



Implication of Excise Duty on Sorghum Value-Chain

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SUMMARY

In September 2013, a new tax regime came into force through the Customs and Excise Act that introduced excise duty on beer made from Sorghum, millet or cassava at 50% of the rate charged on other beverages on top of the 16% VAT that beer attracts. In this analysis, we find that this duty led to an increase in sorghum beer prices, and a decline in sorghum beer sales leading to subsequent reduction in demand for sorghum, a raw material produced by smallholder farmers. We anticipated that withdrawal of a major buyer in the sorghum value chain could lead to income losses of over Ksh 6.4 billion to the various actors. The country risked adverse long run effects on poverty, food insecurity and unemployment. The analysis proposed the following to the government of Kenya for consideration: A downward review of the excise tax rate on sorghum beer; Exploration of options for up-scaling use of sorghum in feed manufacturing to cushion farmers from market uncertainty;; Review the rationale for imposing excise duty on value added products manufactured using locally produced agricultural raw materials since agricultural marketing and agro-processing is critical to agricultural growth

BACKGROUND

Sorghum is a staple food crop for many low-income households in Kenya and a raw material in the food, feed and brewing sectors of this country. A realization of its importance increases when it is viewed in terms of its suitability for production in drought-prone, semi-arid areas of Kenya. The growth of these regions will best be served by promoting the production and use of crops suited to these agro-ecological conditions.

In 2004 the government granted a remission of 30 % on excise duty on beer made from sorghum, which had been increased to 100 % in 2006. This allowed beer made from locally produced sorghum to be sold at Ksh 16. per 300 ml glass (equivalent of \$0.20), approximately the same price as most illicit brews. This was meant to promote the use of locally produced raw materials (sorghum) while encouraging consumers of illicit brew to switch to hygienically prepared beer. The incentive to produce sorghum by farmers in marginal areas where food insecurity and poverty is high was enhanced by market access offered by the East African Breweries Limited and the hope for better returns.

However, in September 2013, a new tax regime came into force through the Customs and Excise Act that introduced excise duty on beer made from sorghum, millet or cassava at 50% on the basis that the initial objective of discouraging illicit brews was not achieved and difficulty to administratively differentiate between various beer products and those made from sorghum hence posing a threat to revenue collection. However, this argument did not take into account how the small scale sorghum producers would be affected if the demand for sorghum-a raw material in beer production- is curtailed by the new tax regime on the sorghum beer.

This brief analysed the implication of the revised excise duty remission rate on the sorghum value chain to demonstrate the anticipated welfare losses to farmers as a result of its implementation and the implication on efforts to reduce poverty, food insecurity and unemployment.

OBJECTIVES

This review highlights the potential impact of the tax on sorghum value-chain if East African Breweries Limited (EABL, a major buyer of sorghum) terminates supply contracts with farmers. It uses a case study of smallholder sorghum producers, assemblers, processors and government tax revenue from the value-chains to demonstrate the anticipated welfare losses mainly to farmers as a result of the implementation. In addition, it looks at the implication on the fight against poverty, food security and job creation.

The review supposition is that the country risks adverse long run effects on poverty, food insecurity, malnutrition and unemployment in sorghum growing regions with implementation of this excise duty on beer made from sorghum, millet and cassava

DATA AND METHODS

The data is drawn from government publications in the Ministry of Agriculture, Livestock & Fisheries; Ministry of Finance; East African Breweries Limited Annual reports; and intermediaries in the sorghum and sorghum beer value-chains.

KEY FINDINGS

1. Implications of Excise Duty on Sorghum Farmers: Cereals, including sorghum, are classified as exempt from VAT. Additionally, majority of the farmers involved in sorghum growing are small scale and do not meet the thresholds of a minimum annual turnover of Ksh 3 million to charge VAT. However the small scale farmers are the suppliers of

sorghum- a primary raw material used in beer production. As a result, the small scale farmers are likely to be the worst affected as a result of introduction of the 50% excise duty on beer made from locally produced raw materials. Results of our analysis show that farmers' forgone earnings through loss of EABL market was Ksh 180 million (Figure 1).

Majority of farmers growing sorghum are from semi-arid regions of the country where food insecurity is a major problem. This forgone income is likely to aggravate the problem of food insecurity in these regions since income from sorghum has been mainly used to buy food staples like maize. Sorghum production had helped to stabilize maize prices in these regions since farmers had an alternative to maize. The supply chain also created job opportunities in transportation and threshing within the areas producing sorghum.

2. Implications on the Intermediaries: Intermediaries between the sorghum farmers and the brewer include EABL agents who do the sorghum bulking, traders and transporters EABL agents were instrumental in organizing farmers into producers groups and developing the supply chain. Transporters of sorghum from the production areas to the brewer relied on this income to stay afloat in business. The boda-boda operators transporting the sorghum from very remote farming villages where infrastructure is very poor

could lose their income streams from the termination of supply contracts. Sorghum production in these regions created employment and income creation opportunities to these intermediaries.

Analysis on the revenue of these intermediaries before and after excise duty show that their earnings before the introduction of excise duty was about Ksh 123 million. The introduction of excise tax saw their incomes decline to Ksh 44 million (Figure 2). It is expected that this Excise duty affected sales and revenues to the processors and even tax collection by government due to decline in sales.

3. Implication on Overall Value Chain: Even without data on the value of sorghum utilized by food and feed processors which we estimate to be insignificant since most feed manufactures use mainly maize in feed formulation, the positive gain from feed and food processors cannot alter the direction of the impact of this duty on potential losses accrued by all other actors.

We estimated an overall loss of about Ksh 6.4 billion. Sixty one percent of the total loss in the value chain is by the brewer followed by the government at 31 percent. However, the welfare losses to the other value chain actors especially farmers should not be underestimated considering the importance of sorghum as a source of income (Figure 3)

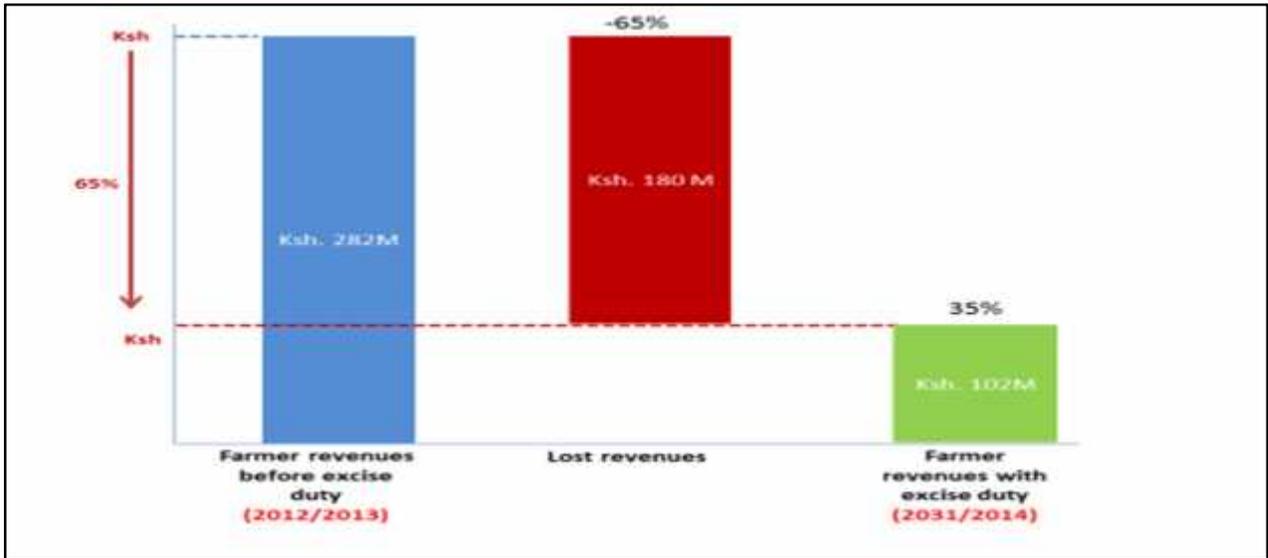


Figure 1: Farmer revenues before and after imposition of the excise duty

Source: Author's computation, EABL, 2014

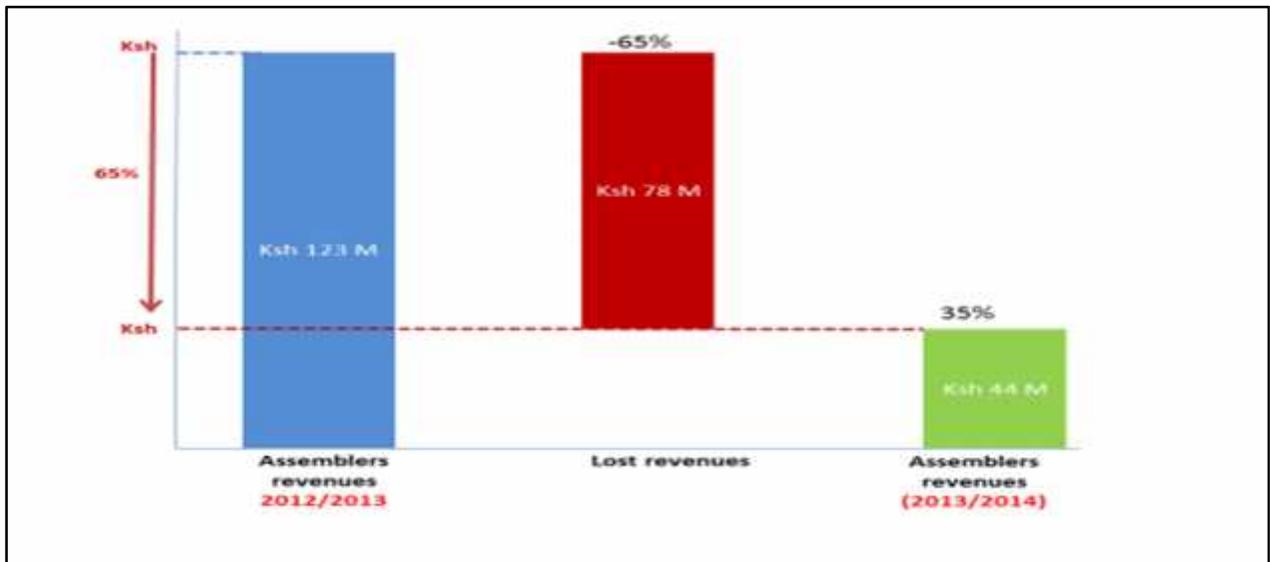


Figure 2: Sorghum Assemblers revenues before and after imposition of the excise duty

Source: Author's computation, Data from EABL, 2014

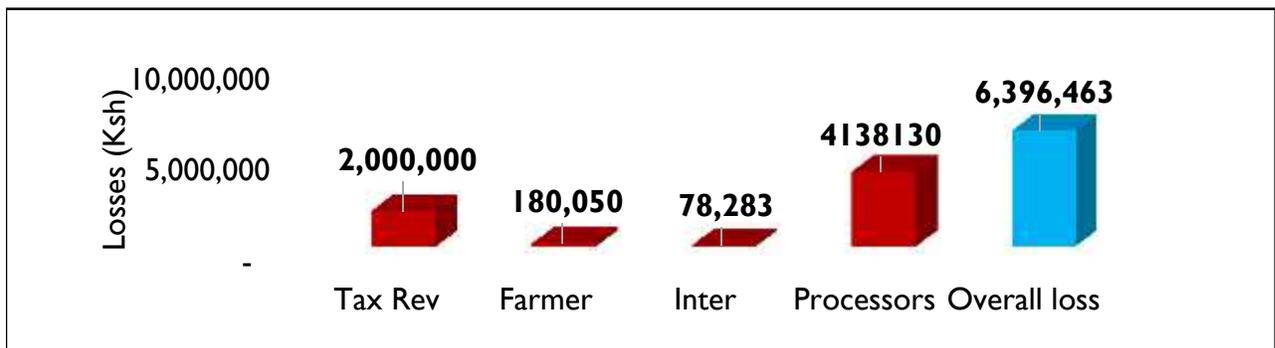


Figure 3: Overall forgone loss across the value chain (Ksh)

Source: Author's computation

Conclusion

Most price increase arising from taxation always results in reduced welfare for the society. From the case study, it is clear that this excise duty on beer made from sorghum may plunge sorghum production into disarray even without calculating economic surplus to see the overall effect. With tax in force, we anticipate that the sorghum sector is going to lose over Ksh 6.4 billion in revenue if supply contracts are terminated.

The loss in welfare is demonstrated by the anticipated loss in income by farmers in the event that supply contracts are terminated, the impact on household food security and the fight against poverty.

Therefore, government policies and investment strategies should be designed to exploit the competitive advantages of poor people living in marginal areas in the production of sorghum and other marginal crops. They should also ensure agricultural growth with favorable marketing incentives in the agro-processing sector.

Recommendations

In response to the Custom and Excise Act 2013 that introduced a 50% excise tax on sorghum beer, the government should consider the following actions:

1) Reviewing downward the rate at which the excise duty has been set. This could ensure that farmers remain in business as they continue to meet their food security needs. It would also stimulate demand for sorghum as a raw material hence help the government collect more

tax revenue from the sorghum value chains.

2) Explore options for up-scaling use of sorghum in feed and food manufacturing to cushion farmers from market uncertainties and overreliance on one major buyer since agricultural marketing and agro-processing is critical to agricultural growth Haggblade, (2007).

3) Review the rationale for imposing duty on value added products manufactured using locally produced agricultural raw materials. The government should embrace careful analysis of the domestic, regional and international markets as a basis for policy formulation.

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