Country Update

Trade and Investment in the Multilateral Trading System: EAC Stakeholder Perspectives

Provided by

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1. Introduction

This note presents the views of stakeholders concerning inclusion of trade and investment in the multilateral trading system. The note is based on data collected from stakeholders through key informant interviews, phone calls, electronic communications, and field visits. The stakeholders were sampled from the following institutions:

- The University of Nairobi, School of Economics – A chartered public university involved in research and training on international trade and investment among other courses
- Kenya Investment Authority – A public sector organization mandated to facilitate/ promote investment in Kenya.
- Export Promotion Council – A premium public sector organization under the State Department of Trade. The Council is responsible for development and promotion of export trade in Kenya.
- Kenya National Chamber of Commerce and Industry- A membership based non-profit institution working to protect commercial and industrial interests in Kenya.

2. Context

Promoting investment in key sectors such as agriculture and manufacturing was identified under the economic pillar of Kenya's Vision 2030 as an important strategy for achieving rapid economic growth and industrialization in Kenya. The government is developing a National Investment Policy to guide investment activities. Thus, strategies that are meant to facilitate investment are currently enshrined in different policy documents. For instance, the Investment Promotion Act, 2012 established Kenya Investment Authority and the National Investment Council as key institutions that are mandated to promote investment. The Authority promotes investment through other functions, issuing investment certificates, identifying investment opportunities, reviewing the investment environment and making recommendations to the government for improvement. The Council advices the government on strategies to increase investment and facilitate cooperation between the public and private sector to attract investments. Other investment related policies and legislations include the Competition Act, 2012, Public Private Partnership (PPP) Act 2014, and Micro and Small Enterprises (MSE) Act, 2012. The Competition Act facilitates investment by promoting fair competition among firms. The PPP Act promotes cooperation between the public and private sector in investment initiatives. It provides a framework for participation of the private sector in financing, construction, operation, and maintenance of infrastructure such as roads that are needed to attract investment. The MSE Act provides for the legal and institutional framework for promoting investments in micro and small enterprises.

3. Stakeholders' Perspectives

3.1 Including Trade and Investment in the Multilateral Trading System

The consulted key informants unanimously supported inclusion of trade and investment in the multilateral trading system. Kenya has participated in the multilateral trading system under GATT and WTO trade agreements with the objective of achieving effective market access. The government in a bid to increase its trade performance has embarked on promoting foreign direct investment (FDI) inflows. In particular, the government is already implementing several initiatives such as construction of export processing zones (EPZs) and participating in regional economic communities (RECs) such as the East African Community (EAC) and the Common Market for Eastern and Southern

Africa (COMESA). These efforts can lead to better development outcomes if they are supported by trade and investment agreements in the multilateral trading system that are conducive for growth of local industries and creation of job opportunities.

3.2 Implications for Developing and Least Developed Countries (LDCs)

Incorporating trade and investment in the multilateral trading system was associated with positive and negative effects on LDCs and developing countries. To begin with, the development trajectory of most LDCs and developing countries is geared towards industrialization, that can be realized if trade and investment agreements in the multilateral trading system attract FDI. An increase in FDI inflow is expected to increase employment and stimulate economic growth. As a result, the level of poverty is likely to reduce, especially in LDCs. Increased investment is also expected to encourage value addition and technology transfer, that in turn will enhance industrialization. Effective trade and investment agreements will promote healthy competition. This will motivate firms in LDCs to improve their efficiency and competitiveness in order to participate in international markets that are often characterized with high competition and product innovation. Improved efficiency coupled with technology transfer is expected to facilitate increased production in industries where LDCs have a comparative advantage.

However, trade and investment commitments in the multilateral trading system may also undermine development efforts if they do not take into account the realities or development needs of developing and least developed countries. One of the concerns raised by the interviewed key informants was the tendency of multinational firms to invest in LDCs for purposes of extracting and exporting raw materials rather than producing final goods. This limits the amount of earnings that LDCs and developing countries receive from their natural resources such as minerals. Additionally, exporting raw materials by foreign firms limit opportunities for technology transfer that results from FDI inflows.

3.3 Benefits or Loss to Kenya

Trade and investment agreements that promote FDI inflows will improve the rate of industrialization and create more job opportunities in Kenya. The backward and forward linkages created by trade and investment will facilitate economic growth and development. Moreover, increased investment is expected to support export diversification, that in turn will increase Kenya's export earnings. Kenya is also likely to benefit from technology transfer in sectors such as manufacturing and information and communication technology (ICT). The growth of these sectors is currently constrained by limited capital and expertise. This can be addressed through trade and investment agreements that allow foreign capital inflow and participation of foreign experts in the local labour market.

Inclusion of trade and investment in the multilateral trading system may also enable Kenya to reduce its current account deficit through an increase in the value of exports. Binding commitments on trade and investment will improve investor confidence by alleviating uncertainty and inconsistency in policy implementation. The resulting increase in the level of investment is expected to boost industrialization. Moreover, consumers will enjoy access to a variety of goods and services as the level of investment increases. However, inclusion of trade and investment in the multilateral trading system may also expose the country to negative development and industrialization effects. These include crowding out of local firms, abuse of dominant market position by foreign firms, and excessive control of local firms/ industries by foreign investors.

3.4 Challenges that May be Confronted in the Event that Trade and Investment is Negotiated in the WTO

A multilateral agreement on investment is expected to increase the number of foreign firms operating in Kenya, as well as, to encourage investment by Kenyan firms in foreign countries. In this regard, Kenya is likely to face several challenges in the event that multilateral disciplines are put into place with regard to investment.

First, an increase in the number of multinational corporations (MNCs) in Kenya may complicate implementation or limit the effectiveness of national policies. For instance, the effectiveness of monetary policy will be limited if a large number of MNCs are able to borrow huge funds from external financial or capital markets and use them in Kenya. In this case, increasing interest rate by the Central Bank is not likely to facilitate a reduction in inflation rate. Additionally, MNCs due to their financial strength and importance in job creation may exert pressure on the government of Kenya either directly or through their home country governments to adopt policies that benefit them at the expense of local firms. As a result, the objective of national policies in areas such as development and industrialization will be difficult to achieve.

Second, the presence of a large number of foreign firms in Kenya is likely to worsen the balance of payment in the medium term due to repatriation of profits and increased importation of raw materials or intermediate goods for production.

Third, a multilateral agreement on investment is expected to increase competition for FDI, that will force Kenya to provide costly incentives to attract foreign investors. Taxpayers are expected to lose if the cost of providing the incentives exceeds the financial benefits such as tax revenue generated by the attracted FDI. For instance, MNCs could opt to leave the country at the expiry of their tax holiday, thereby denying the government the much needed tax revenue.

Fourth, as local companies establish commercial presence in other countries in the region, Kenya's exports and level of job creation may reduce.

Finally, Kenya is likely to face challenges in ensuring fair distribution of the benefits associated with FDI. Although the benefits of investment by foreign firms in terms of job creation and demand for raw materials may be enjoyed disproportionately in the locations where such firms operate, the cost of providing the incentives to encourage the firms to invest is expected to be borne by all Kenyans through taxation. This is likely to worsen social and economic inequality in the country.

3.5 The Capacity and Technical Assistance Required to Ensure Compliance

The support required to ensure compliance includes technology transfer programs. These programs are geared towards improving the competitiveness of local firms to enable them to take advantage of existing investment opportunities in local and foreign markets. This will alleviate the resistance to compliance that is likely to be experienced if local firms are not benefiting from trade and investment agreements. It is also important to quantify or analyze the expected impact of incorporating trade and investment in the multilateral trading system. This will facilitate adoption of appropriate measures to address the negative impacts that may lead to poor compliance. Capacity building and awareness creation programs should also be implemented to ensure compliance. Traders, investors, and policymakers should be provided with the right information and skills through appropriate training programs in order to comply with trade and investment agreements.

3.6 Recommendations to Policymakers and Geneva Ambassadors

The new issues, particularly trade and investment should be negotiated at the WTO if the negotiations have real benefits for LDCs and developing countries such as Kenya. Additionally, technical assistance schemes should be established to benefit developing countries during negotiations and implementation to ensure success. Most LDCs and developing countries lack capacity in terms of expertise, human resources, and funds to participate effectively in negotiations and implementation of multilateral agreements. Thus, providing technical assistance is key to the success of agreements in trade and investment. Special and differential treatment should also be provided to enable Kenya and other developing countries to benefit from inclusion of trade and investment in the multilateral trading system.

CUTS International, Geneva

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37-39, Rue de Vermont, 1202 Geneva, Switzerland
geneva@cuts.org ● www.cuts-geneva.org
Ph: +41 (0) 22 734 60 80 | Fax:+41 (0) 22 734 39 14 | Skype: cuts.grc

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