The Use of Supportive Domestic Mechanisms Is a Distortion of Sugar Trade in the Comesa Region

UNGAYA Cotty Godfrey [*], Malenya Musebe James [**]

[*] Department of Peace and Conflict Studies, Masinde Muliro University of Science and Technology
[**] Department of Peace and Conflict Studies, Masinde Muliro University of Science and Technology

DOI: 10.29322/IJSRP.8.10.2018.p8262
http://dx.doi.org/10.29322/IJSRP.8.10.2018.p8262

Abstract- The COMESA pact brought together twenty one countries with the aim of easing trade between them. This was aimed at creating more trade in terms of volume flows across the borders within the COMESA region through removal of tariff and non-trade barriers. However, trade volume statistics, with regard to sugar trade in this region indicates that member states do not benefit mutually. Sugar statistics in the region between member states indicate that industries that receive supportive domestic mechanisms had an edge over those that do not in the regional sugar market. It is upon such understanding that this paper interrogated the issue of supportive domestic mechanisms, and whether these are mercantilist approaches that distort sugar trade. The use of non-tariff barriers and other domestic supportive mechanisms are protectionist in nature. The researcher used questionnaires and interviews to collect primary data while secondary data was collected through sugar journals. Data was analysed by use of descriptive statistics such as tables, frequencies and percentages, and presented in form of graph, pie charts and tables. The results of the study indicate that member states that applied supportive domestic mechanisms in their sugar industries accrue more economic benefits from regional sugar trade than those that do not. The results indicate that Zimbabwe, and Sudan sugar exports have reduced while Egypt and Malawi exports into Kenyan sugar market have increased significantly since the implementation of the COMESA pact, the biggest loser being Kenya. It should be pointed out that non-tariff barriers were still in use in the region, seemingly only tariff barriers were done away with upon implementation of the COMESA pact. Therefore, to reduce distortions in sugar trade and realise further trade liberalization in the region, negotiations should now focus on removal of other supportive domestic mechanisms and use of non-tariff barriers that lead to sugar trade distortions in the COMESA region.

Index Terms- Tariff barriers, Non-tariff barriers, mercantilism, protection, economic benefits, negotiations

I. Introduction

The COMESA region is a vibrant economic area and membership to the Free Trade Area started in October 2000, to boost trade and investment (Republic of Kenya, 2009). Sugar is traded at zero-border tariff among eleven countries that are signatory to the COMESA FTA. Under FTA, countries trade in goods under the rule of origin without custom duties and import quotas. Other countries that are not signatory to COMESA FTA, trade under preferential terms whereby custom duties were reduced for qualifying products. The level of preference offered a reduction of 80% of the Most Favoured Nation duties for Uganda and Eritrea while 10% for Ethiopia (Republic of Kenya, 2009). Under COMESA FTA, countries that produce their sugar cheaply would automatically enjoy the economic benefits that come with regional liberalization. This means that there are losers and winners whenever trade liberalization takes effect.

Sugar as a trade item receives extreme support in respective sugar producing countries. According to Anderson and Masters (2009), sugar is heavily supported in Africa. Mozambique, Sudan and Egypt support their sugar producers, while Egypt subsidizes sugar production. However, sugar farmers are taxed in Sudan, Egypt and Kenya. In Kenya, over taxation is the main constrain, as a wide range of taxes, levies, cesses and fees are charged in sugar production, imports and services distorts prices (Kwa, 2005). Supportive domestic mechanisms, according to Shaffaeddin, were meant to promote outward industrialization. In fact, it was a shift from the traditional import substitution to export oriented industrialization in the late 1980s. However, the use of supportive mechanisms by sugar exporting countries has been abused in the sense that it gives edge to certain industries over others.

Though the COMESA pact removed tariff barriers, progress on elimination of non-tariff barriers has been slow. There are trade restrictions in the region; for instance, Zambia uses import prohibitive international trade policies such as import permits against members (Ellis and Sigh, 2010). And as much as the COMESA pact was meant to promote trade within the region, sugar trade within the COMESA region is still minimal because of poor domestic and regional trade policies that have promoted trade with the US and EU sugar preferential markets (Kwa, 2005).

II. Materials and Methods

The study was conducted in Kenya. Kenya sugar market is considered lucrative by other COMESA sugar producing countries because of high domestic prices. Though COMESA region consists of twenty one countries (World Bank, 2013), the study focused on six countries active in sugar exports in the regions. The Free Trade Area was achieved on 31 October 2000 when nine of the member States, namely Djibouti, Kenya, Madagascar, Malawi, Mauritius, Sudan, Egypt, Zambia and

Zimbabwe, eliminated their tariffs on COMESA originating products in accordance with the tariff reduction schedule adopted in 1992. Burundi and Rwanda joined the Free Trade Area on 01 January 2004 (Republic of Kenya, 2009). The six COMESA states include Malawi, Egypt, Sudan, Zambia, Zimbabwe and Swaziland. The sample was small since it consisted of administrative attaches of the six COMESA countries and COMESA Desk in Kenya to provide information. Therefore a small sample size of seven (7) was used. To manage limitation in research, the study relied heavily on secondary data from reputable firms such as KPMG to gather information on supportive domestic mechanism in use in the COMESA region.

To collect primary data, the researcher used structured questionnaires and interview schedules, which were trial tested in a pilot study. The questionnaires used had both open and closed questions intended to capture a detailed level of content. It was chosen due to its ability to reach distant respondents hence minimized researchers influence on the respondents. It also allowed time for respondents to give well thought answers and time to respond to the items. The interview was chosen due to its flexibility and adaptability. It provides the researcher with some measure of control over the research setting and one can modify questions and probe answers (Prewitt, 1975). With secondary data analysis, the researcher paid focus on sugar prices, import and export volumes, and domestic and international trade policies applied by COMESA sugar producing countries

Quantitative data was analyzed using descriptive statistics such as frequencies and percentages while qualitative data responses were grouped in themes and frequencies done. The researcher presented data findings in form of frequency tables, pie charts, bar graphs and narratives. There were factors that affected the accuracy of the results of the research study. One, the researcher was unable to gather information from some respondents who declined to participate or were unavailable for interviews. Two, the researcher did not carry out the study in individual COMESA states because of lack of funds. Some of the respondents could not understand technical terms on trade. To overcome these shortcomings, data collected from other COMESA countries was provided by administrative attaches at embassies and the COMESA office in Kenya. In addition, the researcher utilized secondary materials from Kenya Sugar Board and COMESA office on trade policy and sugar trade in the COMESA bloc.

III. Findings and Discussions

Tax exemptions, tax holidays and allowances

Most sugar producing countries in the COMESA region receive support in terms of tax exemptions, holidays or breaks and allowances. Therefore to find out trade policies that govern import of plant, farm inputs and other materials used in sugar production, the researcher asked economists at the COMESA desk (1)and administrative attaches(6) at embassies to identify tax exemptions, allowances, tax remissions, breaks and holidays enjoyed by sugar producers in COMESA partner states. Three questionnaires were not returned from embassies.

The researcher also analyzed documents on sugar trade policy of COMESA partner states. Findings indicate that Malawi producers enjoyed tax concessions while new firms enjoyed 100% investment allowance on plant, equipment and raw material. In Swaziland, new sugar producers enjoyed a five-year tax holiday, and then a 30% corporate tax at the end of the five years (Ndung'u, 2012). This means that there were no other taxes, charges or levies in respect of sugar manufactured in or imported in Malawi. In Zambia, sugar producers enjoyed a tax allowance of 50% on farm improvement and 100% for farm works or manufacturing while import of raw materials was duty free in Egypt (Ndung'u, 2012). This means that VAT did not apply on import of fertilizer and other sugar farming materials in most of these COMESA partner states or an allowance was applied. Figure 1below is a summary of the findings.

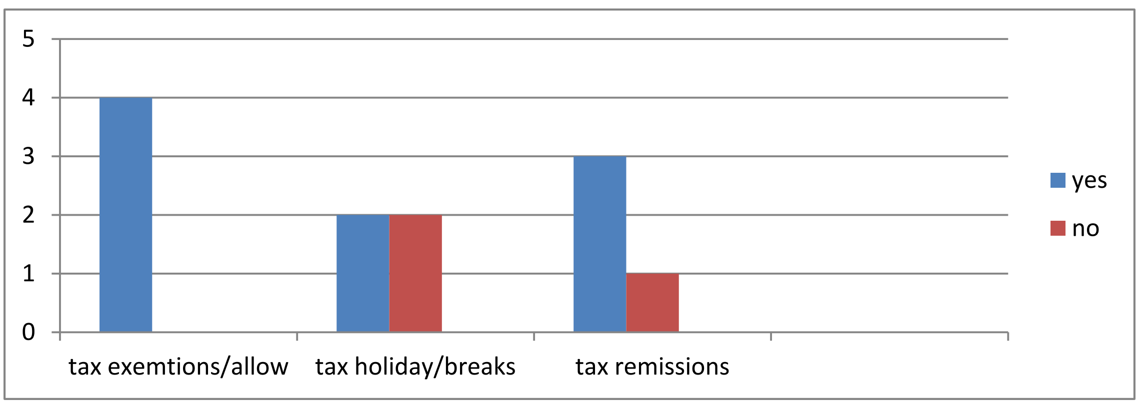

Figure 1: Exemptions and Allowances on Plant, Farm Inputs and Other Materials in COMESA Partner States. Source: Field Data, 2012

Figure 1 indicates that 4(100%) agreed that tax exemptions or allowance were applied on import of plant and farm inputs used in sugar production. However, 2(50%) posited that tax breaks and holidays applied while 3(75%) argued that tax remissions were applied. Egypt subsidized farm inputs such as fertilizer, raw materials, equipment and machinery. The state also compensated farmers for low producer prices (Ndugu, 2012).

This means that subsidies and incentives lowered cost of sugar production in COMESA partner states. It also means that tax allowances or exemptions enhanced both local and foreign investments in the sugar industries of COMESA partner states.

With adequate capital and foreign investment, these countries have the capacity to diversify and add value to their primary product, sugar.

Taxation Regimes in COMESA Partner State Sugar Industries

The findings indicate that the cost of sugar production in COMESA partner states was low because of a favorable taxation regime. Most sugar producers in the region were not subjected to sugar levies or other levies beside the VAT. Moreover, the VAT rates in some of these COMESA partner states were lower. Malawi applied VAT at 16.5%, Swaziland at 14%, Sudan 15.5%, Egypt and Sudan at 10%. Study findings indicated that Swaziland applied a sale tax at 14%, however, it was not applied to goods that form part of a final product for resale. New investors enjoyed a five year tax holiday, then a 30% corporate tax rate at the end of the five years. Figure 2 is a summary of taxes COMESA partner states applied in their sugar industries.

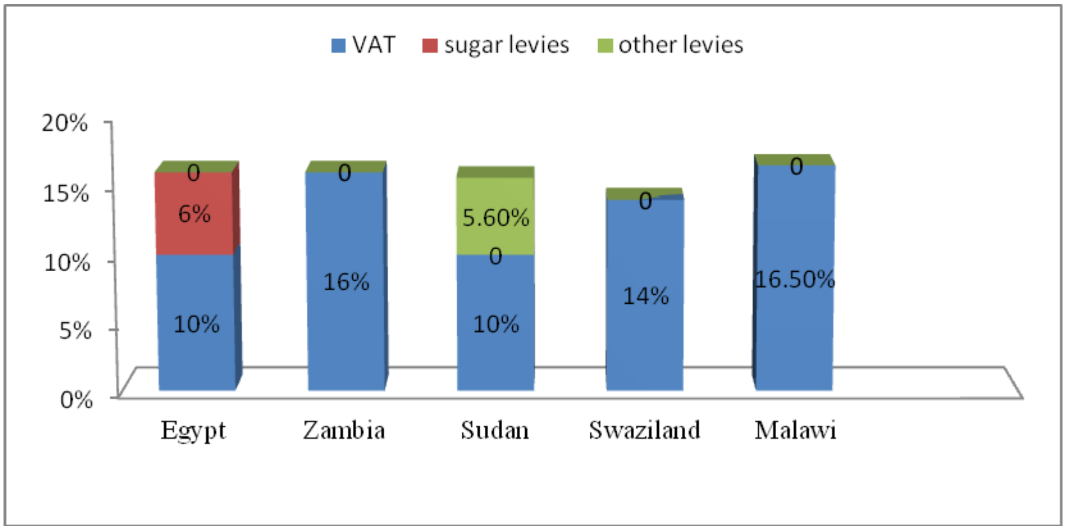

Figure 2: Taxation in Sugar Industries of COMESA Partner States

Source: Adopted from KSB Report, 2012

Figure 2 indicates Zambia, Swaziland and Malawi did not impose levies on their sugar producers while Egypt and Sudan did at 6% and 5.6% respectively. However, Sudan sugar producers were subjected to a range of taxes that were fixed under sugar levies such as state support tax (Ndung'u, 2012). Sugar producers in Sudan paid an excise tax at 17%, White Nile and state duty. In addition, there were other domestic fees such as Zakat, production, administration and transportation fees.

State Support of Infrastructure in Sugar Zones

The researcher asked administrative attaches and economists at the COMESA office to identify infrastructural areas that receive the support of the government. These infrastructural areas included power or energy, irrigation schemes and roads in sugar growing zones. State involvement in these areas is important because cost incurred indirectly add to sugar end prices. The following Table 1 is a summary of the findings.

Table 1: COMESA Partner States infrastructural Support in Sugar Zones

	Subsidized power N=4	%	Irrigation schemes N=4	%	Roads N=4	%
Yes	1	25	3	75	4	100
No	3	75	1	25	0	0
Total	4	100	4	100	4	100

Source: Field Data, 2012

Table 1 indicates that 3(75%) agreed to state support of irrigation, 4(100%) roads while 1(25%) posited that energy was subsidized in production of sugar. For instance, Egypt subsidized water for irrigation and power used in manufacturing. In Swaziland, electricity and water were subsidized to encourage investment and increase sugar production.

This means that sugar production in these countries was low because of a favorable taxation regime and support of government in infrastructural areas particularly roads and irrigation. These findings concur with Anderson and Masters (2009) observation that sugar as a trade item enjoyed a supportive government environment in Africa. Anderson and Masters (2009), main argument was that other COMESA countries enjoys supportive government policy but they fail to point out that natural factors such as soil type, amount of rain and temperature levels favour sugar production in these countries.

Import Sugar Policy in COMESA Partner States

Import sugar policies include use of taxes, other border charges and non tariff barriers such as licenses, registration, permits, rules of origin and weighbridges to manage trade. Respondents such as administrative attaches and an economist at the COMESA were asked to identify sugar import policies that apply in COMESA partner state. The following Figure 3 is a summary of the findings.

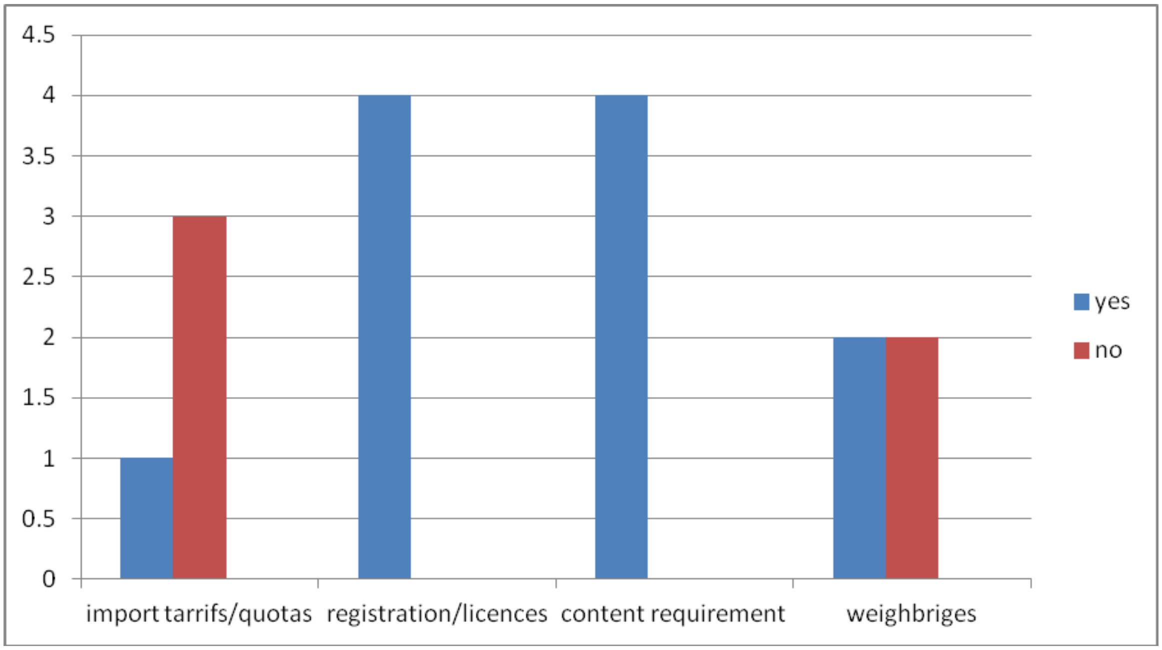

Figure 3: Import Sugar Policy in COMESA Partner States

Figure 3 indicates that 4(100%) agreed that import registration, licenses and content requirements were used. 1(25%) agreed that import tariffs and quotas were used while 2(50%) posited that roadblocks or weighbridges were applied. The findings indicate that COMESA partner state did not apply tariffs since they are signatory to the COMESA FTA which zero-rated the border tariffs for sugar trade within the region. However, these countries used licenses, registration and other non-tariff barriers in sugar importation.

Findings of the study indicate that, Zambia allowed importation of fortified sugar with vitamin A and imported sugar that has not been fortified may be seized. This means that the use of non-tariff barriers was still high in the COMESA region, which reduced flow of sugar trade. Furthermore, these import policies were complicated and cumbersome customs procedures.

Export Sugar Policy

The researcher asked administrative attaches and the COMESA office to identify export sugar trade policies. Table 2 below is a summary of the findings.

Table 2: Export Sugar Policy in COMESA Partner States

	Export subsidies N=4	%	Export taxes N=4	%	Export registration and licenses N=4	%
Yes	1	25	1	25	4	100
No	3	75	3	75	0	0
Total	4	100	4	100	4	100

Table 2 indicates that 3(75%) posited that sugar exporters did not receive export subsidies while 1(25%) indicated that taxes applied on sugar exports. 4(100%) of the respondents agreed that sugar exporters were required to register and obtain export licenses. This means that non-tariff barriers were used by COMESA partner states to manage export of sugar in the region. The use of non-tariff barriers in sugar export makes it difficult because excessive documentary requirements were required. For example, an exporter would seek clearance from twenty to thirty parties and complete over forty documents. This explained why the regions still experienced low sugar trade. Moreover, most of the sampled countries exported sugar to preferential markets in the EU and US (Vink and Hans, 2011). The findings in this section indicate that as much as regionalism promotes trade creation, the volume of sugar trade was still low in the COMESA region. The export levy was used by COMESA partner states to discourage sugar exports. Findings of the study revealed that Swaziland applied an export levy at 5.75% but Zambia, Malawi and Egypt did not apply export taxes (Ndungu, 12). However, export subsidies were not applied in the COMESA region.

Sugar Import and Exports in the COMESA Region

The supportive domestic mechanisms are important for a sugar industry that aimed at exporting sugar in the region. Sugar import and export volumes depict a picture whereby low cost producers, reap economic benefits from regional sugar trade. On October 31st 2000, eleven out of the nineteen COMESA member countries entered an agreement to zero-rate the border tariff for sugar trade. Under the COMESA Free Trade Area agreement, sugar from the mentioned countries were to enter the Kenya domestic market duty-free (KSB, 2010).

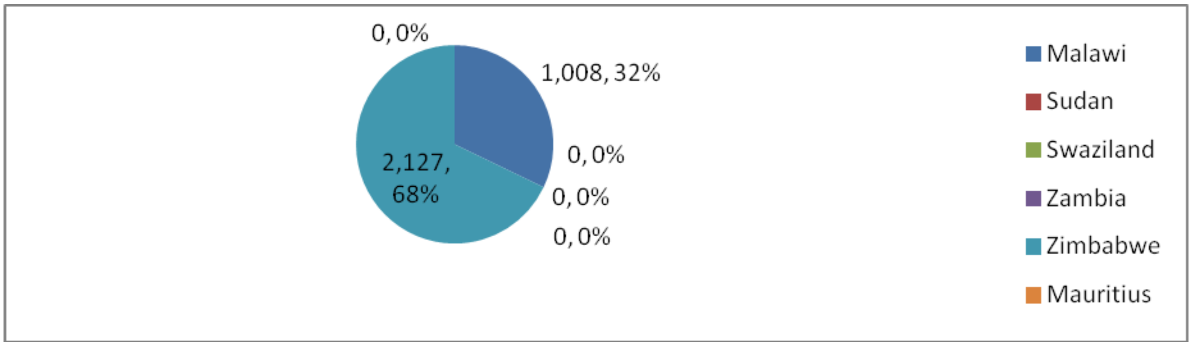

Figure 4: Pre-COMESA Sugar Imports in Metric Tonnes into Kenya, 2000
Source: Document analysis, Kenya Sugar Board, 2010

Figure 4 indicates that pre-COMESA FTA sugar imports into Kenya from the region were minimal since restrictive import policies were in force. As a result, Kenya imported only 3,135 MT in 2000 before the COMESA FTA pact. There were only three suppliers: Sudan, Malawi and Zimbabwe in 2000. With the launch of the COMESA FTA, Kenya sugar imports rose to 120,881 MT from five COMESA countries in 2001.

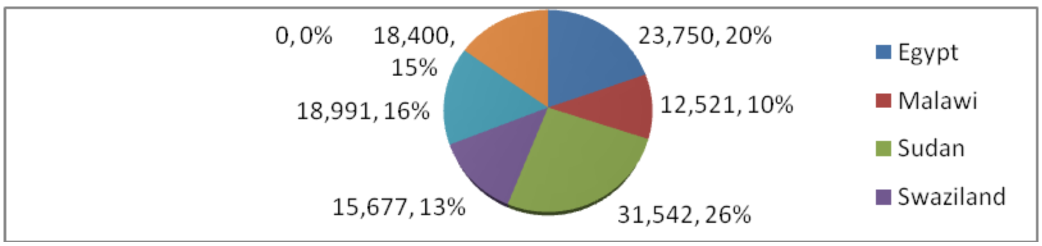

Figure 5: Post COMESA Sugar Imports in Metric Tonnes into Kenya, 2001
Source: Document analysis, Kenya Sugar Board, 2010

Figure 5 indicates that the market share for imported sugar from COMESA partner states increased in the domestic sugar market. The market share before the COMESA FTA was less than 10% but in figure 7, it increased to 48.5%. This finding concurs with Stern (2011) observations that removal or lowering of the border tariff and non-tariff barriers creates more trade. Under the COMESA safeguard, Kenya was allowed to impose a quantitative restriction on sugar imports. Kenya was allowed to import a quota of 200,000 metric tonnes annually from the COMESA region. 89,000MT was for domestic white sugar, while 111,000MT was for industrial refined sugar. Sugar importation beyond the specified amount attracted a 123% border tariff (100% tariff, 16% VAT and 7% SDL). The tariff is Ad Valorem.

Post COMESA Safeguards and Sugar Imports

The local sugar producer had lost market share to imported sugar in the domestic market. To forestall further economic decline, Kenya applied for an intervention by way of a Safeguard under Article 16 of the COMESA Treaty. The COMESA safeguard was awarded on premise that the local sugar industry becomes competitive after a four-year period.
The COMESA safeguards introduced import quotas, high tariffs and licenses, which restricted sugar imports from the COMESA region into Kenya sugar market. Thus, sugar exports from the COMESA partner states into Kenya were subjected to custom duties once a quota of about 200,000 metric tonnes was filled. The figures show that Malawi, Egypt and Swaziland increased their export volumes meaning the Safeguard did not weaken but enhanced. These findings concur with Shafaeddin's (2005) observation that not all participating members could realize mutual economic benefits. The losers were Zambia and Zimbabwe, which exported 18,991MT, and 18,400MT respectively following the launch of COMESA Safeguard which saw their exports decline sharply with the application of the Safeguard. Likewise, exports from Sudan declined from a high of 31,542MT in 2001 to 9,000MT in 2002 to an annual average of 6,200MT between 2003 and 2005.Table 15 indicates changes in import volumes after the introduction of the mentioned tariffs and non-tariff barriers.

Table 3: COMESA Safeguard Sugar Imports in Metric Tonnes, 2004-2008

	2004	2005	2006	2007	2008
Egypt	39,286	38,870	59,507	108960	51,084
Malawi	28,060	16,021	7,026	7549	0

Sudan	6,484	6,107	2,322	0	3,950
Swaziland	31,399	58,902	43,090	19636	61,937
Zambia	0	0	0	484	0
Zimbabwe	3,580	40,056	2,344	7540	1,193
Mauritius	0	0	0	0	0
Total	108,809	123,957	130,705	144,169	123,164

Source: Document analysis**,** Kenya Sugar Board, 2010

Table 3 indicates that following the implementation of the COMESA Safeguard in February 2004, sugar import and export volumes reduced. However, decline in sugar imports was not same for all exporters in the COMESA region. The zero entities for Zambia and Mauritius were because these countries were unable to compete with other COMESA partner states in the Kenyan market. Moreover, they had other trade agreements such as ACP-EU to fulfill.

IV. Conclusions

Sugar producers in COMESA partner states enjoyed incentives and subsidies. The VAT in COMESA partner states applied only on sugar sales while state support was evident in areas of irrigation, roads and energy. The use of these policies was an indicator of government involvement in sugar industries of COMESA partner states. These policies range from tax exemptions or allowances to light taxation. The study findings indicated that the use of non-tariff barriers was still high in the region. Sugar importers and exporter were registered and licensed in all the countries sampled.

Sugar prices in Zambia, Malawi, Swaziland, Egypt and Sudan are low because of supportive trade policy environment. It was evident that state support for sugar producers in these countries had lowered production costs of sugar. Therefore, these countries were able to attract capital and skilled labour into their sugar industries. With adequate capital, their sugar industries were able to diversify and add value to their primary product, which further reduced cost of sugar production. Furthermore, management of these sugar industries is sound because of imported labour and participation of private agents. The study findings also indicate that non-tariff barriers were used in the COMESA region to limit sugar imports and exports. Sugar exporters and importers were required to register and acquire licenses, which in one way or another restrict trade flow in the region.

The findings indicate that COMESA partner states sugar trade policies are favorable to their sugar producers. This is because COMESA partner state governments are heavily involved in sugar production. Therefore, COMESA member states should negotiate to reduce the use of non-tariff barriers and other supportive mechanisms that negate the very essence of free trade in the region. The rule of origin should be reinforced to reduce incidences whereby member states sourced sugar outside the bloc with aim of boosting their sugar trade fortunes in the region. This is possible through adoption of anti-dumping tax and countervailing duties by COMESA member states.

References

[1] Anderson.K and Masters. D (2009). “Distortion of Agricultural Incentives in Africa,” Washington DC: World Bank.

[2] Ellis.K and Sigh.R. (2010). “Assessing the Economic Impact of Competition,” Bridge Road, overseas development institute.

[3] Kenya Sugar Industry (2009) “Kenya Sugar Industry Strategic plan 2009-2014,” Kenya Sugar Board.

[4] Kenya Sugar Board (2010). “Year book of Sugar Statistics 2010”, Kenya Sugar Board.

[5] Kwa. A (2005) “Impact of Agriculture Import Surges in Developing countries,” Action Aid Journal Vol 1,’ Post Net.

[6] Ndung’u. R (2012). “KSB Report: Study of the Taxation Regime of the Sugar industry in Kenya,” KPMG.

[7] Prewilt.A(1975). *Introducing Research Methodology*. Nairobi: East African Applications.

[8] Republic of Kenya (2009). *National Trade Policy*, Nairobi: Government Printers.

[9] Shafaeddin. M. (2005).Trade Liberalization and Economic Reforms in Developing Countries: Structural Change or De-industrialization? Geneva: Conference Paper No. 179, United Nations.

[10] Vink. R and Hans .V (2011). *Sugar: the implications of trade liberalization for East and Southern Africa*, Johannesburg, South Africa: Tralac Working Paper No. D11WP0.

Authors

First Author – UNGAYA Cotty Godfrey, Department of Peace and Conflict Studies, Masinde Muliro University of Science and Technology
Second Author – Malenya Musebe James, Department of Peace and Conflict Studies, Masinde Muliro University of Science and Technology