



African Cotton & Textile Industries Federation

POLICY RESEARCH ON THE KENYAN TEXTILE INDUSTRY Findings and Recommendations

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Executive Summary

Within the last 20 years, there has been a significant shift in the national, regional and international policy environment in relation to the Kenyan textile sector. Some of the policies have resulted in positive, negative or have had no impact or effect. The import substitution policies put in operation soon after independence, between 1963 and 1986, coincided with the period during which the textile industry performed well. During that time there was a robust and integrated cotton-textile sector with extensive institutional support mechanisms, public sector participation and elaborate subsidy programmes.

According to KIPPRA report, the textile sector recorded its peak performance in 1984, when cotton production was over 70,000 bales supplying the domestic textile industry, which comprised of 52 textiles mills and employed over 42,000 people. The textile and clothing industry was at that time the second largest employer after the civil service. Since then, however, domestic spinning and weaving capacities have drastically reduced from approximately 52 mills in 1984 to only 15 main textile mills that are currently in operation, but under capacity. The key reason attributed to the collapse of the industry was the Global Economic Reforms under the Structural Adjustment Programme's (SAP) and Trade Liberalization of the 1980s/'90s. Corruption and mismanagement at the defunct Cotton Board of Kenya also contributed to the collapse of the industry.

However, there has been intermittent recovery and good performance within the context of some regional and international initiatives impacting positively to the textile industry. The garment sector, in particular, has performed relatively well under the African Growth and Opportunity Act (AGOA) provision especially with the inclusion of the 3rd country fabric provision that allows the sector to utilize imported fabric from Asia. In the last 12 years, the garment sector in Kenya has been principally driven by exports to the US under the AGOA initiative. Unfortunately, the success of the garment industry has to a large extent had a foreign affiliation has had practically no direct effect on the existing textile mills in Kenya. The local mills have not recorded a correlated growth, the main reason being that they do not supply fabric to the garment factories that export to US under AGOA. Without local sourcing of fabric for export manufacturing, the value chain remains seriously broken and disjointed between garment / made ups, and other sections of the chain.

This has necessitated an in-depth evaluation of the value chain to identify segments of potential economic growth with highest returns with a view to strengthening the backward and forward integration linkages. In view of the fact that cotton is a strategic crop in Kenya and has been the basis for industrial transformation the world over for many centuries; Vision 2030 and the Government's medium term plan 2008 – 2012 including the Agricultural Sector Development Strategy (ASDS) 2010-2020 (2009) identified cotton industry as an important sector in employment creation, poverty reduction and food security.

The key challenges revolve around poor productivity, high input costs including labour and energy, transport, out dated technology, expensive credit, low investment and poor product quality and unpredictability of prices and lack of market outlets. This has resulted in the influx of second hand products displacing the Kenyan industry. In bench marking against global best practise, the solutions lie in coming up with a policy mix to include clustering, buying local especially by government, conducive business environment, industrial infrastructure, incentive packages and subsidies, dedicated funds. Other interventions include strengthening institutions, skills development including promotion of fashion design houses. The resultant benefits include employment creation, redistribution of incomes and foreign exchange savings.

The immediate benefits of local government procurement of uniforms and hospital lines would result in the immediate employment of 8,275 people and engagement of 6,325 new farmers. This would be at no cost to the garment since these resources are already budgeted for in the respective ministries. The real benefit lies in local supply of fabric to the EPZs for manufacture for export. An additional 8,275 employees along the value chain would be engaged in uniforms manufacture while 349,041 would be required to manufacture fabric for the EPZs. Another saving of Ksh 12.5 billion in foreign exchange by EPZs used in the import of raw materials in 2012 would be released. These benefits should be staggered over a 3-4 year period- with incremental implementation of 25% annually. A residual of 25% imports shall be sustained to complement national production.

ACRONYMS

ACTIF	African Cotton & Textile Industries Federation
AFFA	AGRICULTURE FOOD and Fisheries Authority
AGOA	African Growth Opportunities Act
ASAL	Arid & Semi-Arid Land
ASDS	Agricultural Support & Development Services
CBA	Commercial Bank of Africa
CBK	Central Bank of Kenya
CODA	Cotton Development Authority
COE	Centre of Excellence
COMESA	Common Market for Eastern & Southern Africa
DANIDA	Danish International Development Agency
EAC	East Africa Community
EPA	European Partnership Agreement
EPC	Export Promotion Council
EPZ	Export Processing Zone
EPZA	Export Promotion Zone Authority
ERB	Electricity Regulatory Board
ERS	Economic Recovery Strategy
EU	European Union
FDI	Foreign Direct Investment
FY	Financial Year
GATT	General Agreement on Trade & Tariff
KAM	Kenya Association of Manufacturers
KAMEA	Kenya Apparel Manufacturers & Exporters Association
KARI	Kenya Agricultural Research Institute
KEBS	Kenya Bureau of Standards
KENINVEST	Kenya Investment Authority
KEPSA	Kenya Private sector Alliance
KIPPRA	Kenya Institute of Public Policy Research & Analysis
KNCCI	Kenya National Chamber of Commerce & Industry
KTB	Kenya Tourist Board
KU	Kenyatta University
MFA	Multi Fibre Agreement
MFN	Most Favoured Nation
MIDP	Machakos Integrated development programme
MOEd	Ministry of Education
MoF	Ministry of Finance
MoIm	Ministry of Immigration
MOL	Ministry of Labour

MOSS	Ministry of Social Services
MOT	Ministry of Trade
MTS	Multilateral Trading System
MUB	Manufacturing Under Bond
NESC	National Economic and Social Council
REC	Regional Economic Communities
RTA	Regional Trade Agreements
SADC	Southern Africa Development Community
SAP	Structural Adjustment Program
SDT	Special and Differential Treatment
US	United States of America
USAID	United States Agency for Intern Development
WTO	World Trade Organization

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This report was prepared a team of four experts consisting of **Local Resource persons**- Chemengich, Kariuki, Olweny and an **International resource person**- Varun Vaid, Senior Consultant, Wazir Advisors. We hope the report answers the many queries the industry has been battling with.

The views expressed in this report are those of the authors, who are the only ones responsible for any errors or omissions contained therein.

DEFINITIONS:

Import substitution policies: Is a strategy for economic development which encourages industrial growth within a nation in order to reduce imports of manufactures, save foreign exchange, provide jobs, and reduce dependency. Import substitution is also expected to stimulate innovation, and make the country self-reliant in critical areas such as food, defence, and advanced technology. This strategy was prevalent immediately after independence in 1963 to mid-80s.

Structural Adjustment Programme liberalisation policies: introduced by IMF and World Bank in the mid-80s as a precondition to qualify for the heavily subsidised loans. They are anchored on the principles of export-led growth; privatisation and liberalisation; operations in a free market. SAPs were implemented by countries to devalue their currencies; lift import and export restrictions; balance their budgets; and remove price controls and state subsidies and state marketing boards.

Privatisation - The transfer of ownership of property, businesses or service from a government to a privately owned entity. It also entails outsourcing of services and business hitherto provided by government to the private sector

Export promotion policies - consist of outward oriented policies of producing products targeting international markets in order to achieve industrialisation. It came into effect in Kenya with the implementation of Sessional Paper No 1 of 1986 but consolidated in the 90s with the establishment of Export Promotion Council (EPC) in 1992.

Regionalisation: the coming together of independent countries on basis of geographical proximity of ideology to leverage economic, social or political opportunities. Examples include EAC, COMESA, IGAD.

Bilateral Agreements: Contracts of mutual benefit binding parties to it. Examples include Lome, EPA, and AGOA

Globalisation: Is a process of integrating international markets leading to inter—dependence. It was consolidated in the mid 90s with the establishment of the WTO. It covers trade, investment, migration and movement of people, information dissemination, climate change,

Multi-Fibre Agreement: governed the world trade in textiles and garments from 1974 through 2004, imposing quotas on the amount developing countries could export to developed countries. It expired on 1 January 2005.

Vision 2030: Kenya's blue print, adopted in 2007 guiding future development scenarios to 2030.

1.0 BACKGROUND

Within the last 20 years, there has been a significant shift in the national, regional and international policy environment in relation to the Kenyan textile sector. Some of the policies have resulted in positive, negative or have had no impact or effect. The import substitution policies put in operation soon after independence, between 1963 and 1986, coincided with the period during which the textile industry performed well. During that time there was a robust and integrated cotton-textile sector.

Other policy environments in which the textile industry continued to perform include:

1. At National level: The Government initiated Industrial-Oriented policies through:

- a) Export Promotion Council, Manufacturing Under Bond (MUB), Export Processing Zone Authority (EPZA) , etc;
- b) Launch of Kenya's Vision 2030 - Textile Sector identified as flagship and key contributor to the central economic pillar;
- c) Kenyan Government Policy directives on Second hand clothing, Domestic Sourcing etc;

2. At Global level: The preferential market access **provision entrenched into the:**

- a) African Growth Opportunity Act (AGOA 2000) – An initiative by the US Congress to provide among other economic activities, opportunity to revive the textile industry in Sub Saharan Africa (SSA).
- b) European Partnership Agreements (EPAs) - Provisional status;
- c) Bilateral Agreements;

3. At Regional level: Kenya Government participation under various regional integration initiatives incorporating industrial and trade liberalization policies. These include:

- a) Common Market for Eastern and Southern African Region (COMESA);
- b) Common Market Protocol under the East African Community (EAC);
- c) EAC-COMESA-SADC Tripartite – still under discussion

According to KIPPRA report, the textile sector recorded its peak performance in 1984, when cotton production was over 70,000 bales supplying the domestic textile industry, which comprised of 52 textiles mills and employed over 42,000 people. The textile and clothing industry was at that time the second largest employer after the civil service. Since then, however, domestic spinning and weaving capacities have drastically reduced from approximately 52 mills in 1984 to only 15 main textile mills that are currently in operation. The key reason attributed to the collapse of the industry was the Global Economic Reforms under the Structural Adjustment Programme's (SAP) and Trade Liberalization of the '80s/'90s. Corruption and mismanagement at the defunct Cotton Board of Kenya also contributed to the collapse of the industry.

However, there has been intermittent recovery and good performance within the context of some regional and international initiatives impacting positively to the textile industry. The garment sector, in particular, has performed relatively well under the African Growth and Opportunity Act (AGOA) provision especially with the inclusion of the 3rd country fabric provision that allows the sector to utilize imported fabric from Asia. In the last 12 years, the garment sector in Kenya has been principally driven by exports to the US under the AGOA initiative. As of 2010 (ACTIF report), there were over 170 large scale garment manufacturing units operating in Kenya. The garment sector still remains as the dominant sector within EPZs accounting for 29% of all EPZ enterprises, 78% of total EPZ local employment, 56% of all EPZ exports, 52% of total EPZ sales and 30% of all EPZ private investments. As of December 2011, Kenya among other SSA countries was ranked as the leading exporter into US market under AGOA with a market share of 31.6% and export value of US\$ 261 Million.

Unfortunately, the success of the garment industry which to a large extent has a foreign affiliation has had practically no direct effect on the existing textile mills in Kenya. The local mills have not recorded a correlated growth, the main reason being that they do not supply fabric to the garment factories that export to US under AGOA. Fabric sourcing as raw material is a critical factor in textile manufacturing for export. Without local sourcing of fabric for export manufacturing, the value chain remains seriously broken and disjointed between garment / made ups, and other sections of the chain. As a case in point, there has not been any trickle effect to the cotton growing in the country. However, Kenya being an agricultural country, there is need to carry out an in-depth evaluation of the value chain to identify segments of potential economic growth with highest returns with a view to strengthening the backward and forward integration linkages.

In view of the fact that cotton is a strategic crop in Kenya and has been the basis for industrial transformation the world over for many centuries; Vision 2030 and the Government's medium term plan 2008 – 2012 identified cotton industry as an important sector in employment creation, poverty reduction and food security.

The cotton crop is suitable to varied agro-ecological zones in the country and is a source of raw material to many industries. Towards this end NESC through the then Office of the Prime Minister has worked with a number of sector players to formulate the relevant policies and strategies to revitalize the cotton sector (GOK, 2012). NESC is a high level advisory body to the Government that coordinates advice to the Government on strategic policies aimed at promoting economic growth, social equity and employment creation.

Consequently, the Agricultural Sector Development Strategy (ASDS) 2010-2020 (2009) in addition to prioritising cotton/textile industry undertook among other initiatives to rehabilitate the irrigation schemes with the aim of reviving irrigated production of various crops including cotton.

The cotton/textile industry has a potential of contributing over Kshs.4 billion (....) to the gross national income. This is due to the long value chain ranging from cotton production to finished products. This enormous potential has not been fully exploited due to policy gaps and institutional limitations. In particular, the lack of a favourable policy environment to stimulate farmers and other stakeholders to promote production, processing, utilization and marketing makes Kenya cotton/textile products uncompetitive in both local and international markets.

In the cotton sector, the Kenyan government currently does not provide subsidy to: cotton growing, price support for producers, ginning or marketing. However it has continued to provide targeted support to the smallholder farmers in form of provision of planting seeds as a food security measure and free advisory service, extension service and research.

There are efforts to the development of infrastructure that would reliably support 100% testing and classing of cotton lint through instrument based classing system with technical support by development partners. The program commenced recently, 2012 -2013 FY.

The Government is working towards promotion of a vibrant private sector participation in the development of the sector in production, ginning, milling and marketing. Further, the government also supports all efforts that would hasten conclusion of cotton and global trade initiatives under the WTO negotiations as this has significant effects towards realization of Kenya development objects highlighted in country Vision 2030.

This research therefore endeavours to address the policy gaps and challenges to provide a broad framework within which all stakeholders and development partners will contribute to cotton sector development. The research intention is to produce an advocacy framework as key output of this study.

1.1 Objectives

In conducting the comprehensive market research, the overall objective is to evaluate the impact of the different policies and environments on the Kenyan textile industry during diverse (50 years) periods since independence.

The specific objectives are to evaluate the impact of these different policy scenarios on:

- a) Local and foreign investment in the Kenyan textile industry.
- b) Level of competitiveness in comparison with emerging markets taking into account production costs and related support industries.
- c) Technology uptake and product quality.
- d) Effective Market access (domestically, regionally and internationally).
- e) Stock and quality of human resource and skills.
- f) Impact of international trade protocols including Africa Growth Opportunity Act (AGOA) and European Partnership Agreements (EPAs) on the performance of the Kenyan textile industry.

1.2 Scope of Work

The scope of work shall entail:

- a) **Literature review and research on the Policy** environment and its impact on the existing textile industry in Kenya as well as the impact on the related subsectors, over time.
- b) **Stakeholders' consultations and engagement** – To validate the approach to the study, including obtaining their inputs on the approach and subsequently to validate the research findings and launch advocacy activities.
- c) **Advocacy actions – Identify and prioritize** key actions for advocacy, that need to be implemented to influence policy environment to promote the existing industry and pave way for growth, including:
 - Media action (press releases & documentaries)
 - Engaging key Government agencies including relevant Ministries, Vision 2030, CODA, Kenya Investment Authority, Export Promotion Council
 - Engaging key regional and international agencies, private sector institutions, civil society, Ministries and others to present policy papers on behalf of the stakeholders
- d) **Peer review** through local and external experts to validate and benchmark the proposed raft of policy scenarios to strengthen the growth of the textile industry in Kenya.

1.3 TOR

The Key issues that need to be answered in order to track the impact of Government, international and global policy environments on the Kenyan textile industry include:

- a) Analysis of the impact of the different policy environments since independence; namely -import substitution, SAPs, privatization, globalizations, Vision 2030; sourcing and trading within the frameworks provided for in the RECs, international trade protocols (AGOA, EPA), MTA, and MFAs expiry, second hand clothing, etc. On the following:
 - Cotton/textile industry;
 - Local and FDI inflows into the sector
 - Product quality and competitiveness
 - Support institutions
 - Technology uptake
 - Consolidation of market access
 - Skills
 - Product lines to identify those that have benefitted or been impacted on positively, negatively or no effect

The analysis of the impact of the changing production systems including outsourcing on the cotton/textile industry in Kenya was also reviewed.

- b) Benchmark Kenya's cotton/textile industry against best practice

International and regional lessons for Kenyan cotton/textile industry

- c) Propose policy changes and strategies required to support existing operational textile mills, including identification of niche markets that the Kenyan industry can operate from in the globalizing business environment

1.4 Expected Outputs

The expected outcomes are identification and prioritization of key advocacy activities with the aim of improving the existing policy environment to strengthen and promote the growth of the existing textile industry in Kenya.

In particular, the policy advocacy activities will be targeted at:

- a) The implementation of Vision 2030, related government directives and business environment tailored towards being more effective in promoting the existing textile industry in Kenya;
- b) The Kenya Investment Authority instituting specific policies that will be conducive to build the existing textile industry and attract new domestic investments and foreign direct investment which in turn will generate employment, increase foreign exchange earnings by reducing imports of raw materials and in the long run impact positively on the related support institutions;
- c) Identification of more competitive product lines and niche markets best suited for the Kenyan textile industry under the current local, regional and international policy environments;
- d) Policy Mix to spur the cotton/textile sector; and
- e) Developing a more integrated textile sector that connects all the key players and results in growth across the cotton value chain including cotton farming, ginning, spinning, weaving, garment and fashion sub sectors that work in harmony to advocate for a sustainable policy environment.

2.0 METHODOLOGY

2.1 Study Focus

The study approach entailed analysis of primary and secondary data including review of past researches to identify the impacts of the various policy environments on the Kenyan cotton/textile sectors. Secondary data was obtained from Government statistics, policy documents, international data series and related researches undertaken on topical areas of interest. The primary data was obtained from direct and mail questionnaire consultations with key stakeholders along the cotton/textile value chain.

Structured questionnaires were used to collect primary data from the key stakeholders. The broad areas of focus included:

- Impact on national policy environments since independence covering import substitution, liberalisation, privatisation, regionalisation and globalisation on the performance of the cotton/textile sector
- Impact of second hand clothing imports on the cotton/textile industry
- Impact of Sector specific policies on investments, market access and incentive structures on the textile industry directly and support industries
- Impact of Regional agreements (EAC and COMESA), AGOA and EPA on the textile industry
- Impact of International agreements including MFA expiry on the textile industry
- Contributors to success especially during the period 1963-1984
- Impact of changes in production processes; skill mix; changing consumer tastes; information access in the cotton/textile industry
- Product lines in Textile sector which have been favoured or not favoured by the policy environment in relation to the existing potential.
- Critical challenges the textile sector continues to face including factors impacting on competitiveness
- Benchmarking against best practice for lesson learning
- Proposals on the way forward in the cotton/textile sector taking into account the globalised business environment

The research focussed on the broad thematic issues of policy environment, technology, production systems, competitiveness, institutions, markets and proposed policy scenarios to take the textile industry forward.

2.2 Target Groups

In order to obtain the relevant information on the impact of the past policy environments on the cotton/textile sectors, a representative sample of 55 key stakeholders in the cotton/textile value chain were interviewed (*Table 2.1*).

Table 2.1: Research Sample

Stakeholders	Total Numbers	One-on-one Direct consultation (No.)	Focus group (No.)	Mail ¹ questionnaire
Farmer organizations	2		2	
Farmer groups	3		3	
Ginners	6	6		
Spinning and Mills	17	17		
Weavers, Knitters Processors	18	18		
Garment Manufacturers	25	25		
Fashion Designers	3	3		
Universities / Education & Training	2	2		
Regulatory and promotion institutions	1	1		
Research institutions	2	1		1
Policy makers	2	2		
Trade and Investment facilitation/promotion institutions	2	2		
Research and Development	1	1		
Trade Association				
Advisory Service Providers				

To facilitate wider dialogue, the media was engaged from the start for information dissemination, including eliciting debate from the broader consumers and beneficiary sectors.

2.3 Approach

1. Recruitment of relevant skilled personnel mix from local and international arena; specifically in the areas of:

- Cotton production
 - ✓ Production technology and quality arrangements
 - ✓ Investment and partnerships
 - ✓ Competitiveness
- Textile and garments
 - ✓ Garment manufacture
 - ✓ Fashion/designers including niche lines
 - ✓ Statistical trends against policy environments

¹The one on one questionnaire was administered to some of the participants who attended the launch workshop on 17.01.13

- Comparative policy environments
 - ✓ National level policy trends
 - ✓ Comparative analysis and benchmarking of policy environments
 - ✓ international best practices
 - ✓ Policy options and advocacy agenda
- 2. Literature review and analysis of secondary data to link sector performance with the different policy environments
- 3. Field survey and focus group discussions based on structured questionnaires to obtain views from the different stakeholders
- 4. Analysis and synthesis of primary and secondary data and information to come up with advocacy messages, policy mix to sustain an integrated textile sector in a dynamic globalizing policy environment
- 5. Benchmarking against best practices
- 6. Peer reviews through technical committees, professionals and stakeholder validations
- 7. Technical committee and Stakeholder validations
- 8. Dissemination to policy makers

The findings shall be benchmarked to international best practices in coming up with proposals of policy mix and advocacy messages to facilitate an integrated cotton/textile and garment industry in Kenya.

3.0 KENYA'S POLICY SCENARIOS SINCE INDEPENDENCE IN 1963

Kenya's policy environment has been impacted on through local and external (regional and international) dynamics, some of which the government had no control over. The policy environments ranged from import substitution² prioritizing self-sufficiency; to liberalization³ through the structural adjustment programmes⁴; multilateral agreements⁵ (MTAs), globalization including expiry of the multi-fiber agreement (MFA); regionalization under regional economic groups (RECs) and regional trade agreements (RTAs) and national long term Vision 2030 (*Box 3.1*). These policy scenarios shall be elaborated on while evaluating their impact on the cotton/textile industry in Kenya including the overall socio-economic architecture.

Box 3.1: Kenya's Policy Regimes since Independence in 1963

Policy	Policy definition	Period	Impact on cotton/textile sector
Import substitution	High tariff walls to facilitate industrialization Subsidy support to productive sectors including irrigation schemes Extensive public sector involvement in production, manufacture and marketing	1963-86	Booming cotton and textile sector, peaking in 1974 with production of 70,000 bales, 52 textile mills,
SAP liberalisation policies	Liberalization Privatization, outsourcing Export-led growth orientation Declining government and donor support to industry	1986-mid 90s	Beginning of the decline of the cotton/textile sector Displacement by second hand textiles originally destined for the Great Lakes
Regionalization	Harmonized market based policies in Neighbourhood blocs (EAC, COMESA, IGAD, CES)	From 1995	Limited impact to stop decline
Globalisation	Interdependence of global markets Second hand imports for national market increased	From 2000	Sustained decline to 50% of peak period

²Economic development strategy that encourages industrial growth within a nation in order to reduce imports of manufactures, save foreign exchange, provision of jobs, and reduce donor dependency.

³ Anchored on the principles of export-led growth; privatisation and liberalisation; operations in a free market.

⁴Entailed devaluation of currencies; lifting of import and export restrictions; balancing national budgets; and removal of price controls and state subsidies and state marketing boards in economic activities

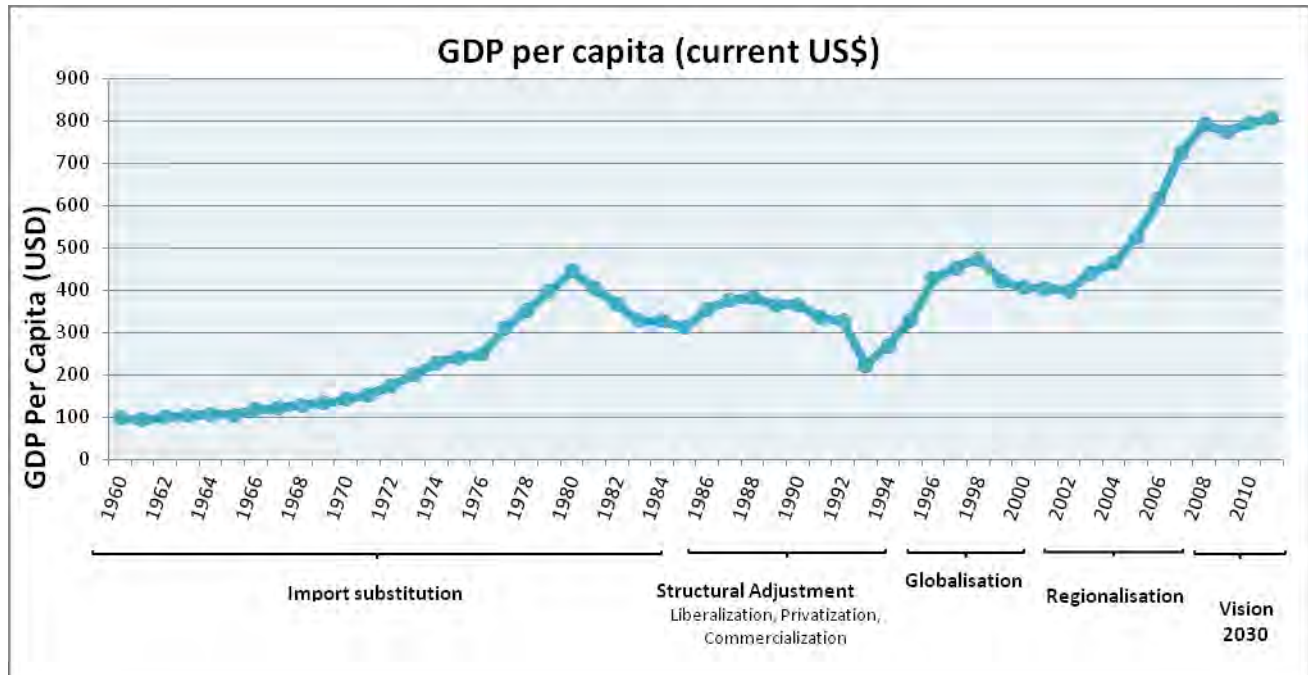
⁵Governed the world trade in textiles and garments from 1974 through 2004, imposing quotas on the amount developing countries could export to developed countries. It expired on 1 January 2005.

Policy	Policy definition	Period	Impact on cotton/textile sector
Bilateral Agreements	Preferential market access into developed countries	1975-Lome 2002-AGOA	Lome impact was negligible AGOA impact was successful in garments sectors
MFA	Quota based market access for developing countries into developed country markets	1974-2004	Near collapse of the garment sector with expiry in 2005
Vision 2030	Development blue print long term strategy emphasizing competitiveness	2007-2030	In spite of cotton/textile sector being prioritised, performance remains thwarted and subdued

Source: Various Policy documents

A composite indicator of population wellbeing is the per capita income. The per capita incomes during these different policy scenarios are reflected in *Figure 3.1*. They correspond to a large extent to what was happening in the cotton/textile industry. The import substitution regime was aligned to upward growing per capita incomes. This is the period when Kenya sustained economic expansion from agricultural sector productivity, buoyant commodity global prices among others. The first phase of the structural adjustment programmes (1986-early 90s) was marked by declining per-capita incomes with a further dip after USA export ban of Kenyan originating textiles in 1998. Government sustained efforts in policy and support to the cotton/textile industry after 2000 (ERS and Vision 2030) including the expansion of markets from EAC and COMESA and AGOA bilateral agreements are also reflected in upward swing of the per capita incomes.

Figure 3.1: GDP per Capita Income 1960 - 2010



Source: World Bank National accounts data and OECD national accounts data files

3.1 Import substitution Regime

Kenya's cotton sector was still dominated by private investor ginners till independence in 1963. Immediately after independence, Kenya adopted an import substitution policy that ensured a backward integration of textile mills to the cotton production. In addition, the crop was also introduced as a cash crop across the country, with emphasis in the ASAL areas (EPZA, 2005). This was in recognition of the fact that cotton production offers the greatest potential for increased employment, poverty reduction, rural development and generation of increased incomes in arid and semi-arid areas of the country. To date the sub-sector has been identified as one that could help bring rapid economic development in the country. It has therefore been classified as a core industry by the Kenyan government (EPZA, 2005, Vision 2030).

Between 1963 and early 1980's the Government systematically introduced controls into the sector along the whole value chain: Some of the key interventions included:

- Helping cooperative societies buy ginneries from pre-independence private owners through Africanisation and Kenyanisation targeted interventions
- Controlling marketing margins such that all stakeholders along the chain made profit
- Fixed producer prices regardless of effort or market demands
- Heavy Government investment in textile mills
- Donor support to complement Government subventions

In addition, the Government protected the local industry by imposing a 100% duty on imported goods, which ensured the rapid growth of the local textile industry with an average production capacity of

over 70%. The industry also received substantial assistance from the Government and donor agencies especially in the 1980s, which in effect either expanded productive capacity or reduced direct costs to players along the value chain.

The public sector support came in form of government subsidies- marketing through government parastatals, elaborate extension services through Ministry of Agriculture, Ministry of Cooperatives, and Public Sector Investments in the mills and some garment manufacturers. The private sector associations were equally strong. Some of the donor assistance programmes included the USAID Smallholder Credit Scheme, New Seasonal Credit Scheme, Farm Input Supply Schemes financed (FISS) by DANIDA, Machakos Integrated Development Programmes (funded by EU), and the Cotton Processing and Marketing Project funded by World Bank (KIPPRA, 2002).

The consumer benefitted from lower costs of end products, while the processors and manufacturers captured more sizable market. There were no second hand clothing's in the market then and as such there was no competition from alternatives.

More importantly, the farmers always received their payments on time. With the Cotton Lint & marketing Board having absolute power in the cotton/textile sector, the margins for the different players were controlled and assured. The Government also invested in textile mills like KICOMI, RIVATEX, MOUNTEX, etc. which had extensive linkages with the ginneries and by extension the farmers. During this same period, donor support directed to the industry was also reasonably high. *Box 3.2* summarises the incentives along the cotton/textile value chain during import substitution policy regime.

Box 3.2: Cotton/Textile Sector Interventions during Import Substitution Regime; 1963-86

Type of subvention	Incentives	Production intervention	Marketing intervention	Institution
Value chain	Access to Bank loan funds	Extension services	Buy Kenya Build Kenya drive	Strong GoK policy support institutions
Farming	Prompt payments Easy access to inputs Fixed prices	Free seeds Extension services GoK supported R&D	C L & M B support agenda KFA support activities	Vibrant quality control Cooperatives
Ginning	Easy access to Bank loans	Seed cotton available	Booming grey spinning	Strong Ginners Association
Spinning / milling	Easy access to Bank loans	GoK equity investment Private investment	Booming finished apparel demand	I C D C & Development Banks
Garment / made ups	Tax remission	Training arrangement	Wide range advertisement	K N T C , K I P C
Markets	Export compensation	Wide product range	Assured national market New regional market (defunct EAC) GoK procurement	Tender Board

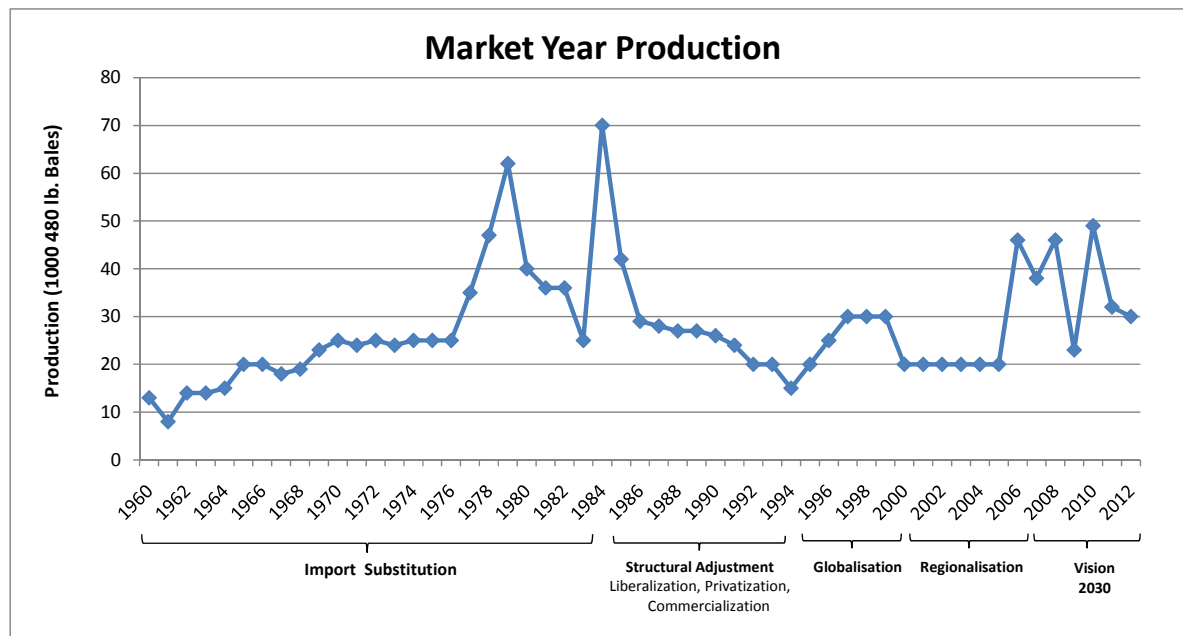
Source: Various Government Policy documents

At the peak of its performance in the mid-80s, the cotton/textile sector was the second highest employer after the civil service, employing over 200,000 households in cotton production, accounting for 30% of employment in manufacturing sector. The sector was also the fifth contributor of foreign exchange (KIPPRA, 2005, EPZA, 2005). The cotton lint production has been on the decline in spite of the temporary recovery in the late 80s (*Figure 3.2*). Even after signing on the AGOA in 2002 which was to facilitate backward linkages to production, the cotton sector has not recovered.

However, between 2006 and 2012, at the time when the Cotton Act was amended to establish the Cotton Development Authority (CODA), there was a notable increase in production as a direct result due to support to the Ministry of Agriculture in facilitation to extension services and limited provision of inputs (seeds, pesticides, and organized market channels) but the increase dropped in 2009 as the support was withdrawn. The trend picked up again due to the double increase in the world's market cotton price (Kshs 65). This was short-lived as the market prices dipped to the equivalent of Kshs.35 in 2012(farm gate price).

Besides price, there must be more fundamental issues that require government interventions to unlock the potentials that existed in this sector. This constitutes the subject of the cotton/textile industry policy study review.

Figure 3.2: Cotton production in Kenya (1960-2012), in 000 Bales



Source: USDA; CODA

3.2 Structural Adjustment Programmes Regime

The late 1970s and early 1980s were a difficult period for many developing countries because of high inflation, slow rates of economic growth, and declining earnings from exports. These were further complicated with the persistent droughts and high unemployment. These factors affected national incomes and resulted in large government deficits, which in turn caused deterioration in the standard of living of families in the developing world (Parsitau ...). These exacerbated by the oil shocks of the 80s and sustained drought of 1984, which in the case of Kenya impacted negatively on government's ability to provide public services to the general population.

During the 1980s, stabilisation and adjustment packages, spearheaded by IMF and World Bank, were introduced in many developing countries in an attempt to stop further deterioration in standards of living (Dixon et al. 1995, Barhin, 1998). The key ingredients of structural adjustment programmes were based on an economic model of private ownership, competitive markets and an outward-oriented development strategy. They were anchored on the principles of export-led growth; privatisation and liberalisation; operations in a free market. As a precondition for accessing the highly subsidised World Bank structural adjustment loans and IMF financial restructuring resources, the countries implementing the SAPs were expected to devalue their currencies; lift import and export restrictions; balance their budgets; and remove price controls and state subsidies and state marketing boards. In this regard, the policy environment prevailing during the first phase of SAP regime was underwritten by:

- a) **Liberalisation** - mainly in the form of elimination of price controls and gradual elimination of the licensing requirements.
- b) **Privatisation** - which entailed the transfer of ownership of property, businesses and services from government control to private sector. It also entailed outsourcing of services and business hitherto provided by government to the private sector.
- c) **Export promotion policies** - consisted of outward oriented policies of producing products targeting international markets in order to achieve industrialization. It came into effect in Kenya with the implementation of Sessional Paper No 1 of 1986 but consolidated in the 1990s with the establishment of Export Promotion Council (EPC) in 1992.

The intermediary instruments for implementing this model was done through removal of foreign exchange (FE) restrictions, lifting of price controls, opening up the sectors for private sector participation and intense and targeted export promotion activities and products. Consequently, the government with effect from the late 80s formally adopted market based policies, divested from commercial undertakings provided through the Cotton Board, including those in the cotton sector mills.

In 1991, the industry was liberalised but the policy change was not accompanied with a review of the Cotton Act, Cap 335. The policy change led to Cotton Board of Kenya becoming redundant, while the private sector did not have adequate capacity to provide quality planting seed, credit facilities, guaranteed prices and efficient marketing. The industry therefore began to decline.

In the case of the cotton/textile sector, this unfortunately resulted in reducing capacity utilization, along the value chain, with devastating effects on rural welfare and low returns on investment. The private sector underperformed and did not take full advantage of the changes in the policy and business environment (*Figure 3.2*).

The industry then was characterised by lack of coordination, institutional and policy failure and lack of competitiveness after liberalisation. The value chain was in disarray. These were characterised by:

- a) Lack of a policy framework to manage the cotton/textile sector in a liberalized environment
 - Liberalisation apparently amounted to announcement of a policy.
 - There was no lead time to prepare policy and regulatory environment adjustments and put in place safeguard mechanisms to bring into effect the liberalized policy environment.
 - This subsequently lead to influx of *mitumbas* (second hand clothing) which overtime have displaced the local textile industry

- b) Withdrawal of GOK institutional support along the cotton/textile value chain without adequate preparation of private sector associations or private sector to take over or provide the necessary leadership to manage the vagaries of external exposure. In the end there was:
- Failure to manage quality control
 - Absence of governance policy and structure in the industry
 - Lack of consistent policy for skills development to take over from government institutions and large scale manufacturers
 - Lack of a dynamic technology development policy
- c) Absence of lobby voice especially for the SME practitioners (garment manufacturers) to petition government and other stakeholders along the chain to effect a strong governance structure
- d) Lack of strategic positioning policy to identify the niche areas that the country should pursue
- e) Lack of competitiveness because of the high infrastructure costs, high utility costs, high finance costs, corruption and unfavourable fiscal policies,

Box 3.3 summarises the different types of incentives along the cotton/textile value chain during the structural adjustment policy regime.

Box 3.3: Cotton/Textile Sector Intervention during Structural Adjustment Regime (1987-95)

Type of subvention	Incentives	Production intervention	Marketing intervention	Institution
Value chain	Export compensation schemes	Export- oriented	Branding/ packaging	GoK led privatization
Farming	Guaranteed minimum returns	Extension services GoK supported R & D	Limited C L & M B support agenda and KFA support activities	Quality control cooperatives
Ginning	Curtailed incentive funds	Seed cotton availability	grey spinning	Strong Ginners Association
Spinning / milling	Access to Bank loans	No additional GoK funds No additional private investment	Watch emerging market trends	Local fiber manufacturing.
Garment / made ups	Tax incentives E.g. tax holidays.	Training	Market diversification surveys	Reduced impact institutions
Markets	Access to new markets.	Adjusting product range	Adjusting national market New regional market (defunct EAC) limited GoK procurement	Impotent institutions

Source: Various GOK Papers

The SAPs period was also characterised by reduction in government and donor support. The net effect of resource constraints resulted in drastic decline in lint production by 57% between 1984/85 and

1992/93 (EPZA, 2005). This was further worsened by the USA textile import ban of 1994 (*Figure 3.2*) occasioned by trans-shipment.

3.4 Globalisation and Multilateral Agreements

3.4.1 WTO Agreements

Globalisation which entails the integration of economies, industries, markets, cultures and policy-making around the world, was consolidated in the mid-90s with the establishment of the WTO in 1995. It covers trade, investment, managed migration and movement of people, information communication and dissemination, climate change. Globalization in effect implies the opening of local and nationalistic perspectives to a broader outlook of an interconnected and interdependent world with free transfer of capital, goods, and services across national frontiers.

Under the WTO, countries signatory to the multilateral framework, operated from rules based environment underpinned by the principles of:

- a) **Non-discrimination**/equal opportunity or **MFN** treatment in which, discriminate between its own and foreign products, services or nationals (giving them “national treatment”). **Competition** in doing business from a standardised business environment of transparent rules and regulations—discouraging “unfair” practices such as export subsidies and dumping products at below cost to gain market share.
- b) Relatively freer business environment with minimum barriers to trade, investment or
- c) **Progressive trade liberalization** through negotiation
- d) **Predictable** policy and business environment tariff rates in which market-opening commitments are “bound” in the WTO. This of necessity entrenches investor confidence, creating the conducive environment for long term investment for both local and foreign investors that governments cannot raise trade barriers (including tariffs and non-tariff barriers) arbitrarily;
- e) **Special and Differential Treatment (SDT)**, in which more benefits are extended to the **less developed countries** — This include giving them more time to adjust, greater flexibility, resources for capacity building and special privileges.

Consistent with GATT and WTO framework, SDT was extended to the cotton/textile sector under the **Multi-Fibre Agreement- (MFA)** which governed the world trade in textiles and garments from 1974 through 2004, imposing quotas on the amount developing countries could export to developed countries. It expired on 1 January 2005. The MFA in part contributed positively to the performance of the cotton/textile industry until 1994 when the benefits ceased to apply to Kenya due to challenges of trans-shipments (*Box 3.4; Figure 3.2*).

Box 3.4: Cotton/Textile Sector Intervention during Globalisation/Regionalization Regime (1995-2012)

Type of subvention	Incentives	Production intervention	Marketing intervention	Institution
Value chain	Tax remission for export	Export orders	Promotion fora	USTRADE
Farming	Price pegged to world prices	Export demand for cotton	Intermediaries	Foreign cotton buyers RATES / ACTIF, CODA
Ginning	None	Reduced activity	Low market drive	Weakened Ginners Association
Spinning / milling	None	Reduced activity	Low market drive	Stand-alone mills
Garment / made ups	Tax free for export Array of export support incentives	Wide potential Regional market 3 rd country fabric	EAC, COMESA, free trade area Tax free export to US under AGOA MFA expiry Abundant supply Ethnic Prints Category 9 products	EABC KAMEA ACTTRADE
Markets	Concessionary utilities	Large orders	Lead time	EPZA, US Fashion Houses; EPC

Source: Various GOK Policy documents

The globalisation era coincided with the second phase of economic and political liberalisation in Kenya. During this phase, privatisation and commercialisation were intensified. The same policy scenarios applied on cotton/textile sectors. Regulators in a number of sectors were put in place to manage liberalised environment. This was particularly the case in energy, telecommunications, education, insurance, finance and banking, tourism, investment, exporting where regulators are represented by ERB, CCK, CMA, CODA, CBK/CBA, KTB/, KenInvest/EPZA, EPC among others. The private sector and producers also set up organisations for dialogue and lobby. These included KAM, KCC&I, KEPSA, Professional bodies, CSOs.

Unfortunately, during this period, the government did not put in place legal and regulatory frameworks for managing globalisation, liberalisation and privatisation. Apart from the limited EPZ opportunities which the garment sector took advantage of particularly under AGOA, Kenya has not positioned or leveraged herself in the global outsourcing production arrangements necessary to grow the cotton/textile industry, an important strategy which has benefitted and spirited less developed countries into emerging economies within short periods of time. Indeed the expiry of the MFA in 2005 led to the flight of foreign investors out of Kenya. This in effect should have triggered further policy changes to sustain the cotton/textile sector.

3.4.2 Bilateral Agreements

The SDT provisions were also extended to **Bilateral Agreements**, which give preferential market access into developed country markets for developing and less developed countries. In the majority of cases these bilateral agreements are complemented with strategic capacity development components to facilitate the less developed countries take advantage of the market openings. The bilateral agreements are enforced through contracts of mutual benefit binding parties.

The bilateral agreements in point include the successive Lome agreements, EPA and AGOA. In addition, Generalised Preferential Systems (GPS) also guarantee market access into developed economies without a signed contract for developing and less developed countries. While the Lome bilateral agreements between EC and ACP countries had been in effect since 1975, its impact on the cotton and textile industry was minimal.

The coming into force of AGOA diversified Kenya's trade basket, which had suffered from the export ban of 1998, to include textiles and apparel and market destinations to include USA. In addition to policy reforms that include entrenchment of the rule of law, property and labour rights and democratisation; a number of policy reforms were carried out to streamline the business environment. The requirement of democratization and respect for human rights which is anchored on continued eligibility of AGOA has to a large extent served to undertake requisite political, economic and social reforms. Additional incentives to the standard EPZ incentives include express processing of customs documentation.

Fiscal incentives

- 10 year corporate income tax holiday and a 25% tax rate for a further 10 years thereafter;
- 10 year Withholding Tax holiday on remittance of dividends;
- Duty and VAT exemption on raw materials, machinery, accessories and other inputs;
- Stamp duty exemption;
- 100% investment deduction over 20 years on initial investment.

Physical Infrastructure Benefits

- Ready factory buildings for rent or purchase
- Serviced land for construction of buildings
- Office premises
- Concessionary rates for water, sewerage and electricity supply
- Landscaping, garbage disposal, street cleaning services
- Illuminated perimeter fence and 24-hour security
- Easy access to Customs offices.

Duty drawback Scheme

The EA Customs Management Act provides for drawback of import duty on goods imported for the manufacture of goods which are to be exported transferred to a free port; and transferred to an Export Processing Zone

Manufacture under Bond (MUB) Scheme

This facility was introduced in 1986 as an export drive policy measure. It aims at promoting industrial production for the export market, outside the EPZ areas. The facility allows manufacturers to import plant, machinery, equipment and raw materials tax free, for exclusive use in the manufacture of goods for export. Specific incentives include exemption from customs/excise duty and VAT on imported plant, machinery, equipment, raw materials and other imported inputs; and 100 percent investment allowance on plant, machinery, equipment and buildings.

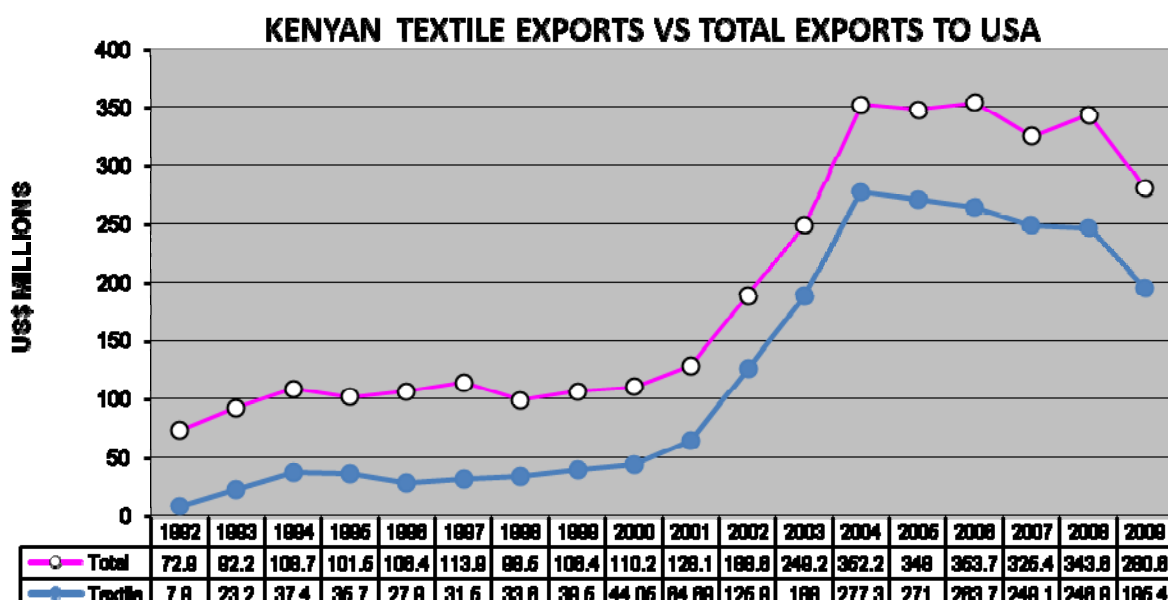
Tax Remission for Exports Office (TREO) Scheme

The TREO scheme aims at encouraging local manufacturers to export their products by remitting duty and VAT on raw materials used in the manufacture of goods for export. It also provides for tax remission on inputs to make goods defined as essential for the domestic market. The TREO encourages manufacturers to produce for the export market by granting remission of import duty on inputs; exemption of IDF fees on inputs except for payment of processing fee of Kshs. 5,000; remission of VAT on inputs; and remission of excise duty on fuel oil and kerosene.

Unfortunately, the anticipated backward linkages were limited. The services sectors including transport, banking, and employment expansion associated with additional investment. Nevertheless, with expiry of the MFA in 2005, most of the foreign investors relocated to their home markets in Asia while servicing the American markets more competitively. The transport sector in particular, benefitted from development of international logistics, partnerships with large textile/apparel importers and trading houses. Human skills were also expanded.

Table 3.1 - 3.2 and Figure 3.3 summarise Kenya's textile exports to the USA under AGOA non-reciprocal trade regime. Kenya is among the top three SSA beneficiaries of the AGOA. This demonstrates the potentials of the upper value chain in the textile and garment manufacturers. Similarly, the non-textile exports have also maintained an upward export trend.

Figure 3.3



Source: US Census Bureau, Otexta)

Table 3.1: Textile and apparel exports from Africa to USA

	Country	US \$ Million		% Growth
		Jan – Nov 2008	Jan – Nov 2009	
1	Botswana	14.675	11.962	-18.49
2	Ethiopia	9.020	6.126	-32.08
3	Kenya	221.385	177.002	-20.05
4	Lesotho	310.491	258.669	-16.69
5	Madagascar	257.371	194.022	-24.61
6	Malawi	11.517	9.015	-21.72
7	Mauritius	93.429	91.348	-2.23
8	South Africa	16.913	10.040	-40.64
9	Swaziland	114.603	87.654	-23.52
	TOTAL	1,049.404	845.838	-19.40

Source: EPZ report, 2009

Table 3.2: EPZ Garment Manufacturing Enterprises: Employment, Investment, Total Exports, Quantity Exported and Total Imports 2000 -2010

YEAR	No. of Factor ies/Firms	No. of Employee s	Quantity Exported (pieces)	Export Value (US\$)	Average Unit price (in US \$)	No. of Visas Issued	Investment Ksh (Billions)	Imports (Kshs Millions)
2000	10	10,000	6,050,000	30,000,000	-	-	1.2	-
2001	17	16,000	14,548,266	70,095,508	4.82	1,060	3.74	-
2002	25	26,000	28,615,384	119,907,104	4.19	1,986	6.90	5,699
2003	40	37,000	41,463,230	178,384,135	4.30	2,980	8.595	7,121
2004	36	36,600	61,312,309	261,014,329	4.26	4,185	9.710	10,012
2005	25	34,000	59,958,104	263,109,630	4.39	3,337	9.977	8,592
2006	25	32,000	61,730,934	272,435,816	4.41	3,431	10.317	7,674
2007	22	29,000	63,322,416	241,630,196	3.82	2,720	8.314	8,439
2008	28	31,000	66,919,400	232,217,560	3.47	2,830	7.578	16,348
2009*	19	31,000	19,607,260	194,641,000	3.08	755	5.490	12,672
2010	16	32,000	67,822,198	221,909,576	3.27	2881	6.959	16,518
2011	18	32,000	66,150,609	292,672,176.	4.42	3308	6.858	21,443
2012	19*	33,000	63,290,462	277,268,875.	4.38	3624	6.211	22,559
Total			660,557,306	2,642,810,064	4.00	34,383		

Source: EPZA Annual Reports of 2003 & 2008 and 2010 KAM Policy Brief Vol. 3 No. 1: KNBS, Economic Survey 2013

3.3 Regionalization

Regional integration in SSA was in part sparked by globalisation. Individual country markets were too small to sustain meaningful investment and trade. The policy environment characterising regional integration consists of preferential market arrangements in tariff structures, harmonised trade facilitation instruments including transport, insurance and technical regulations- effectively leading wider market access, opening up to large scale investments. Serious regional integration initiatives started with COMESA FTA in 2000, EAC CU in 2005 and EAC CM in 2010. The regional markets remain key destinations for Kenya's manufactured exports. However, the US remains the key export destination for the textiles and apparel. (Box 3.5/ Fig 3.3). Nevertheless with the expiry of the MFA in 2005, there was a temporary dip between 2006 and 2008/more than made up by exports into the regions and Africa.

Box 3.5: Cotton/Textile Sector Intervention during the deepening of regional integration (2000 and beyond)

Type of subvention	Incentives	Production Interventions	Marketing Interventions	Institutions
Value chain	Financial returns	Increased production	Strengthening proposals	Ministries of Agriculture
Farming	Attractive price for cotton	Intensification	Regional sourcing	Irrigation Boards
Ginning	Attractive price for lint cotton	Technology modernization	Increased lint cotton use	Ginner Association
Spinning/Milling	Attractive price for fabrics	Technology modernization	Comparative advantage /specialization agenda	Weavers / knitting Association
Garment manufacture	Growing markets	Wide market available	AGOA extension lobby	Regional EPZs/ MUBs
Marketing/ Promotion	Local/ regional sourcing	Combined regional market	Joint campaigns	Joint campaign Activities
Markets	Regional population	Adaptive youth	EAC/COMESA	Regional, international

Source: Various GOK Policy documents

The preferential market access enshrined in regional economic groupings facilitated Kenyan textile and apparel exports as well as imports of cotton.

3.4 Vision 2030

Kenya's blue print, adopted in 2007 guiding future development scenarios to 2030. The vision built on the successful ERS policy regime of 2003-2007. A number of policy reforms were undertaken during the ERS period. These include those impacting on governance, wider collaboration between government and the private sector including the civil society. More important was the prioritisation of the target sectors that the government put more focuses on to turn around the economy.

Cotton is one of the main industrial crops that the Government of Kenya has earmarked for promotion, value addition and integration with the manufacturing sector to create employment opportunities for Kenyans. Within the public sector, the respective ministries have prioritised key interventions across the value chain, starting with production, processing and manufacture. Concurrently, the support institutions have within their competences and resource availability institutionalised these key interventions.

The ministries of agriculture and industrialization have been directed to pay special attention to the cotton sector and proactively develop intervention measures that will support the numerous linkages of the textile industry. From the year 2005 to date the Government through the Ministry of Agriculture has continued to support the cotton sector. Some of the key interventions are summarised in *Box 3.6*.

The impact of the policy changes and targeted interventions are further discussed under the performance of the cotton/textile trade in *Chapter 4*.

Box 3.6: Cotton/Textile Sector Intervention during ERS and Vision 2030 Regime (2003 and beyond)

Type of Subvention	Incentives	Production Intervention	Marketing Intervention	Institution
Value chain	Concessionary fund	Increased demand Government sourcing locally	Buy /Wear Kenya build Kenya Branding	Strengthened institutions
Farming	Improved / guaranteed prices Price stabilizing fund	Quality seeds Cheaper farm inputs Fertilizers Revived ginning	Prompt payment on delivery scheme	Strengthened Farmers cooperatives CODA
Ginning	Easy modernization fund	Reduced production cost	Increased demand for yarn	Strengthened Ginners Association
Spinning / milling	Easy modernization fund	Increased demand for fabric and grey cloth	Increased demand for cotton wear	Spinners / weavers Association
Garment / made ups	Tax holiday Concessionary utility tariff	Locally produced fabric Levied cotton clothe imports Reduced dumping Reduced imports of cotton 2 nd hand clothes by category Skills training	AGOA Extension or new trade ACT with US More fashion designs More trade shows	New foreign investors Local investors in EPZ / MUB
Markets	Tax free export	Wider range of products	Niche markets New market concepts Entry into new markets EU, CANADA	EPC , KenInvest, Fashion houses Strengthened Tender Board EU, Canada,

Source: Various GOK Policy documents

The Government established the Cotton Development Authority (CODA) through the Cotton (Amendment) Act, 2006. Through a structured governance mechanism, the Authority's principle objects being that of promoting, coordinating, regulating and directing the cotton industry in Kenya. However, the Kenyan government is not providing subsidy to cotton growing or price support for producers or for ginning or marketing. Instead the government is providing targeted support to the smallholder farmers in form of provision of planting seeds, as a food security measure, advisory service through extension service and research. It is also supporting rehabilitation of irrigation schemes to reinstate irrigated cotton production in the next 5 to 10 years. Alongside provision of irrigation water, the government is aiming to increase the efficiency of water use by embracing modern production techniques of conservation and management. Other targeted support has been packed in form of coordination, wider stakeholder involvement, research and quality control.

3.4.1 Cotton Production

In order to expand cotton production, the government has prioritised a number of initiatives including:

- a) Reviving two irrigation schemes (Bura and Hola) for large scale production of irrigated cotton. The schemes used to produce 40% of national cotton production. Currently 5200ha have been rehabilitated in BURA scheme. Plans are under way to expand the scheme to 16,000ha in the next 5 years. For Hola irrigation scheme, 1200ha out of targeted 2400ha are about to be completed.
- b) Provision of free seeds since cotton is a strategic crop for communities in the marginal areas, and as such guarantees food security;
- c) Working with other stakeholders (including the Banking sector) to advance credit in form of targeted inputs support to smallholder farmers at a rate of 552 USD per HA. Financial sector in the country is averse in advancing credit to smallholder farmers.
- d) Continued support to training and demonstration of better crop practices through extension and advisory services
- e) The private sector is being encouraged to provide extension services to complement the government's efforts for example the Cotton Growers Association and the Ginners Association.
- f) Facilitating stake holders' fora to map out strategies for the sector revitalization at all levels (county) and National.
- g) Farmers are continuously being encouraged to form organized groups to lobby for their interests and to benefit from economies of scale.
- h) Encourage large scale commercial production of cotton through irrigation and mechanization.
- i) Support to be given to public institutions to produce and maintain seed for cotton which may not be attractive to the private sector.
- j) Cotton seed production to be mainstreamed as a scheduled crop in Seeds and Plant Varieties Act.
- k) Support to mainstream acquisition of biotechnology, infrastructure, legal and regulatory framework and access to planting materials.
- l) Farmers should be empowered to form organizations for credit access and inputs acquisition to benefit from economies of scale.

Figure 3.2 and Table 4.1 demonstrates the cotton improvement from 2005 that corresponds with the key government interventions during the ERS and Vision 2030.

The country has an estimated potential of 350,000 hectares suitable for rain-fed crop production and 35,000 hectares of irrigated cotton. This combined potential can produce an estimated 300,000 MT of seed cotton. However of this potential only 35,927 Ha is under cotton production, producing an average of 24,975 MT of seed cotton annually. –

3.4.2 Quality Control

The government in 2009 embarked on development of infrastructure that would support reliable testing of cottons through instrument based classification system to pave way for branding of Kenyan cotton. In this regard, substantial progress has been made in:

The Development of standard test methods for measurement of physical properties of cotton fibres by High Volume Instruments (HVI) in association with Kenya Bureau of Standards paves the way for branding of Kenya Cotton. The HVI classification laboratory is complete and operational and is due for commissioning towards the end of this year.

3.4.3 Research and Technology

Publicly funded cotton research in Kenya as other countries in sub-Sahara appears weak but, nevertheless, has a vital role to play in helping to ensure the competitiveness and sustainability of the cotton sector over the long run.

A major technology that is likely to be of particular interest to cotton growers in Kenya over the near to medium term is genetically modified cotton. Currently, Bt cotton is by far the most common genetically modified type and the most relevant for ESA Region, but additional innovations already exist for further consideration i.e. herbicide resistant, “stacked” genes. Bt cotton has undoubtedly been a major source of yield gains in cotton in India (much of it Rain-fed) since 2000. Among the countries which have adopted BT technology is Burkina Faso and South Africa. Kenya is still in the process of application for open release and hence commercialization. Clearly, there needs to be a public debate in many countries before Bt cotton can be commercially released. However, there are important technical steps to be taken, including the development of bio safety assessment procedures (where lacking) and the equipping of laboratories, plus breeding work to incorporate the Bt gene into locally adapted cotton varieties. There may be regional economies of scale in aspects of this work; therefore further assistance from international agencies could be useful in this area.

In order to continue maintaining the properties of the current commercial varieties as well as breeding better new varieties with better fibre qualities there is need to:

- Involve stakeholders in setting research priorities, monitoring research performance, and accounting for how research funds have been used.
- Reward researchers who achieve high performance and meet stakeholders’ expectations.
- Include majority funding of research effort by the industry through direct contributions or levies. Stakeholders should also work together to attract outside funding to complement internal resources, and such collaboration will be facilitated by the confidence that comes from working together to set priorities and to monitor performance.
- Allow stakeholders, through whatever management regime is put in place, to play a key role in researchers’ evaluation, pay, and promotion (or termination), rather than relying on public sector practices and scales.

- Feature more active regional information sharing, strategic priority setting, and eventually financing across countries in similar agro-ecological zones.
- Enforce strict application of the zoning of varieties, as a means of preventing any mixing or deterioration of varieties.
- Bayer's seed is conducting on farm trials with two varieties which have gone through NPTs with KEPHIS. Quton seed from Zimbabwe is the recent development. We are in the process of applying for Import of two varieties through their subsidiary seed company in Kenya –Seedco. The varieties from the two companies have already gone through evaluations by KEPHIS and will be ready for commercialization by end of 2013

In addition, the Government also recognises the role played by quality seed if the country has to become competitive in terms of yields, quality, costs and logistics despite subsidies offered by some cotton producing countries.

3.4.4 Cotton/Textile Policy

In spite of the prioritisation of the cotton/textile sector within Vision 2030, there is no textile policy in the country. Consequently, programme outreach is limited. The segments of the value chain are promoted independent of each other, often in response to external market demands.

3.4.5 Skills and Training

Worker-level data suggests that the Kenyan workforce is relatively well-educated and adaptive. The workforce in the formal manufacturing firms is experienced, middle-aged and possesses a high level of education. Almost all workers have some schooling. There is a wide dispersion in earnings, driven largely by differences in education, experience, and industry type

Productivity comparisons

Nevertheless, the level and quality of production and technical training in Kenya is low. This may be in part because the current training incentive system does not encourage firms to invest in enhancing production skills. Firms appear to invest more heavily in managerial and professional training than in developing production skills. Training deficiencies can be traced, at least in part, to structural problems in the technical and vocational training system. The current training levy system is financially troubled and appears to be inadequate to firms' needs, as it does not support in-house training in production skills. There is sufficient international evidence to indicate that incentives to firms to increase in-house training are vastly superior to public provision of training.

4.0 IMPACT OF THE DIFFERENT POLICY ENVIRONMENTS ON THE PERFORMANCE OF STAKEHOLDERS IN THE COTTON/TEXTILE SECTORS

The six major sectors in the supply chain are the farmer growing cotton, the ginner producing the cotton lint, the textile mills manufacturing the yarn and fabric, the apparel and garment makers and finally the retailing and the market. The success of the textile industry depends on how well all the six sectors in the chain work together.

4.1 Production and Processing Capacity

4.1.1 Land under Cotton Production

Cotton production in Kenya is faced with numerous challenges emanating from the small scale nature of production, overdependence on rain-fed production, inadequate quality seeds system and high cost of production. However, in limited operations, irrigation has been introduced.

The lint processed in the local ginneries is marketed to the textile industries for fibre while the seeds are returned to farmers for planting or are used for animal feed manufacturing and oil extraction.

At the peak of the cotton/textile performance in the mid-1980s, the country produced 60,000 bales of lint. Further government subsidies came in form of supporting irrigation through the NIB. The key schemes accounting for almost 40% of cotton lint were Bura, Pekera and Hola irrigation schemes. As presented in *Table 4.1*, area under seed cotton fluctuates largely influenced by producer prices, with average yield of 0.6 per Ha on average. This compares unfavourably with the top cotton producers worldwide and within the continent (*Table 4.2*).

Table 4.1: Seed Cotton Production, 2005-2012

YEAR	2005	2006	2007	2008	2009	2010	2011	2012
Area (Ha)	32,357	36,277	35,929	43,035	39,963	20,533	32,240	25,540
Seed cotton Production (MT)	19,414	22,492	24,993	15,093	14,886	11,822	15,255	13,877
Seed Cotton price (KES/kg)	20.00	21.00	20.00	22.00	26.00	48.00	65.00	35.00
Bales (Cotton Lint)	23,000	51,000	45,035	27,027	28,000	21,300	27,487	21,450
Yield (MT/ha)	0.60	0.60	0.69	0.35	0.37	0.58	0.60	0.55

Source: CODA

Farmers respond favourably to policy scenarios that are sensitive to farmer needs; particular regarding prompt payments, seed and chemical availability. However, between 2006 and 2012, at the time when the Cotton Act was amended to establish the Cotton Development Authority (CODA), there was a notable increase in production as a direct result due to support to the Ministry of Agriculture in facilitation to extension services and provision of inputs (seeds, pesticides, and organized market channels) but the increase dropped in 2009 as the support was withdrawn. Subsequently, the trend picked again due to the double increase in the world's market cotton price. This was short-lived as the market prices dipped to the equivalent of Kshs.35 in 2012(CODA farm gate price).

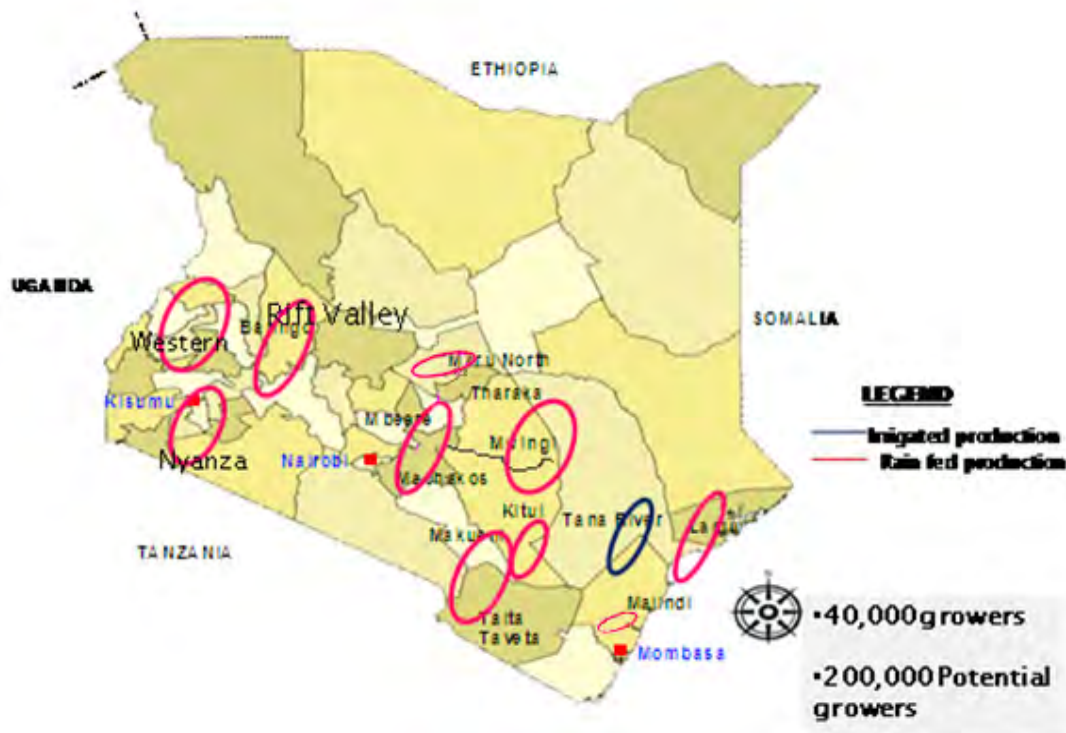
Table 4.2 below shows comparative cotton production and productivity in selected countries

Table 4.2: Comparative Cotton Production And Productivity In Selected Countries Data for 2012 (Aug 1 - Jul 31)

S. No.	Country	Cotton Production ('000 bales of 480 lbs each)	Cotton Yield (lbs / acre)
Top 10 cotton producing nations			
1	China	35,000	1,289
2	India	25,500	420
3	USA	17,290	880
4	Pakistan	9,300	602
5	Brazil	5,800	1,273
6	Uzbekistan	4,500	672
7	Australia	4,200	1,833
8	Turkey	2,600	1,263
9	Turkmenistan	1,600	518
10	Greece	1,215	828
Selected African nations			
1	Burkina	1100	407
2	Mali	1000	388
3	Cote d'Ivoire	600	359
4	Benin	550	427
5	Egypt	515	691
6	Zimbabwe	475	217
7	Cameroon	460	397
8	Tanzania	400	181
9	Uganda	150	233
10	Kenya	30	220

Source: National Cotton Council, USA

Figure 4.1: Main Cotton growing areas in Kenya



4.1.2 Ginning Capacity

There are 24 ginneries in the country with an installed capacity of approximately 140,000 bales annually (*Table 4.4*). But the utilised capacity is a meagre 20,000 bales (about 14%), meaning that if the cotton production capacity were increased by 400% the ginneries would still be able to handle the production.

Out of the 24 registered ginneries, some have been leased to the private sector. In total there are only about 10 ginneries that are working currently. Some of the ginneries like Hola ginnery eased operation as a result of the collapse of the Hola Irrigation scheme, after River Tana which was supplying water changed course and left the pumps dry. Some of the major ginneries that are privately owned include Kibos & Nyanza Ginneries in Nyanza Province and Tharaka Ginnery in Eastern Province.

Table 4.3: Installed Ginning Capacity in the Country (EPZA, 2005)

	Name of Ginnery	Year of Establishment	District	Original Owner	Present owner and operator	Installed/ No. of Gins	No of Gins operational	Bales at full capacity	Ginning costs/kg
1	Mwea	1969	Kirinyaga	CBK	Private	20	7	3600	30
2	Hola		Tana River	CBK	Private	20	0	3600	-
3	Lamu	1960s	Lamu			11	0	1980	-
4	Malindi		Malindi	Private	Private	37	37	6660	35
5	Mpeketoni		Lamu			16	16	2850	30
6	Voi	1969	Taita	Private	Private	8	8	1440	-
7	Kitui	1935	Kitui	Private	Private	16	16	2850	25
8	Makueni	1980	Makueni	CBK	Private	20	8	3600	30
9	Tharaka	1992	Tharaka	Private	Private	15	11	2700	-
10	Meru (1994)	1970	Imenti North	CBK	Private	30	10	5400	-
11	Meru Farmers	1996	Imenti North	Private	Private	6	0	1880	-
12	Homa Bay	1937	Homa Bay	CBK	Private	12	0	2160	-
13	Kendu Bay	1935	Homa Bay	CBK	Private	12	0	2160	-
14	Kibos	1935	Miwani	CBK	Private	7	7	1260	-
15	Nyanza	1971	Miwani	Private	Private	10	10	1800	30
16	Ndere	1937	Siaya	Private	Cooperative	8	2	1440	-
17	Algenya	1964	Siaya	Private	Private	5	4	900	-
18	Salawa	1985	Baringo	CBK	Private	10	7	1800	70
19	Isimbii	1992	Teso	Private	Private	20	0	3600	-
20	Luanda	1922	Busia	Private	Cooperative	20	14	3600	-
21	Malaba Malakisi	1921	Bungoma West	Private	Cooperative	10	0	1800	-
22	Angurai	1992	Teso	Private	private	0	0	0	-
23	Nambale	1922	Busia	Private	Cooperative	12	6	2160	-
Total									

Source: EPZA, 2005; CODA, 2013

The total installed annual ginning capacity of the cotton ginneries is 140,000 bales. The combined actual operating ginning capacity is 70,000 bales at full capacity for 6 months. The combined actual ginned cotton from the operating ginneries is estimated at 5,000 bales which are believed to be an underestimate. These ginneries are underutilized due to the low supply of seed cotton, which currently stands at less than 15,000 MT.

The cotton co-operative societies used to own four cotton ginneries in Nyanza and Western provinces, namely Ndere, Nambale, Malaba/Malakisi and Luanda. Three had been leased to private ginnery operators while only Nambale ginnery was operated by the cooperative society before they closed down. Except for Luanda Ginnery, the other cooperative ginneries are at poor state of maintenance, following many episodes of mismanagement and the high operation costs

Out of the existing private ginneries, six were originally owned by the Cotton Board of Kenya (Mwea, Makueni, Kibos, Meru, Salawa and Hola) but were later sold to private entrepreneurs through divestiture in the 1990s.

4.1.3 Textile/Milling Potentials

At the moment, Kenya only manufactures less than 12 million square meters of woven fabric per year, which is estimated at 7% of the potential market. The other 93% is being imported. It is cheaper to import fabric/garments into Kenya because the cost of production in Kenya is high. This includes post-harvest handling, ginning, textile and cottage industry manufacturing. There are inadequate quality control measures at post-harvest handling while the main challenge in the processing and manufacturing is how to attract investments in the subsector given the current operating environment. Furthermore, most of the fabric/garments are distributed through illegal hubs while some are disguised as used clothes whose import duties are very low. Kenya is therefore losing out on the massive opportunity of sustaining the textile requirement locally.

The processing and manufacturing is characterized by closures, scaling down of operations and deferring of investment decisions due to an uncertain future business outlook. This has resulted in limited range cotton and textile products.

Currently there are 18 textile mills in the country. If they were to operate at their installed capacity, they would create demand for cotton lint of 60,000 bales per annum, on top of the current annual demand of 120,000 bales to be able to meet the increasing demand for the increasing Kenyan population.

Table 4.4: Milling and Spinning Textile Capacity

Name of the firms	Status	Capacity utilisation
RIVATEX	Operating	30-35%
Bedi investment	Operating	35-45%
Thika clothes Mills	Operating	30-35%
Sunflag	Operating	35-45%
Rupa	Operating	35-45%
KICOMI	Closed	0
T.S.S	Operating	35-45%
Specialised Tower manufacturing	Operating	35-45%
Spinners and Spinners	Operating	35-45%
Fine Spinners	Operating	30-35%
Alpha Knits	Operating	35-45
KenKnits	Operating	30-35
Nakuru Industries	Operating	30-35
Londra	Closed	0
Megaspin	Operating	35-45
Spin Knit	Operating	35-45

Proposals

The country needs to invest substantially in value addition to offer a wide range of fabrics and cotton products as a strategy to catalyse higher domestic consumption and enhance exports. The following are the issues affecting value addition:

- Importation of textiles and clothing stifling the domestic market
- Tax regime that favour imports
- Over reliance on preferential export markets
- Comparatively high unit cost of production (power, labour productivity and other utilities)
- Weak and poorly organized value addition stakeholder organizations which constrains acquisition and adoption of new technology
- Inadequate investment in cotton by-products processing
- Obsolete technology and under-utilization of installed capacities
- Low participation by local investors in value addition activities

Proposals on Value Addition

The country needs to improve competitiveness of textiles with a view to reduce dependence on preferential markets and increase our domestic consumption. This will entail support to cost reduction in processing and manufacturing, improvement of quality and on delivery lead time.

The cost of power is estimated at 40% of the production cost at manufacturing level. This and other utility costs to be benchmarked to market leaders.

Obsolete technology, weak and poorly organized value addition stakeholders lead to less competitive local products. There is need to support investments to modernize and embrace more efficient technologies.

Revenue from seed which comprises 60 – 64% of raw cotton is almost at par with sale of cotton lint per ton. Inadequate seed processing reduces the returns from raw cotton. Investments in seed processing has the potential of doubling farmer income and increasing the income of the processor. Thus there is need to promote seed processing.

Key innovations targeting value addition:

- Partnerships between universities and textile mills- Moi University/Rivertex; KU/Thika Clothing Mills;
- External university/Farmers/Ginner in Machakos

4.1.5 Apparel/Garment Textile Trade

Local textile manufacturers supply only 45% of the Kenyan textile market requirements while imported new and used clothes account for about 37% of the market, as shown in the figures detailing cotton/textile trade performance in the different markets. Demand for textile products in the country is estimated to be growing at 3.8% annually. Lint and second hand clothing trade dominates

cotton/textile trade between Kenya and the different regions. Figure 4.4 depicts the trend of imported second hand clothing which basically tracks the imports from USA.

Figure 4.2: Imports of second hand clothing, 2000-2012

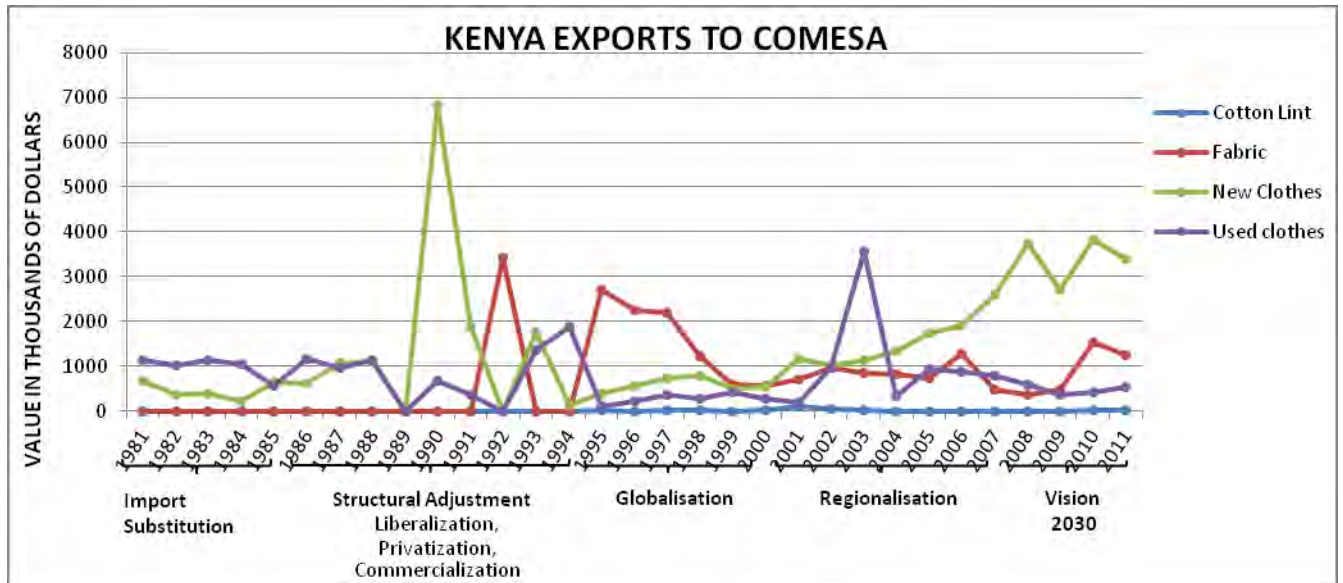


Source: USDA

4.1.5.1 Kenya Cotton, Textile/Apparel Trade in COMESA

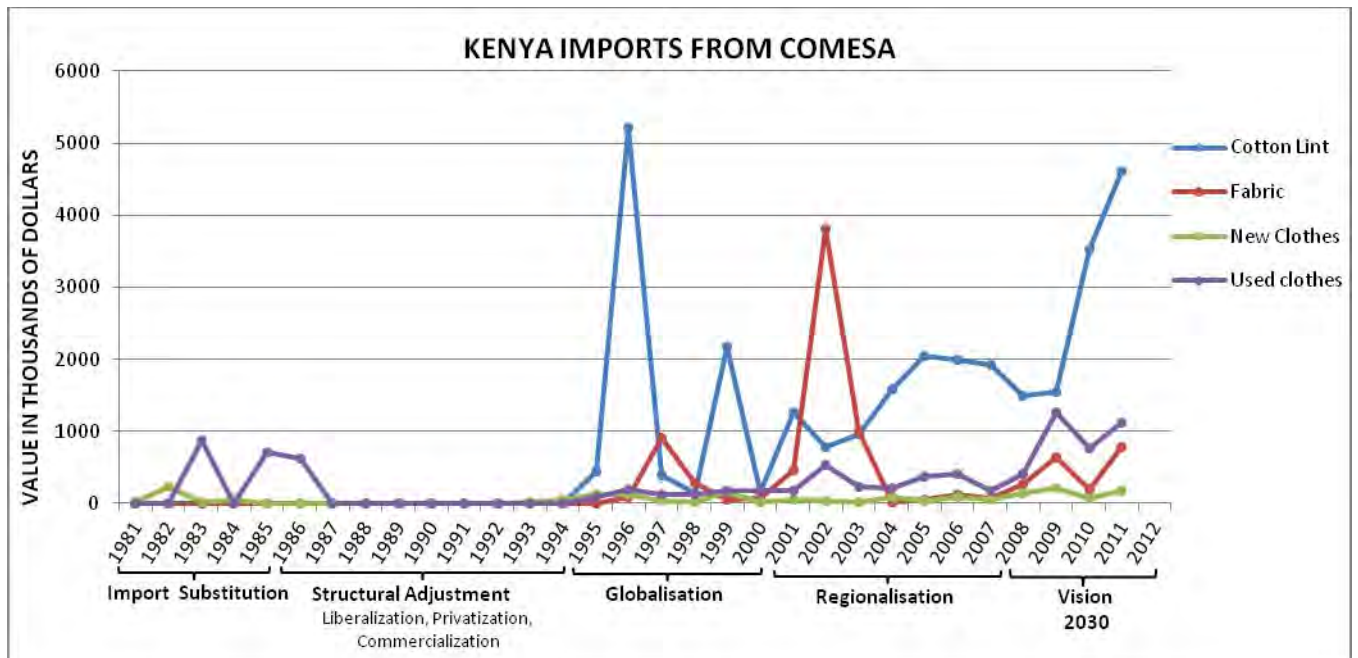
Kenya’s cotton/textile trade within COMESA picked up with the entry of the FTA in 2000. New cloth exports originate from the EPZs (Figure 4.5). There will be need to review further the current benefits of EPZs with the entry of the COMESA-EAC-SADC tripartite under discussion. The imports are dominated by cotton lint and fabric (Figure 4.6). While trade was registered during all policy environments, it picked up with the signing of COMESA Treaty in the 80s. This in effect confirms that market access creates trade opportunities.

Figure 4.3: Kenya Cotton, Textile/Apparel Exports into COMESA



Source: USDA

Figure 4.4: Kenya Cotton, Textile/Apparel Imports from COMESA

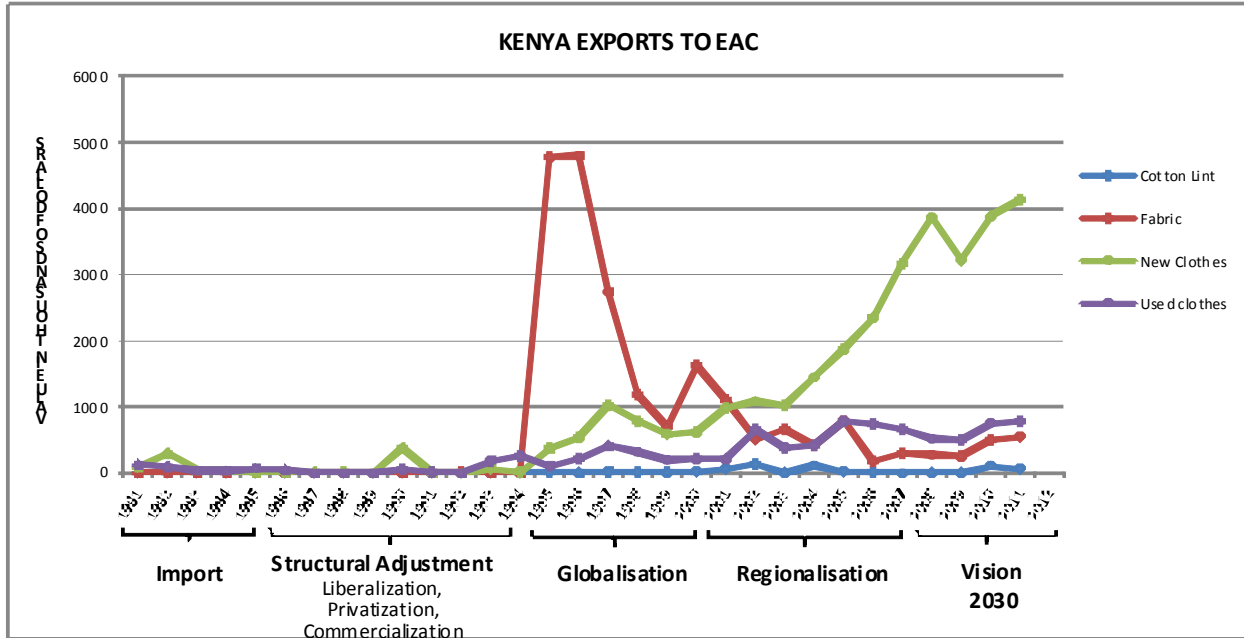


Source: Source: TradeMap

4.1.5.2 Kenya Cotton, Textile/Apparel Trade in EAC

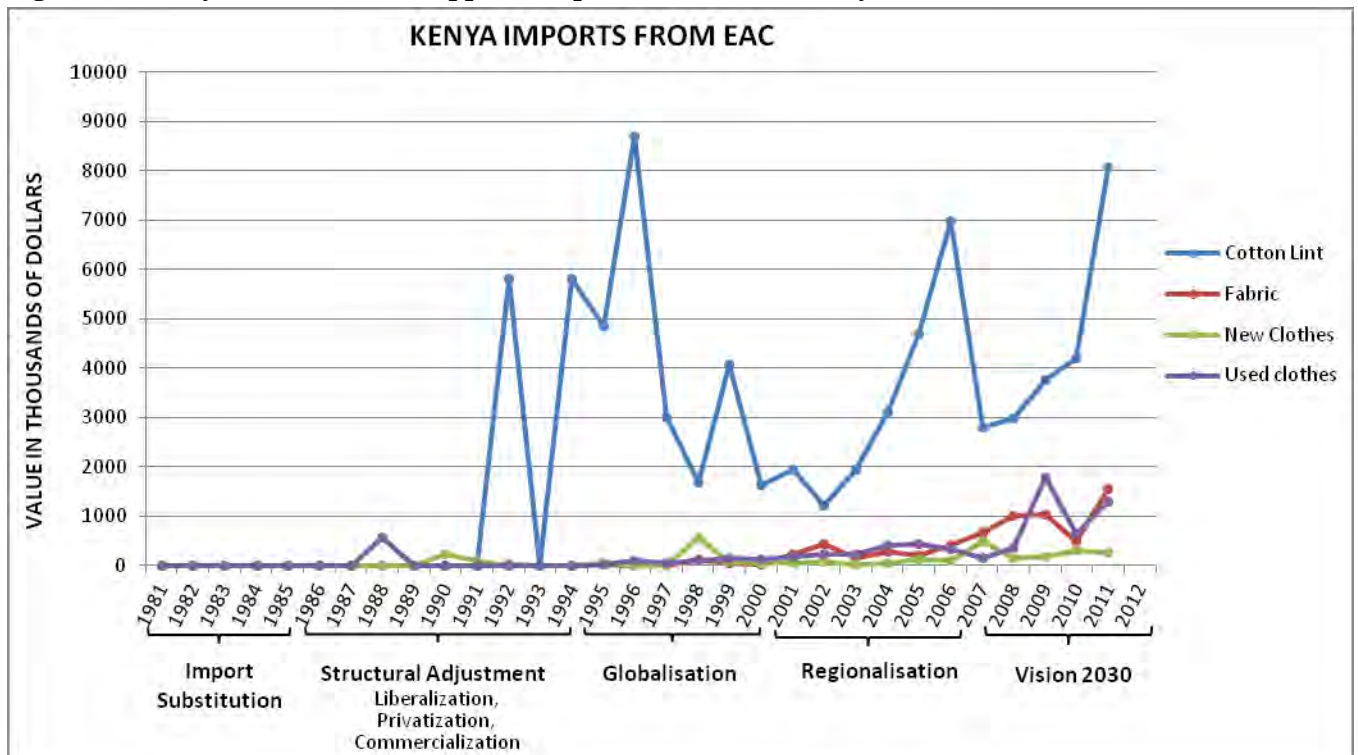
Kenya's cotton/textile trade within EAC is mixed; with exports of both fabric, new and re-exports of used clothing (Figure 4.7) and cotton lint import (Figure 4.8). There was very little trade in used clothing within EAC. However, cotton lint was the major import while fabric and new clothing were the exports.

Figure 4.5: Kenya Cotton Textile/Apparel Exports into EAC



Source: TradeMap

Figure 4.6: Kenya Cotton Textile/Apparel Imports from EAC Prior years??

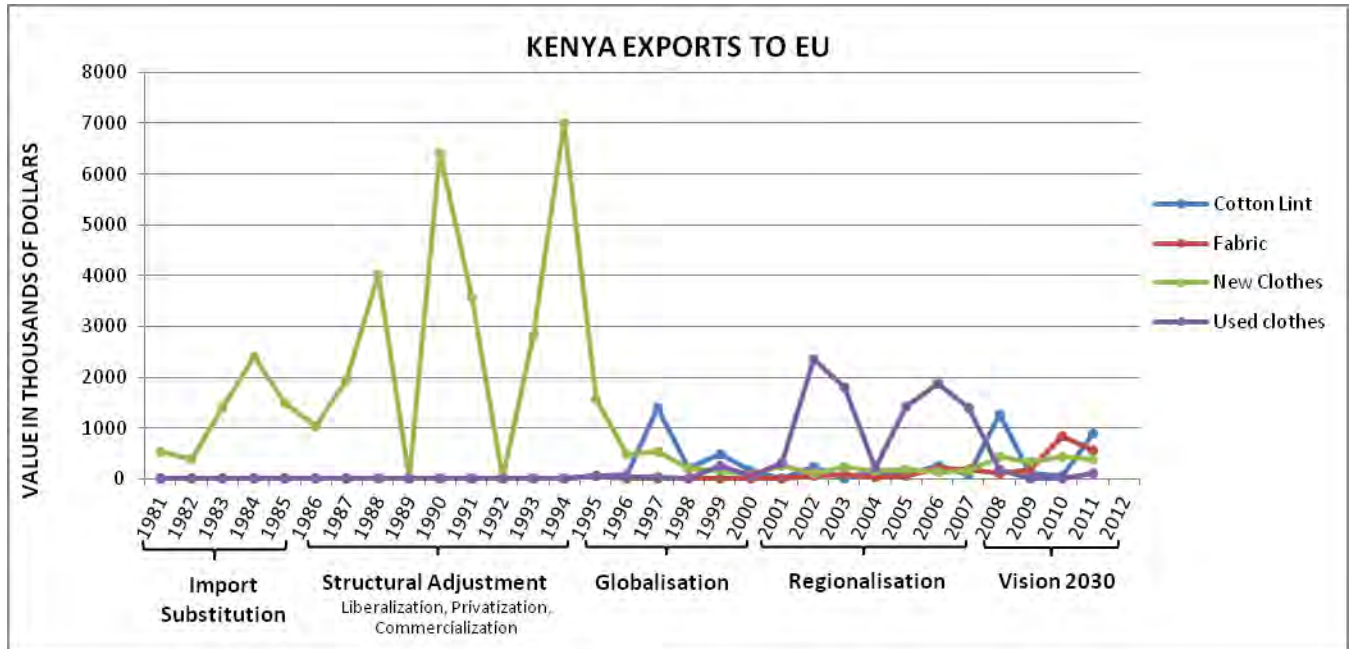


Source: TradeMap

4.1.5.3 Kenya Cotton, Textile/Apparel Trade in EU

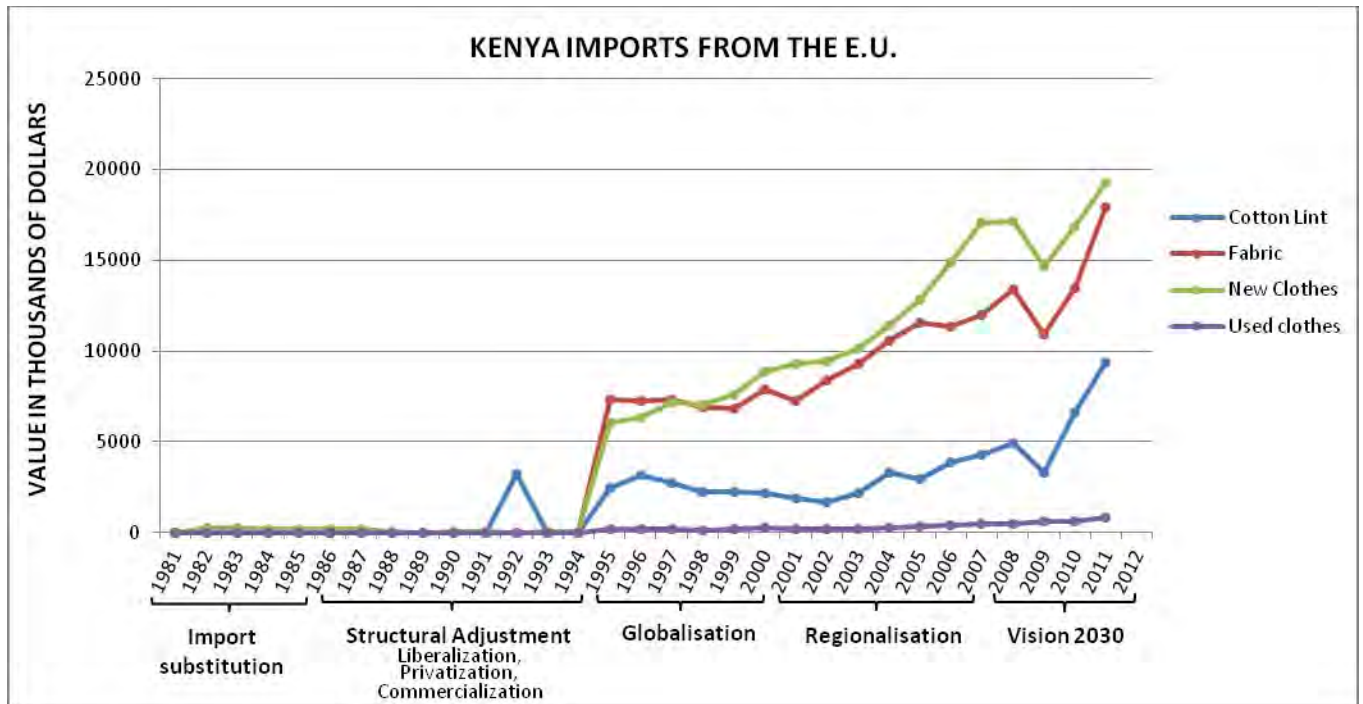
The Kenyan exports of new cloths into the EU were substantial during the import substitution regime (Figure 4.9). Imports of used clothing picked up starting from the late 80s with the entry of the SAP policy regimes.

Figure 4.7: Kenya Cotton Textile/Apparel Exports into EU



Source: Trademap

Figure 4.8: Kenya Cotton Textile/Apparel Imports from EU

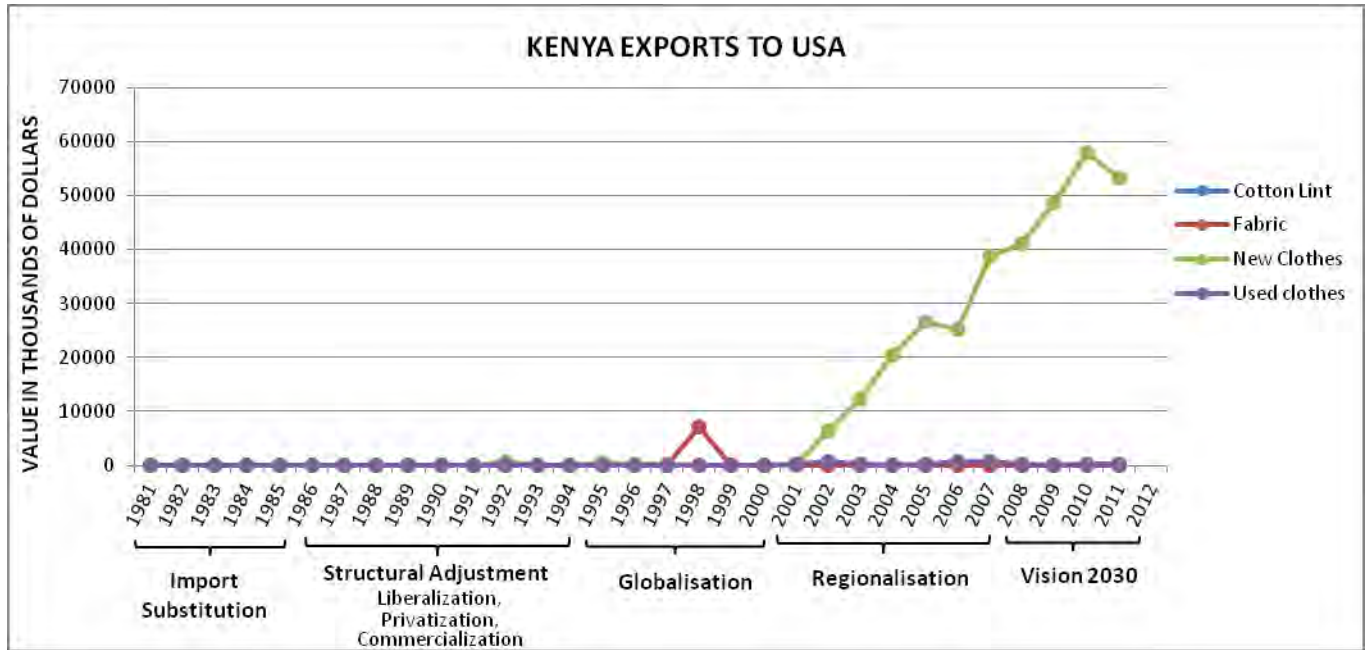


Source: Tradema

4.1.5.4 Kenya Cotton, Textile/Apparel Trade in USA

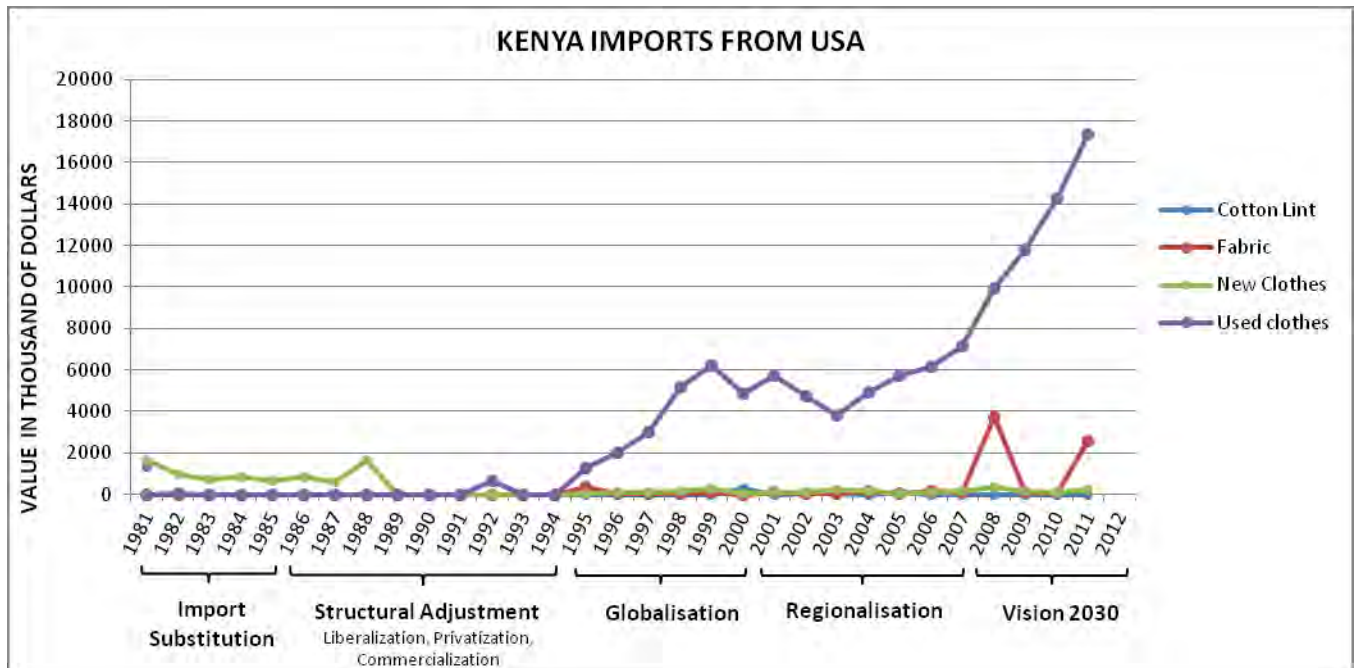
Kenya's cotton/textile trade with USA is dominated with export of made up garments and import of used clothing (*Figure 4.11 & 4.12*). The exports intensified with the entry of AGOA while the SAP policy was the precursor to trade in used clothing.

Figure 4.9: Kenya Cotton Textile/Apparel Exports to the USA



Source: Trademap

Figure 4.10: Kenya Cotton Textile/Apparel Imports from USA

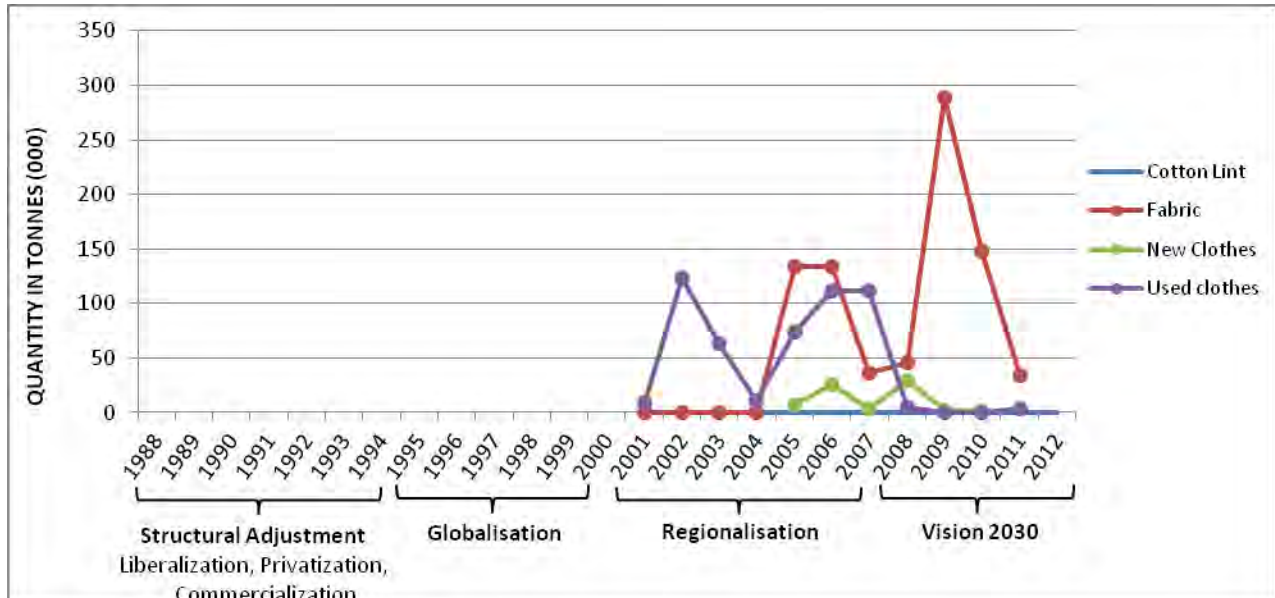


Source: Trademap

4.1.5.5 Kenya Cotton, Textile/Apparel Trade with Middle East

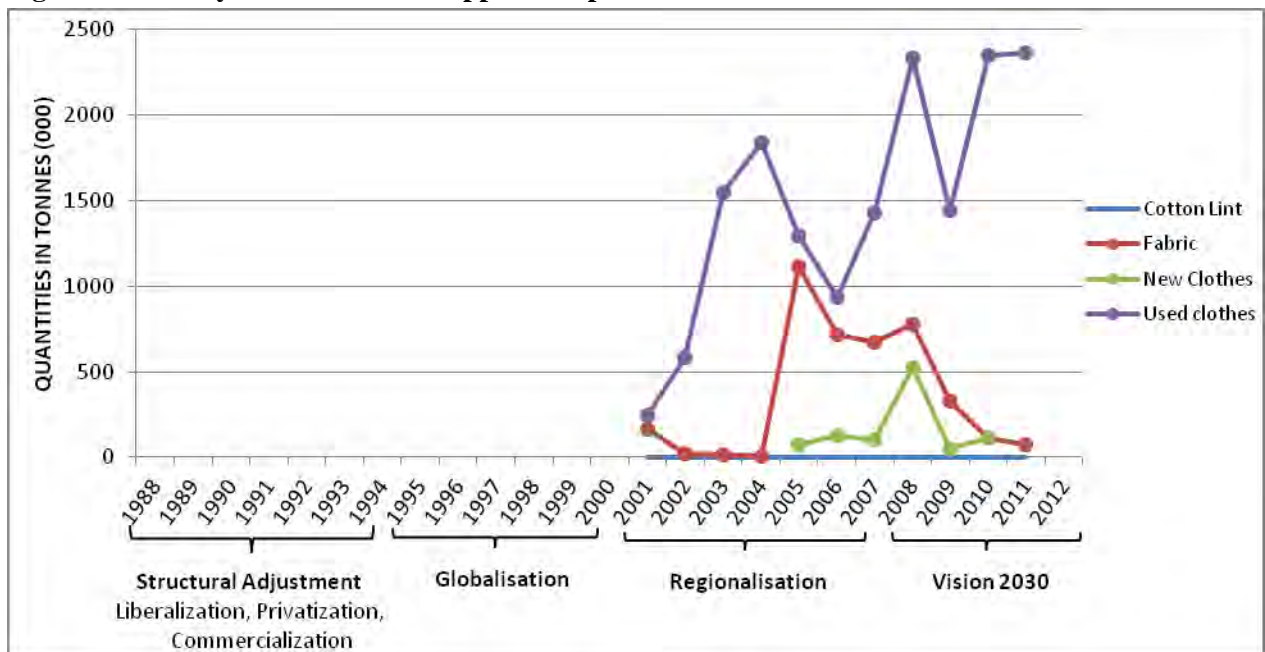
Kenya's cotton/textile trade with the ME is minimal, focusing mainly on fabrics and used clothing (Figure 4.13 & 4.14). Textile trade with ME is very low.

Figure 4.11: Kenya Cotton Textile/Apparel Exports into the ME HANGING



Source: Trademap

Figure 4.12: Kenya Cotton Textile/Apparel Imports from the ME



Source: Trademap

4.2 Investment

Since the government intensified market liberalization in the cotton/textile industry in early 1990s, the industries competitiveness experienced a downward trend. This has in part been occasioned by the lack of the right market and institutional dynamics required to remain competitive with global players like China, or even with regional competitors such as South Africa and Mauritius. However, due to the AGOA benefits, most of the foreign investors who came into the country were specifically under the Export Processing Zone (EPZ) program to manufacture apparel for export to the US market. The AGOA initiative revitalized the textiles and apparel industry, which led to a substantial growth in investment and exports of apparel to the USA from Kshs 1.2 billion (investment) and 2.3 billion (exports) in the year 2000 to Ksh 9.7 billion (investment) and Ksh 17.6 billion (exports) in 2004.

Table 4.5: Trends of Investment in Textile and Apparel Industry in Kenya, 2000-2012

Year	No of firms	Value of investment, US\$	Employment
2000	10	30,000,000	10,000
2001	17	70,095,508	16,000
2002	25	119,907,104	26,000
2003	40	178,384,135	37,000
2004	36	261,014,329	36,600
2005	25	263,109,630	34,000
2006	25	272,435,816	32,000
2007	22	241,630,196	29,000
2008	18	232,217,560	31,000
2009	19	194,641,000	31,000
2010	16	86,177,539	32,000
2011	18	80,617,764	32,000
2012	19	72,196,921	33,000

*Source: EPZA Annual Reports of 2003 &, 2008 and 2010 KAM Policy Brief Vol. 3 No. 1 ;
KNBS Economic Survey 2013*

As seen from *Table 3.2*, the number of textile enterprises in Kenya rose from 10 in 2000 to 40 in 2003 and decreased to 36 in 2004 and 19 enterprises in 2008. The confidence generated from AGOA in attracting foreign investors to Kenya declined with the expiry of the MFA in January 2005. Investment also decreased from 8.6 billion in 2004 to Ksh 7.6 billion in 2008, an average annual decline of 3.04%. The exports of both finished goods and imports of raw materials declined by -2.8% and 2.2% respectively against the declining US market access.

(a) Employment Generation

Direct employment rose from 10,000 in 2000 to 36,600 in 2004, but declined to 24,000 by 2012. It is expected that more than twice as many employees benefitted from the textile value chain as well as complementary services,

(b) Impact of the Expiry of the MFA

A number of foreign investors from EPZs relocated to their countries of origin with expiry of MFA in 2005 and the knowledge that AGOA was a temporary market initiative. Few new investments in textile firms have been undertaken since 2005. However, the majority of the firms that remained in operations are basically local investors. In this regard sustainability of the textile could in part lie in the number of local investments.

With 73 % decline in investment between 2006 and 2012, local employment contracted by 3 % to stand at 33,000 persons in 2012 from 34,000 persons in the 2005. Sadder still is the fact that those losing jobs are women with no other alternative sources of employment and income. This is against the spirit or governments' ambition to create 500,000 jobs annually. Instead the sector with the greatest potential to generate jobs is the one losing jobs.

In spite of the fact that the Kenya Textiles and Apparels Sector has had great potential to spur economic growth, the textile sector has been declining over the years from a high of 40 firms in 2003 to only 22 recorded in January, 2012⁶. However, the available statistics (*Table 3.2 and Figure 3.3*) indicates that following the MFA expiry Kenya's Textile and apparels exports to the US under AGOA and GSP continued to increase due to the already established networks with the US buyers.

4.3 Factors leading to underperformance of the cotton/textile sector

The factors leading to this under performance of the Sub-sector include:-

- Weak legal and Institutional framework,
- Weak farmers' organizations,
- Inadequate quality planting seed,
- High cost of production inputs,
- Overdependence on rain-fed cotton in the marginal areas,
- Inefficient marketing channels,
- Obsolete ginning technology leading to high ginning costs, however, garment manufacturers have relatively newer technology compared to mills
- Flooding of the local market by cheap imports,
- Low seed cotton production and productivity,
- Distortion of world price through subsidies
- Lack of qualified labour, designers, managers, appropriate technology,

4.4 Competitiveness

Since cotton is a global commodity, the solution in the cotton/textile industry lies in enhancing the sector competitiveness.

⁶ See Annex 3 in which out of 99 EPZ operating enterprises by January, 2010, 26 were Garment Manufacturers.

4.4.1 Research and Technology

In order for the textile sector to remain competitive in a globalised environment, there is need for strong research on the appropriate contemporary technology uptake. Kenya's textile mills technology is out dated and therefore not capable of producing competitive products. This has been largely contributed by the fact that cotton research in Kenya has been faced with several challenges which include the following:

- a) Inadequate technology transfer.
- b) Inadequate funding and capacity for cotton and industrial research.
- c) The research agenda for cotton had been low-keyed as a result of collapse of the industry.

Proposed Intervention

There is need for greater public sector participation in technology transfer. This calls for establishment of a Cotton/Textile Development Fund with more elaborate incentive mechanisms across the chain to facilitate wider local and foreign investment using such vehicles as the PPPs.

Support for setting up of infrastructure to develop a centre of excellence for research and technology development to cater for the needs of the ginning, textile, fashion and design levels of the value chain.

4.4.2 Labour costs

(a) Skill sets

CODA recognizes the dynamism of capacity building along the entire cotton value chain. Majority of players in the value chain are characterized by inadequate institutional capacity to support adoption and absorption of modern skill.

Most of the small scale farmers have low levels of education, while staff engages in promotion of cotton production lack the necessary skill to keep pace with the technological advancements currently being experienced in the cotton industry. Much of this is attributed to the wide generation gap of players in the industry that was occasioned by the collapse of the Cotton Board of Kenya.

At the ginning, textile, fashion and design levels there are skills gap due to low performance of the industry leading to poor quality of products, high cost of production and low labour productivity. As a result, most SSA manufacturers Kenya included produce lower-value, basic apparel products. Expensive and often low-quality raw materials, rising labour costs have compromised Kenya's competitiveness. For example, Kenya's labour costs of USD 95-110/month compare unfavourably with the more competitive prices of USD 35/month.

The main issues requiring attention under training include:

- Deficiency of capacities of institutions along the cotton value chain to access information, support their specific needs for the sector in research, production, designs and manufacturing
- Specialized on-job skills training at mid-management level especially at ginning, textiles, fashions and designs

Proposed Interventions

The development of the necessary professional, technological as well as industrial skills is an essential prerequisite to the transformation of Kenya's cotton industry into a globally competitive undertaking.

This will be achieved through:

- Developing a highly skilled and motivated human resource base.
- Establish an institutional framework for the Development and implementation of a cotton-textile curriculum for mid-level training.
- Establishment of a regional centre of excellence

- Enhancing technology and innovation awareness and transfer especially through improved information management and dissemination systems.
- Strengthening capacities and capabilities of the existing institutions.
- Strengthen linkages between training institutions, universities, research institutions and other industry players.

4.4.3 Energy Access and Affordability

The poor and inadequate infrastructural conditions are one of the many constraints affecting the competitiveness of textile and apparel exports among Kenya producers, as well as between SSA producers and global competitors. Inadequate infrastructure, such as unreliable electricity, poor road quality, and limited access to international shipping, increases production costs and limits speed to market. Additional constraints include, but are not limited to, geographic distances to major markets, lack of access to affordable capital, and political instability.

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The unreliable and expensive energy (e.g. US\$0.15c/Kwh in Kenya versus US\$ 0.07c/Kwh in China and US\$0.04c/Kwh in South Africa, US 0.04c/kwh in Ethiopia) have led to high costs of productionⁱ. Poor infrastructure and inadequate services, such as water and other input supplies, have also contributed to the high cost of local manufacturing.

4.4.4 Trade Logistics

There have been initiatives since 2008 at the port of Mombasa, international airports and border ports including administrative reforms to make procedures and processes more efficient for importers and exporters involved in international trade and trade across borders. A case in point is the National Single Window Community Based Project currently under implementation by the GoK. The

introduction of this system will result in a reduction in import cargo delays both at the port of Mombasa and JKIA.

On successful implementation of the program, time to export should take 16 days down from 29 days and time to import 19 days down from 26. This is by improvement brought about by the new program and also enhancement of processes going on since DB 2009 including:

- Enhanced use of X-ray scanners;
- Customs border control services in line with international standards;
- Systems interface; RADDEX connectivity to URA and RRA to enable data exchange in order to facilitate cross border trade in the region;
- Valuation database; this gives 10% deviation allowance from the database hence verification made easier and in turn clearance is not delayed;
- Single entry documentation (SED) for both import and export online; and
- OSBP (one stop border post) with RTMS and CSS implemented; _ VMS and S2005S have been integrated; among others

Inefficiency in the local transport and logistics sector (e.g. port, rail and road transport services), greatly hampers the ability of local manufacturers to access and be competitive in regional and global markets. The Kenyan road transport rates of Kshs 4/Kg/km are way above the global competitive road transport rates of Kshs 1/kg/Km. Similar challenges persist in rail transport where the Kenyan applicable tariffs of USD 5.8c/Km are compared with the competitive tariffs of USD 2.6c/Km. The telecommunication sector which has grown substantially still carries higher tariffs of USD 30c/Minute compared to the more competitive rates of USD 3c/minute.

The in country transit transportation also needs to be improved. In particular, there is need to reduce the number of road blocks which have turned into toll stations for fleecing the business community. Continued operations of cross border ports of entry even with a fully operational customs union and Common market, causes delays in the clearance of goods which do not attract any duty.

4.4.5 Unfavourable Business Environment

The unfavourable business environment arises from complex regulations, weak trade agreements, lack of rigorous legal enforcement, incidences of insecurity, as well as limited access to capital.

Complex regulations have sometimes led to overlapping business and investment registration; affecting both the ease and the cost of doing business in the sector (e.g. Kenya issues multiple business-related licenses). Weak negotiating capability impedes the country's ability to negotiate for favourable trade agreements and therefore creates barriers against Kenyan companies. Weak enforcement of standards and of tax laws has led to dumping of sub-standard imports and counterfeit goods into the domestic market, making it unfavourable for local manufacturers to compete.

4.5 Impact of Second Hand Clothing

Buying second hand clothing is very common in Kenya. Shoppers hunt for the best deals on shirts, trousers, dresses and other clothing.

But while the mitumba (second hand clothing) business may be good for sellers and buyers, others say it hurts Kenya's struggling textile industry.

Mitumba first came to Kenya in the late 1980s at a time when the textile industry was booming, employing some 30% of the formal labour force. But economic liberalisation policies that included the mass importation of used clothing led to the textile industry's virtual collapse by the early 1990s.

In 2000, the signing in the U.S. of the African Growth and Opportunity Act (AGOA) briefly revived the textile industry, but mostly in the export sector rather than the domestic market.

In 2012, the government reduced import duties on second-hand clothing, leading the Kenya Association of Manufacturers to predict further job losses. The Kenyan textile industry currently employs less than workers from more than 200,000 at the peak of the industry in the 80s.

New imported clothing comes in disguised as mitumba and it gets into the market, and of course without paying taxes, which makes it a big challenge for domestic textile producers to be able to find a market. The recovery of the cotton/textile sector depends on targeted intervention coordinated through government.

4.5.1 Cotton Fund

Establish Cotton Investment Fund⁷ with low interest rates to have a framework like Coffee Development Fund and Sugar Development Fund. The capital for the Fund shall be contained from a levy to the mitumba imports (*Table 4.6*). The funds will be administered by a financial institution.

Table 4.6: Levy Second Hand Imports, 2012

No. of 20Ft containers	Applicable tariff (Kshs millions)	Customs duty	Adj. Tariff for stabilisation Fund	Stabilisation Fund per container (Kshs)	Customs duty (Million)	Contribution to stabilisation Fund (Million)
33,250 ⁸	1.1	36,575	1.2	100,000	39,900	3,325
			1.15	50,000	38237.5	1,662.5
			1.11	10,000	36,907.5	332.5
			1.12	20,000	37,240	665.0
			1.125	25,000	37406	831

⁷ The levy on imports should be consistent with the SDT flexibilities accorded to developing countries

⁸ On basis of the current market prices for a 20ft Container of 110lb bales. No. Of containers = 106,920,797/3,216.87

Source: OECD Stat 2012

Application of the levy

- a) Minimum Support Price mechanism for seed cotton that guarantees minimum returns per kilogram produced to cushion farmers from world price fluctuations. This type of support is practiced world over; for instance USA provides input and price subsidies, China guarantees producer price that is above world market price of lint while India provides minimum support price. The fund for minimum price guarantee can be kept in treasury and be accessed only when the price falls below a certain threshold. With a Minimum price of KES 40 per kg is proposed, Kshs 300 million to sustain the higher production would be set aside for stabilisation.
- b) Funding of certified seed production-Ksh.50million
- c) Refurbishing of two ginneries to be operated in Private –Public arrangement like KCC and Kenya Tea Development Agency (KTDA) so that it assists to stabilize the market in cases of deficits and over supplies. –Ksh. 60million
- d) Funds to buy seed cotton from farmers which will be a source of revenue as well as providing stability to the industry. The amount required is Ksh.420million.

Table 4.7: Application of the Proceeds of the Fund

	Rate	Amount allocated (million)
Minimum Support Prices (Stabilization Fund) Kshs million	10	300
Certified Seed production (million)		50
Refurbishing 2 ginneries (Kshs milliomm)	30	60
Refurbishing of mills		xxxxx
On lending to ginneries/mills to Buy seed cotton from farmers		420
Total		

Apart from the expenditure on certified seeds, the rest of the resources shall be accessed on concessionary terms. The fund shall be managed on commercial basis.

Further, for purposes of sustainability, there will be need for a stakeholder driven system whereby farmers, ginners, spinners, weavers buy equity in the Fund. More important however, is the retention of part of the sale proceeds when international prices are in excess of the minimum price of Kshs 40 per kg.

4.6 Impact of Substitutes

The stiff competition posed by man-made fibres continues as reflected in the relative price of cotton to Non-cotton fibres. Between 2005 and 2009, the average relative price of cotton to polyester was 0.87 indicating that cotton was 13% cheaper than polyester. However in 201 and 2011 the relative price of cotton to other fibres shot up to 1.41, meaning that cotton became 41% more expensive (source

ICAC). It is therefore important to look at niche markets to counter these challenges as well as concerted efforts to communicate messages about cotton.

4.7 Financing

Internationally bank financing contributes significantly to the activities along the cotton-textile-garment value chain. In Kenya the higher parts of the chain are well catered by bank financing. However, in the recent past, commercial banks have shown interest in the lower parts of the chain. The Cooperative Bank was heavily involved in the past through the associated cooperative unions but when the industry collapsed the bank could not continue the heavy support to the sector. Other commercial banks have also tended to shy away from involvement in financing cotton production and ginning. This emanates from small scale nature of cotton production, lack of collateral, high cost of credit and the legal status of the credit seekers.

In the Act there are no legal mechanisms provided for financing research, production, input supply, upgrading of technology among others for the industry at the moment. Though the Cotton Amendment bill of 2005 was to address this issue the attempt could not bear fruit due to the limitations put by Article 48 of the Kenya constitution.

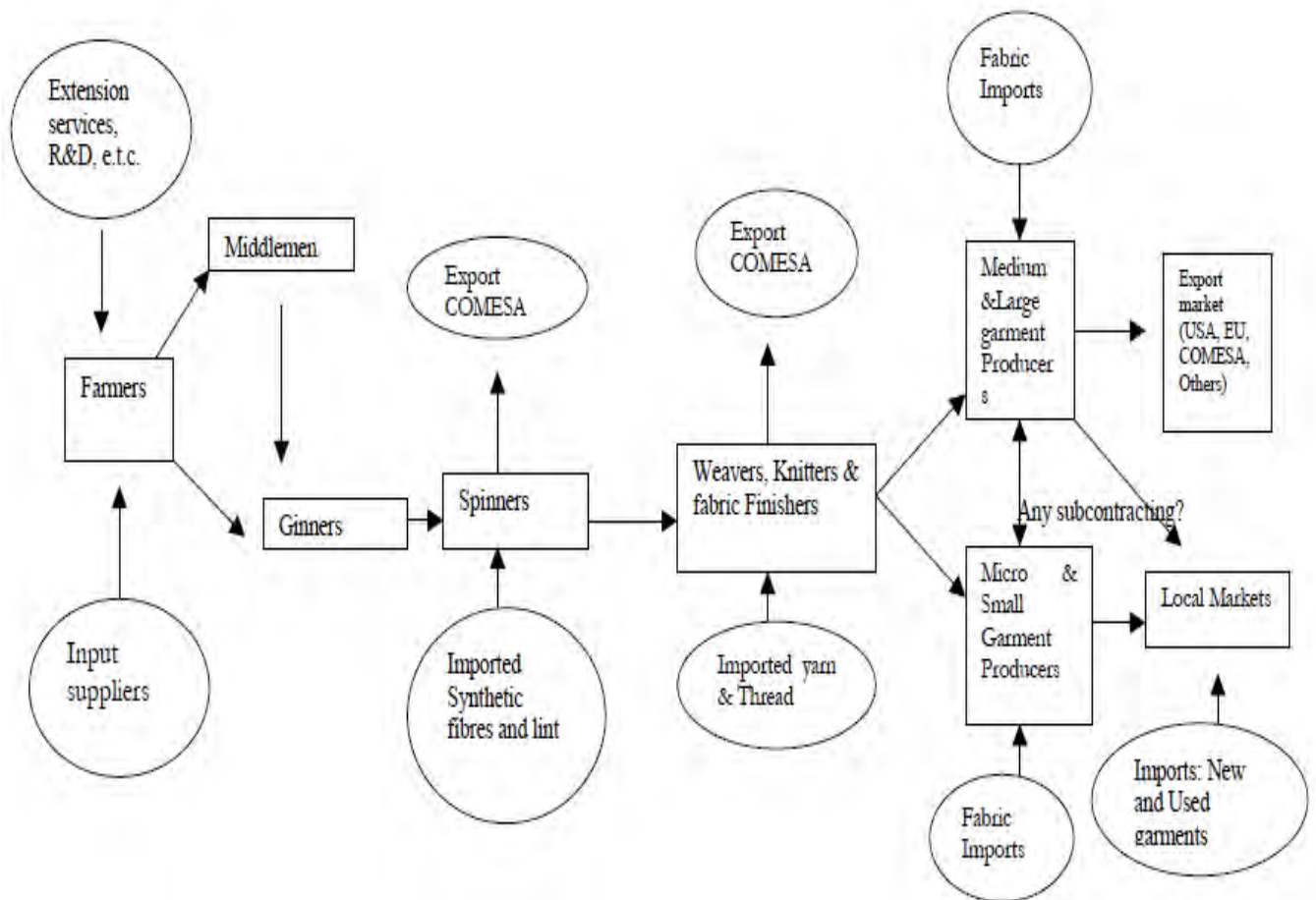
The industry will be financed from the Cotton Development Fund by availing credit to stakeholders in the value chain and grants for research in production and processing.

Public-private partnerships and contract arrangements will be encouraged in financing development of the sector.

4.7.1 Cotton-Textile Value Chain in Kenya

The textile and apparel value chain in Kenya links garment manufacturers, textile producers, gin operators as shown in *Figure 4.13*.

Figure 4.13: Kenya's Cotton-Textile Chain



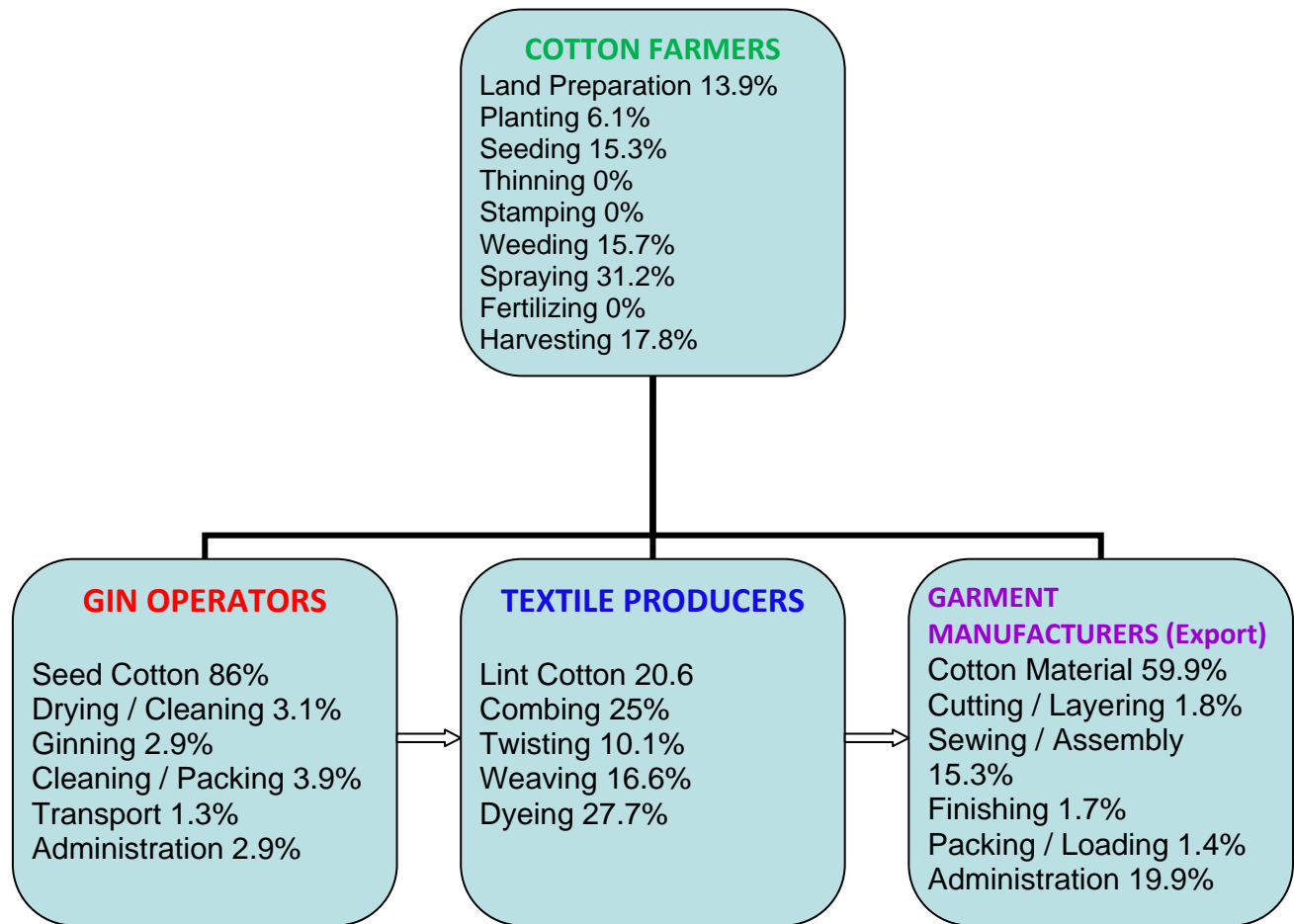
Source: KIPPRA Cotton/Textile Study, 2002

4.7.2 Cost structures along the cotton/Textile value chain

Cotton farming

This value chain begins with the cotton farmers. As demonstrated by the Kenya's Cotton farmers are not achieving their full potential as demonstrated by the low capacity utilization (40,000 hectares of 384,000 hectares under production) and production potential (25,000 bales of a potential 368,000 bales). Much of this low output can be attributed to a single overriding cost—imported agrochemicals. As evident in Figure (4.14), spraying makes up 31.2 percent of the value added in cotton farming, and agrochemicals account for 77.1 percent of that cost. Cost not only restricts the spraying frequency (currently the best smallholder farmer can afford five sprayings per season, whereas a robust cotton harvest requires twelve sprayings per season), but it also limits the ability of farmers to afford to invest in the labour costs for thinning, stamping, and fertilizing, which are important activities in crop maintenance.

Figure 4.14: Cost Structure in Cotton-Textile Chain



Adopted from Global Development Solutions, LLC with Modification in diagram

Ginning

The primary cost in ginning is occasioned by inefficiencies and high cost of maintenance. The cost of spare parts is 60 percent of the maintenance costs that impact both drying/cleaning and cleaning/packing activities. Thus, improvements and competition in cotton farming will likely play the largest role in reducing ginning costs.

Milling (Textile Producers)

Lint cotton, combing, and dyeing account for nearly 75 percent of the value added for the textiles link in the value chain. The changes to be covered in farming and ginning can contribute to reducing the cost of lint cotton. Thus, the focus here will be on combing and dyeing.

The cost of electricity once again dominates the inputs to these two processes. Electricity accounts for 24 percent of combing costs and 35 percent of dyeing costs. As stated in relation to the garments link, the high cost and low quality of electricity in Kenya is degrading competitiveness. A separate issue related to combing is the high cost of overhead. Financing costs account for nearly 50 percent of combing overhead costs.

Garment Manufacturing

Aside from input materials, the garment value chain is dominated by sewing/assembly and administration. Electricity accounts for about 20 percent of maintenance costs under sewing/assembly. The price per kilowatt-hour (kWh) in Kenya is \$0.15-\$0.18/kWh. This price is between 2.75 and 4.75 times higher than the price paid by manufacturers in South Africa, and between 1.5 and 2.7 times higher than in China.

Controlling electricity costs should be a top priority, because it would benefit firms in many sectors. Aside from electricity cost, the quality of electricity service is also an issue. Outages force companies to maintain parallel power supplies, adding to cost. Frequent blackouts damage or jam equipment, further adding to cost. A separate issue in the garment value chain is the high reject rate that contributes to administration costs. This high rate suggests that improved labour productivity, management practices, and cotton quality should receive some focus.

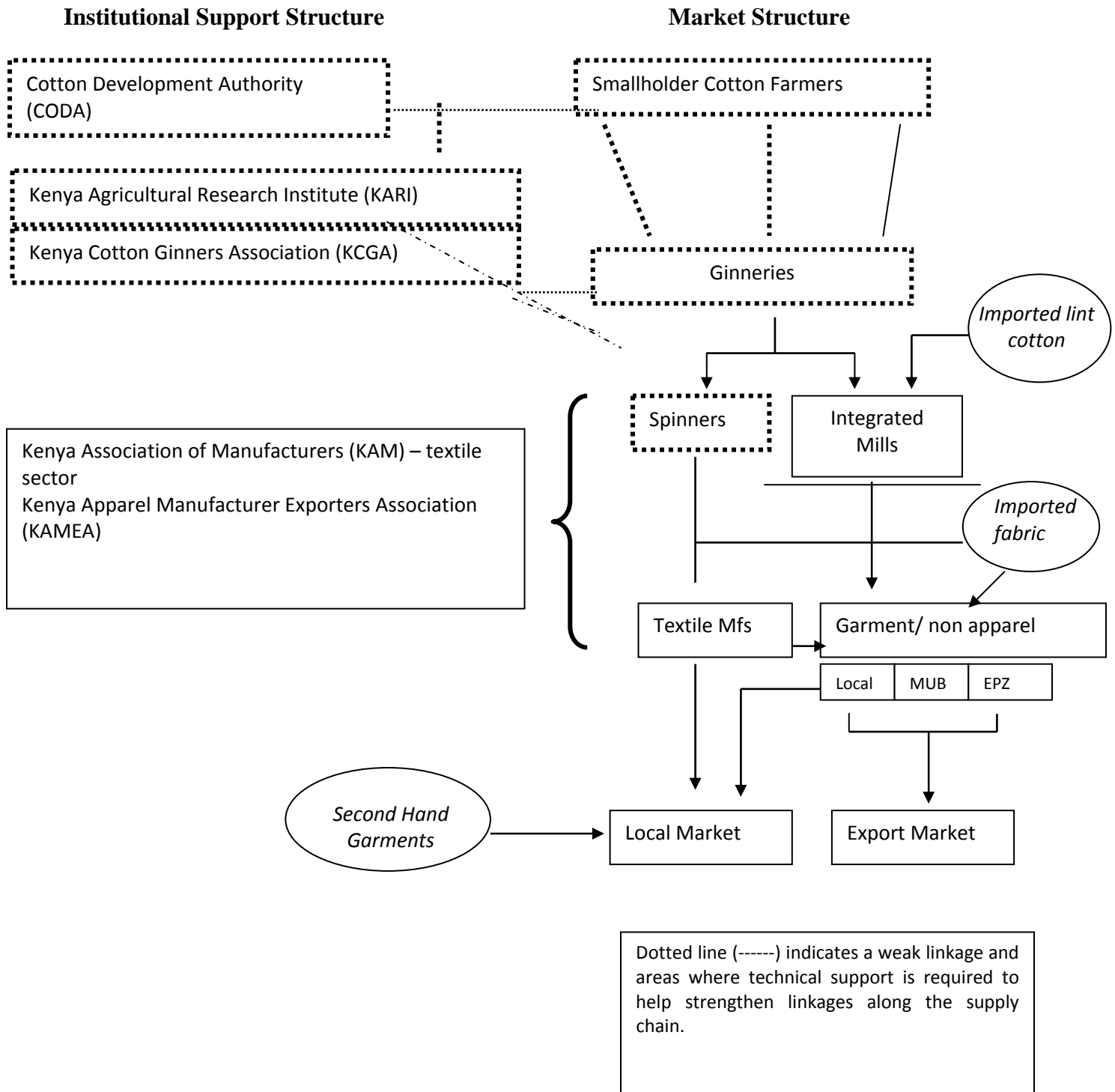
4.7.3 Institutional Framework

The government has undertaken a number of studies to evaluate the cotton/textile industry institutional framework. Kenya's cotton industry is manifested by lack of strong producer associations; weak or ineffective mechanism for overseeing critical issues such as quality seed production and distribution; provision of inputs to producers on credit; quality of such important inputs as pesticides and lack of extension services and limited extension services. Cotton farmers and small scale garment producers are weak in terms of institutions for lobbying. They lack broad representation and aggressive associations. In order to revitalize the cotton textile industry there is need for various stakeholders to form their respective organizations for lobbying purposes, realizing economies of scale and harnessing the synergies within the stakeholders.

The existing farmers' associations are bedevilled by governance problems with limited farmers' representation and participation. In addition the organization's operations have inadequate coordination mechanisms and structures to undertake the overall goal of revitalizing the cotton industry.

The Cotton (Amendment) Act, 2006 created Cotton Development Authority (CODA) which is the body charged with the mandate of regulating, coordinating, promoting and directing the cotton industry in Kenya. In the year 2008 the State Corporations Advisory Committee categorized the CODA as a regulatory State Corporation. However, the Act accords CODA both commercial and regulatory roles. This has resulted to conflict of mandate of the organization.

Figure 4.15: Cotton-to-Garment Market and Institutional Support Structure



Source: CODA

The Cotton (Amendment) Act, 2006, indicates that there are four categories of directors but only two have been mentioned, namely farmers and ginners. The textile manufacturers and exporters are not represented in the board which has brought about resentment in the higher value chain. Furthermore the composition and number of the Board of Directors need to be revised to reflect the regulatory mandate.

The Cotton (Amendment) Act, 2006 weakened the role of the inspectors greatly affecting their powers to effectively perform their regulatory mandate.

In order to revitalize the cotton/textile industry, there is need for various stakeholders to form their respective organizations for lobbying purposes, realizing economies of scale and harnessing the synergies within the stakeholders.

The stakeholders' organizations will be for farmers, ginners, textile manufacturers, other stakeholders and an apex body for all the organizations.

The following stakeholder organizations will serve the industry well:

a) Kenya Cotton Growers Cooperative Organization (KCGCO)

In order to enjoy economies of scale, access affordable credit and other services farmers will be encouraged to register as primary cooperative societies under Cooperative Societies Act.

Primary societies will come together and form a national cooperative society that shall be called Kenya Cotton Growers Cooperative Organization. (KCGCO)

The function of KCGCO will be to voice the concerns of the primary societies and source credit and other services for the primary societies.

b) Kenya Cotton Ginners Association

The functions of KCGA will be to develop and enforce code of conduct for members to support the development of the ginning sub-sector; source funding; facilitate access to information, technology and services; and promote contract farming.

c) Kenya Textile Millers Organization

KTMO will include spinners, textile manufacturers, weavers associations and exporters. The organization will lobby for conducive environment for local textile manufacturing, trade and promote utilization of modern, efficient and cost effective technology.

d) Kenya Cotton Development Agency

The Agency will be a limited liability company. The membership will be drawn from Kenya Cotton Growers Cooperative Organization, the Kenya Ginners Association, Textile Millers Organization and associations of other stakeholders in the industry.

The function of the organization will be to promote cotton growing, ginning and marketing in Kenya. The members would contribute equity to the establishment of this organization. This would allow farmers to benefit from cotton activities in the higher value chain.

e) **Kenya Parliamentary Cotton Group**

Cotton producing counties should have their own caucus groups in Parliament.

Challenges in the Institutional Frameworks

- Weak extension services –lead to reduction in output
- Weak governance linkages between farmers and other stakeholders in the chain impacts negatively on the farmer potentials (KIPPRA, 2005)
- There is also an arms-length relationship between farmers and input suppliers, thus resulting in cash transaction arrangements, unlike.....the tea/coffee sector where intermediary institutions supply inputs and costs are deducted at end of season when the crop has been marketed
- Very limited outreach and advisory services from the input suppliers.. However, the ginneries are increasingly supporting farmers with pesticide inputs recordable at the point of seed cotton sale. To a limited extent also they have started providing extension services
- The agro-chemical suppliers themselves lack knowledge on input usage (KIPPRA, 2005)
- The SAPs disrupted the governance structures, weakening the producer voice in the process (KIPPRA, 2005). The emergent private sector was ill equipped to handle the value chain. Quality control mechanisms ceased to operate , compromising product quality
- Uncertainty from global pricing arrangements

4.7.4 Legal and Regulatory Environment for Arbitration

Currently there is no dispute resolution mechanism for the industry players which is self-regulated. Therefore the stakeholders are only left with the option of taking their disputes to the courts of law which take a lot of time to resolve the disputes. In addition the process is expensive to the parties involved.

The Authority recognizes the benefits that can be derived from strong linkages of the value chain players. Due to the fact that industry disputes adjudicated in the Courts of Law are expensive to the parties involved and take long to be resolved, it is therefore important that an alternative dispute resolution mechanism be adopted, thus CODA will encourage stakeholders to resort to arbitration.

The legal and regulatory environment governed from the Ministries of agriculture, trade, industry and a host of regulatory bodies.

- Official harassment directed at SMEs
- Fragmented business systems not conducive to business
- Lack of power access especially in SMEs
- High cost business logistics
- Weak enforcement of tariff regimes/duties

4.7.5 Manufacture

The mills are particularly challenged at this point in time. KTMO is moribund and should be re-activated and strengthened to embrace the MSEs in the sector. .

4.7.6 Marketing

The country embraced liberalization policy in the 1990's which led to the withdrawal of the government from performing marketing functions. The private sector was not adequately prepared to perform this task. This created an inefficient marketing chain leading to low producer prices and high costs of production.

The marketing function was not adequately addressed in the Cotton (Amendment) Act, 2006. The main issues that affect marketing of cotton and cotton products are:

- The legal framework governing the sector does not cover the whole cotton-textile value chain
- Lack of well-organized producer organizations/associations with necessary structures to deliver on their mandates
- Low quality fabrics produced by local textile manufacturers
- Inadequate market information, research and promotion leading to overreliance on traditional market
- Influx of unregulated imported subsidized and cheap textile products flooding the local market greatly distorting the price of Kenyan textile products and leading closure of textile mills;

Proposed Interventions

To stimulate investments in the cotton sector incentive schemes need to be developed. This is to mitigate against the high capital investments required in the cotton-textile sector (differentiated power tariffs, rebates in investments, incubation programmes, levies).

Farmers and other stakeholders will be encouraged to form a Cotton Development Agency to undertake the functions of processing, input supply, governance and marketing.

Other interventions are:

- Strengthen linkages between local fashion designers and weavers to the textile manufacturers so that the right quality and quantity of yarns and fabrics are produced to address the changing consumer tastes and preferences.
- Support the weavers and fashion designers to form strong groups.
- The industry should be supported to promote textile products locally and internationally; enforce a ban on unhygienic used clothes and under garments; and strengthen surveillance on undeclared and under-declared imports.
- In order to improve the quality of fabrics produced by the local textile mills franchising strategy with well performing international entities will be encouraged. This will in addition improve market access in different markets.

4.8 Alignment of policy environments with sector performance

Liberalization and Globalization

The provisions relating to production, processing and marketing of cotton did not take into account the liberalization arrangement. The liberalization was done in haste without taking into account the capacity of stakeholder organizations to take over the functions of the defunct Cotton Board of Kenya. A number of reforms have been undertaken to align legal and policy environments. These include:

AFFA ACT 2012-AN ACT of Parliament provides for the establishment of AFF Authority to make provisions for the roles of the National and county Governments. The Authority is expected to establish directorates for each produce such as cotton to enable the carrying out of any specialized activities with respect to the promotion or management of that produce. Each directorate shall have such Autonomy to enable it discharge professional mandate including representing Kenya to meet relevant International obligations.

CROP ACT 2012-AN ACT of Parliament to consolidate and repeal various statutes relating to crops; to provide for the growth and development of agricultural crops and for connected purposes.

The objective of this Act is to accelerate the growth and development of agriculture in general, enhance productivity and incomes of farmers and the rural population, improve investment climate and efficiency of agribusiness and develop agricultural crops as export crops that will augment the foreign exchange earnings of the country, through promotion of the production, processing, marketing, and distribution of crops in suitable areas of the country.

There is to be established a Fund to be known as the Commodities Fund.

The Fund shall be used to provide sustainable affordable credit and advances to farmers for all or any of the following purposes—

- a) farm improvement;
- b) farm inputs;
- c) farming operations;
- d) price stabilization; and
- e) any other lawful purpose approved by the Authority.

The Authority may, in accordance with rules and regulations made under this Act and subject to any other law, put in place programmes for ensuring the provision of the following incentives and facilities to growers and dealers of scheduled crops —

- a) credit assistance including provision of equipment for land preparation and other non-monetary assistance;
- b) credit guarantee;
- c) affordable farm-inputs including quality seeds, planting materials and market linkage;
- d) technical support including research and extension services;

- e) infrastructural support including physical infrastructure development, financial and market information;
- f) fertilizer cost-reduction investment projects including private sector involvement in fertilizer importation and distribution, promoting local fertilizer blending and initiating establishment of national or county fertilizer manufacturing plants;

4.9 Business Environment

- From an assured domestic market to a globalised business environment calling for specialised products to meet niche market demands
- Outsourcing mechanisms under AGOA- dictated by buyers
- Dominance of global suppliers and buyers
- Local manufacturers have a preference with a wholly integrated production system (KIPPRA, 2005)
- IT based marketing platform is out of reach for the lower segments of the value chain
- Implications of political and economic stability to attract investors
- Global incentives e.g. AGOA, GSP, regionalization
- Value chain does not exist in Kenya since liberalization. In the case of AGOA, the last segment is interconnected to the buyer thru EPZ
- Lack of aggressiveness from the representing associations
- Lack of competitive in every segment of the chain

4.10 Government Procurement Policy

Procurement of government orders locally is also very minimal. By gaining this market share, the Kenyan textile manufacturer can expand to the extent of employing over 100,000 people, compared to the 2,000 people employed currently. In the past it used to employ over 100,000 people.

While interviewing the security arms of government, it was established that tenders are floated locally. However, those winning the contracts end up making the uniforms using mainly Chinese fabrics. The same applies to the armed forces and hospitals. Thus there is still need to review the public sector procurement policy. The current 15% preferential treatment has not impacted positively on the textile and made up garments sector. There are arrangements to increase this to 30% in order to strengthen local sourcing. However, in absence of the possibility of flexibility in fiscal support and extension of subsidies to the sector this point in time, the preferred policy support would be that of government procuring of uniforms, hospital linen among others from local firms. The impact of this local sourcing has been estimated through an estimate of fabric requirements on annual basis.

Fabric requirements:

Using conservative estimates as presented in Table, uniform and linen requirements in government hospital amount to 2,024,626 running metres. Again on basis of conservative estimates, the government budgets in excess of 3.5 billion to purchase the uniforms.

Table 4.8: Local procurement of uniforms for security forces and hospital linen, 2012

	Numbers	No of uniforms/sheets & gowns	Running metres per person/bed	Total running metres	Budget allocations per person	Resources set aside
Police	54,000	2	10	540,000	25,000	135,000,000
Military	30,000	3	15	450,000	45,000	1,350,000,000
Prison Staff	22,000	2	10	220,000	20,000	440,000,000
Prisoners	52,000	2	6	312,000	10,000	520,000,000
Hospital beds	52,908	4 pairs + Gown	9.5	502,626	2,200	1,105,777,200
Total 1				2,024,626		3,550,777,200
EPZ requirements						12,462 ⁹
Total 2						

The EPZs continue to purchase all their fabric requirements from outside Kenya.

Table 4.9: Cotton Requirements

	Running metres	Converted to cotton lint ¹⁰ kg	Hectares (assume 600 kg per hectare)	No. of Farmers (Assume 0.4 Ha per farmer)
Local procurement for security and hospitals	2,024,626	506,156.5	2530.	6,325
Serving EPZs	85,000,000	21,250,000	106,250	265,625

(a) Local Procurement for security forces and hospitals

Ginning:

Assume 50 employees produce 12 tons of lint

$$(506.156.5/12)50 = 2100$$

Mill

$$400,000m^2 = 600 \text{ workers}$$

$$(2,024,626/400,000)600 = 3,036$$

Garment Manufacture:

$$(2,024,626/(1.5 \times 430)) = 3139$$

⁹Average raw material values in Kshs millions for EPZs

¹⁰4m² = 1kg yyearn=3kg seed cotton

(b) EPZs

Ginning

Assume 50 employees produce 12 tons of lint

$$(21,250.000/12)50 = 88,541$$

Mill

$$(85,000,000/400,000)600 = 127,500$$

Garment manufacture¹¹

$$\text{Average pcs} = 85,000,000/1.5 = 57,000,000$$

Assume 600,000 pcs requires 1400 workers

$$\text{Employees required in EPZ} = 57,000,000/430 = 133,000$$

¹¹600,000 pcs require s 1400 workers

5.0 STAKEHOLDER VIEWS

5.1 Coverage

The stakeholder views were obtained from ...respondents across the value chain

S. No.	Organization	Cotton Production	Ginning	Spinning	Weaving / knitting & processing	Garmenting / Made ups	Support Institute
Farmer Groups							
1	Asego farmers	✓					
2	Nambale Cooperative	✓	✓				
3	Malindi Farmers	✓					
4	Kilifi Farmers	✓					
5	Ndeere Farmers	✓	✓				
Ginners							
6	Kitui Ginneries		✓				
7	Nyanza Ginneries		✓				
8	Malindi Ginneries		✓				
9	Ndeere Ginneries		✓				
Manufacturing							
10	Alpha knits			✓	✓	✓	
11	Thika Cloth Mills			✓	✓	✓	
12	Rupa Cotton Mills			✓	✓	✓	
13	Royal Garments					✓	

S. No.	Organization	Cotton Production	Ginning	Spinning	Weaving / knitting & processing	Garmenting / Made ups	Support Institute
14	Newwide Garments					✓	
15	blackberry					✓	
16	Kicomi *			✓	✓	✓	
17	Rivatex			✓	✓	✓	
18	Ken Knit			✓	✓	✓	
19	Sunflag						
220	TSS						
221	Specialized Towels		✓	✓	✓		
22	Fine Spinners		✓				
23	Spinners & Spinners		✓	✓	✓		
24	Kapric				✓		
25	Ashton				✓		
26	Senior Best				✓		
27	Hantex				✓		
28	Kenya Shirts				✓		
29	Top Fit Drapers				✓		
30	Sheikh Uniforms				✓		
31	Bedi Investments		✓	✓			
32	Londra *		✓	✓	✓		
33	Mega Spin		✓	✓	✓		

S. No.	Organization	Cotton Production	Ginning	Spinning	Weaving / knitting & processing	Garmenting / Made ups	Support Institute
34	Spin Knit		✓	✓	✓		
35	Nakuru Industries		✓	✓	✓		
36	Sirbrook		✓	✓	✓		
37	Kenya weaver Bird			✓			
38	Masai Villa weavers			✓			
Fashion Designers							
R&D							
22	KARI	✓					✓
23	KIRDI					✓	
Policy							
	Ministry of Trade						✓
	Min of Industrialization						✓
	Min of Agriculture						✓
	KIPPRA						✓
Trade and Investment Promotion							
	EPZA						✓
	EPC						✓

S. No.	Organization	Cotton Production	Ginning	Spinning	Weaving / knitting & processing	Garmenting / Made ups	Support Institute
	KenInvest						✓
	Capacity building						
	Kenyatta University						✓
	Moi University						✓
	Nairobi University						✓

*closed

5.2 Challenges across the Value Chain

The challenges are summarized for each stage of the value chain:

5.2.1 Cotton Farming

- a) High input costs, mainly pesticides that take up 35% to 57% producers overheads.
- b) Poor farm yields because of:
 - Unawareness about best agriculture practices
 - Dependency on rainfall and unreliable rainfall pattern- 600-1800 mm
 - Smaller land holdings
 - Issue of contaminated seeds
 - Lack of use of proper tools & equipment
 - Sub optimal application of fertilizers and pesticides
- c) Sales and Marketing challenge
 - Poor and unpredictable prices
 - Delayed and irregular payments to farmers
- d) Others
 - Lack of certified seed supplier
 - Lack of business management& organization skills.
 - Insufficient availability of information about market prices, weather and knowledge of crop, farm management and fiber handling practices.
 - Low penetration level of extension services.
 - High cost of borrowing

5.2.2 Ginning

- a) Use of old technology (inefficient, frequent breakages and lack of spares parts)
- b) Short supply of cottonseed
- c) High cost of power
- d) Low ginning outturn
- e) High operational costs arising from operational inefficiencies
- f) Low level of ginnery maintenance and ineptitude of the operators,
- g) Farmer owned ginneries suffer from inadequate working capital and weak management
- h) Low buyer demand

5.2.3 Textile and Apparel manufacturing (Spinning, Weaving, Knitting, Processing, Garment and Made-up manufacturing)

- a) High cost of manufacturing, particularly because of high power and manpower cost
- b) Usage of obsolete technology
- c) Threat from very cheap imported products
- d) Unavailability of skilled manpower
- e) Low domestic demand because of high penetration of second hand clothing
- f) Unavailability of finance for technology upgrading or expansion or working capital
- g) High rate of interest
- h) Lack of awareness about niche markets
- i) Unavailability of sufficient cotton from within country
- j) Missing links and disproportionate capacities across the chain

5.2.4 Academic and training Institutions

- a) Insufficient infrastructure facilities: The current infrastructure provides for very few institutes with limited capacities and enrolments.
- b) Outdated course curriculum not in line with industry requirement
- c) Low level of engagement with the industry-
- d) Lack of international collaboration
- e) Low manpower skill level & high cost to employ ex-pats
- f) Low student interest
- g) Low fund allocation for cotton research activities along with several restrictions and delays

5.2.5 Support Institutions

- a) Marketing and Promotion
- b) Investment
- c) Legal framework

The cotton sector is governed by the Cotton Act Cap. 335, the Cotton (Amendment) Act, 2006, the Cotton (General) Regulations, 2007 and the Cotton (Elections and Nominations) rules and regulations, 2007.

- d) Capacity constraints including inadequate curricula
- e) Business environment

5.2.6 Markets

- a) Low sourcing by Government from local suppliers
- b) Second hand clothing
- c) Porous borders
- d) Lack of consolidated marketing effort for sector as a whole

6.0 BENCHMARKING WITH INTERNATIONAL BEST PRACTICES

6.1 Current Status of Global Textile Trade and Major Exporters across the globe

The global trade in textiles and apparel was ~US\$ 680 billion in 2012 growing at a rate of 5% per annum since 2005 which is approximately 4.5% of the trade of all commodities estimated at ~ US\$ 15 trillion. With the shift in the production and consumption centres, Asian countries have become the prominent exporters while developed countries have become the major importers.

Major exporters across the globe include:

International Exporters

- India
- China
- Bangladesh
- Vietnam
- Turkey

Regional Exporters

- Uganda
- Tanzania
- Ethiopia

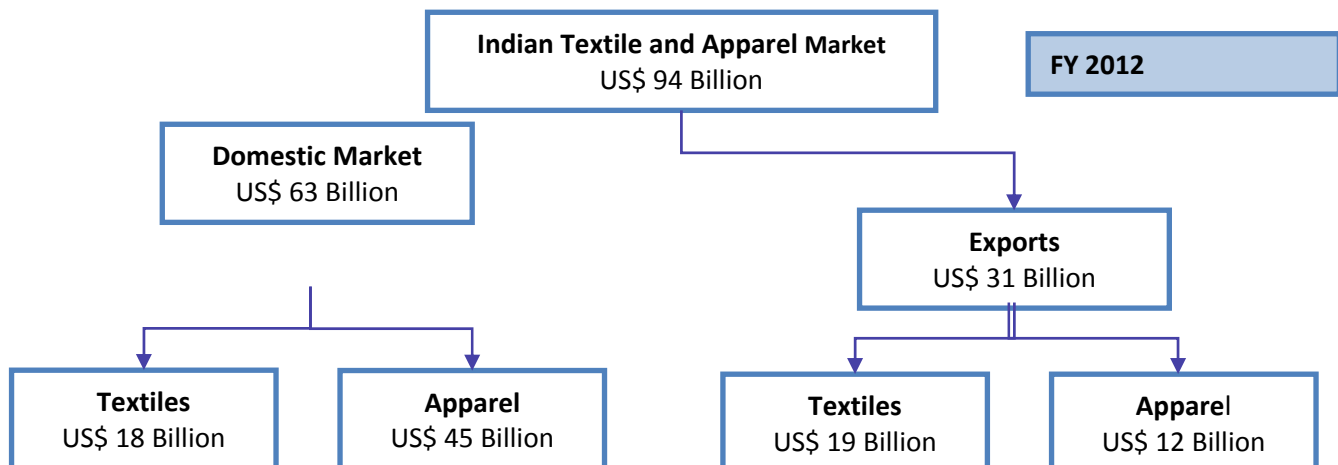
6.2 Trade Policies of the Major Exporters and its Impact

6.2.1 India

The Indian textile and apparel industry is estimated at ~US\$ 94 billion, having grown at a CAGR of ~12% over the last 5 years.

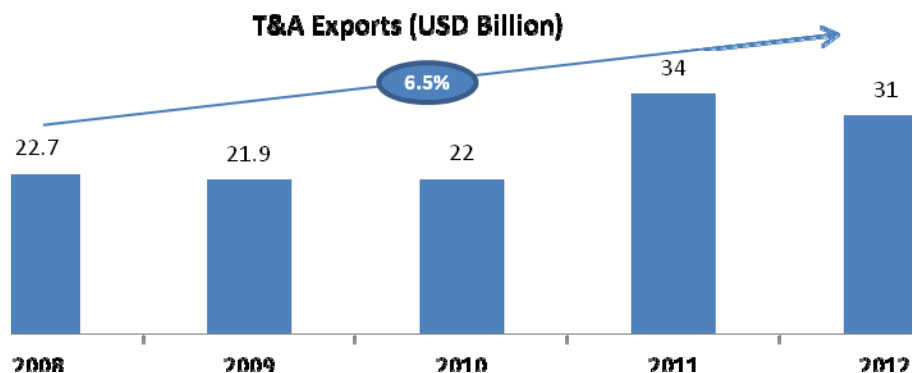
The Indian textile industry is extremely varied, with the hand-spun and hand-woven sector at one end of the spectrum, and the capital intensive, sophisticated mill sector at the other. The decentralized power looms/hosiery and knitting sectors form the largest sections of the textile sector. The close linkage of the Industry to agriculture and the ancient culture, and traditions of the country make the Indian textiles sector unique in comparison with the textile industry of other countries.

Figure 6.1: Indian Textile and Apparel Market, 2012



India has been a consistent net exporter in the T&A sector, with net exports amounting to ~ US\$ 31 billion in 2012. The exports majorly include Women suits, jacket and linen with USA being the main exporting destination.

Fig 6.2: Performance of the Indian Textile and Apparel Market 2008-2012



Policy Initiatives

Technology Up-gradation Fund Scheme

Scheme launched in 1999 to provide firms access to low interest loans for technology up-gradation and setting up new units with state-of-art technology.

Foreign Trade Policy

Up to 100% foreign direct investment is allowed in textile and apparel manufacturing industry under automatic route. So, there is no requirement of any pre-approval by the investor. Companies are free to set up fully-owned sourcing (liaison) offices, as well as marketing operations.

The Government is pursuing a multi-pronged action to increase exports, including introduction of stimulus package consisting of taxes, duties and interest rebates, enhanced incentives under various schemes of the Foreign Trade Policy (2009-14) to various lines of textiles and clothing (T&C) products and mounting of mega shows abroad to enhance exposure to the diverse range and capacities of India’s T&C industry.

Upgrading infrastructure

“Scheme for Integrated Textile Parks” (SITP) was launched in 2005, based on public-private partnership model to build world class infrastructure facilities. Forty parks have been sanctioned till date in nine states with total project cost of about US\$ 750 million with Government contribution of US\$ 260 million. When fully functional the parks would have an investment of US\$ 3.5 billion and provide employment to ~ 1 million persons.

Taking into account the success of the Scheme, the Government has approved sanction of new Parks during the 11th Plan with a financial liability of US\$ 37 million and given permission to carry forward liability of these new Parks into the 12th Plan up to US\$ 37 million.

Product specific “Cluster Approach” targeting development of 100 additional clusters in textiles Technology Mission on Cotton (TMC), focusing on cotton R&D, dissemination of technology to farmers, improvement of market infrastructure and modernisation of ginning and pressing sector In order to give a big push to the technical textiles industry, the Government has launched a Technology Mission on Technical Textiles (TMTT) with an outlay of US\$ 37 million for the next 5 years. TMTT aims at establishing new Centres of Excellence (COEs) in the field of technical textiles and providing support for the development of the domestic and export market for technical textiles.

Skill development

In the line with the Policy Announcement of the Government, the Government launched the Integrated Skill Development Scheme for the Textiles & Apparel Sector, including Jute & Handicrafts, with an objective of capacity building of Institutions providing skill development & training in Textiles Sector.

The scheme proposes to leverage on the existing infrastructure and schemes by up-gradation/enhancement/deepening of the institutional structure. It is intended to impart employable skills in different segments (textiles, apparel, handlooms, handicrafts, sericulture, jute etc.) in two components, viz. (i) Skill development by augmenting and strengthening the capacity of institutions and schemes under the Ministry of Textiles; and (ii) The PPP Module- Skill Development in partnership with the Private Sector.

Under this Scheme, the Government has envisaged skill development of 0.3 million persons with an overall cost of US\$ 50 million over the next five years.

Under the Scheme, the Ministry has approved 8 capacity building projects in respect of ATDC, NITRA, ATIRA, BTRA etc. under component-I of the Scheme. Under component-II, Ministry has engaged consultant for designing the modalities and matters under which, the private/ seal initiatives would be harnessed.

Trade facilitation

Export Promotion of Capital Goods (EPCG) scheme, which allows import of capital goods for pre-production, production and post-production at 3% Customs duty subject to an export obligation equivalent to 8 times of duty saved on capital goods imported to be fulfilled over a period of 8 years reckoned from the date of issuance of the authorisation.

Duty Entitlement Pass Book scheme (DEPB), which neutralises the incidence of Customs duty on the import content of the export product. The neutralisation shall be provided by way of grant of duty

credit against the export product. Under the DEPB, an exporter may apply for credit, as a specified percentage of FOB value of exports, made in freely convertible currency.

100% Export Oriented Units (EOUs)/Special Economic Zones (SEZ): The Government announced facility of refund of service tax paid on all input services, irrespective of whether they are consumed inside or outside the zone, to Special Economic Zones (SEZ) units and developers.

Apart from the national textile policy, different states in India have also come up with their own textile policies to further enhance the growth of T & A sector in the country.

Some of the state-level textile policies are-

Gujarat Textile Policy

Salient Features

- 1) **Interest subsidy** for
 - a) New enterprises / expansion/ diversification / modernization of existing enterprises
 - b) Second hand imported machinery
 - For spinning and technical textiles having 10 yrs vintage with residual life of min. 10 years to the extent of 60% of acquisition value (<50% of value of new imported machinery) of imported machinery
 - For weaving having 10 yrs vintage with residual life of min. 10 years
 - c) The support against the second hand imported machineries will be given only after successful operation of the machineries for six months period after commissioning by the enterprise.
 - d) Machineries should be under TUFs or as decided by State Level Approval Committee (SLAC)

Policy Brief

Credit linked interest subsidy of

- Max 5% per annum
 - Max 7% : for spinning unit and garment/made-ups unit
 - Max 6% for technical textiles
 - In addition to other incentives available from other schemes of GOI
 - For 5 years or for the period of repayment of loan whichever is earlier
- 2) Power tariff subsidy @ US\$ 0.02 per unit in the billed amount for 5 years for
 - a) New enterprises / expansion/ diversification / modernization of existing enterprises of cotton spinning and weaving units
 - b) Units with second hand eligible imported machinery for cotton spinning & weaving
 - c) Units who purchase electricity only from the state electricity / power distribution licensee
 - 3) Assured supply of lignite by supply agreement with GMDC for 5 years for units having captive power plant

- 4) Refund of VAT (Concession available within 8 years from the date of the production) for Intermediate product/raw material except certain goods/transactions which are not eligibility for tax credit under The Gujarat VAT Act, 2003
- 5) Remission of tax (Concession available within 8 years from the date of the production) for End/intermediate product within entire value chain to the extent of 100% of the eligible fixed capital investments in plant & machinery made within 1year (2 years in case of investment > US\$ 90 million) from the date of production or during the operative period of the scheme whichever is earlier
- 6) Financial Assistance for Energy Conservation, Water Conservation & Environmental Compliance
 - Existing units having in operation for more than three years
 - Enterprises will be eligible once in 2 years of operating period of the scheme

Policy Brief

Financial Assistance up to

- Up to 50%, Max USD 910 for audit
 - Up to 20% of cost of equipments, Max US\$ 36,300
- 7) Financial Assistance up to 50% of the investment for technology acquisition / collaboration, with maximum of US\$ 45,500 per process/product once during operative period of the scheme for technology acquisition up gradation.
 - Enterprise acquiring the technology for the first time – in any form including purchase of drawing and designing and technology development through engaging experts/R&D institutions and/or technical consultancy firm.
 - 8) Financial assistance up to 85%, with ceiling of max of US\$ 0.5 million of project cost covering fixed capital investment in building, equipment & machinery (incl. installation cost), furniture, electrification & others excluding land cost for setting up new Apparel Training institutions
 - Maximum 25% cost of Machineries and Training Equipments will be eligible to consider for Infrastructure including Building.
 - 50% of the candidates undergoing training are expected to clear the examination
 - 9) Financial assistance at 50%, subject to a limit of US\$ 36,300 per centre of their investment for new training centres
 - 10) Financial Assistance for Training to Trainers
 - Apparel training institutions/centres approved by State Level Committee
 - Training period should not be more than 3 weeks

Policy Brief

- Reimbursement of training cost with max. limit of US\$ 130 per trainer
- 100% reimbursement – trainers attending autonomous institutions promoted by Govt./PSUs else 50%

- 11) Financial assistance up to 50%, with maximum limit of US\$ 1.8 million (US\$ 5.5 million for Spinning park) of total project cost for establishing Textile & Apparel Park
- Provision for location of min. 20 numbers of manufacturing/service enterprises
 - Provision for the location of min. 10 numbers of spinning units with min. 150 acres of land; besides, up to 35% of land may be utilized for weaving activities
 - Construction should be completed within 3 years
 - Developer should hold 20% equity, operate & maintain the park
 - Should have internal roads, water distribution network, drainage facilities, effluent treatment, power distribution network and other facilities.
 - Stamp Duty exemption on purchase of land for new Textile Parks

Maharashtra Textile Policy

1. Capital subsidy for new textile projects sanctioned and set up under TUF scheme in Vidharbha, Marathwada and North Maharashtra.

Policy Brief

- 10% capital subsidy on eligible capital investment to new projects
 - Not applicable to projects of modernization/ expansion of existing textile units
 - Period: From the date of issuing this Government Resolution till 31.3.2017
2. Capital subsidy of 9% capital subsidy up to US\$ 1.6 million in addition to GoI support for Textile Parks
 3. Interest subsidy for
 - Private and cooperative projects sanctioned on or before 1.4.2011 under Centrally sponsored TUFs excluding jute industry
 - New textile units as well as modernization/ expansion/ rehabilitation of existing textile units in the state

Policy Brief

- Interest subsidy on long term loans admissible for the purpose of the interest scheme under centrally sponsored TUFs.
- **Applicable Rate** - minimum of 12.5% or banks' prime lending rate or rate of interest actually charged, whichever is less
- **Period of Reimbursement:** 7 years included 2 years of moratorium
- Units to be charged either 0% or 2% effective rate of interest

Box 6.1: Applicable Interest rates for Maharashtra Textile Sector

0% Interest Rate	2% Interest Rate
All eligible textile units in Vidharbha, Marathwada, North Maharashtra, Konkan and D+ industrial areas	Private cotton Mills in areas other than Vidharbha, Marathwada, North Maharashtra, Konkan and D+ industrial areas
Garmenting in the entire state	-
New power loom industries based on modern technology in whole state	Private processing units
Modernization of power looms in the whole state	Private knitting units
All types of silk projects in state	-
All eligible textile units in the cooperative sector	All other eligible private textile units

6.2.2 China

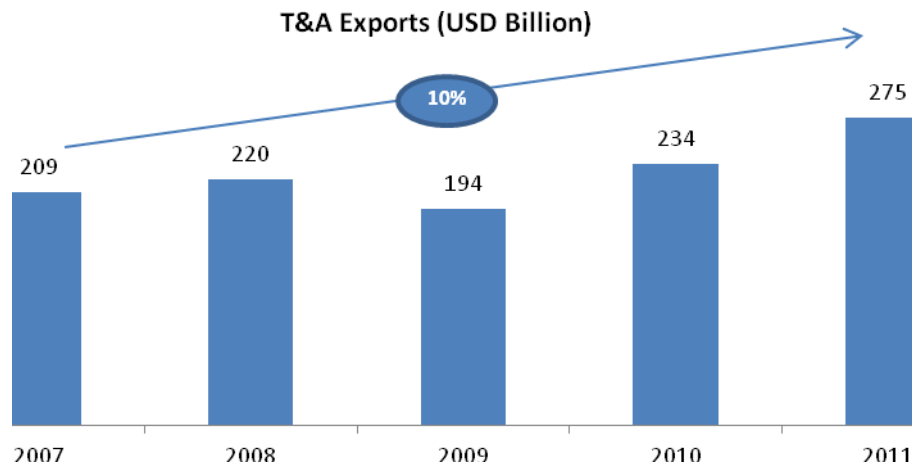
China has the largest textile and garment industry in the world. The industry has ~55,000 sizable enterprises employing ~11 million workers across the country.

China's domestic market is becoming increasingly active, playing a significant role in the textile and garment industry. It serves as the major factor stimulating the growth of production, sales and exports of the China textile industry. China's economy is gearing up to change its growth model from an export driven economy to the one driven by domestic demand by boosting consumption at home.

The garment industry is one of the most prominent industries in clusterisation among all sectors in China. There are ~100 major textile and apparel clusters and each cluster/region specialises in producing one or more products. Through optimal allocation of resources, industry clusters have achieved a cost-saving and regional-scale effect. The strong competitive advantage comes from the support of an integrated industry chain. The upstream firms offer sufficient production capacity of cotton, hemp, wool, silk and other fabrics as well as variety of accessories and auxiliaries, while the downstream companies provide adequate financial & logistics services and IT technology widely applied throughout the industry chain.

Chinese exports have seen a steady growth at the rate of 10% over the 5 year period from 2007 to 2011. In 2011, the exports stood at US\$ 275 billion. China has always remained the largest exporter of T & A to markets including USA, Japan, Hong Kong etc. The product categories for export mainly include knitted jersey, pullover, women suits and jackets.

Figure 6.3: Performance of the Chinese Textile and Apparel Industry, 2007-2011



Policy Initiatives

Trade Promotion Fund for Agriculture, Light Industry and Textile Products

This fund is established to enhance the export quality and competitiveness of these industries. The fund created platforms to serve export oriented textile companies by providing technologies and equipment required in R&D, product design, quality control, and product testing.

The fund is utilized as follows:

- To support technology innovation and restructuring in the textile industry and facilitate the shift to the new growth mode in foreign trade.
- To provide lump sum direct grants to projects of technology innovation, development and industrialization of core technologies and equipment, establishment of innovation services platforms, and brand development and promotion.
- To support the establishment of overseas textile industrial parks, providing a favourable environment for textile companies in the course of “going global.”
- To provide loan interest subsidies for the construction of overseas textile industrial parks.
- To subsidize the provision of land, manufacturing facilities, infrastructure and services in overseas textile industrial parks.
- To support textile companies in “going global” through overseas investment and diversifying their products origin through overseas manufacturing.
- To subsidize the expenses of Chinese textile companies incurred in early stages of “going global” that may involve R&D, consulting services, feasibility study and project evaluation, and intellectual property rights protection.
- To subsidize the expenses of Chinese textile companies in the establishment of distribution channels in overseas markets.
- To support service companies and dragonhead textile companies in the organization of “going global” activities.

Tax Incentives Provided by the Central Government

The Central Government provides various tax incentives to textiles and apparel companies that are designed to support brand promotion efforts, stimulate technology innovation and encourage both domestic and foreign investment. Major types of benefits include income tax deductions and reductions, and refunds of import tariff and value-added taxes (VAT).

The Special Fund for Brand Development

The fund should serve the following purposes:

- To support companies in implementation of brand development programs.
- To support companies in participation of national and international exhibitions.
- To support brand promotion activities.
- To support international exchanges, trainings and seminars related to brand building.
- To support other public services that facilitates brand building.

Grants for corporate development projects provided to textile and apparel companies with brand names that are awarded with the titles of “Export Brand Names with Priority Support from the Ministry of Commerce” and “The Most Competitive Brand Names”:

- To subsidize the exhibition and shipping expenses for major trade fairs organized by the Ministry of Commerce and the provincial government.
- To subsidize the expenses for the establishment of R&D centres of export brand names recognized by the provincial government or agencies of a higher level.
- To subsidize the certification fees for quality and environmental management systems and the testing fees for product certification.
- To subsidize the expenses for the opening of boutique stores and after sales branches in overseas markets.
- To subsidize the expenses for trademark registration and patent application in overseas markets, and the legal expenses for dealing with intellectual property rights infringement cases.
- To subsidize the expenses for acquiring foreign well-known brand names.
- To subsidize the expenses for advertising via major media in domestic and overseas markets.

Grants for public services projects provided to intermediaries and service companies:

- To subsidize the expenses for promoting and advertising brand names in domestic and international trade fairs and exhibitions.
- To subsidize the expenses for coordinating the participation of companies in domestic and international trade fairs.
- To subsidize the expenses for preparing and distributing advertising materials.
- To subsidize the expenses for brand development planning, exchange programs, seminars, research, and training.
- To subsidize the expenses for the development and maintenance of export brand names network that provides information services to companies.
- To subsidize the expenses for brand appraisal.

- To subsidize the expenses for other public services that facilitates brand development.

Support Programs of Provincial and Local Governments

At the sub-central governments, there is an array of benefits available to textiles and apparel companies, including monetary awards, loan interest subsidies, preferential treatment in land use and energy use, and tax incentives.

Monetary Awards to Textiles and Apparel Companies Contingent upon Export Performance and Brand Development

Many local governments provide monetary incentives to boost textiles and apparel exports and encourage brand building. The following reviews such incentives adopted in three municipalities that are at the forefront of the textiles and apparel industry in China.

Loan Interest Subsidies for Technology Renovation

Another major type of incentive offered to the textiles and apparel industry at the provincial and local level is loan interest subsidies for technology renovation. Provincial and municipal governments administer a fund used to subsidize loan interest for upgrading technologies and equipment across a range of key industries.

Incentives Provided by Local Textile Industrial Parks

- a) To boost local competitiveness, many provincial and local governments have established textile industrial parks where various preferential policies are adopted to attract both domestic and foreign investment.
- b) Incentives provided to investors include tax benefits (refund of income tax in full for the next 5 years), preferential treatment in land use (waiver of land leasing fee for 20 years), preferential treatment in administrative fees (waiver of administrative fees during the construction period and within 5 years of operation)

Export Incentive Program (Ningbo City's Jiangdong District Export Contingent Award for Increasing Exports of Textiles and Apparel Goods).

Specific A program in Ningbo City's Jiangdong District offers benefits to certain textile and apparel companies. Example: Textile and apparel company that export more than USD \$1 million per year in this district are eligible for an award for each dollar of textiles and apparel exports which exceed the previous year's total.

Other Support:

2009 (April 24): China's State Council: Three-Year T&C Stimulus Plan. The aim of the plan is to ensure stable development and to upgrade the T&C infrastructure. The plan will eliminate obsolete capacity, reduce energy consumption, improve efficiency, and encourage a shift to higher value-added products plus improvements in product quality and variety. The government is targeting average textile production growth of 10% each year and export growth of 8% annually to reach US \$240

billion by 2011. They want the industry to invest in more advanced technology to increase productivity, nurture 100 domestic brands to make them account for 20% of all export volumes in three years, and to boost domestic consumption and improve access to credit and extend loan repayment deadlines to textile companies facing difficult times. Reports of massive lending sprees by Chinese banks to exporting companies to keep factories going despite customers delaying or defaulting on payments, or demanding price reductions.

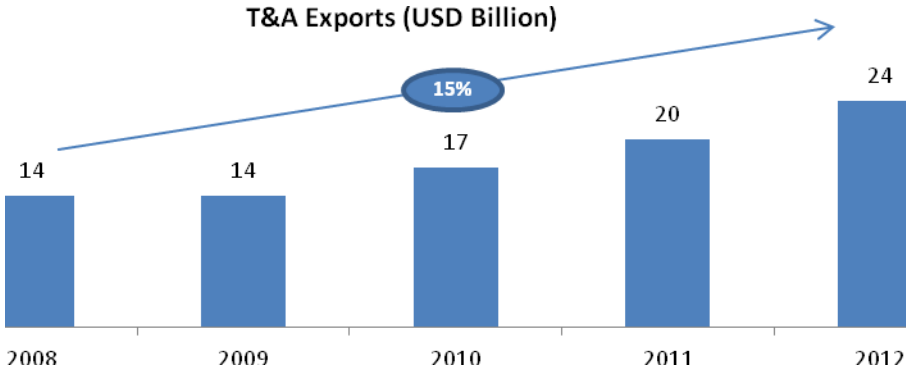
2008-2009: Increase in VAT Export Rebates: China charges a VAT of 17% at every level of the production process and the final product, but firms exporting a product can receive VAT export rebates on finished and input products. Due to decreases in export demand and increasing domestic production costs (currency and labour), China progressively increased VAT export tax rebates a total of five times for T&C (three times in 2008 and twice in 2009). Chinese clothing manufacturers can now claim a rebate up to the 17% ceiling. Prior to increases in 2008, China had been taking measures to slow export growth by decreasing export rebates.

6.2.3 Bangladesh

Bangladesh’s textile and clothing sector has seen an unprecedented growth in recent years accounting for 75% of the country’s export earnings. Bangladesh is a favoured destination for investment in textiles for several countries as all textiles produced there can be exported duty free. There are about 4,500 garment factories in Bangladesh and it is the world’s biggest exporter of clothing after China, with garments making up 80 % of its US\$ 24 billion annual exports.

Currently, Bangladesh enjoys duty concession on exports of 757 products to Chinese market under Asia Pacific Trade Agreement with exports of knitwear and woven products on a rise. Along with China, exports of Bangladesh’s products are also expanding to countries like Japan and Latin America.

Figure 6.4: Performance of the Bangladesh Textile and Apparel sector, 2008-2012



Policy Initiatives

Government Incentives

1. As per Customs Act, 1969 and Value Added Tax Act, 1991 with very few exceptions, almost all exports are tax free.
2. Bonded warehouse facilities: These facilities allow export-oriented factories to import their raw materials duty free.
3. Export oriented units which do not take advantage of the bonded warehouse facilities and import their raw materials independently can claim the duty they paid under the Duty Exemption Drawback Organization, or DEDO.
4. For producers who do not use their DEDO or the bonded warehouse privilege, and utilize local materials. These producers obtain cash compensation of 25% from the government for the items they export.
5. Five to nine years of tax exemption for new factories.
6. Avoidance of double taxation for joint venture projects.
7. Income tax exemption for up to three years for foreign technicians.
8. Duty free import of capital machinery.

Textile Policy: After removal of quotas, Bangladesh's garment and textile manufacturers has been facing stiff competition from countries such as India, Pakistan, China, and Thailand from whom it imports fabric to meet the demands of its RMG sector. These countries are now able to expand their RMG exports, then limited by quotas. As a result, these countries will be able to utilize more of their locally produced yarn and fabrics internally, resulting in the rise of prices of these in the export market. Hence the aim of the policy is to make the country self-sufficient in backward linkages. Hence the Government is investing US\$ 3.5 billion in the development of the vertically integrated value chain.

Skill Development

1. Establishment of Textile Engineering Institutes.
2. Strengthening and Expansion of technical and Vocational Education and Training: A training program for 40,000 workers has been implemented and will be conducted by Bangladesh Garment Manufacturers & Exporters Association.

FDI

Bangladesh is a signatory to the Multilateral Investment Guarantee Agency (MIGA) and the Overseas Private Investment Corporation (OPIC). This provides a guarantee to foreign investors against loss caused by non-commercial risks, the risks of currency transfer, war and civil disturbances. The foreign Private Investment (Promotion and Protection) Act 1980 ensures legal protection to FDI in the country against nationalisation and expropriation and guarantees repatriation of capital and dividend.

Other Support

2006: Government of Bangladesh: support measures taken to bolster the T&C industry include the provision of bonded warehouse facilities, technological upgrading (concessionary duty rates and tax exemptions for the import of capital machinery), cash subsidies for the use of local fabrics as inputs for exporting RMG enterprise and an Export Credit Guarantee Scheme covering risk on export credits at home, and commercial and political risks occurring abroad. The exporters and subsidizes utility charges. Government also supports market promotion efforts of the RMG.

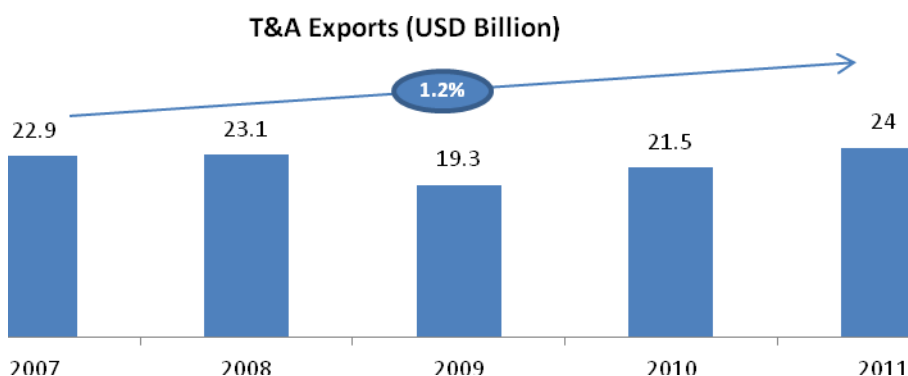
6.2.4 Turkey

Textiles and clothing are among the most important sectors of the Turkish economy and foreign trade. These two sectors are the core of Turkish economy in terms of GDP contribution, share in manufacturing, employment, investments and macroeconomic indicators.

The total number of firms in the sector, dominated (95%) by the private sector, number around 44,000 and 25% of them are active exporters. The apparel industry is constituted mainly (80%) of small and medium sized firms whereas the technology-intensive textile production has been undertaken by large-scale companies. Today, around 20% of Turkey's 500 largest companies are involved in the textiles and apparel sector.

Turkish Textile and Apparel exports stood at US\$ 24 billion in 2011. Turkey mainly exports knitted t-shirts and women's woven suits, jackets and the major market includes Germany.

Figure 6.5: Performance of the Turkish Textile and Apparel sector, 2007-2011



Policy Initiatives

TURQUALITY

- Turquality is a state-supported branding program in the world. Its mission is to develop Turkish brands with global competitive power, thereby increasing Turkey's exports. Turquality provides training support to those companies with capacity of creating local brands, and offers financial resources to sustain marketing investment.
- Turquality offers a significant opportunity to member brands. When a member brand receives consultancy service from a consultancy accredited by the same program, 50% of respective consultancy fee is funded by the state.

Foreign Direct Investment

- Turkey is the 15th most attractive destination for Foreign Direct Investment (FDI) in the world (UNCTAD World Investment Prospects Survey, 2008-2010).
- During the last six years, the intermediation and manufacturing sectors have attracted the highest amount of FDI. In last 3 year (2007-2010) textile attracted USD 348 mn.
- Turkey has taken steps to improve its investment climate through administrative streamlining, an end to foreign investment screening, and strengthened intellectual property legislation.

Institutional Framework and Infrastructure for the Turkish textile and clothing sector:

- Agricultural Sales Cooperatives and Agricultural Sales Cooperatives Unions, established in the mid-1930s protect the interest of cotton growers;
- Semi-governmental export associations are essential for promotional activities to be effective. These associations act as an important link between the Government and the export sector;
- Sectoral trading companies were established in the textile and clothing sector. These trading companies enable small and medium enterprises to join forces to accept large orders. Further, they speed up customs formalities and export procedures;
- Export promotional activities stimulate the development of a sustainable business environment.

6.2.5 Vietnam

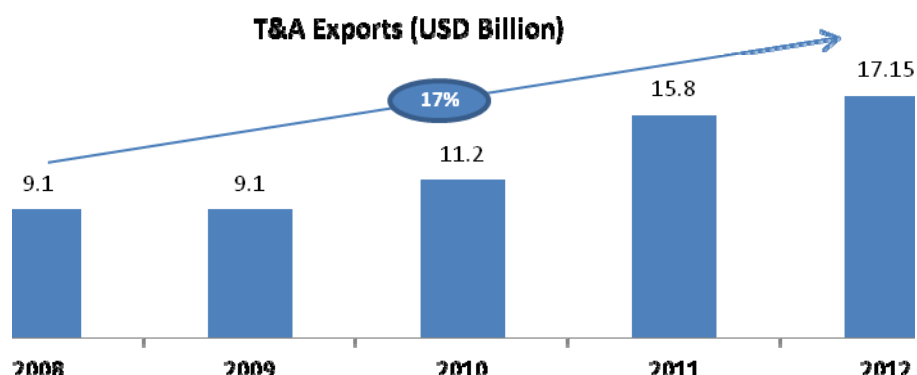
Over the last many years, Vietnam textile and garment industry has witnessed strong development. Products made in Vietnam have penetrated to the world market, thus contributing to the economic development of the country.

The Vietnamese textile industry, with more than 3,800 companies, is the leading export sector. State-owned enterprises make up just 0.5% of Vietnam's businesses; however, 75% are joint stock or limited companies. The country ranks fifth worldwide in textile and apparel exports and has a labour force in that sector of more than 2 million people, of whom 1.3 million are working directly in the industry.

The export values have increased rapidly growing at a rate of 17%. In 2012, Vietnam's revenues from the garment sector grew by 12% YoY to US\$ 15.8 billion, while the textile sector exports accounted for the remaining US\$ 1.35 billion out of total exports of US\$ 17.15 billion.

Its main export markets include the United States, European Union and Japan. Of the total textile and apparel exports, yarn exports accounted for \$1.79 billion and fabric exports totalled \$831.7 million.

Figure 6.6: Performance of the Vietnamese Textile and Apparel Sector 2008-2012



Policy Initiatives

The Vietnamese government is highly supportive of the textile and garment sector, and there are strong incentives to attract foreign investment. The government has outlined ambitious plans for the industry's development. The aim is to shift the industry from commodity type products towards the manufacture of high added value fashion items. Some of the initiatives include-

- Launch of the Doi Moi ('opening up') policy 1986, which allowed for the development of a private sector and the liberalisation of trade.
- Duty-free imports of raw materials on the condition they are re-exported as clothing products within 90-120 days
- The Ministry of Industry and Trade promotes linkages with renewed efforts to invest in the production of quality fabrics in order to compete with imported fabrics.

Trade Agreements

- Signing of the Bilateral Trade Agreement (BTA) with the United States in July 2000, accounting for 55 per cent of Vietnam's textile and garment export revenues which in turn led to signing of the Vietnam-US Textile Agreement (VUTA) in May 2003.
- Under the BTA, in December 2001, the United States granted Vietnam normal trading relations (NTR) and later most-favoured nation (MFN) status, which led to a sharp reduction in tariffs from 40% to 3% on most exports as well as on Vietnamese exports to the US. This was followed in early 2007 by Vietnam's accession to the World Trade Organization (WTO).
- Vietnam has also secured free trade agreements (FTAs) with a number of countries and regions. In particular, through its membership of the Association of Southeast Asian Nations (Asean), it

benefits from the Asean China Free Trade Area (ACFTA), which is the world's largest FTA in terms of the total population of its signatories.

- Through its membership of Asean, it benefits from FTAs with Australia and New Zealand, India, Japan and South Korea. Also, it has bilateral FTAs with Israel and Japan.
- Vietnam has entered into negotiations with the EU with a view to signing a comprehensive FTA. Most importantly, it has entered into negotiations to be part of the Trans Pacific Partnership (TPP), which aims to establish a free trade area for the Asia Pacific region.

Policy on Developing Support for T & A Industries

- **Market development promotion including-**
 - Free advertisement for projects within the supporting industries on the web site of the Ministry of Industry and Trade and provincial-level Industry and Trade Departments.
 - Projects of the supporting industries shall be prioritized for receiving funds from trade and investment promotion programs.
 - Assistance to supporting industry projects classified under high technology
- **Infrastructure related promotion –**
 - The allocation of land, suitable areas, locations, and rental rates shall be aided and prioritized for projects that are classified under the supporting industries.
 - Assistance and opportunities in job recruitment and training and other special support policies
 - Incentive policies for small-medium enterprises that invest in manufacturing projects within the supporting industries on production grounds
- **Promotion in science and technology and human resource training-**
 - The national scientific and technological development fund, and other funds related to scientific and technological activities, could support projects within the supporting industries to cover part of the expenses for technology transfer and purchase of design copyright.
 - Funds have been scheduled from the state budget to cover part of expenses for human resource training under current regulations and to encourage human resource development in high tech industries.
- **Finance-**
 - Projects which manufacture products within the supporting industries framework are entitled to import/export duty incentives under the current law on import/export duties.
 - Benefits are provided to small-medium enterprises investing in projects which fall under the supporting industries.

6.2.6 Uganda

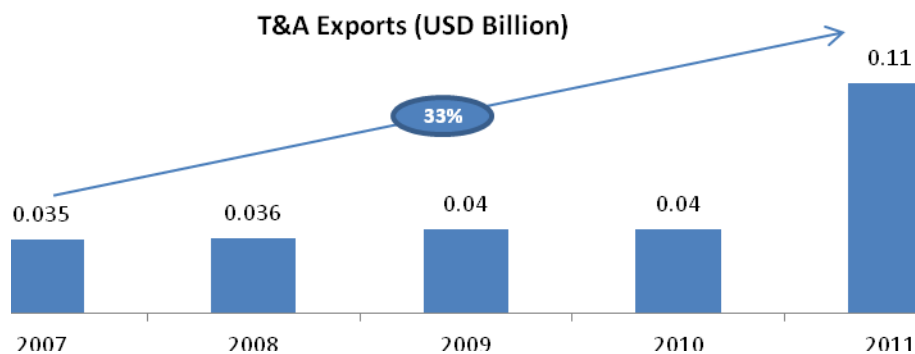
Uganda Government considers the textile sub sector as one of the strategic areas in the economic and social transformation of the country, owing to the fact that the sub sector is supported by wholly locally grown raw materials (cotton lint) that undergoes enormous transformation by processing,

thereby creating opportunities for Ugandans across the value chain; from the cotton farmers to fabric/garment retailers.

Textile manufacturing in Uganda is dependent on cotton lint fibre processing by either the handful vertically integrated big textile millers or by rudimentary processors that are engaged in hand loom weaving. Uganda's production stands at 250,000 bales annually, with 90% exported as lint. The Cotton Development Organisation aims to increase this by 30 % through the introduction of a Bt cotton variety.

The industry has a potential production of 1m bales; despite having a land potential of 350,000 hectares for cotton production, farmers cultivate only 10 % of it. Hence, there is need for backward integration within Uganda supported by a package of intervention for Uganda to sustain her position the global textile arena and industrialization in general. Value-addition is a pre-requisite

Figure 6.7: Uganda's Textile and Apparel Exports, 2007-2011



Policy Initiatives

The following strategies and measures will be undertaken by the Government to enhance the development and revival of the textile sub-sector:

To improve the local Business Environment

The Government shall establish a conducive and competitive fiscal regime that is necessary for the optimal growth of the textile sub sector in Uganda.

To support Technological Up-gradation and modernization

The policy will:

- Continue the efforts to modernise and up-grade technology to international levels by supporting investments in vertical integration.

- Facilitate harmonious development of cluster-based production facilities focused at optimizing production and adopting appropriate technology to meet the Regional and International demand for high value and large volume products.
- Promote Uganda as an attractive investment destination and shall establish economic zones necessary for the attraction of foreign direct investment in the sub sector.

To strengthen textile sub-sector support institutions

To enhance the performance of the textile sector in Uganda, Government shall:

- a) Strengthen Textile Development Agency (TEXDA), a textile training agency currently funded by United Nations Industrial Development Organisation (UNIDO) under Ministry of Tourism, Trade and Industry to work in partnership with Textile Manufacturers Association of Uganda (TEMAU) to offer support services to the sub sector in the areas of training in various textile and garments programs such as surface design, basic dyeing and printing; handloom weaving; business management; branding, merchandizing and others.

Once the training institute is constructed, it can also be responsible for integrating micro and small entrepreneurs, designers and tailors into the national value chain especially then that the Private Sector Foundation and Government have already formed clusters for the SMEs on one hand and on the other; the medium and large millers are in principle agreeable to integrate the SMEs with the view to completing a national value chain.

- b) The government will continuously improve funding for lead agencies for the textile sub sector development like Uganda Export Promotion Board UEPB, Uganda National Bureau of Standards UNBS, Cotton Development Organization CDO, Uganda Revenue Authority URA and others with the view to enabling them adequately perform their mandate.
- c) Government shall strengthen the Department of Industry and Technology to oversee the development of the Textile and Garment Sector in Uganda.

To increase the raw materials supply base

- To ensure sustainability of cotton production, Government shall encourage private sector commercial cotton farming as a means of mitigating the dangers associated with the dependency on peasant growers of cotton based on rain fed agronomical practices.
- Government shall support the silk and other fiber production and processing in Uganda.

To enhance Human Resources Development

The most crucial factor in value addition is the development of human resource capacity. Restructuring of the existing textile mills (i.e. balancing, modernization and rehabilitation which is a regular requirement of any industry) so as to enable the processing, finishing, weaving and spinning segment is required to not only cater to the needs of the local apparel industry but also increase the share of processed fabric and garments available for regional and international exports. In this regard, the existing training facilities would have to go through a revamping process by updating their syllabi, bringing it in line with the current and future industry requirements.

The Government therefore shall:

- 1) Strengthen the existing institutions offering textile science and technology courses such as Busitema and Kyambogo Universities, vocational training centres to conduct courses in textile technology, fashion and textile design.
- 2) Support the strategic idea of COMESA owning a Regional Training Centre for Textile Technologists. This will enable Ugandans train at a world class institution which will, in the medium term, answer the persistent shortage of world- class technical manpower.
- 3) Facilitate specialized training of public servants handling matters related to the textile sub sector for effective management, implementation and monitoring the development of textile sub – sector.

To support a Regional cotton-textile sub sector development Strategy

Government shall

- Continue to negotiate and promote Uganda’s membership to key trading blocs based on the principle of mutual benefit with the trading partners;
- Collaborate with other Regional Programs like PACT and Regional Industrial Upgrading and Modernisation Programme, (RIUMP) of COMESA in the development of the textile sector;
- Support the development of a Regional Strategy in the development of the textile sector like one being developed by COMESA.
- Support strategic alliances with textile majors at a Regional and International level with focus on business and new markets development;

To Strengthen Domestic Market Development

For increasing local consumption of textiles especially by the organized public sector, government shall provide affirmative action to local suppliers under Government procurement, while ensuring conformity with existing National Laws focusing at:

- a) Supporting the “Buy Local and Build Uganda” strategy. In this, all Public Sector procurement for all types of textiles shall be sourced from Uganda save for where no local capacity to produce exists
- b) Supporting the introduction of School Uniforms as a requirement for Universal Primary and Secondary Education (UPE& USE).
- c) Supporting the amendment to the Public Procurement and Disposal of Public Assets Act (PPDA Act) to establish a mandatory requirement for all Government Institutions to source textiles requirements locally save for where no local capacity exists.

6.2.7 Tanzania

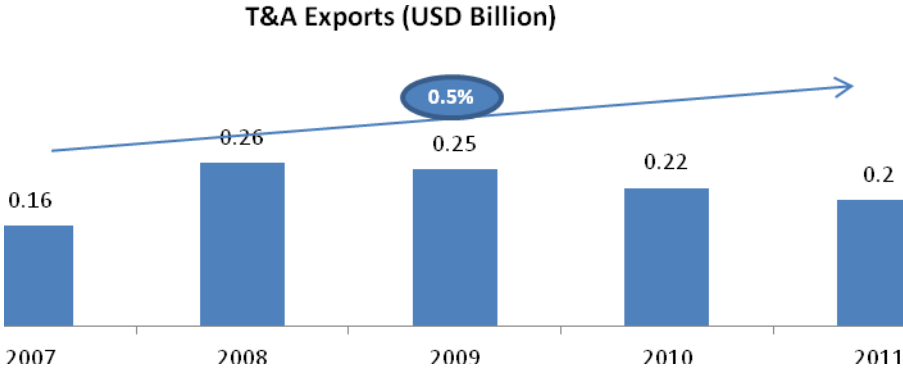
Cotton production and related downstream manufacturing industry plays a crucial role in Tanzania’s economy. Nearly 500,000 Tanzanian smallholder farmers are involved in the production of cotton, and it is estimated that the crop contributes to the livelihoods of up to 40% of the population, or 16 million people.

There is enormous potential to grow the textile and garment industry in Tanzania given the massive quantities of cotton lint produced locally, the ready availability of cheap labour throughout the country, and the current trade preferences.

The Tanzania Cotton Board plans to improve production to 1.5m bales annually by 2015 and improve the proportion of lint consumed in the domestic textile industry by 90%.

Tanzania currently produces 700,000 bales of cotton annually while the proportion of lint used by domestic textile industries is 30 per cent only. As with most countries in Africa, the bulk of Tanzania’s cotton production (in excess of 70%) is exported as lint.

Figure 6.8: Tanzania’s Textile and Apparel Exports, 2007-2011



Policy Initiatives

Taxation and Fiscal Policies

There are a number of fiscal incentives available for companies operating in Export Processing Zones, and those certified by the Tanzania Investment Centre (Certification of Incentives).

Corporate Income Tax

The corporate income tax in Tanzania amount to 35% on average, with the exception of companies registered with and listed in the Dar es Salaam Stock Exchange (DSE), for which the rate is reduced to 25%.

Withholding Taxes

Withholding tax rates are as follows:

Box 6.1: Applicable Withholding tax for Tanzanian Textile Sector		
HS CODE	RESIDENTS	NON-RESIDENTS
Dividends	20%	15%
Interest	15%	15%
Royalty Fees	30%	N/A
Management/Professional	30%	N/A
Rent	40%	15%
Goods & Services	2%	2%
Transport	N/A	4%

VAT

The VAT rate is 18%, and the government is currently introducing a drawback scheme for VAT paid on intermediate goods, if the respective products are exported.

Personal Income Tax

The Personal Income Tax is progressive, ranging from 15 to 35% for monthly incomes over TShs 30'000.

Investment Incentives for EPZs

- Investors in EPZ areas have exemption from Customs duty, VAT and other taxes charged on raw materials and goods of a capital nature
- Investors are also exempt from the payment of Corporate Tax for an initial period of 10 years;
- Exemption is also granted on the payment of Withholding Tax on rent, dividends and interest for the first 10 years of a project
- Exemption is also granted from the payment of all taxes and levies imposed by local government authorities for goods and services produced in the EPZ's, again for a period of 10 years
- Subject to compliance with the applicable conditions and procedures investors can also access the Export Guarantee Scheme

Investment Incentives for Special Economic Zones (SEZ's)

Investors in SEZ's also enjoy a range of Tax and Fiscal benefits including:

- Exemption from the payment of taxes and duties for machinery, equipment, heavy duty vehicles, buildings, construction materials, and any other goods of a capital nature to be used for the purposes of development of the SEZ infra-structure
- Exemption from the payment of Property Tax for the first 10 years

- Exemption from Customs Duty, VAT and any other tax charged on raw materials and goods of a capital nature related to production on an SEZ
- Exemption from payment of Withholding Tax on interest on foreign sourced loans
- Exemption from Customs Duty and VAT payable in respect of importation of one administrative vehicle, ambulance, fire fighting equipment, fire fighting vehicles and up to two buses for employees' transportation to and from the Special Economic Zone

Trade Protection, Duties and Tariffs

Tanzania forms, with four other states (Kenya, Uganda, Rwanda, Burundi) of the region the East African Community (EAC), an intergovernmental organisation which is at the same time a customs union with:

- A common External Tariff on imports from third countries
- Duty-free market access between member states since October 2010 (if the rules of origin in place are respected)
- Common customs procedures

In general terms, EAC import duties on raw materials are zero, whilst 10% apply on intermediate products and 25% on finished goods

Currently, no duties apply to any kind of fibre, as raw materials such as cotton can be imported duty free without restriction. The duty rate for yarn of any fibre is 10%, with the exception of sewing thread imports, which are charged 25%. Generally, the same rate of 25% also applies to all knitted and woven conventional fabrics, readymade garment and home textiles, carpets and other textile floor coverings.

In order to grant a higher level of protection to the local textile manufacturing sector, a higher duty rate (~50%) is imposed on sensitive items such as imported Kangas, Kikois and Kitenges both as fabrics and made ups as well as on cotton woven home textiles (bed, table and toilet linen). Duty rates on other sensitive textile items are 45% or USD per bag (whichever is higher) for sacks and bags of jute and other textile bast fibres and 35% or USD 0.20 per Kg (whichever is higher) for worn cloths and articles.

Level of Trade Protection Provided by Import Duties

As the Tanzanian internal market is decidedly price-sensitive, the import duty regime in place is in principle sufficient to adequately protect domestic manufacturers from foreign competition.

Import Duty Exemption on Capital Goods and Raw Materials

According to the Tanzania Revenue Authority and under the harmonized East African tariff no customs duties on raw materials, computers, capital goods, replacement parts etc are levied. Therefore the import of textile equipment and spare parts is duty free.

Investment Financing

Banks have indicated that any potential projects from the sector seeking finance would be assessed on an individual basis around the business case fundamentals. Meanwhile, the Cooperative Rural Development Bank (CRDB) have active investments in the Tanzanian textile sector, providing a maximum lending limit of 50 bn. TSH, and seeking minimum equity of 25% and more commonly 40%.

The main drawback from a borrower's point of view is the prohibitively high rate of interest, which applies to both long-term and short-term loans of 17%. At the time of data collection in November 2011, the Central Bank Rate was 12% and the Treasury Bills rate 15%.

A notable exception in terms of investment and growth was A to Z, where large investments have been made and continue to be made in buildings, installations and textile machinery.

The national ambition of adding value to the indigenous cotton crop will involve significant capital requirements as spinning, weaving and processing/finishing are all capital intensive. Access to competitively priced finance, whether from within or without the country will be a key requirement in allowing the required investments to take place.

Additionally, in the spinning sector working capital requirements can often be very high. This is particularly so in Tanzania where mills have to pre-finance the purchase and storage of cotton for the year ahead. Access to competitively priced working capital loans is therefore also a key consideration for spinners.

Labour Policies, Wage Constraints and Social Costs

Tanzania has ratified all the eight core ILO labour conventions, including those on Freedom of Association, the right to organise and Collective Bargaining, the elimination of discrimination in respect of employment and occupation, the right to equal remuneration, the elimination of forced or compulsory labour, and the abolition of child labour.

The Employment and Labour Relations Act of 2004 sets out the basic condition of employment, including the provision of employment contracts, normal weekly working hours, maximum shift lengths, and maximum hours of overtime allowed per week, and employee benefits.

The Tanzania government sets the wages for different sectors of the economy and, with textiles and garment, the current minimum wage is set at 80,000 TSH per month (USD 45).

The Social Security Regulatory Authority Act of 2008 requires a 20% contribution of the basic wage bill to be paid to a Social Security Scheme (SSS), of which there are now several operating in Tanzania. The SSSs provides a range of benefits to employees, including old age, disability and survivors' pensions, a funeral grant, maternity benefits, injury benefits and social health insurance

Employers are also required to pay a contribution of 6% of the basic wage as a Skills Development Levy.

In terms of Occupation Health and Safety issues, employees must also have a Health and Safety policy and abide by the regulations of the Occupational Health and Safety Act (OHSA) of 2003. Under this Act, those employers with over 10 employees must meet certain minimum standards of safety, and establish a safety committee to constantly monitor and mitigate risk in the workplace.

Environmental Policies and Pollution Controls

Government focus on environmental conservation and management in Tanzania has, to date, taken a community-based approach, with the government policy largely following the objectives below:

- Sustainability, security and equitable use of resources to meet the basic needs of current and future populations
- Prevention and control of degradation of land, water, vegetation, and air

In all matters related to environment management, the Government of Tanzania is advised by the National Environment Management Council (NEMC). NEMC is responsible for coordinating technical activities of all bodies concerned with environmental matters, including enforcement of environmental regulations, assessment, monitoring and evaluation

The National Environmental Standards Committee of the Tanzania Bureau of Standards is responsible for developing environmental quality standards, and criteria in terms of water (including effluent discharge), air, noise, soil etc.

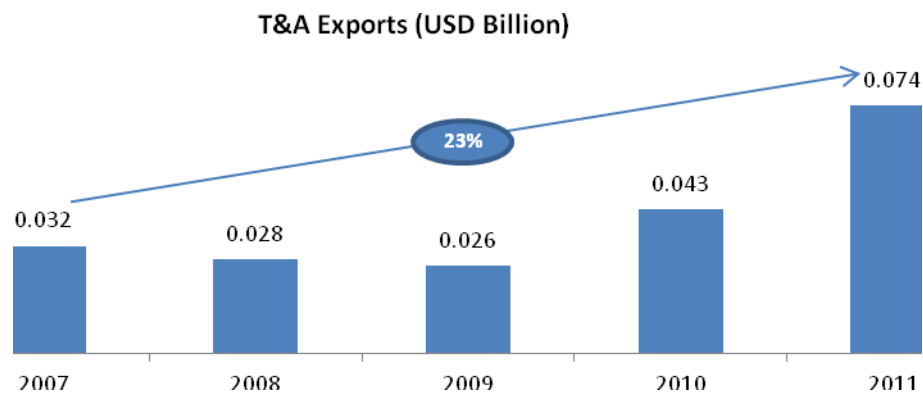
6.2.8 Ethiopia

Textiles and garment sector is one of the most important part of the manufacturing industry in Ethiopia given its high contribution to output, employment and trade. The total output of this sector was US\$95 million in 2009/10 with a direct employment record of over 20,000 people in 2007/2008 (CSA, 2009). Some of the factors which make Ethiopia a favourable destination for investment include-

- Availability of some 3 million hectare of land and climate suitable for cotton cultivation out of which only some 5 % has been utilized so far.
- Ethiopia, known as the water tower of Africa, provides one of the cheapest environmental friendly hydroelectric power supplies in the world (5US cents/kwh).
- Low cost and easily trainable unskilled labour force (wages 40USD /month), less than Africa's average.
- Skilled labour in the sector is increasing rapidly as a result of fast growing education and training institutions in Textile Technology; two institutes, a couple of textile Engineering departments in different Universities and a lot of TVET Schools and private training institutions.
- Ethiopia offers one of the largest domestic markets in Africa, given its population size and rapid economic growth.

Currently, export of cotton is banned because of the growing needs of local textile factories for cotton as the main raw material for locally produced fabrics. This is as part of the support for the local textile industries without damaging the cotton farmers i.e. the cotton producers are allowed to sell at the international price reducing transport cost. This is part of the Government’s strategy to promote the export of value added products and import substitution.

Figure 6.9: Performance Ethiopia’s Textile and Apparel Exports, 2007-2011
Policy Initiatives



Due to the very high growth potential of the Textile and Garment sector, it became one of the highest priorities in the Ethiopian government’s economic development program. There are several incentives for investment in manufacturing industry to encourage investment and promote the inflow of foreign capital and technology into Ethiopia (both domestic and foreign) as follows-

Investment Incentives

Tax holidays-

- 100% Duty free importation of new or used machineries, equipments, construction materials and vehicles (used as capital goods for the investment) as far as it is not producible locally in Ethiopia.
- Duty free importation of spare part of 15% of capital investment for the first 5 years of operation.
- Ownership Transfer of invested capital goods to third party enjoying similar privilege.
- It is possible to hire international expatriates free from income tax as far as they stay for no more than two years.
- Reconciliation of VAT for materials purchased locally during the project period is possible if declared in 6 months’ time.

Financial Incentives

- Development Bank of Ethiopia (DBE) extends a 70% loan against 30% equity contribution in cash by the investor for Brand New Establishments.
- Development Bank of Ethiopia (DBE) extends a 60% loan against 40% equity contribution in cash or in kind by the investor for used machineries and equipments or existing Establishments.
- DBE's extends loan with an interest rate of 8.5% and grace period of 5 years.
- Co-financing, loan buyout, working capital and international loan repayments out of Ethiopia are some of the services DBE and many of the domestic banks extend to the private sector.
- In addition, investments are constitutionally and by law (of Multilateral Investment Guarantee Agency of the World Bank) guaranteed of non-commercial risks.

Operation incentives

Tax holidays-

- Income Tax Holiday for 2-8 years depending on export performance.
- Exemptions From Export Customs Duties through a set of incentive schemes called duty drawback, voucher and bonded manufacturing warehouse
- Exemption from customs duty of locally purchased raw materials on fast refund bases
- On site (factory) inspection of imported raw materials and exportable products
- Loss carry forward for maximum of half the income holiday period

Other Incentives

- Currently a new Institute for textile and garment has been established. The aim of the institute is to build the textile and garment industry of the country with increasing trained and skilled labour in the production and maintenance in addition to other operational matters.
- Ethiopia enjoys quota and duty free market access to the US and EU as well as COMESA markets. In addition Ethiopia has signed more than 16 bilateral trade agreements with countries including China, India, Turkey and Russia.

6.3 Institutional Structure of the Textile and Apparel Sector – A few examples

6.3.1 India

The structure of the Indian textiles industry is as below-

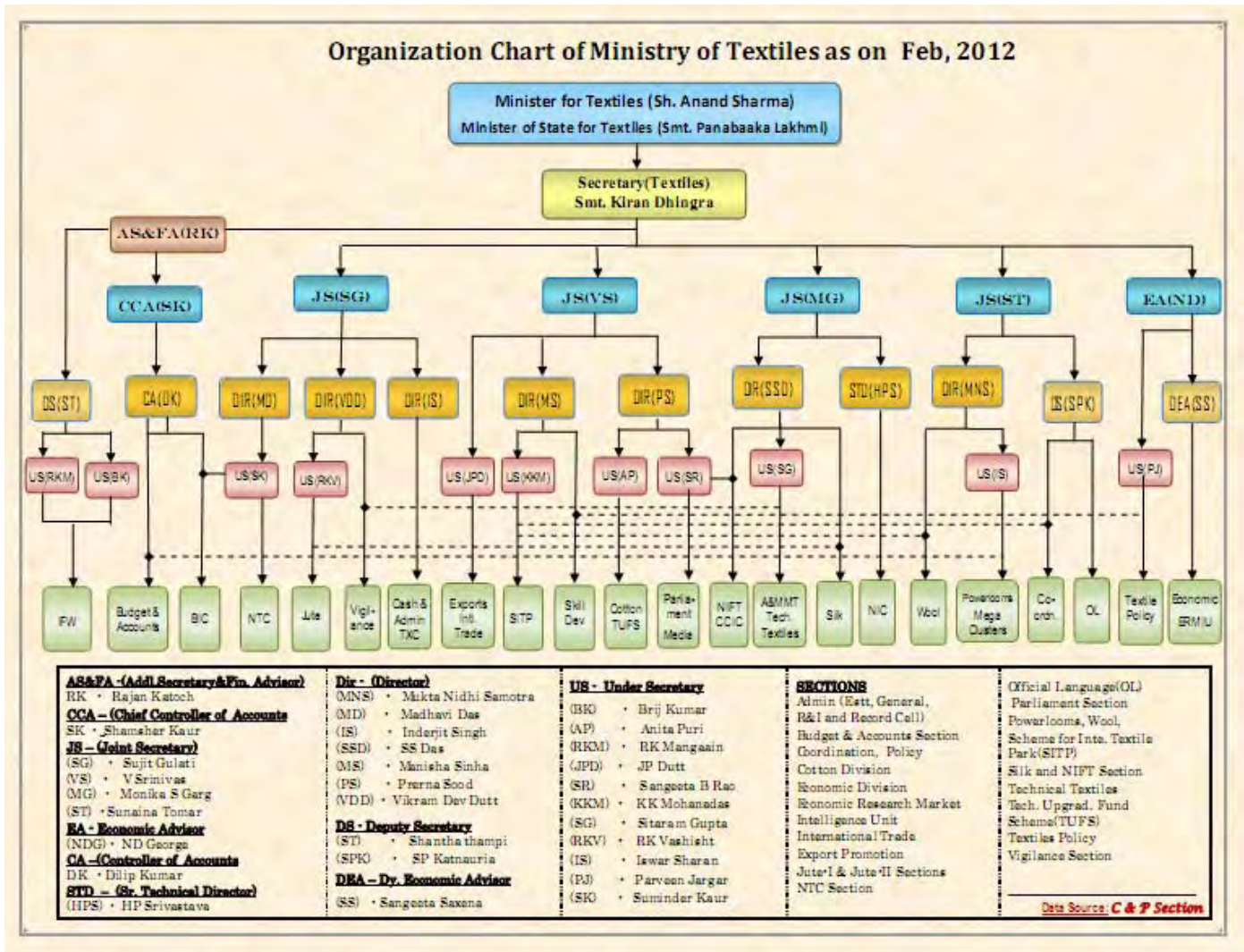
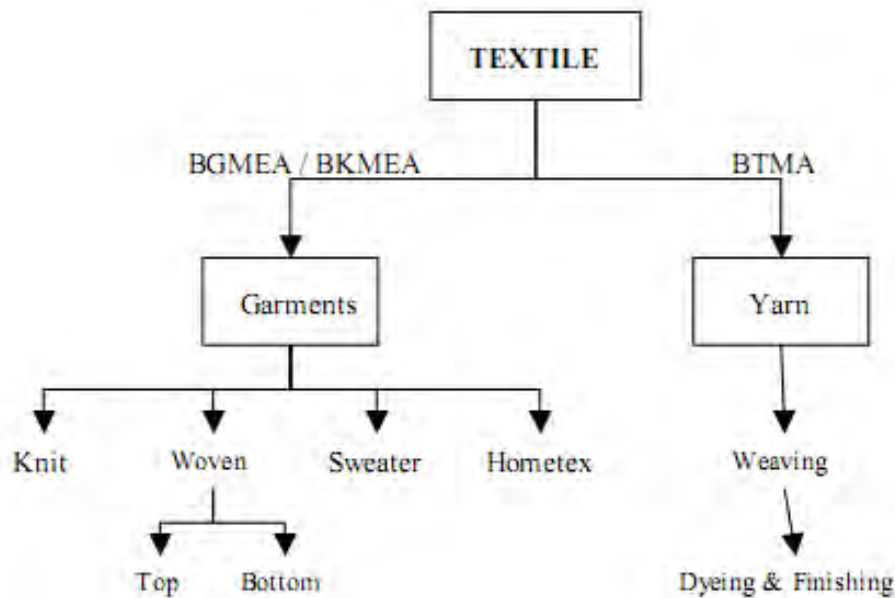


Figure 6.10: Organisational Structure for the Indian Textiles Industry

6.3.2 Bangladesh

The textile industry is divided into two parts, garments and yarn. The Bangladesh Garment Manufacturers and Exporters Association, BGMEA, and the Bangladesh Knitwear Manufacturers and Exporters Association, BKMEA, monitor the garment sector. Bangladesh Textile Mills Association, BTMA, is the monitor of the yarn sector. Further the garment sector is divided into four parts, knit, woven, sweaters and hometex products. The subdivision for yarn is weaving followed by dyeing and finishing. The structure of the textile industry in Bangladesh is illustrated below-

Figure 6.11: Organisational Structure for the Bangladesh Textiles Industry

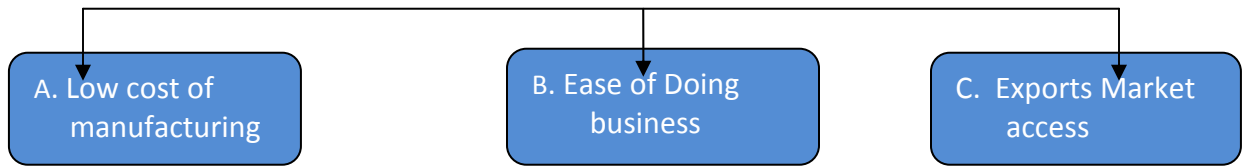


6.4 Recommendations to Improve the Sector Performance

The prime challenge for Kenyan textile sector is low level of investment in the manufacturing value chain. Large scale investment in any of the value chain step will create business opportunity for the upstream and downstream industry. Such a trickledown effect can create large scale employment and improvement in the exports scenario. In order to attain this scenario, there is a need to sensitize Kenyan and international investors to invest in the country. For this suitable policies need to be formulated to facilitate the setting-up as well as running of the operations.

With this basic premise the following growth model is proposed:

3 Key requirements of textile & apparel sector investors to invest in Kenya



Key requirements for T&A sector

- Land
- Power
- Labour
- Water
- Finance

• Fast approval & clearances

- Predictable environment
- Fast policy action to help industry adapt to changing scenario

<Kenya has preferential market access to US & EU

<Local sourcing of fabric>



PRIORITY ACTION POINTS TO ATTRACT INVESTMENTS IN KENYAN TEXTILE AND APPAREL SECTOR

1. Local government procurement
2. Stabilization fund
3. Inclusion of integrated textile mills in the SME parks.
4. Full tax collection on 2nd hand textile/cloth imports
5. Improvement in availability of finance
6. Showcase Kenya as investment destination to probable international investors
7. Establishing a textile specific body at ministry level to oversee sector
8. Establishing a regional centre of excellence

7.0 PROPOSALS ON THE WAY FORWARD

The proposed interventions shall be made within Vision 2030 framework and as aligned with the sector strategies and Jubilee manifesto. In particular, the cotton/textile forward strategies shall be anchored on the SME Perks. However, political goodwill and sector champions have to be in place. Further the proposals hereunder have also benefitted from the benchmarking against best performers in the industry as well as regional competitors (China, Bangladesh, India, Turkey, Vietnam, Ethiopia, Uganda, and Tanzania).

7.1 The key objectives

The review of the policy environment is the key objectives within the sector include;

- Leveraging the regional and preferential markets
- Reviewing institutional arrangements to come up with symbiotic relationships
- Private sector has to play a more proactive role
- Identification of unique and niche products and markets
- Encourage cotton production strategies that are geared towards increased yield for both rain fed and irrigated cotton and also encourage timely payment to growers; and
- Establish institutions that will spearhead the development of the cotton industry as follows: -
 - a) Cotton Development Authority has been formed responsible for coordination, regulation, promotion and development of the cotton industry in Kenya in line with the current liberalization policy of the economy.
 - b) Encourage the establishment of an apex body that will act as a consultative forum for all cotton/textile stakeholders' organization to ensure coordinated development of the industry. This will enhance vertical and horizontal forward and backward linkages and act as a lobby group for the growth of the sector.
 - c) Provision of adequate funding to the cotton Industry.
 - d) Facilitate organization of farmers into formal groups to attract credit facilities and capital for timely purchase of seed cotton from farmers by ginners.
 - e) Establish and resolve the actual level and legitimacy of past debts to the predecessor Cotton Board.
 - f) Promote use of efficient technologies in the whole value chain.
- Develop value addition enterprises along the cotton value chain to improve returns
- Establish national quality standards and quality assessment infrastructure for cotton and products.
- Establish marketing systems and infrastructure
- Reinstate cotton research into our National research priority agenda.
- Establish basic infrastructure and sustainable financing Mechanism
- Promote partnerships with other institutions.
- g. Institutional mechanisms

Intervention areas include:

- The cotton marketing system with a view of developing an efficient seed cotton marketing system that will motivate farmers to increase their production,
- The empowerment of cotton farmers groups with a view to improve on their governance a management so that they capitalize on the economy of scale and can play their rightful role,
- Improving efficiency in the ginning sector and in other value addition areas.
- Three areas of intervention have been identified. These include:
 - The cotton marketing system with a view of developing an efficient seed cotton marketing system that will motivate farmers to increase their production,
 - The empowerment of cotton farmers groups with a view to improve on their governance a management so that they capitalize on the economy of scale and can play their rightful role,
 - Improving efficiency in the ginning sector and in other value addition areas.

7.2 Input Specific Intervention

1. Reduction in cost of power

- The effective cost of power in Kenya is in the range of USD cents 18 to 20 / unit, which is higher in regional as well as global perspective. (Ethiopia ~ USD 5 cents, Uganda ~ USD 14 cents, India ~ USD 12 cents, China ~ USD 8 cents, Bangladesh ~ USD 7 cents)
- Since power is the main cost contributor in textile manufacturing, investors can be attracted by lowering down the prices in first few years of operations e.g. 50% reduction for first 5 years followed by 25% for next 5 years.

However, in consulting Vision 2030, subsidies in the power sector have been stayed to allow for adequate investments to step up power generation. In this regard, this recommendation shall not be taken forward at this point in time.

2. Improvement in availability of finance

- Textile and apparel businesses in Kenya consistently suffer from a) non-availability and b) high cost of finance.

A policy wherein the Government earmarks a certain amount (say, USD 100 Mn to start with) to be provided as credit to textile and apparel businesses through the financial institutions at a competitive rate of lending will help tremendously in expansion of manufacturing in Kenya.

3. Establishing a textile specific body at ministry level to oversee sector

- The institutional framework in most of leading textile and apparel producing countries is segregated from general manufacturing and very comprehensive
- Kenya should also have a separate Government body – either a Ministry or an Office of Textile Commissioner reporting to Ministry of Industry, to dedicatedly look into sector related matter, from fiber to exports

4. Showcase Kenya as investment destination to probable international investors

- Kenya carries certain distinct advantages over other neighbouring countries e.g. own port, better infrastructure, existing garment manufacturing set-up, political stability & peace, etc. The need is to showcase these advantages to the global investors in countries of China, India, Turkey, Indonesia and South Korea.
- An aggressive investment promotion drive should be undertaken by authorities in such countries by having investment promotion road shows, conferences, inbound and outbound delegations, etc.

Campaigns for national pride and patriotism with respect to Kenyan products.

Elimination of subsidies at the global level

Revival and expansion of irrigation schemes for enhanced production

Application of biotechnology for enhanced productivity, quality enhancement. GMOs are safe , seed cotton cake is harmless

Availability of extension services by government including training of input distributors

Access to quality seed

Funding research

Support infrastructure and institutions

Strengthen the producer voice

Increasing production of seed cotton in order to improve capacity utilization

- Seed cotton
- Ginning
- Milling
- Garment manufacture

This will be done through clustering the industries along the value chain and counties through in particular revival of existing dormant mills.

Table 7.1: Cotton/Textile Industry Clusters

	Counties
Kisumu- integrated textile mill	Busia
	Bungoma
	Siaya
	Kisumu
	Homa Bay
Eldoret-integrated textile mill	Migori
	West Pokot
	Turkana
	Baringo
	Marakwet

Nakuru-Garment manufacture	
Nairobi- Garment manufacture	
Thika- Integrated textile mill	Kirinyaga
	Muranga
	Embu
	Kiambu
	Meru
	Tharaka Nithi
	Machakos
	Makueni
	Kitui
Mombasa- Integrated textile mill	Kwale
	Lamu
	Taita Taveta
	Tana-Bura/Hola
	Kilifi

Potential locations for specialised integrated industries



7.3 Employment potentials

- Cotton is a strategic crop for the future due to emerging bio fuels fould opportunities and capacity for diversification and poverty alleviation potential for the rural poor.
- About 4 million rural poor beneficiary stand to benefit through improved income levels.
- Partnership collaboration with other sector players creates potential for synergy leveraging with other development partners.
- Women and youth participation will result in immense socio-economic gains.

7.4 Policy Mix

a) General policy level

- Dedicated textile policy
- Power subsidy
- Industry clustering- leveraging county governments to implement development in the cotton textile industry including lifting the vulnerable groups in the ASAL regions
- Supporting Industrial parks, incubation centres, village cottage industries
- Incentive packages- cash awards, credit schemes
- Integrated skills development scheme at entry and mid management level, leveraging PPP model for implementation
- Establishing marketing boards - Promotion and marketing support especially the SMEs and women projects. Indigenous players to be assisted with a pavilion in NY and Canada to retail/sell their products
- Credit facilities with appropriate incentives
- Incentives for technology up grading
- Promoting Kenyan products “buy Kenya build Kenya”. Branding the way forward
- Prioritise growing the economy from within including improving local production marketing and branding

(b) Farm Level

- Quality seed including-application of biotechnology for enhanced productivity, quality enhancement and capacity utilization
- Encouraging the use of organic fertilizer
- Guaranteed returns to farming community- Establish Stabilisation Fund
- Revival and expansion of irrigation schemes for enhanced production
- Availability of extension services by Govt. including training of input distributors
- Funding research
- Support infrastructure and institutions
- Strengthen the producer voice- integrated participation

Policy Scenarios along the Value Chain

Policy	Farming	Ginning	Spinning and Textiles
<ul style="list-style-type: none"> ✓ Dedicated textile policy–Funds, ✓ Industry clustering–leveraging county governments ✓ Policy for gradual reduction second hand imports ✓ Enforce tax collection for all imports ✓ Industrial parks, incubation centres, village cottage industries ✓ Incentive packages– cash awards, credit schemes ✓ Contract farming ✓ Farmer lint ownership ✓ Public procurement ✓ Crop insurance schemes 	<ul style="list-style-type: none"> Quality seed including– application of biotechnology for enhanced productivity, quality enhancement and capacity utilization along the value chain Guaranteed returns to farming community– Establish Stabilisation Fund ✓ Revival and expansion of irrigation schemes for enhanced production ✓ Availability of extension services by government including training of input distributors ✓ Funding research ✓ Support infrastructure and institutions ✓ Strengthen the producer voice– integrated participation, ✓ Food security in cotton farming areas ✓ Value addition at farm level 	<ul style="list-style-type: none"> ✓ Power subsidy ✓ Technology up grading– with help of Technology Fund ✓ Government guarantees for new investments 	<ul style="list-style-type: none"> ✓ Power subsidy ✓ Technology up grading ✓ Subsidized interest rates ✓ Technology Fund ✓ Government guarantees for new investments

(c) Additional Investment

For new investments, a moderate investment of USD 50 million would be adequate with a full recovery period of 3 years and up to 2200 direct employees in weaving spinning and garment manufacture. For a start, a new factory can be set up in Kitui or Machakos to complement the Thika based mills.

County governments, particularly those in the cotton growing areas should introduce integrated textile mills within the SME Parks principles.

Importance of textile industry /1

Illustrative investment in an integrated set-up:

Process	Infrastructure	Input material & source	Output & markets	Product type
Spinning (3 shift working)	50,000 spindles	Cotton from Kenya	Yarn for in-house consumption and exports	30s combed yarn
Weaving (3 shift working)	50 shuttle less looms	Cotton yarn manufactured in-house	Fabric for in-house consumption	30 x 30 / 133 x 72, 150 inch width, greige
Processing (3 shift working)	4 million / annum capacity	Cotton greige fabric manufactured in-house	Processed fabric for in-house consumption and sales to other exporters	30 x 30 / 140 x 72, 148 inch width, dyed
Garmenting (1 shift working)	500 sewing machines	Cotton fabric manufac. in-house and imports of other fabrics, trims and accessories	Trousers for exports	Light weight chinos

Expected investment ~ US\$ 50 million

Major Figure

- Major figures:

Department	Employment potential	Output (excl. in-house consumption)	Annual sales estimate
Spinning	~700-750	Yarn - 36 tons / day	US\$ 28 mn.
Weaving	~100-120	Woven fabrics - 4,000 m / day	US\$ 3 mn.
Processing	~80-100		
Garmenting	~1000-1200	Garments - 5,000 pieces / day	US\$ 10 mn.
Total	~1900-2200		US\$ 51 mn.

- With investment of US\$ 50 million in an integrated textile and apparel unit, same level of turnover (exports) can be expected once the unit starts performing with optimal capacity and it will employ about 2000 people.
- The unit will also create a demand for cotton, which otherwise is exported out of country without any value addition.
- From Government's point of view, any support provided to establish and run such a unit will bring far-fetched returns. Over a period of say 10 years, this investment would have earned foreign currency about 8 to 9 times of the original investment. It would also support 2,000 families with an annual wage outgo to an extent of US\$ 3.5 mn.
- It will earn about US\$ 10 mn of foreign exchange annually (through garment exports) and also save ~US\$ 31 mn. of foreign exchange by supplying yarn and fabric to local market (which otherwise would have been imported)

(d) Incentives to existing Industries

In addition to quality and adequate seed cotton and skilled staff, the key incentive packages to the mills in particular consist of:

- i. Local Procurement
- ii. Presently school uniforms use local fabric, but the quality is inadequate to sustain 24 hour milling
- iii. Local purchases for security, hospital and other public sector local institutions; and in time hospitality industry
- iv. Strengthen the marketing channels to provide export opportunities
- v. Facilitation of partnerships through sourcing
- vi. Partnerships with the academia and related training institutions
- vii. Continue with incentives to the EPZs and SEZs in the counties in particular
- viii. Promotion of indigenous investors including those majoring in category 9 under AGOA. To start with indigenous players to be assisted with a pavilion in NY and Canada to retail/sell their products

7.5 Niche Product lines

- a) Sustain the garment manufacture sub-sector- throughout sourcing,
- b) Promote Kenya ethnic prints-(Kanga, kikoy, maasai shuka, leso, jungle wear, hand loom, hand woven articles and art facts, etc)
- c) Design and Fashion
- d) T-shirts, socks, jeans, towels
- e) Uniforms for SMEs
- f) Linen

Proposals

- Strengthening the institutional frameworks for managing niche areas for specialisation

7.6 Advocacy messages

- Textile policy
- Role of government in the cotton/textile industry
- Government procurement ⁱⁱ
- Upgrade textile mills for **quality fabrics-** to diversify product lines, create employment and incomes
- Partnership between public and private sector
- Incentives-credit, dedicated funds, subsidy, cash awards, minimum prices to farmers
- Dedicated/Special development funds and instruments
- Dialogue for participants along value chain
- Designated industrial sites/SEZs
- Promotion of niche products including support to fashion designers-target youth and women enterprise funds
- Aim to produce for global markets

Annex 2: Critical Policy Issues facing with Strategic Objectives

CRITICAL FACTOR by subsector	STRATEGIC OBJECTIVE	RESPONSIBILITY	Performance MONITORING INDICATORS	TIME FRAME score card
GROWERS Coordination of farmers Low returns for farmers Price unpredictability Low farm yield Lack of extension services High inputs cost Poor market arrangements Poor chemical handling Technology upgrading Irrigation schemes	Build capacity in farmers Intensified farming activity Standardized pricing system Set improved yield practices Expand extension services Subsidize farming inputs Address market bottlenecks Educate farmers on safe use Subsidize farm equipment Rehabilitate irrigation schemes	County Government County Government Agriculture, Food & Fisheries Authority Ministry of Agriculture County Government Ministry of Agriculture MOA & MOT&I MOA, County Government Central Government Central/County government	No of farmers groups organized / empowered No. of retained & new farms established Guaranteed price level / guide established Report on percentage increase in yields Type of extension services diarized / executed Gazettement of farm inputs subsidized Policy strategy on farmer / Ginnery relations Safety use code enacted Gazettement of farm equip. to be subsidized Irrigation support policy enacted	December 2013
PRODUCTION High cost of utilities / power High cost of finance High cost of inputs Lead time constraints Low productivity Many customs procedures Obsolete technology Challenges on quality The fabric issue	Waive all levies Guaranteed lending/low int Reduce cost of inputs Remove impeding factors Improve labour productivity Streamline clearing proceed Modernize the technology Benchmark quality output Concentrate on local fabric	Central Government Central Govt Central Government MOT&I MOL KRA MOT&I KEBS MOT&I	Benchmarked cost to 5 -10 Cents/kwh Guaranteed low interest rates gazette Guaranteed low cost inputs gazette Action taken on L/T constraints Skills inventory published Streamlined procedures published Modernization fund introduced Report on standards developed Report on local fabric policy	December 2013

CRITICAL FACTOR by subsector	STRATEGIC OBJECTIVE	RESPONSIBILITY	Performance MONITORING INDICATORS	TIME FRAME score card
MARKET RELATED Competitiveness Local sourcing Second hand clothing Porous borders Branding campaigns Wear Kenya build Kenya	Reduce cost/doing business Local sourcing by Govt/Inst Controlled importation Sealed /Punitive deterrent Intensified campaigns Promotion appeals/ advert	Central Govt / MOT&I Central Govt Central Govt KRA EPC/ KenInvest/ MOSS	Improved infrastructure developed Policy directive on local sourcing Policy guideline Strict policing / compliance Report on branding actions taken Dress code developed	
EDUCATION, TRAINING & RESEARCH related issues Skills capacity building Low interest among student High cost of expatriates Funds for cotton research Role of universities/colleges Fashion design / trends	Higher level skills training Popularize at degree level Need assessment Avail more research funds Intensify textile education Spear head ethnic fashions	MOL MOEd MOIm MOF	Skills curriculum developed Sensitization on career opportunities Annual /FY assessment report FY budgetary allocation report Textile curriculum developed National dress code	2013/2014 FY
INSTITUTIONS Cotton / Textile industry Policy Promoting institution	Strengthened sector Advocacy / lobbying body	CODA/MOT&I MOT&I	Centre of Excellence established Apex textile committee established	

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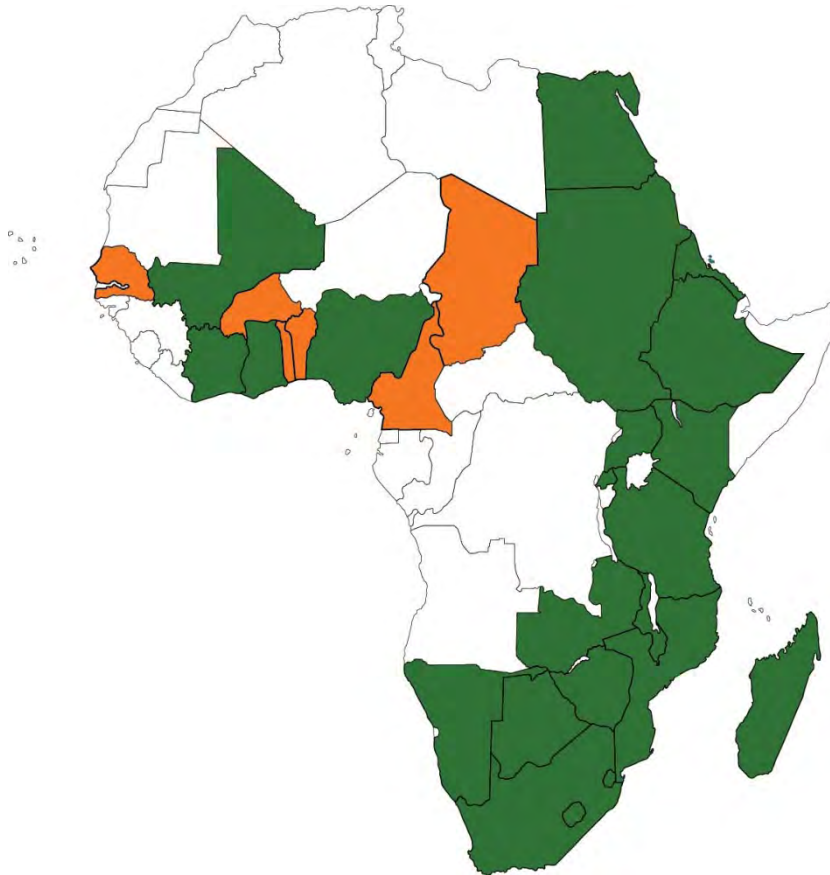
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