed liberalisation onto developing countries had not always been helpful to all the sectors in the economy; therefore there is significant scope for investigating some of the reasons for this across the newly liberalising developing countries.

The literature on development especially argues that external bodies like the IMF and the WB are less familiar with the specific need and requirement of the different countries within the region. Future researchers might want to explore how the process of liberalisation in the post Asian financial crisis has affected the various economic sectors and the macro-economy in general. It is argued that international bodies like the IMF and WB are obsessed with creating market oriented reforms in the hope that resource allocation would automatically be achieved through competition and privatisation, however in many developing countries, this has not happened, therefore by investigating and highlighting some of the reasons other factors that impede the efficient functioning of the market can be unravelled.

APPENDICES

Appendix 1

Interview schedule

Politics
Economics
Coffee

PhD

Interview Schedule

Procedure

1. Introduce myself and the research
2. Release form – agreement
3. Start interview

Purpose

To obtain primary data for my PhD research

Aim

To study the effect of political institutions on the economic development of Kenya

3 parts

- i) Background information
- ii) Identify the influence of politics on economic development
- iii) Understand the effects of rent seeking on the coffee industry

Introduce myself and the research

I am interested in learning about how the politics in Kenya has influenced the economic development in Kenya

In order to do that I have selected you to be on the sample panel, because I think your involvement in the coffee economy and your overview of the industry is very useful and highly valuable to my research. This interview is also helpful in identifying the gaps in some of the aspects of the political economy of coffee in Kenya.

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page 1

COPY OF INTERVIEW SCHEDULE

START

i) Background information

Personal information

Name (optional):

Title:

Age:

Gender:

Ethnic group:

Job related

What is your job?

What does your role involve?

How long have you been in the job?

What other appointments do you have?

Is this your main job?

ii) Identify the influence of political factors on economic development

How do you think politics has impacted on economic issues in Kenya?

Was the single party rule a good thing for Kenya? If so in what way was it positive and negative? Did things get worse?

Why international bodies have had to assist the country? (Capital, employment, government unable to generate economic growth).

The IMF suspended Kenya's Enhanced Structural Adjustment Programme, to Kenya in late 1996 after the Moi government failed to adhere to IMF governance agenda. It resumed again in 2000 (BBC News, 28th July 2000) and then suspended again and resumed again under the new administration in 2003.

Why do you think Kenyan government resisted reform in the area politics? [legalising political parties, irregularity of voter registration, amendment to the constitution, media coverage and campaign of harassment in 92 and 97 elections] (Suggestive: to protect the political and economic interest)

What have been the effects of international advice on elimination of corruption - in Regulatory/Law Enforcement, Employment services and businesses? (BBC News, 18th Jan 2001)? Can you elucidate?

Has this advice helped Kenya? How

Do you think there is a relationship between politics and how the resources are distributed? For example, do you think politics determine how much money should be channelled to a region? (Suggestive: ethnic, political affiliation, etc)

From the literature It is suggested that single party rule, can breed cronyism (favouritism by politicians to seek votes by giving special privilege to someone because they're close friend, rather than good business man)

Do you think cronyism have proliferated in Kenya during the single party rule?
(Suggestive: privileges and favour thrive)

Kenya had enjoyed relatively good political stability but not sustainable economic growth. Do you think the changing political systems (single to multiparty politics) have become an impediment to the economic growth of Kenya?

iii) Understand the effects of rent seeking on the coffee industry

The political governance will undoubtedly have an impact on the regulation of the Kenyan economy.

How does the political governance during the single and the recent multiparty politics affect the coffee interest groups?

(Some of the interest groups include:

Coffee Board of Kenya

(These three have marketing oligopoly)

Kenya Planters Co-operative Union (KPCU) – oldest miller

Thika Coffee Mills (TCM)

Socfinaf Mills

Large and Small Coffee Marketing (K) Ltd

Mt Kenya East Coffee Marketing Agency

Allied Coffee Marketing Company

Socfinaf Ltd

Gatatha Coffee Mills)

How does the government affect these interest groups?

Are there any changes the interest groups have sought?

What is the reaction of the government to these changes – accepted or resisted?

Kenya is dependent on export of high quality coffee for its revenues.
How does the government attempt to preserve the quality and quantity of coffee production?

Would the farmers not see these controls as barriers? Yes/no, can you say more about it?

Which is the body that monitors and enforces violations of coffee output on behalf of the government?

So who has the authority to appoint the members onto these body /institution?

Would the members appointed onto this institution require any special qualification or experience?

What advantages are there to be a board member? Is the Board representative?

Would the present administration consider imposing any new restriction in coffee sector?

What is the re-action from coffee interest group on these restrictions?

If positive then

Does the coffee interest group enjoy good relations with the government?

If negative then

Does the coffee interest group enjoy independence from the government?

Overall do you think the governance have improved in Kenya over the years? (refer to political and economic institutions)

CLOSE

Appendix 2

Release form

Politics
Economics
Coffee

PhD

Release form

I agree to participate in this research to study, '*The effect of political institutions on the economic development of Kenya*'.

I understand that I will be taking part in a voluntary capacity and understand the aim and purpose of this study.

I give permission for the data collected by Mr.Sathia Varqa to be used for his PhD thesis.

I understand that my personal data will be anonymised. I grant permission for the recording of this interview.

Mr. Sathia Varqa will conform to the ethical code of research.

Research participant

The researcher

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Appendix 3

Table: Quantitative data from secondary source

No.	Variables	Source	Comments
1	Gross Domestic Product (GDP) growth	World Bank (2005)	Annual percentage growth rate of GDP per capita based on constant local currency, 1980 to 2006
2	Per-capita GDP growth	World Economic Outlook database, IMF	Gross domestic product, constant prices (National currency), 1980 to 2006
3	Current account balance	World Economic Outlook database, IMF	Gross domestic product, current prices (National currency) Current account balance (U.S. dollars), 1980 to 2006
4	Gross domestic investment	African Indicator	Percentage of GDP, 1980 to 2001
5.	Agriculture growth rate	Kenya Economic Survey	Percentage rates of growth measured in current prices, 1971 to 2003
6.	Sale of coffee to marketing board and company.	Kenya Economic Survey	Sale of selected produce to marketing boards and company ('000 tonnes), 1965 to 2004
13	Coffee production	International Coffee Organisation (ICO)	Total production of exporting members in crop years [60 kilo bags], 1976 to 2005
14	Kenya - Prices paid to coffee growers in US cents per lb	International Coffee Organisation (ICO)	Historical data 1977 to 2006 http://www.ico.org/historical.asp (Arabica)
15	Exports of ICO member countries	International Coffee Organisation (ICO)	Historical data 1977 to 2006 http://www.ico.org/historical.asp [60 kilo bags]
17	Colombia, Brazil and Ethiopia, Kenya- Price paid to coffee growers	International Coffee Organisation (ICO)	Historical data 1977 to 2006 http://www.ico.org/historical.asp in US cents per lb (Arabica)
18	Domestic consumption of coffee - Kenya	International Coffee Organisation (ICO)	Coffee production minus exports = domestic consumption. Historical data 1976 to 2006 http://www.ico.org/historical.asp
19	Coffee prices	International Coffee Organisation (ICO)	Historical data 1976 to 2006 Monthly averages of ICO Indicator prices in US cents per lb http://www.ico.org/historical.asp
20	Total production of exporting members in crop years [60 kilo bags]	International Coffee Organisation (ICO)	Total production of exporting members in crop years [60 kilo bags] http://www.ico.org/historical.asp

21	Cooperatives coffee production Estate coffee production	The European Commission report on the potential of the Kenyan coffee industry	Assessment of the Value-Adding Opportunities in the Kenyan Coffee Industry, Final Report (2004) ('000 tonnes
22	Cooperative yield Estate yield	The European Commission report on the potential of the Kenyan coffee industry	Assessment of the Value-Adding Opportunities in the Kenyan Coffee Industry, Final Report (2004) [(Kg/ha]
23	Investment Share of RGDP (% in 1996 Constant Prices)	Penn World Data Request Form	Biz-ed website, historical data 1950 to 2000 http://www.bized.co.uk/dataserv/pennata/penn.htm
16	Human Development Index	United Nations Human Development reports	Shows ranking of countries based on life expectancy, literacy, education, and standards of living for countries worldwide. Ranking is from 1 being high HDI to close to 0 for low HDI. HDI is classified according to high, low and medium, Available at: http://hdr.undp.org/hdr2006/statistics/
17	Transparency International Ranking	Transparency International Report (2005)	Ranks corruption perception index (CPI), Bribe Payers Index (BPI). The index ranks from 1 to 10 with 1 being most corrupt and 10 being highly clean. Available at: http://www.transparency.org/
18	Civil liberties and press freedom	Freedom house (2006)	Rates civil liberties with 1 representing the most free and 7 the least free. Available at: http://www.freedomhouse.org/template.cfm?page=15
19	Index of Globalization	KOF Index of Globalization	KOF Index of Globalisation Available at: http://globalization.kof.ethz.ch/query/
20	Democracy	Marshall and Jaggers (2000)	0-10 (0 = low; 10 = high) democracy score. Measures the general openness of political institutions.
21	IMF transfers	Kenya Transaction with the fund	The transaction is in the SDR units. SDR is an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. SDRs are allocated to member countries in proportion to their IMF quotas. The SDR also serves as the unit of account of the IMF and some other international organizations. Its value is based on a basket of key international currencies. http://www.imf.org/external/np/fin/tad/extrans1.aspx?memberKey1=540&endDate=2007%2D02%2D27&finposition_flag=YES

Appendix 4

Special Drawing Rights

SDR is an abbreviation for Special Drawing Rights. SDR is the IMF unit of account and a unit for allocation for its member countries in proportion to their IMF quotas. Its value is calculated based on a basket of key international currencies. One unit SDR is almost equivalent to 1 USD. Kenya's SDR is 271.40 million) (IMF, 2006).

Appendix 5

Table: Kenya's participation under IMF programmes

Presidency	Year	Participated	Programme	Programme abbreviation
Moi	1980	No		
	1981	No		
	1982	No		
	1983	No		
	1984	No		
	1985	No		
	1986	No		
	1987	No		
	1988	Yes	Structural Adjustment Facility	SAF
	1989	Yes	Poverty Reduction and Growth Facility	PRGF
	1990	Yes	Poverty Reduction and Growth Facility	PRGF
	1991	Yes	Poverty Reduction and Growth Facility	PRGF
	1992	Yes	Structural Adjustment Facility	SAF
	1993	Yes	Poverty Reduction and Growth Facility	PRGF
	1994	Yes	Poverty Reduction and Growth Facility	PRGF
	1995	Yes	Poverty Reduction and Growth Facility	PRGF
	1996	Yes	Poverty Reduction and Growth Facility	PRGF
	1997	No		
	1998	No		
	1999	No		
2000	Yes	Poverty Reduction and Growth Facility	PRGF	
2001	No			
2002	No			
Kibaki	2003	Yes	Poverty Reduction and Growth Facility	PRGF
	2004	Yes	Poverty Reduction and Growth Facility	PRGF

(Source: IMF: Kenya Transaction with the Fund, 2007)

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