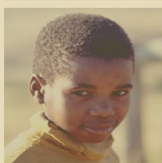
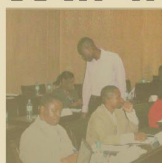


# Taking East African Regional Integration Forward

## A Civil Society Perspective



Taking East African Regional  
Integration Forward  
*A Civil Society Perspective*

## Taking East African Regional Integration Forward: *A Civil Society Perspective*

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# List of Acronyms

ACP	African, Caribbean and Pacific
AGOA	Africa Growth and Opportunity Act
BIEAC	Building an Inclusive East African Community
BMP	Business Migration Programme
CET	Common External Tariff
COMESA	Common Market for Eastern and Southern Africa
CPA	Cotonou Partnership Agreement
CSO	Civil Society Organisation
CUTS	Consumer Unity & Trust Society
DFQF	Duty Free Quota Free
EAC	East African Community
EACSONEI	East African Civil Society Network on Economic Issues
EADB	East African Development Bank
EBA	Everything But Arms
EC	European Commission
EPA	Economic Partnership Agreement
EPZ	Export Processing Zone
EU	European Union
FAO	Food and Agriculture Organisation
FDI	Foreign Direct Investment
FEPA	Framework Economic Partnership Agreement
FTA	Free Trade Area
GATS	General Agreement on Trade in Services

GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GSTP	Global System of Trade Preferences
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
ICBT	Informal Cross-Border Trade
ILO	International Labour Organisation
LDC	Least Developed Country
MFN	Most Favoured Nation
MSME	Micro, Small and Medium Enterprises
NTB	Non Tariff Barrier
PPP	Public Private Partnership
R&D	Research and Development
RECs	Regional Economic Communities
RoO	Rules of Origin
S&DT	Special and Differential Treatment
SADC	Southern African Development Community
SEZ	Special Economic Zone
SME	Small and Medium Enterprise
SPS	Sanitary and Phytosanitary
SWP	Skilled Workers Programme
TBT	Technical Barriers to Trade
TNCs	Transnational Corporations
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added Tax
WTO	World Trade Organisation



# Preface

The East Africa Community (EAC) was first established in 1967 comprising of Kenya, Tanzania and Uganda. It collapsed in 1977 as a result of several factors including political differences, but was re-established in 2000 constituting the same member countries, and expanded to include Burundi and Rwanda in 2007.

The member states have agreed to establish closer economic links through a Free Trade Area (established in 2001), a Customs Union (established in 2005), a Common Market (established in 2010), a Monetary Union (by 2012), and ultimately a Political Federation. The EAC members are also collectively negotiating an Economic Partnership Agreement (EPA) with the European Union (EU), where supporting regional integration is an overarching objective.

This effort in regional integration offers significant opportunities for promoting economic and social development in the EAC region. However, a wide range of challenges, many of which proved to be stumbling blocks in the previous effort to establish the EAC, still remain. These include:

- Implementing existing agreements: Phasing out tariffs within the region in order to implement an FTA and a common external tariff (CET) and removing non-tariff barriers (NTBs).
- Agreeing to future terms for cooperation and external trade: Adjustments to the CET and external trade terms relating to the EPA and the region's engagement in the wider regional integration process for EAC, Southern African Development Community (SADC) and Common Market for Eastern and Southern Africa (COMESA).

- Adjusting to emerging economic and social dynamics: While regional integration creates new opportunities, it also leads to redistribution of resources away from some sectors, and those within these sectors need support to take up opportunities elsewhere.
- Ensuring cooperation and inclusivity: Promoting inclusive development and poverty reduction, for which economically and socially marginalised groups require targeted assistance in order to access new trading opportunities.

Successfully tackling these challenges require a wide range of actions and cooperation across the region. Engaging citizens in the policy dialogue and implementation process so that action responds to their needs and attracts the ownership required to be politically sustainable is a prominent action in this context. The Building an Inclusive East African Community (BIEAC) project was conceptualised and implemented as a contribution to address this need.

The project was implemented by CUTS Geneva Resource Centre (CUTS GRC) and covered all the five EAC member states: Burundi, Kenya, Rwanda, Tanzania and Uganda. The project's aim was to support a range of civil society organisations (CSOs) in the EAC member countries to examine the implications of external trade policies on the welfare and livelihood of people and provide a better understanding of both challenges and opportunities of regional integration. It supported these CSOs in their effort to raise the awareness of the general public on relevant issues, gather their concerns and carry out advocacy to highlight them to the policy makers.

The CSOs researched potential implications of the proposed intra-EAC and external trade policies for the poor and marginalised in the region, identified interventions and policies required to support economic and social adjustment to trade reforms and measures necessary to support the poor and marginalised to better access opportunities provided by the intra-EAC and external trade integration. This was not research conducted by an expert sitting in the hallowed precincts of any international organisation, but by

national researchers based in these countries. It reflected the perceptions and needs of the masses, thus helping forge an ownership of the research and its conclusions among the local citizens. It focussed on a limited set of 13 issues identified by project partners through an iterative process, and therefore is a bottom-up identification of relevant issues rather than an exhaustive list of all issues relevant to achieve regional integration. Policy briefs and easy-to-read trade guides were produced based on this research.

National and regional level advocacy workshops were organised to bring together CSOs, relevant government officials, private sector and the academia to discuss research papers, validate them and build consensus around advocacy efforts. Thereafter, numerous awareness raising workshops were organised to disseminate the findings of the research and take feedback from the citizens on policy advocacy emphases of their interest. These workshops involved a wider cross section of citizens of the EAC. Hence, apart from the main cities (Bujumbura, Dar Es Salaam, Kampala, Kigali and Nairobi), the dissemination included other cities such as Arua, Dodoma, Kabale, Kasese, Morogoro, Mwanza, Seeta and Mukono.

Civil society positions resulting from the activities under the project were shared with the stakeholders relevant for informing the EAC trade and regional integration policy. The CSOs were also engaged in informal advocacy with national and regional governments. Finally, a Regional Conference was organised in Arusha, the seat of the EAC Secretariat, to discuss a synthesis of all the researched issues and develop plans for carrying forward the aims of the project beyond its completion. A number of issues have been identified on which the CSOs are working together to pursue their efforts to create an informed and involved citizenry in the EAC to support its regional integration efforts.

These CSOs have also decided to organise themselves into an East African Civil Society Network on Economic Issues (EACSONEI). This network hopes to feed into the EAC Secretariat's efforts for a sustainable, inclusive and participative dialogue between all the stakeholders of the region.

This paper brings together key messages, conclusions and recommendations from the research conducted under the BIEAC project. Apart from helping to continue raising awareness of issues relevant for regional integration, the paper is also intended to serve as a comprehensive collection of the wishes and desires of the civil society of EAC. It is also an assurance of the civil society to policy makers, researchers and businesses that it will continue to support regional integration efforts that bring about development and prosperity in the region and an offer to join hands as equal partners in the process.

December 2010

**Pradeep S Mehta**  
Secretary General  
CUTS International

# Executive Summary

In recent years, the member states of EAC: Burundi, Kenya, Rwanda, Tanzania and Uganda have scaled up their regional integration efforts. The primary and strategic goal is to convert deeper economic, social, cultural and political integration into a political union of the EAC. CUTS with support from Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) implemented a two-year long project in the five countries to create capacities of the civil society for a better understanding of both challenges and opportunities of trade integration. 13 research papers were produced during the project, six dealing with the issue of EU-EAC EPA and seven with the issue of regional integration. Based on that research and various dialogues conducted during the project at regional, national and sub-national levels, this synthesis paper summarises ways in which an inclusive EAC integration can be achieved.

Regional integration requires political will and commitment of the leaders of the EAC member states to relinquish parts of their sovereign decision making powers to a regional authority with a view to achieve the broader benefit from the economies of scale that come with larger production centres and markets. Creation of a single economic space requires them to harmonise national economic and social policies, create infrastructure and facilitate trade keeping regional development in view and bring down administrative and transaction costs. When neighbouring countries benefit from each other, peer pressure from the beneficiary citizens creates soft policy coordination.

More substantive policy coordination and implementation comes with regional institution building, better coordination among adjudicatory, regulatory and administrative agencies of the countries and the eventual creation of regional agencies to enforce policies. Such

collective action usually requires a champion, a leader among the participating nations to drive and even subsidise the regional integration efforts of weaker partners. Harmonisation of and coordination for aligning the national development plans of member states in the medium to long term should go hand in hand with developing research based policy options that emphasise the benefits of the integration process to EAC households and individuals in each of the member states. The cultural and historical affinities among the peoples of the region will help in ensuring support from masses.

The BIEAC research on regional integration focussed on select issues: regional migration, informal cross-border trade (ICBT), tax harmonisation, NTBs, implications of accession of new and small member states on private sector development, and fostering competition. The research brought together a comprehensive list of recommendations on addressing challenges and leveraging opportunities in this second and resurgent avatar of the EAC.

The research takes on some of the difficult issues of making markets work. For example, it makes a case for facilitating easy movement of people across the regional borders for better economic development. It suggests ways to attract, retain and spread skills across the region. These include harmonisation of labour laws, simplification of the red-tape, education of the citizens about its benefits to imbue it with ownership and creation of a regional identity.

On ICBT, while the research identifies a number of its negative implications, it also lists some positive effects on people living near borders and competition among enterprises. It goes on to make some clear policy recommendations including trade facilitation, support programmes for small enterprises and improvement of the business environment. The research notes wide differences in tax systems in the member states of the EAC as a barrier to regional integration and argues strongly for developing incentives to encourage small and medium enterprises (SMEs) in particular to enter the formal economy and access its benefits. It lists actions required to create an EAC-wide value-added tax (VAT) system.

The research also takes up issues common in many developing country regions seeking integration. Despite having decided to remove NTBs two years back, for example, the EAC member states are still struggling with them. These are inherently structural bottlenecks addressing which needs political decisions to coordinate regional initiatives, enhance regional infrastructure, reduce informal trade, harmonise business practices and establish a regional monitoring body.

On the issue of competition it takes Uganda's example and suggests forging of healthy links between competition policy and law on the one hand, and intellectual and industrial policy on the other. It emphasises a culture of competition and raising stakeholder awareness of the benefits of competition. Private sector is nascent, to say the least, in the late entrants into the EAC, Burundi and Rwanda. The research argues that while the private sector in two countries require building and crossing many bridges, its integration into the EAC market is beneficial for all due to the larger market size. It goes on to list the steps taken by these countries to organise their private sector and recommends in particular public-private partnerships (PPPs), micro-enterprise development and harmonisation of regional property rights.

Finally, the research on regional integration takes stock of the EAC in its second avatar and argues that the resurgence in regional integration efforts is sustainable if the priorities are right. It recommends some key coordination efforts and awareness raising steps to benefit from this resurgence.

The BIEAC research on the EAC-EU EPA has also brought forth a number of key messages that can feed into the regional integration process.

The EPA has potential to deliver development benefits, reduce regional poverty and enhance the region's integration process, if the following are ensured: (i) adequate technical preparation for negotiations within the EAC; (ii) increased use of empirically backed public policy options by the EAC negotiators; (iii) EAC is enabled with the capacity to eliminate structural constraints (institutional and physical

infrastructure) that limit the region's competitiveness; and (iv) investments in some sectors of the regional economy to promote competitiveness are accompanied with deeper reforms to attract foreign direct investment (FDI).

The balance between the need for EAC to fulfil its contractual obligations enshrined in the Cotonou Partnership Agreement (CPA) and the need to ensure that the EAC-EU EPA is benchmarked on the development needs of the region requires that the signing of an EPA with the EU should be preceded by careful preparation by the EAC member countries on all the key pillars of the CPA, especially trade and development cooperation. Adequate research and preparation on each of these issues will enhance EAC negotiating position and also ensure that development is benchmarked as a central pillar for the outcome EPA for EAC member states to derive maximum benefits from the partnership.

A proactive role of the civil society in the EAC integration process and EAC-EU EPA negotiations is an imperative. EAC should open up avenues to facilitate the CSOs' participation in policy and decision making processes to ensure the primary objective of building an inclusive EAC. CSOs in the region also need to equip and organise themselves to take advantage of the advocacy space that exists and enhance their effective involvement.

CSOs have a unique role of using their vast networks and outreach to the ordinary people, thereby carrying out public education campaign and mobilisation for the success of all integration processes and initiatives. There is need to enhance capacities of the CSOs to identify integration opportunities, bring citizens on board and enhance their monitoring and evaluation capabilities. For the EAC governments, it is important to introduce legally binding mechanisms for stakeholder engagement at the regional level to ensure an inclusive approach to integration.

The BIEAC research complements the existing literature on how to achieve an inclusive EAC integration and negotiate a pro-development EPA with the EU. It documents the success factors that will need to be borne in mind by all stakeholders if the EAC is to stand the test of



time and achieve inclusiveness. The key success factors include sustaining of the political will, ensuring participation of the public to bring about collective responsibility and ownership, sharing of benefits from the integration process equitably and proportionally among member states to make it inclusive.

Regarding the EAC-EU EPA negotiations, BIEAC research recommends that it is essential that the development needs of the EAC member states take centre stage and drive the process of EAC-EU EPA negotiations rather than deadlines. It argues that EAC member states should make adequate technical preparation on the negotiation menu and all outcomes be benchmarked on their contribution to the region's reduction in household poverty, increased job creation, increased indigenous industrial growth, regional investment, technology transfer and trade opportunities for EAC products in the EU market.

The research also recommends securing of institutionalised mechanisms to guarantee and ensure active engagement of an informed civil society with capacity to influence the regional integration processes including the EAC-EU EPA negotiations in favour of the poor in the region.

# 1 | Introduction

This synthesis paper sets out the key issues of importance to an inclusive and optimal integration of the EAC. It is based on the findings of the background research commissioned by CSOs of the five EAC member countries (Burundi, Kenya, Rwanda, Tanzania and Uganda) under the BIEAC project implemented by CUTS GRC.

The research focusses on two broad areas: (i) regional issues that affect optimal and inclusive integration of the EAC, and (ii) the scope and implications of EAC-EC EPA negotiation issues.

On the integration between partner states of EAC, the paper sets its premise on the fact that the EAC aims to achieve deeper integration economically, socially and culturally, eventually leading to a political union. The paper asserts that to achieve a fast, people centred, and balanced regional development, it needs to avoid repetition of the history that led to the dissolution of the East African Cooperation Treaty in 1977. At that time there was a: (i) lack of strong political will, (ii) lack of strong participation of the private sector and civil society in cooperation activities, (iii) the continued disproportionate sharing of benefits of the community among the partner states due to the differences in their levels of development, and (iv) lack of adequate policies to ensure harmonised integration<sup>1</sup>.

On EAC-EC EPA negotiation issues, the paper aligns itself with the primary objectives of negotiating the EAC-EC EPA with the EU, i.e.: (i) an EPA that contributes to economic growth and development of EAC states through meaningful market access for EAC products in

EU markets; (ii) fostering EAC regional integration, economic cooperation and good governance; (iii) promoting structural transformation of EAC economies through the development cooperation component of the EPA<sup>2</sup>; and (iv) ensuring transparency during the negotiations to reduce mistrust and increase quality inputs by all stakeholders<sup>3</sup>.

The rest of the paper is arranged in four sections as follows. Section two suggests 12 pillars for a successful, inclusive and optimal regional integration. Section three summarises the findings of the research on regional integration issues and section four synthesises the findings on EAC-EU EPA negotiation issues. Lastly, section five draws some key policy recommendations from the research.

## 2

# The 12 Pillars of EAC Inclusive Integration

Some key pillars are essential for an optimal, inclusive EAC regional integration among the EAC partner states. This section identifies these pillars and draws heavily from the findings of the BIEAC research papers as well as history of EAC and from best practices of regional integration elsewhere. Reference is also made to theoretical and scholastic analysis of regional integration. The paper presents 12 pillars as pre-requisites for a successful and deeper EAC integration.

### *Pillar 1: Political Will*

One of the key reasons for the failure of EAC in 1977 and the ineffectiveness of the previous efforts to achieve greater integration of the region was the lack of commitment to adhere to or implement programmes at the regional level. This may have arisen primarily due to the inability of member states to keep regional goals ahead of the national ones.

It is widely noted in BIEAC research that relinquishing some of the sovereignty by member states to the EAC Secretariat organs has been slow and sometimes not so forthcoming. Some member states are not willing to sacrifice sovereignty for economic development for the greater good of the region and the potential increase in bargaining power at multilateral forums such as the United Nations (UN) or the World Trade Organisation (WTO) that would result from a single political force of the region.

Also, poor or inadequate mechanisms for handling the adjustment problems of integration is widely blamed in literature as a possible cause of conflict between member states, especially on the distribution of costs and benefits necessary for the prevention of imbalanced regional growth. Therefore, it is essential that all member states should not only show willingness to overcome the temptations to undermine the goals of regional integration, but also institute robust mechanisms to handle adjustment problems at the EAC level in the overall framework of common public interventions. In EAC, this will be crucial especially regarding the distribution of benefits that come from exploitation of common natural resources.

For balanced regional economic growth, the encouragement of coordination and coherence in the regional structures of production among the partner states is essential. That is to complement the natural outcome of deeper integration by allowing relocation of resources of production to those member states that have comparative advantage, permit adaptation and specialisation within the region and allocate adjustment costs to ensure that economic growth in the region is fairly well distributed. This should also reduce the tendency of stronger members to use their economic muscle to benefit most, at the expense of the weaker members.

Mechanisms must be instituted and agreed upon at the heads of state level among the partner states so that the EAC decisions do not conflict with specific national interests. Such mechanisms ensure minimisation of economic divergence and attempt to satisfy all the members of the EAC at all levels of economic development.

### *Pillar 2: Facilitation of Faster and Full EAC Economic Integration*

To achieve a deeper economic integration in which all potential economic gains are exploited by economic actors in the region, there is need to move fast to remove or reduce administrative and transaction costs thus leading to a “single EAC economic space<sup>4</sup>”. A single economic space will guarantee economies of scale for the region’s enterprises and firms, reduce production costs per unit, create a larger consumer base for their goods and services, and attract both domestic and international investment flows<sup>5</sup>.

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4 ♦ Taking East African Regional Integration Forward

The single economic space will also permit fair inter-firm competition, generate and disseminate better information on prices of goods and services in the region, and increase the availability of a variety of intermediate goods, inputs and consumer products thereby increasing the welfare of all EAC residents<sup>6</sup>.

This will require that the EAC enact, implement and monitor economic policy and thus reduce the region's administrative transactions and trade barriers responsible for market segmentation. Through extensive harmonisation of national economic policies, fiscal and social policies and other public policy interventions, the EAC partner states can empower the EAC Secretariat or an EAC Economic Authority to put into action EAC economic integration aspirations and goals.

The Food and Agriculture Organisation (FAO) 2003 notes that in a single market, states should move to smoothen and unify their public policy interventions, ideally by transferring the interventions at the EAC Secretariat level through a form of positive integration; a practice that will help not only reduce market segmentation but also unintended trade barriers within the single economic space<sup>7</sup>.

The commitment to a single economic space without market segmentation or discriminatory domestic policies within member states pay dividends in terms of increased bargaining power of the region in international forums, increased credibility in policy reforms, raised visibility in attracting FDI (i.e. investors will assume that integration effort will not be reversed, therefore increase investment certainty) and technology that comes with it. It would also expedite the political unification of the region.

### *Pillar 3: Encourage Equal Participation of the Public, Non-State Actors, Regional Firms and Enterprises*

Lack of involvement of the non-state actors, the business community (enterprises and regional corporations), CSOs, academics etc. is said to have played a crucial role in the demise of the EAC in 1977<sup>8</sup>. The top down model of regional integration largely driven by the public sector officials and heads of state has been blamed for the

ineffectiveness of African regional integration initiatives<sup>9</sup>. FAO (2003) notes that pressure from regional non-state actors like regional corporations and business entities, once involved, can create an impetus for political change, particularly triggering the surrender of sovereignty in sectors of the economy that are essential to improving regional welfare<sup>10</sup>.

It is essential to note that potential economic gains for the nation translate into economic potential gains for individual firms, since integration provides a larger market for them to export their goods. This should act as a reason for corporate actors within the community to lobby with their governments to make changes necessary to effect deeper political and economic integration<sup>11,12</sup>. Direct involvement of the private sector in the formulation and implementation of a favourable policy environment is a pre-requisite for faster and deeper economic integration.

#### *Pillar 4: Regulatory Harmonisation and Coordination*

BIEAC research has documented many differences in the existing regulatory profiles of EAC partner states in all sectors of the EAC economy. While it is noted that differences in national regulations may reflect different social preferences within a particular member state, for deeper EAC integration, a cohesive regulatory coordination will be essential. This is because regulatory coordination (as a minimum requirement, but harmonisation as first best) will help the EAC minimise the market segmentation impacts of differences within the member states of EAC<sup>13</sup>.

As first best, members in the EAC common market states should move to harmonise or at least coordinate their regulatory requirements in all sectors of the region's economy and as a benchmark for effective operation of the single market (i.e. removal of market segmentation due to differences in national rules, regulations, and standards in the region). At the very least they should achieve mutual recognition of the standards applicable in member states<sup>14</sup>.

Scollay (2001) notes that sectoral policy and rules coordination (and harmonisation) in areas of customs procedures, competition policy,

government procurement, services and investment, deregulation, intellectual property rights (IPRs), mobility of business persons, information gathering and analysis, and standards and conformity assessment is essential for deeper and faster integration.

Additionally, sectoral cooperation confers advantages to the region in terms of decreasing the duplication of functions (which according to BIEAC research is rampant in the EAC) in the member states; facilitating the sharing of regional resources and experience in activities such as research and training; and building a regional service infrastructure and other additional public goods necessary for effective functioning of a single market<sup>15</sup>.

***Pillar 5: Encourage Measures to Secure “Collective Action” (Collective Responsibility)***

Ideally, collective action gets facilitated by the existence of a willing regional leader capable of championing decision making regarding rules, regulations and policies to adopt in the region. Such a leader also takes the lead in footing the bills of regional integration, aiding the weaker members of the group in the transition period, and meeting the adjustment costs as their industries adjust to greater competition in the larger market<sup>16</sup>.

***Pillar 6: Commitment to Institution Building***

The EAC Secretariat needs to be empowered both with authority and resources to carry out the monitoring function in order to ensure that both member states and individual entities live up to their EAC treaty obligations. It is also essential that the EAC Secretariat organs adopt enforcement procedures against states and individuals which violate the EAC treaty obligations<sup>17</sup>. Member states should politically empower the EAC Secretariat to ensure that states, firms, and individuals in the EAC economic space comply with their obligations under EAC treaty and other secondary EAC legislation.

Legal organs of the EAC Secretariat (such as the EAC Court of Justice) should adopt the doctrine of supremacy and direct effect. Under this doctrine, the EAC law will be directly applicable to the citizens of EAC member states, thus helping the EAC to execute the functions



of monitoring and enforcement of the regional law. This also prevents member states and individual entities from avoiding their regional obligations and undermining deeper integration initiatives<sup>18</sup>.

FAO (2003) notes that a complex system of secondary laws that take the form of directives and regulations like those characteristic of the EU can help strengthen institutional harmonisation within a regional block, in this case of the EAC. This secondary law system would aid EAC in regulating in a coordinated fashion every aspect of economic, trade, political and development cooperation within the EAC, thus providing a level playing field for entities, corporations etc., reducing transaction, transport and administrative costs between member states.

It is also noted that supranational institutional arrangements foster long term commitments to regional integration and sustain the regional integration agenda beyond member states' changes in political leadership and variations in public support.

Overall, for the success of supranational institutional arrangements, it is essential to ensure democratic participation of stakeholders, transparent supranational decision making and accountability of regional institutions in order to sustain public support.

#### *Pillar 7: Cultural and Historical Realities*

Emphasis should be placed on leveraging historical and cultural ties of the EAC region into the institutional legal instruments<sup>19</sup>.

#### *Pillar 8: Policy Research and Analysis*

It is necessary to create a regional policy agenda, informed by greater utilisation of regional empirical studies and analysis on the projected effects (costs and benefits) of integration on each member state. Policy formulation based on regional realities will strengthen the appropriateness of these policies both in the short and long term. Therefore, a deliberate effort should be undertaken to strengthen the human capital in research and analysis, establish the necessary infrastructure in the form of regional centres of excellence, and strengthen the regional academic institutions and private research

organisations. This should further strengthen public support, if the benefits of EAC deeper integration are used to raise public awareness or constantly consulted in the policy formulation exercises<sup>20, 21, 22</sup>.

Furthermore, research and analysis institutions should play a role of identifying opportunities for cross border collaboration, encouraging or preparing analytical studies, publishing regional statistics and regional market information, and supporting training and networking functions including policy analysis networks.

#### *Pillar 9: Avoid Multiplicity of Membership*

Multiplicity of membership within different regional configurations is considered in the literature as a stumbling rather than a building block for deeper integration. The EAC member states, to ensure speedy and deeper integration, should resist being in a “spaghetti bowl” of parallel regional integration initiatives. If for geopolitical reasons multiple memberships can be useful, proactive coordination mechanism should precede such membership with intent to streamline policies within each block<sup>23</sup>.

#### *Pillar 10: Trade Facilitation*

BIEAC research notes significant levels of structural constraints to the free flow of goods and services, movement of business people, and fragmented trade regulation among the member states in the EAC. For example, complicated and slow customs procedures and disparate health and safety or technical standards still exist despite the Common Market coming into force. They are cost increasing and therefore anti-business which limits growth of trade flows within the region. The research notes that resources which could be employed productively elsewhere in the economy are tied up or wasted in the form of transaction costs, as a result of these barriers<sup>24</sup>.

Trade within Africa has been crippled by a very long list of cost raising barriers<sup>25</sup>. The removal of constraints regarding the transportation system for intra-regional trade and the telecommunications system will not only boost intra-regional trade but also regional welfare. This also includes harmonisation and modernisation of the regional standards on food safety and

standardising sanitary and phytosanitary (SPS) measures, which are all essential to the promotion of intra-regional trade.

Therefore, the partner states, in coordination with the EAC Secretariat should strive to implement trade facilitation measures to reduce frontier formalities, recognise mutual equivalence of SPS measures, and harmonise documentation for the flow of goods and services within the region<sup>26</sup>.

This also applies to trade policy barriers that arise from differences in the domestic agricultural and rural development policies. Member states should begin to initiate a common agricultural policy to avoid duplication of these barriers and ensure a common agricultural market.

#### ***Pillar 11: Regional Networking***

The objective is to improve regional education by enabling those involved in similar labour and business activities in neighbouring countries to benefit from each other's experiences, exert peer pressure to raise standards, and encourage the spread and adoption of best practices. Such "soft" policy coordination is an essential tool to speed up the process of regional integration as the EU experience demonstrates and can be used at the national and regional level in employment and anti-poverty strategies in the region.

#### ***Pillar 12: Regional Public Goods***

EAC partner states will have to act in unison to create regional public goods, making it necessary for the region's public goods to be delivered at the supranational level<sup>27</sup>. These include scientific research, environmental protection, public health issues, financial market regulations, scientific research infrastructure, coordination of cross-border transport networks, law enforcement, and enforcement of property rights.

EAC member states should aim to provide regional public goods funding and boost human resource capacity of the institutions responsible for the management of these goods<sup>28</sup>.

# 3

## Regional Integration Issues

Research under the BIEAC project was undertaken by the stakeholder CSOs in the five member states of the EAC selecting issues they perceived as most important to enhance their understanding of the intricacies involved. For the phase of the project dealing with regional integration, they chose seven issues that they felt were the most critical to understand the economic benefits of integration and to suggest a way forward to the policy community. It was not the intention to cover all aspects of regional integration in an exhaustive manner, but to pick up a limited set of issues that enable better policy choices and policy implementation to reach the goals of integration.

This section therefore deals with seven key policy issues: (i) integrating migration with development in the EAC; (ii) how might EAC reduce the negative implications of ICBT to support regional trade integration and development; (iii) harmonisation of EAC tax policy and laws; (iv) NTBs in trading within the EAC; (v) implications for Private Sector Development of accession of Burundi and Rwanda to the EAC; (vi) socio-economic implications of competition policy and law; and (vii) a case for trade in the resurgent EAC policy. These constitute key policy priorities that the EAC member states should embark on to realise an inclusive holistic regional integration of the EAC.

### 3.1 Regional Migration

This subsection examines challenges, opportunities, and policy responses of intra-regional migration within EAC partner states. The

objective is to identify and suggest the best practices for an inclusive and optimal East African Integration.

The research emphasises the need for a policy paradigm that aims to reduce potential xenophobic responses to migrants of member states of the EAC through various measures, for instance: (i) the creation of public awareness to increase ownership of the integration process; (ii) education of citizens on their rights, obligations, regulations and laws in the recipient countries; (iii) reduction in the negative mindsets toward EAC regional migrants by highlighting their benefits to deeper integration within the EAC; (iv) establishment of coordination and information centres with EAC member states to coordinate migration with national and regional directorates of migration and also dissemination of labour market information to prospective workers and employers in the region; (vii) harmonisation of laws, regulations, worker's rights, compensation schemes (including equal access to social services and benefits) and mutual recognition of credentials among member states; and (viii) skill enhancement programmes at job centres based on the region's market needs, preparing candidates to move within the region and developing a regional recruitment procedure that ensures equal opportunity for all EAC citizens.

BIEAC research<sup>29</sup> highlights various challenges of intra-regional migration: poor infrastructure; widespread information barriers; and lack of harmonisation of the region's labour laws and regulation within member states. Sporadic flow of refugees and internally displaced persons because of conflicts, natural calamities and illegal or under-qualified migrants also contribute to the widespread negative mindsets of the people of some of the member states in EAC toward migrants. These challenges can impact negatively a balanced development and deeper EAC integration.

The research suggests some solutions to these challenges, and notes that to maximise the pro-development effects of intra-regional migration, emphasis has to be placed on efficient management of migration between member states and effective implementation of the EAC Common Market Protocol, which provides for free movement of people and the right of establishment and residence within any member state of the EAC. This will require streamlining

### Box 1: Why do People Move in the EAC?

Kanyangoga (2010) notes the following reasons for intra-regional migration in EAC:

*a. Economic/poverty related migration:* East Africans migrate from one part of the region to another in search of work and better standards of living. Until recently many East Africans migrated to Kenya because of its well performing economy and relatively higher standard of living. Currently, the new frontiers of migration in the region are Rwanda, Burundi and Tanzania. This is largely driven by an increasing demand for skilled labour in these countries as a result of booming FDI flows into new sectors of their economies.

*b. Historical, cultural and tribal linkages between the peoples of East Africa:* Prior to colonisation, people in East Africa benefited from a lack of official boundaries which allowed them to interact freely, exchange goods and services and conduct barter trade; a practice that enhanced networks within regional clans, tribes and cultures of East African countries. This practice continues.

*c. Conflict activated:* This type of migration includes refugees, internally displaced persons and other irregular situations and natural disasters like droughts, floods and volcanic eruptions.

*d. Trade :* Informal networks of exchange of goods and services within the border vicinities.

migration issues within the region's member states' development plans to deliver the benefits of deeper integration, increased sense of ownership of the integration process by EAC citizens and for them to appreciate the benefits of the integration process through increased work opportunities and consequent standards of living. It will also permit the sharing of the region's pool of skills, talents and technology and speed up the process of regional cultural integration.

Once skilled labour moves freely in the region, member governments will gain revenues from income tax of resident skilled workers and help spread development opportunities to all parts of the region. Further, families of the migrants will gain from remittances being sent back home.

The region also has several potential indirect gains from increased flow of migrants. These include boosting ownership of the integration process among communities of the migrating individuals as well as a speeding up of the integration processes through the re-establishment of family ties and business networks resulting from the increased movement of people within the region.

#### Box 2: A Case Study of Rwanda's Migration Policy

A case study of Rwanda is used in the research which reveals the importance of a comprehensive policy approach to the issue of migration that could be replicated within the region. The Rwanda migration policy seeks to maximise the returns of inflows of migrants for its economic development, social empowerment and technological progress and consequent poverty eradication. The following constitutes key elements for proactive policies for migration management in EAC:

*Skill attraction:* The Skilled Worker Programme (SWP) aimed at attracting skilled labour to Rwanda intends to serve Rwanda's post conflict demand for skilled labour, fill the existing labour market gaps, and encourage the overall entry of foreign skilled workers found to be lacking in Rwanda's labour market. This should be adopted by all member states in EAC.

*Investment attraction:* Allowing and facilitating the entry of investors by cutting the documentation red-tape for them to acquire the necessary permits, visas and authorisation to start operating their business in the shortest possible time and at the lowest cost possible through the Business Migration Programme

Contd...

(BMP) and other initiatives may lead to high job creation, economic prosperity and poverty eradication.

*Train, retain talent:* Initiatives ‘encouraging’ increasing and boosting domestic skills and human productivity based on knowledge transfer from foreign expatriates to generate quick wins in terms of the economic and social growth.

*Simplification and abolition of red-tape in migration procedures:* Reducing the number of steps and documentation required for visa, work or residence permit and digitisation of the application process including submitting applications online and common regional identification (EAC passport).

The case study shows that Rwanda has pursued a policy goal to maximise the benefits of skilled migration while at the same time mitigating the consequences of illegal migration through a SWP. It is also noted that Rwanda receives revenue from taxes paid by these highly skilled immigrants, which creates a win-win situation for both parties while indirectly promoting the objective of deeper regional integration and economic transformation.

Taking lessons from the Rwanda case study, the region should aim at policy initiatives that encourage member states to reduce barriers to intra-regional migration, enhance the process of deeper integration, boost social cohesion and allay fears of negative effects of free movement of EAC citizens within member states as well as promote the region’s competitiveness and economic prosperity. This will require policies that guarantee minimum social protection for the immigrants, non discrimination in work opportunities and equitable access to social benefits and social services. In addition to common market protocol provisions, supplementary policy instruments should include initiatives to include cooperation to harmonise and mutually recognise academic and professional qualifications as well as coordinate and harmonise social policies amongst the EAC member states.



There is a tendency for migrants to follow pockets of economic opportunity. Areas or countries with potential sources of employment or high economic growth will attract more migrants than others. To achieve a balanced migration pattern within the region, policy initiatives must focus on preventing emergence of selective enclaves of economic activity in one part of the region. This will require coordination among EAC members.

There will be need for a migration coordinating body at regional level capable of coordinating with member governments' departments of migration (or migration directorates) or regionally decentralised coordinating and information centres. The coordinating body could have tasks such as: (i) initiation of policy; (ii) coordination of policy; and (iii) monitoring transparent implementation of regional migration policy, including the provisions of Common Market Protocol that guarantees the right of establishment, residence and equal treatment of all citizens of EAC in each partner states of EAC.

Additionally, decentralised information centres across member states would serve to complement the regional coordinating body and domestic migration departments by: (i) being one stop sources of information to educate migrants on their rights and obligations, with respect to national laws of the countries of destination; (ii) implementing citizens' education/sensitisation programmes; (iii) conducting periodic labour market surveys in each region; (iv) providing information on potential employers, employing sectors and available job candidates and skills in each country and sector of the region's economy; (v) registering and collecting data in liaison with the regional coordinating body on migrants in each partner state; and (vi) acting as platforms for sharing information with the CSOs in each member state.

Rights and obligations of citizens of the EAC in each member state should be simplified and published in local languages, and disseminated in brochures, booklets and flyers spelling out sources of information, and possible work opportunities within the region. An online service for documentation should be established where one can obtain, fill in and submit application forms, with immediate responses that are accompanied by receipts.

Through targeted integration programmes, cultural and linguistic integration should be encouraged. Efforts should be made to encourage curricula in regional languages to reduce the effects of language barriers. This could include: English, Kiswahili (Swahili), Kinyarwanda, Kirundi and French. An initiative to encourage evolution of East Africans as common people and as one society will be a strong pillar to support the deeper integration process.

A regional identification card will facilitate smooth crossing of borders. This can happen only if central data management system in which EAC citizen profiles can be centrally accessed by any official in the region for regional planning purposes is created. The process of ensuring that the EAC citizens get EAC passport should be expedited.

In sum, focus should be put on harmonising institutional reforms, labour laws and regulations governing workers and employers, social security laws, remuneration standards (including minimum wage harmonisation) and mechanism to report abuse in order to allow labourers to freely move across the region without hardship. International Labour Organisation (ILO) conventions on aspects such as occupational safety and health, forced labour, and discrimination provide minimum international norms that may be used in formulating national legislations. This should be initiated at the EAC Secretariat to create a harmonised set of laws.

### **3.2 Informal Cross-Border Trade in EAC: Implications for Regional Integration and Development**

This subsection highlights the nature, cost and role of ICBT. It also examines its impact on household agents in the border areas. It then recommends policy measures to improve cross-border trade facilitation to achieve the primary objective of deeper integration in the EAC.

Ogalo (2010) refers to ICBT as “imports and exports of legitimately produced goods and services (i.e., legal goods and services), which directly or indirectly escape from the regulatory framework for taxation and other procedures set by the government, and often go

unrecorded or incorrectly recorded into official national statistics of the trading countries”. He notes that in general, the informal economy in EAC largely corresponds to the micro, small and medium-scale enterprises that are semi-organised and unregulated. There are big firms (formal firms) that are engaged in the practice as well. They range from professional consultants (such as lawyers, doctors, accountants and engineers), to fruit and vegetable vendors. The study also reveals that there are big formal firms which prefer to remain small by splitting into several branches of the same businesses registered under different names and ownership with intent to hide in the informal economy largely to evade taxes and regulations to maximise profits.

Participants in the informal economy in EAC use simple labour intensive technology with limited or no permission from the authorities and therefore are not registered. Because the businesses are small, there is ease of entry (and exit), as they are mostly self-employed with little capital and equipment. The participants have limited formal education and limited access to services in the formal sector like credit where transactions are largely on cash basis. The sector is characterised by low productivity and substandard goods and services.

Those participating in ICBT operate entirely outside the formal economy through use of “unofficial routes” to evade trade-related regulations and duties on their goods and services. They also engage in illegal practices such as under declaration of the quantities, weight or value of goods so as to pay lower customs duties, falsification of the description of goods so that they are treated as products subject to none or low tariffs or wrong declaration of the country of origin to avoid any applicable taxes and duties.

ICBT employs the largest number of the poor and attracts an increasing number of the young and educated. Therefore, they are well informed on various provisions of the Customs Union and the regulatory requirements.

The nature of goods traded informally across the borders of EAC member states constitute small quantities of small staple food

commodities, low quality consumer goods, footwear, clothes, textiles, vehicles and bicycle parts, household consumable goods like salt, sugar, cooking oil and plastic containers. These goods cross at border points or via unofficial routes using hand/head, bicycles, animals, motorcycles, wheelchairs, push carts, boats and canoes.

The study notes a number of negative implications of ICBT to the region's economy:

- (a) Unreported trade between EAC states and their trading partners leads to understatements of intra-regional trade performance and inaccurate records of national statistics which could result in improper planning and poor economic policy design.
- (b) ICBT distorts competition. It limits the possibility of regional enterprises and firms in the formal private sector to enjoy scale economies. This is because informal trade across borders distorts market competition by artificially lowering prices. In many instances, informal traders may be supplying substandard goods whilst undercutting their formal partners on price and therefore market shares. This unfair competition from ICBT players may have a long-run effect of distorting competition and as such may prevent the more productive formal firms from entering or expanding.
- (c) Since the practice is encouraged by reasons of tax evasion, it leads to government losses in revenue (such as VAT), which diminishes the resources at its disposal to carry out projects that would improve the regional business environment.
- (d) ICBT encourages a culture of corruption. It breeds an environment for rent seeking including seeking of bribes by public administration, customs officials, the police at the border points, and along the trade routes within the region.
- (e) The practice hurts the emergence of formal SMEs which constitute the majority of the private sector in the EAC and major sources of new jobs.

- (f) ICBT hurts prospects of increased FDI through distortion of competition and together with structural bottlenecks in the regional economies limits expansion of intra-regional trade, improvements in product quality, product innovations and technology spill-over from FDI.

In addressing the structural and infrastructure constraints to economic expansion, policymakers will need to focus on the long run path of creating economies with a higher proportion of formal enterprises and jobs in order to achieve sustainable long-term welfare of their citizens, economic expansion and poverty eradication.

ICBT also has positive spill-over effects. Informal economies fuel many developing countries' efforts towards industrialisation and gross domestic product (GDP) growth, and the change over from the informal economy to the formal economy has therefore to be made with deliberation of these benefits. These include:

- (a) ICBT leads to increased trade flows on the border and tends to have positive effects on the people around the border points. Thus, the informal players have a facilitating role of promoting trade through the informal networks.
- (b) ICBT enables small scale entrepreneurs, poor households, and retrenched workers to escape poverty by providing alternative sources of income and meet basic needs like education and health costs for their families. Since little capital is needed to start an informal business, it attracts and helps micro-entrepreneurs, allowing numerous people in EAC to start and generate their own income.
- (c) Since the practice evades a significant number of business transaction costs, it offers relatively cheaper goods and services to consumers. This can also generate competitive pressures on the formal sector firms which can thus generate significant increases in consumer welfare within the region.

Therefore, attempts to eliminate cross-border trade can be counterproductive in the quest for enhanced trade, poverty

eradication and consequent improvement in people's standards of living. This implies that policy initiatives should aim at incorporating measures favourable to the poor and disadvantaged households in the border areas.

Based on its analysis of the costs and benefits of ICBT, the research makes some clear policy recommendations. These include:

- (a) *Trade facilitation:* There is need to strengthen channels of formal cross-border trade by eliminating or reducing the structural bottlenecks to flow of goods and services, i.e. reduce time consuming red-tape and procedures including trade licensing, registration of formal business entities, as well other NTBs to intra-regional trade.
- (b) *Raising awareness:* Initiate a public awareness campaign within the trading community on the importance for both national economy and individual citizens of recording trade statistics especially cross-border trade and paying taxes on traded goods.
- (c) *Micro-enterprise support programmes:* There is a need to initiate a policy to support and encourage informal traders to evolve into formal business entities through micro-enterprise support programmes, in which the costs of formalisation are eliminated or subsidised by the government. This can be supplemented by extension of start-up capital (seed capital) to all potentially viable business enterprises and basic enterprise management courses especially in poverty intensive sectors of the economy like the food, agriculture and other household consumables.
- (d) *Public sector-private sector and civil society collaboration:* There is a need to increase collaboration especially with CSOs, which could help in creating awareness of the advantages and business opportunities of formalising informal trade through outreach and network by the CSOs. There is a need to undertake aggressive publicity and dissemination of the EAC treaty, the Common Market Protocol, the Community's

policies and other applicable laws and principles as provided for under article 39 of the Protocol. Government agencies need to be made aware of the Common Market Protocol including attitudinal change among customs officials and other border officials who continue to collect tax on duty free goods and those seeking rent from ICBT.

- (e) *Improvement of regional business environment:* Harmonisation of laws, regulations, procedures and documentation, including formalisation procedures of business entities in the region should be undertaken on a priority basis. Common thresholds and qualifications should be in place regarding what constitutes a formal business entity and any entity in that category that is found to be operating informally should be penalised.
- (g) *Policy initiatives that encourage FDI inflows:* A strategy to promote FDI should be adopted, especially in the manufacturing and processing sectors (value addition strategy that increases the forward and backward linkages in the economy which bring the marginalised on board along these linkages). This would not only expand employment opportunities but also export products and in due course increase employment opportunities, technology transfer and rapid human resource development.
- (h) *Capacity building programmes:* Trade related training programmes, trade promotion, and business networking will improve the region's international trade practices, increasing chances of formalising the ICBT and thus increased documentation of cross-border trade.
- (i) *Create jobs in member states' economies:* Two key factors that keep the practice thriving are the number of jobs and the opportunities the practice creates for border residents. Policy initiatives should be devised to include a pro-poor approach through which more disadvantaged people will benefit and contribute toward poverty alleviation and economic development. The programme should also encourage and

promote trade exhibitions, involving informal traders across the EAC borders.

- (j) *Further research*: It is worthwhile to undertake further research to identify the impact of the Common Market Protocol of EAC that came into force on July 01, 2010 on the ICBT between the partner states.

### 3.3 Tax Policy and Law Harmonisation

A tax regime (tax policy and law) of a nation significantly shapes its production structure, trade patterns in goods and services, technology acquisition and domestic and FDI flows and therefore the overall structure of the economy and its international competitiveness. In the process of economic integration, fiscal barriers (largely taxes and tax policy) can significantly interfere with macroeconomic convergence, with free flow of goods and services or factors of production between partner states in a regional grouping and their global competitiveness.

Mutsotso (2010) research on the subject notes that the EAC has prioritised tax harmonisation to ensure a smooth functioning of their Common Market and promote development of SMEs, job creation and regional economic growth<sup>30</sup>. The essence is to eliminate discrimination among regional economic actors, eliminate double taxation, and encourage cooperation and coordinate their tax administration. A harmonised tax regime will enable all member states of the EAC to discourage special incentives or disincentives for the location decisions of enterprises and citizens within the community.

The process of tax harmonisation can be complex but the common rational is to: (i) ensure optimal allocation of resources; (ii) maximise economic benefits; (iii) stimulate economies of scale; (iv) stimulate regional competitiveness; (v) maximise revenue collection (prevention of revenue loss); (vi) prevent tax evasion; and (vii) protect the environment<sup>31</sup>.

The research notes that regional optimal tax should aim at maximising economic welfare for individual member states, i.e. set tax level where



the marginal retail selling price is equal to the marginal impact on social welfare taking into account: (i) consumer affordability with tax levels benchmarked against consumer's purchasing power and incentives for substitution minimised; (ii) tax rates in neighbouring countries to minimise incentives for cross-border shopping, smuggling and counterfeiting; and (iii) ease of administration and enforcement to minimise bureaucracy and tax compliance costs. This means that a good tax regime should be easy to administer, bring as many tax-payers under the tax net as possible and either be difficult to evade or should inherently motivate everybody to meet his/her tax obligations.

There are wide differences in tax systems and unequal treatment of tax payers and goods and services in the EAC, calling for shared responsibility within the public and private sectors to promote harmonised, fair and efficient tax system in the region. The research emphasises the importance of a tax structure that creates a favourable environment for growth of SMEs. This will gradually reduce the size of the informal sector and consequently increase the regional tax base.

SMEs constitute the largest number of business entities in the EAC and because of their size, ease to start, and ability to reach almost all sectors of the EAC economies, have a significant potential in addressing some key chronic development challenges like poverty and unemployment. Therefore, any tax harmonisation regime created to expand the formal sector in the EAC should aim at providing incentives for the development of SMEs while fostering a climate for a culture of taxation and tax compliance, as well as curbing the prevalence of tax penalties, bribery and corruption<sup>32</sup>.

The research argues strongly for incentives to be developed to encourage the informal enterprises to formalise and thus access public services that would otherwise only be accessible to formal enterprises. This includes bidding for government contracts and other service provisions as well as access to credit services that present an opportunity to these business entities to expand and become regional and international competitive enterprises.

The incentive structure could include special taxes with a graduation criterion from these incentives. Still, research needs to be done to reinforce these proposals and encourage a culture of transparency and accountability in business practices as well as within the ranks of the local government authorities. There should also be greater involvement of the business community in all stages of decision making.

The overall message in the research is that taxation of small SMEs and the informal sector is complex and it is thus recommended that further studies on this phenomenon in the region should be undertaken with the intent to generate tax policy options for these special economic agents which are varied in scope and spread widely throughout the EAC.

As a priority, EAC member states should seek to develop a common EAC VAT model, jointly agree on the tax base, and harmonise rules and practices for VAT refunds, administration and the tax procedures in all partner states including strengthening the taxpayers' rights<sup>33</sup>. The following actions can achieve this objective:

- (a) Initiate a harmonised legal basis for excise taxation (and hence harmonise excise tax bases, and excise rates), and abolish discriminatory rates for imported goods from partner states.
- (b) Harmonise the regional structure of tax incentives including corporate income tax, withholding taxes on dividends, interest payments, royalties and services fees as well as incentives in the export processing zones (EPZs) and special economic zones (SEZs) in partner states.
- (c) Strengthen the regional human resource capacity in tax administration, enact a harmonised tax procedure, encourage rotation and exchange national staff involved in tax administration among the member states in order to encourage ownership of the harmonisation process and strengthen the spirit of cooperation within the member states.

- (d) Encourage coordination between revenue authorities of partner states by designing a joint mechanism to monitor their performance and efficiency as well as their conduct.
- (e) Harmonise penalties for non-tax compliance.
- (f) Encourage improvements in transparency and information exchange within each member state as well as complement the ongoing EAC Secretariat efforts to improve information base and the statistics as fast as possible before the harmonisation details mentioned above are realised<sup>34</sup>.
- (g) There are varied characteristics of the informal sector within the partner states of EAC (how do the SMEs across the five countries differ?). A set on criteria of what constitutes recognised enterprise in each category from SMEs to big companies should be developed. It should involve a mechanism to reward SMEs that formalise their business but also penalise companies that fragment their business for purposes of evading taxes. It should also include an education component to sensitise entrepreneurs about the incentives as well punishments for bad practices across the region for tax harmonisation purposes<sup>35</sup>.
- (h) The common characterisation of business enterprises should be followed by a joint comprehensive reform of property rights regulations and other incentives that could enable tax administrators to access reliably harmonised tax rates and enable businesses to access productive resources in the formal channels<sup>36</sup>.
- (i) Tailor made and business friendly courses should be jointly designed for the business community on the forms of tax, importance of paying taxes as well consequences of tax evasion etc. Such courses should include modules of importance of any business doing bookkeeping and reporting on standards of small business<sup>37</sup>.

The research notes that harmonisation also poses the challenge of balancing integration and maintaining sovereignty. In the EAC, certain taxes, like excise, may be justified on certain products consumed by the population for reasons of revenue based on the different cultural background and preferences, which might not be the case in the other member states<sup>38,39</sup>.

Therefore, a joint tax assessment and administration criteria for all categories of economic agents operating in the EAC region to avoid overlap of presumptive tax system with standard tax regime could be developed, a practice that would remove obstacles in facilitating the movement of business from one system to another. Further, joint and coordinated data management system on economic agents and tax administration will be essential in tax planning for regional integration.

The research further notes that formulating harmonised tax policies and enacting tough legislations is not sufficient for inducing good practices. It will need to be followed up by building good will, a sense of patriotism and increased appreciation for the socio-economic benefits of individuals and business meeting their tax obligations. This initiative requires continued education of the masses.

### **3.4 The Non-Tariff Barriers in Trading within the EAC**

Expanding, diversifying and stabilising intra and inter-regional trade in Africa in general, and in the EAC region in particular, remains a significant challenge. At the heart of this challenge is the African countries' ability to secure each other's markets in a reliable manner and with ease. While traditional trade policy instruments (tariffs and border duties) are declining in importance in their determination of international trade flows and patterns, non-tariff measures remain in significant use<sup>40</sup>.

### Box 3: The Nature of Non-Tariff Barriers in the EAC

Hangi (2010) characterises the EAC NTBs as “structural bottlenecks” that include: inadequate government structures; unfriendly business procedures and mismanagement; complex customs and administrative documentation; erratic application of rules and regulations; import policy barriers, labelling, certification requirements; anti-dumping and countervailing measures; non-transparent government procurement practices; services barriers such as visa requirements; and bureaucratic staff attitude coupled with low staff morale. All these represent additional costs to enterprises and negatively impact the flow of goods and services within the EAC.

In literature, the rise of NTBs is not contested. They include all the measures and practices by government policies which serve to distort the volume or production composition of international trade. NTBs are differentiated into three types: (i) which are generally employed as instruments of commercial policy, such as quotas, subsidies to import-competitors, and variable levies; (ii) which are sporadically employed with trade-restrictive intent, like packaging and marking requirements, phytosanitary regulations, customs valuation and classification practices; and (iii) those whose trade restrictive effects are largely incidental to non-trade policy objectives, such as certain types of consumption taxes and government monopolies.

Measures other than tariffs are potential and viable alternative sources of protection for import competing interests in the region. They disrupt regional trade flows by: (i) affecting volume of imports among the partner states and their third party trade partner countries (especially in Africa); (ii) affecting the patterns of trade by imposing quantitative limitations as well as product diversification (especially stringent product NTBs like SPS measures in food industry); and (iii) increasing directly the transaction costs for firms involved in regional and international trade, in this case the partner states of EAC.

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NTBs not only have a quantitative restriction effect on trade but also affect the competitiveness of the region, curtail investment levels, and limit the pace of the integration process. The EAC Customs Union instruments explicitly prohibit the use of quantitative restrictions on imports and all measures having equivalent effects.

NTBs can delay or increase costs which ultimately hinder the free movement of goods and services and therefore the expansion of intra-regional trade. Because they affect the flow of goods and services and limit the expansion of trade they also indirectly hamper the resultant welfare gains from trade, employment generation, and poverty reduction.

NTBs can also be legitimate policy instruments and have been significant in shaping patterns of international trade over time. They can be used to: (i) safeguard health, safety and security of human beings, animals and plants and protect them against environmental pollution; (ii) protect home industries and consumers; (iii) safeguard national security; and (iv) safeguard against revenue loss.

With the elimination of NTBs and structural inefficiencies that are currently impacting the speed and quality of doing business in the EAC region, there will be: (i) significant improvement in the region's competitiveness; (ii) a rise in up-scale investment flows; (iii) possible industrial diversification and increased volumes of trade flows in goods and services, consequently leading to an expansion of regional economies; and (iv) greater socio-economic cooperation with possible positive political effects of the regional integration process.

The BIEAC research demonstrated that the NTBs affecting EAC countries are inherently structural bottlenecks. Therefore, policy initiatives have to focus on reducing these structural bottlenecks and create an environment that facilitates the flow of trade within the partner states. Thus, it suggests the following initiatives:

- (a) Coordinate regional integration initiatives within the EAC Common Market and discourage multiple memberships of regional blocs. This will ease procedures like proof of rules of origin (RoO) and its administration.
- (b) Focus on comprehensive trade facilitation measures including upgrading of regional physical infrastructure like: container handling facilities, inland ports, roads, railways, airways, energy, and telecommunications within the region, so as to reduce the costs of doing business and facilitate efficiency in production, transportation, and delivery of goods and services.
- (c) Create stakeholder awareness campaigns and capacity building initiatives to educate customs officials and the business community on the agreed regional efforts and their implementation at the national level of each member state. Traders and business people in the region do not have enough education or knowledge on how to conduct business properly; hence there should be a formal training system for this group of people so as to have a greater positive impact on the regional trade performance.
- (d) Deploy greater incentives to reduce the portion of the informal sector of the EAC economies and curb or reduce incidences of rent seeking behaviour within the police and customs officials.
- (e) Harmonise business practices in the region, i.e. initiatives must be created to harmonise documentation, standards, domestic tax systems, and other trade facilitating border measures. Steps should also be taken to reduce distortions and smuggling as well as to introduce some level of predictability in business transactions.
- (f) Establish an active NTB monitoring body<sup>41</sup> at the EAC Secretariat, i.e. an enforcing machinery for all policy initiatives aimed at promoting regional integration at the EAC Secretariat or make the Secretariat more effective by

reinforcing its infrastructure, including human and physical, to carry out its work of monitoring policy initiatives in conjunction with regional agencies and the civil society to implement policies promoting regional competitiveness.

### **3.5 Accession of Burundi and Rwanda to the EAC**

Economies on the right path of upward economic progress have been driven largely by the ingenuity of the entrepreneurial spirit amongst their people that constitute the private sector and the private enterprises. Understanding the nature and characteristics of the private sector is crucial in designing appropriate and effective business, investment promotions and support strategies in a variety of sectors of member states' economies.

The EAC region is projected to achieve an economic growth of 9 percent during 2011-2012 largely driven by agriculture growing at 4.5 percent, services at 8.9 percent and industry at 9.6 percent depending on the region securing and sustaining good governance<sup>42</sup>. This is particularly relevant for the accession of Rwanda and Burundi, whose economies remain the most vulnerable to internal and external shocks within the region. Improving business environment also forms part of the essential priorities if the region is to attract private sector investments and diversify from the current enclave of extractive industries which remain the major sources of new FDI in the region<sup>43</sup>.

Ndereyahaga (2010) research explores the following questions regarding EAC expansion by accession of Burundi and Rwanda: (i) what impact will the accession have on private sector growth in the region; (ii) what are the implications for trade growth and patterns of trade in the region; (iii) what impacts will it have on investments flows, both domestic and foreign; and (iv) what is needed to identify and evaluate the various ways through which potential benefits can be maximised and the potential adverse effects minimised.

The research notes that the region will need to focus its attention on the long standing physical infrastructure problems in order to competitively attract diversified foreign investments<sup>44</sup>. This could include the provision of reliable low costs sources of energy,



specifically electricity as well as improvements of road and railway networks to improve the movement of goods and services and ease inland travel time. Also important is the long term financing for business and private sector growth as part of an improved business environment. EAC member states need focussed efforts toward securing and providing sustainable long term financial services (credit) to business entities.

Further, member states should commit to reduce prevalence and incidence of corruption, scale up efforts to enforce business contracts, guarantee property rights, reform tax regimes on company and profit taxation – all to enhance the establishment of predictability and stability within the regional business environment and regional competitiveness. The Anti-corruption Association of EAC will be essential in institutionalising the elimination of corruption in the regional economies and improving the business prospects in the region and growth of the private sector.

In economic theory, market size is essential for triggering economies of scale and resultant economic expansion, industrial diversification, attraction of FDI and consequent welfare gains with economic growth and prosperity<sup>45,46,47</sup>. Expansion of the EAC by the accession of Burundi and Rwanda should be seen as beneficial for all the member states' private sector in terms of market size for entrepreneurs and supply of a variety of goods and services, and as a wider source of inputs and labour force for efficient production of goods and services to attain enhanced scale economies.

The key challenge for Burundi and Rwanda is to prepare their private sector to take advantage of this and other ongoing regional reforms to be able to benefit from this economic integration. The trends are positive to begin with. Burundi is reorganising its Federal Chamber of Commerce and Industry to enable industries and business entities to take advantage of potential benefits from the accession to the EAC. Similarly, Rwanda is undertaking efforts to organise its private sector foundation along the lines of industries and business entities. These efforts should be accompanied with training of the prospective entrepreneurs on entrepreneurial skills for both small scale and medium size entrepreneurs and in identification of the right investment

and business opportunities in the region. For the people in both economies, the accession comes with the emergence of new enterprises, the creation of new jobs in the long run and potential sources of cheap and quality goods and services potentially improving the welfare of their people.

The research makes a number of recommendations to enable the integration process for these new EAC members to benefit from the larger regional effort. These include:

- (a) The integration process should prioritise macroeconomic policy convergence among member states, harmonising commercial, legal and regulatory framework, and improving competitiveness by upgrading of physical, energy and market infrastructure, financial labour and other social services.
- (b) The free movement of skilled labour within partner states should be encouraged especially amongst weaker members of the EAC, such as Burundi and Rwanda, whose human capital development lags behind the rest. This will stimulate the accumulation of human capital in these states through spill-overs such as skills transfer, learning through observation, and learning by doing. These can act as short term strategies to complement public investment in human capital development of each member state.
- (c) There is need for PPPs in key sectors of the economy, i.e. infrastructure maintenance, education, health, export processing zones, training of entrepreneurs in enterprise management, building of core business competencies, strengthening market systems, and corruption control. The partnership should also extend to investment in building a reliable infrastructure system that connects all business centres economically and competitively in the region (e.g., telecommunications, water, energy, transportation and financial intermediaries).
- (d) PPP should be geared toward strengthening the region's institutional capabilities. Such partnership should bring on

board non-governmental organisations and the academia building cooperative relationships with business entities, government agencies, communities, gender advocacy groups and other stakeholders within the member states especially in areas of decision making and policy processes geared to improving business and investment environment in the region.

- (e) There is need to establish micro-enterprise development programmes, i.e., support the emergence and development of SMEs, grant small business government secured credit (starting capital), establish performance goals for government supported enterprises, and reward high performing entrepreneurs periodically in the region to encourage positive and best business practices.
- (f) There is need to establish a region wide network of agricultural extension system. This system should provide entrepreneurs in the farming sector with access to new and existing technologies and agricultural inputs.
- (g) There is need to harmonise regional property rights and land tenure systems, which would enable entrepreneurs to have recognised ownership of property for instance in the formal banking system enabling them to obtain credit by collateralising their property. Also if need be, regional banking facilities, like those provided by East African Development Bank (EADB), should be simplified and be accessible to even small business enterprises in the region at concessional terms. A window for SMEs should be opened at the EADB with simplified requirements to secure seed capital. The bank should initiate a public awareness campaign for SMEs about the financial and business opportunities it supports with regard to small business entrepreneurs.
- (h) Efforts should be made to strengthen research capacity of the CSOs, think tanks, and academic institutions in thematic areas that have a direct bearing on the improvement of private sector development and strengthening of integration processes.

### 3.6 Socio-Economic Implications of the Uganda's Draft Competition Law

A pro-development competition policy is a *conditio sine qua non* for a successful integration of the EAC<sup>48</sup>. It has become crucial not only in the context of a rapidly globalising world that exerts competition pressure on domestic and regional business entities, but is also an essential tool for creating an environment for the success of small private enterprises that provide more than 75 percent of new jobs in any economy in EAC.

The rapidly emerging small enterprises need an enabling environment to enter the market for goods and services, create new jobs in the poverty intensive sectors like agriculture, retail and agro-processing. Additionally, service provision in EAC partner states need to be protected with a comprehensive and well designed national competition policy, which ultimately feeds into a harmonised regional competition policy.

#### Box 4: What Should National Competition Policy Achieve?

In line with the primary objective of the EAC, a regional competition policy should aim to provide an enabling environment to increase regional production of goods and services, boosting competition and achieving full economic integration.

A pro-development competition policy ensures the proper functioning of the markets, in favour of the poor majority in the EAC region, in which firms compete fairly to produce and distribute goods and services to benefit consumers in terms of quality, variety and affordable prices of goods and services. A properly conceived competition law that delivers fair competition among firms in the markets contributes indirectly to national and regional economic growth.

It needs to be ensured that both large and small foreign firms compete fairly with domestic firms in the regional markets

*Contd...*

(enabling attraction of FDI) and generate opportunities for job creation and new small business start-ups as a means for poverty reduction in the region. Therefore, it should be a policy regime that will lead to a market environment that promotes increased trade and attraction of direct domestic and foreign investments, job creation, expansion of the formal sectors of the economy, and improved standards of living for everyone.

Kaggwa (2010) notes that Uganda is emerging from an environment in which state operated enterprises have dominated its markets. However, reforms have gradually been taking root during the last 20 years. The current draft competition bill (Uganda Competition Bill 2004) is part of an effort to establish market regulatory framework to reflect national development aspirations and guarantee consumer welfare and other benefits of efficient markets. The research further notes that instead of favouring big business, the current draft must take into account the interests of consumers and their welfare, boost the opportunities for bottom-up entrepreneurship at all levels (emergence of small businesses), and recommends an independent assessment of the current draft against those benchmarks.

Roberts, (2004) as cited in Kaggwa (2010) points to a competition law that guarantees market efficiency, innovation, and optimal national policy space. Amsden & Singh, 1994, Adhikari & Knight-John, 2004 emphasise a competition law that takes into account the national policy and a country's stage of development.

The research notes that Uganda's evolving competition law has not attracted the participation of key stakeholders possibly because of limited knowledge of the technical issues involved or a lack of appreciation for the importance of competition policy on national development and the impact of the law on their business. It notes that strategic sectors like agriculture and emerging agro-processing industry should only be gradually subjected to the law and that the law should be designed to protect these sectors. Additionally, the law should guarantee sufficient policy space and flexibility at country and regional levels for periodic initiation of appropriate developmental friendly policies in the national and regional markets.

A proactive competition regime (law or policy) should aim to reduce incidence of restrictive, anti-competitive or unfair business practices that limit entry or hurt other market participants or other enterprises (private or public) and harm consumer welfare.

The research identifies a number of market inefficiencies in Uganda including: (i) price discrimination, (ii) artificial prices for basic utilities especially water and electricity, and (iii) bid rigging. These were common anti-competitive behaviours identified that negatively affect consumers and producers of goods and services.

Local firms in Uganda cannot compete with foreign companies and enter into sectoral markets dominated by the Transnational Corporations (TNCs). Thus, the policy should ensure that indigenous private sector growth in Uganda is not undermined by anti-competitive behaviour.

The Ugandan competition law aims to foster and sustain competition, protect consumer interests and safeguard the freedom of economic action of all market participants and prevent practices that limit market access. However, it is conspicuously silent on emerging enterprises that need support (protection) as they catch up with the competition from mature enterprises already enjoying the economies of scale (i.e. it does not support the rise of “bottom-up entrepreneurship” which is essential for poverty eradication in the country).

The research makes a set of key recommendations for the competition law to benefit competition environment in Uganda. These include:

- (a) *Create stakeholder awareness on the law:* There is need to create stakeholder awareness on the draft law, since it is noted that the implementation process is dependent on a thorough understanding of the law. The explicit institutional capacity building to investigate and report uncompetitive practices and the ability to meet the legal costs, warrants an intensive education on the significance of the law to all stakeholders. Also efforts must be made to bring on board politicians and regional officials to appreciate the merits and challenges associated with a competition policy.

- (b) *Create policy linkages*: The new law should encompass linkages to other national and regional laws (for instance intellectual property law), and national and regional development objectives and aspirations. Khor (2005) makes a case for the complexity of linkages between competition, competition policy and trade and development. These complexities should be kept in mind while designing national and regional competition policy. Therefore, the policy should evolve from the bottom-up to create the above mentioned policy inter-linkages.
- (c) *Establish a monitoring body for the law (enforcement structure)*: An independent and strong competition authority at national and regional level with both the capacity to discharge its duties and to nurse a culture of a healthy competition should be established. This body should also be able to provide an institutional platform for civil society, private sector and consumer bodies' engagement. It should also transparently exchange information, build competencies in detection, and improve the reporting of anti-competitive practices to the authority for successful implementation of the law.
- (d) *Encourage innovation*: The World Bank Development Report (2005) emphasises the importance of a competitive environment that promotes innovation both by local firms and international firms in the regional market; creation of new products and services; and the development of new technologies. This will lead to more jobs being created and an increase in the competitiveness of the region in the long run. It should also encourage attraction of favourable FDI together with the associated foreign technology transfer.
- (e) *Establish a complementary competition law and industrial policy*: It is essential that the evolving national and regional competition policy provide flexibilities to pursue the use of industrial policy to promote sectoral industrialisation in EAC countries. In general it should make room for national development priorities. Well designed competition and

industrial policies may co-exist without contention and can even be complementary, especially in the context of international instruments such as the “Development Box” of the WTO.

- (f) *Encourage policy research*: There are significant grey areas with regard to the relationship between a fair competition policy and other national development priorities like the industrial policy, sectoral regulations, and infant industry protection. Therefore, there is a need to build national capacity to do more empirical research on the impact of competition policy and law on case study basis in certain sectors to inform and generate best practices that can be adopted in the EAC.
- (g) *Promote a culture of competition*: There is need for policy to promote a culture of competition where all market participants appreciate rules and benefits of fair competition and where principles of fair competition are central in a firm’s decision making process. This is quite desirable in the long run and would lead to a sustainable and competitive business environment that attracts both domestic and foreign investment.
- (h) *Promote capacity building*: There is a need for training of specialist staff.

### **3.7 A Case for Trade in the Resurgent EAC Policy: Challenges and Opportunities**

The EAC, now a single market of five member states with an estimated 128 million producers and consumers and a total output of US\$66bn, is at a vantage point to reap significant benefits from its integration with the world economy.

Mukiibi (2010) notes that deeper integration, maximisation of integration benefits, regional competitiveness and consequent integration into the global economy will be achieved faster if the member states can harmonise their trade policies, and trade related regional instruments and regional development plans. Uniform,



predictable and consistently applied policies provide an enabling investment regime essential for optimisation of growth and welfare of the people. This harmonisation also gives the region the advantage of being able to combine resources, avoid duplication of efforts, and to enjoy economies of scale and effectiveness in approaching regional development, i.e. streamlining the EAC regional policy initiatives into national plans for the greater good.

#### **Box 5: Getting the EAC Policy Priorities Right**

- Prioritise trade facilitation above revenue collection among member states to reduce disparities between objectives pursued at the national and regional level. While it is in the interests of national revenue collection officials to maximise revenue collection at member state level, trade facilitation should be prioritised because of its indirect contribution for increased revenue through increased trade volume between member states.
- Boost the human resource capacity of the EAC Secretariat's Directorate of Customs to help steer the implementation of the Common Market Protocol and other trade related policies, initiate focussed programmes to train and retain specialised technical staff by each member state, and to accurately and in a timely manner interpret and implement regional regulations.
- Prioritise harmonisation of relevant regulations and forms alongside procedures such as licensing, clearing and forwarding to facilitate effective operations of the Common Market and reduce time loss and related transactions for business entities in the EAC.
- Eliminate NTBs as despite commitment from member states to eliminate them, they continue to be a major impediment to trade. There is need for sensitisation of the private sector to position itself strategically to take advantage of the opportunities of the Common Market.

There is unanimity on the benefits of regional integration; the issue is how to realise them. Mukiibi lists some other important challenges and opportunities in speeding up the integration process in the EAC. These include:

*National sovereignty over regional integration:* Mukiibi (2010) notes that though the political will to integrate has been expressed, member states are reluctant to change from national to regional orientation. This is evident from the non-compliance with regional laws and regulations, duplication of national activities, which should be otherwise handled at the regional level, and bureaucratic red-tape that often leads to delays in implementing regional obligations.

*Overlapping membership:* The overlapping membership in the regional economic communities (RECs) of COMESA and SADC by EAC member states is a major challenge to the implementation of the EAC Customs Union since each of the regional groupings aspire to progress and achieve deeper integration. However, in recognition of this, the three RECs initiated a process of coordination and harmonisation of their regional integration programmes as a way of mitigating the challenge of multiple memberships.

*Emerging market opportunities:* The EAC as a block is negotiating FTAs with the EU, among others, offering duty-free quota-free (DFQF) market access and development assistance (adjustment assistance and capacity building). These opportunities complement the fact that all EAC members as members of the WTO enjoy S&DT. They also benefit from the AGOA of the US. Further, the LDCs within the EAC benefit from Everything But Arms (EBA) initiative of the EU. All these present opportunities for trade promotion as well as expansion.

*Policy lessons from the EU experience:* The EAC member states have a precedent to follow within the experience of the EC integration. First, they need to constitute a single trade commission that will help henceforth to initiate, negotiate and execute a common commercial policy and international as well as regional trade negotiations. Such a commission should be given mandate by the member states and autonomy to negotiate trade policies on their behalf. This mandate

could constitute a “built in agenda” for the conclusion of international trade agreements with other states as third parties to the block, i.e. a common commercial policy based on uniform principles and implemented by the EAC trade commission that should be empowered by a statute both at national and regional level by a treaty.

*Speaking with one voice:* The EAC needs to be able to speak with one voice and act as one in its economic relations with the rest of the world while harmonising its internal trade and trade related policies. This would enhance uniform development and make the region more attractive to investment in a predictable and well regulated environment.

The research makes some important policy recommendations:

- (a) *External trade policy coordination:* Now that the common market is in force, the EAC member states have to speak with one voice in trade negotiations both at the regional and multilateral level. It is imperative that lessons are learnt in the current EPA negotiations in which the EAC is negotiating as a block with the EU. These lessons should be transferred to execute other bilateral, regional and multilateral trade deals. The EAC does not have its own mission in Geneva, even though one of the member states coordinates on behalf of the region.
- (b) *Policy harmonisation:* Harmonisation of all policies, especially those dealing with trade and trade related aspects, should be prioritised to create an enabling environment for increased intra-regional trade. This augmented by the region’s potential in abundant raw materials, labour force, political stability, and the emerging market size would make the region more attractive to investors while enabling faster development through trade led growth and enhance the living standards and livelihood of its people.
- (c) *Institutional coordination:* There is need for better institutional coordination between the national and regional bodies. This would enable uniform implementation of the

EAC treaty while at the same time drawing on synergies among the member states, especially considering the limited technical personnel that deal with trade and trade related aspects in the region.

- (d) *Mainstreaming trade:* Mainstream trade and trade policies jointly in national development plans through a regional trade policy “blue-print” that is coordinated at the regional level by the EAC trade commission which ensures that such a blue print is mainstreamed in the national policies of all member states (harmonisation of regional development plan priorities).
- (e) *Regional research capabilities:* For the region to develop the ideal trade and trade related policies that would promote development, there is a need for dedicated research institutions as well as partnerships with international institutions for benchmarking enforcement of best practices.
- (f) *Public awareness and information exchange:* Awareness raising and bringing on board all stakeholders, especially the private sector, is crucial. This would ensure that their needs are addressed in various policies while also ensuring that they are aware of opportunities arising in the EAC. There is also need for continuous monitoring and evaluation of the impact of policies being implemented jointly in the EAC with a view to continuously improve and make necessary adjustments for the betterment of its people.
- (g) *Public investment in upgrading the physical infrastructure:* This would ensure trade facilitation to allow faster and cheaper business transactions within the region and improving people’s livelihoods through trade.

## 4

# Policy Options for Maximising EPA Negotiations Outcome

For over 30 years, until December 31, 2007, most exports of ACP (including EAC) countries entered the EU market free of import duties. This was as a result of a non-reciprocal preferential market access arrangement which the EU unilaterally extended to ACP Group of countries, first under the Lome Conventions (1975-2000) and later under the Cotonou Partnership Agreement (2000-2007). However, this preferential trade regime did not achieve its objectives. Instead of promoting industrial development in the ACP and enhancing their trade with the EU, the share of exports from EAC, as most other ACP countries, in the EU market remained very low, largely in primary form and scarcely diversified. At the global level, the ACP suffered marginalisation in terms of their share of the value of world trade. To address these concerns, the ACP and the EU agreed to negotiate an alternative trade arrangement, pillared mainly on promoting integration of ACP into with the world economy and enhancing their access to the global market.

At the same time, the non-reciprocal preferential market access contravened the WTO rules against discrimination. During the WTO Ministerial meeting in 2001, the European Commission (EC) and the ACP countries sought a waiver to continue their trade relationship until end of 2007 to find a WTO-compatible solution in their trading relationship and opted to negotiate a reciprocal preferential FTA

where both parties would substantially liberalise their trade in conformity with the principles of GATT Article 24<sup>49</sup>. They decided to call it “EPA” between ACP and EU and covered an agenda much wider than the reciprocal exchange of concessions. Its overall objectives are to ensure sustainable development of ACP countries, their smooth and gradual integration into the global economy and eradication of poverty. Specifically, the EPAs aims at: promoting sustained growth; increasing the production and supply capacity; fostering the structural transformation and diversification of ACP economies and supporting their regional integration.

On November 27, 2007, the EAC initialled an interim Framework EPA (FEPA) with the EC. In that FEPA, EAC committed to liberalise her market fully for 82.6 percent of goods-only imports from the EU over a period of 25 years starting from 2010. The interim EAC-EC liberalisation agreement is as follows:

- a) From 2010: EAC will phase down tariffs on all raw materials and capital goods. This represents approx 64 percent of imports from the EU.
- b) 2010-2023: EAC will gradually phase down 10 percent rated tariffs on intermediate goods to zero. These account for another 16 percent of the total trade between the EAC and the EU. By 2023, EAC would have liberalised a total of 80 percent of its trade with the EU.
- c) 2024-2033: EAC countries will gradually phase down 25 percent rated tariffs on final products to zero. These constitute 2 percent of the total trade between the EU and the EAC. By 2033, the EAC would have opened 82 percent of its market with the EU.
- d) EAC will exclude its sensitive products, representing 17.4 percent of trade with the EU, mainly consisting of agricultural and industrial goods such as wines and spirits, chemicals, plastics, wood based paper, textiles and clothing, footwear, ceramic products, glassware, articles of base metal and vehicles.

- e) EU will provide DFQF market access to EAC with the exception of sugar and rice – both would be fully liberalised by October 2009 and 2010 respectively.

Although, the interim goods-only FEPA sufficed for the EAC-EU trading relationship to attain WTO-compatibility, both parties agreed to extend their negotiations to include extra areas and reach a comprehensive agreement by July 01, 2009. However, as 2010 comes to an end, none of the EAC Partner States have signed the initialled FEPA.

Part of the challenge in concluding these negotiations is that no consensus has been reached so far on the contentious issues specified in Article 27 of the EAC-EC FEPA, in particular on the issues of export taxes, most-favoured nation clause, standstill clause, trade in services, agriculture, and a range of trade-related issues (covering competition policy, investment and private sector development, environment and sustainable development, intellectual property rights, and transparency in public procurement). Other areas of contention included the development matrix, customs and trade facilitation, technical barriers to trade (TBT) and SPS measures, and legal and institutional arrangements.

While some progress has been achieved on some of the contentious issues, the intention of this paper is not to present the state of play of the negotiations. Rather, this paper presents some key policy issues and recommendations emanating from the BIEAC research carried out on some of the contentious issues emanating from discussions by stakeholder CSOs in the five EAC countries.

Six issues were researched: (i) Leveraging the agriculture sector through trade: opportunities and challenges in the EC-EAC EPA, (ii) the Most Favoured-Nation provision in the EC/EAC EPA and its implications, (iii) export taxes and EPAs: another policy tool under threat from the EC? (iv) trade in services and EPAs: the way forward for EAC, (v) standards and market access under EPAs: implications and way forward for EAC, and (vi) revenue implications for the EAC-EU EPA: the case of Tanzania. Summary of policy issues and recommendations emanating from this research and subsequent discussions that were based thereon is presented here.

#### 4.1 Revenue Implications for the EAC-EU EPA: The Case of Tanzania

The EAC-EU EPA negotiations will culminate into a FTA between EAC and EU member states, with the EU granting DFQF market access for EAC products in return for progressive EAC market opening for EU products until 2033, when all import duties on EU goods in EAC market, apart from sensitive goods, will be fully abolished. The resultant market liberalisation on part of EAC member states will have a number of implications on their economies, one of which is revenue loss from customs duties on products of European origin.

The research by Mkenda and Hangi (2009) shows that Tanzania<sup>50</sup>, as indeed other EAC countries, will experience significant revenue loss due to reduction of tariff on goods originating from Europe. The study also notes that despite this revenue loss, trade relations between EAC and EU may also constitute dynamic gains from each other's market liberalisation and the creation of new products in the long-run.

Therefore, in this scenario, the research makes the following recommendations.

*Sectoral liberalisation approach:* In addition to the EAC adopting a gradual liberalisation approach, sectoral analysis should be made to identify the sectors that bring in more revenue for EAC countries. Furthermore, rather than artificially assigning deadlines for liberalisation of these sectors, a graduation criteria for sectoral liberalisation should be adopted as a benchmark, based on: (a) compensatory adjustment assistance transferred by EU to EAC for loss of this revenue; (b) technology and technical assistance transferred to these sectors and hence their achieved competitiveness especially in the infant manufacturing sector of EAC member states; (c) growth of the sector (in terms of exports to the EU) or domestic market shares; or (d) these sectors should be excluded altogether from liberalisation for the moment.



### **Box 6: The Expected short-run and long-run Impact of EPAs**

*In the short run:* The EAC countries will incur adjustment costs as a result of trade liberalisation with the EU. In particular, costs related to loss of government revenue from eliminated import duties in some sectors that are transmitted to fiscal policy challenges will affect government budget and funding of development priorities. Adjustment costs will relate to possible competition between products from Tanzanian (or EAC's in general) firms with those of EU firms in those sectors that will be liberalised first. This competition will create losers in Tanzania's indigenous firms, which will most likely shut down. Therefore, the short term challenge is to prepare a mechanism as an "inbuilt agenda" in the ongoing negotiations and as part of the benchmark to address these adjustments costs to Tanzania specifically and the member states of EAC in general.

*In the long run:* The liberalisation of EAC-EU trade relations could have some beneficial effects on the EAC economies. The duty free access to the European community presents a significant market opportunity for EAC goods and services that will stimulate expansion of external trade from EAC.

Second, investors will be attracted to EAC to take advantage of producing for DFQF export to the EU which makes up a significant market in the world.

Third, economic theory asserts that FDIs and the import of capital goods leads to technology spill-over in the destination country, in this case Tanzania and the EAC region.

Foreign investments in EAC region will be an opportunity for transforming regional firms into technologically efficient firms that can compete globally and expand the region's production possibility frontiers for a variety of products (Amurgo Pacheco, 2006). In addition, innovation that comes from fair competition (creation of new products and firms creating new niches in the market), would help EAC firms reduce trade costs and make the EAC firms competitive in the EC market relative to their competitors, which will confer the growth of technology and the possible catch-up by the EAC companies in the long run.

*Source: Mkenda and Hangi (2009)*

*Adjustment assistance:* EPA development-related support by EC should be made binding. This is due to the fact that liberalisation on the part of EAC countries will be binding and involve a significant percentage of government revenue loss. EAC countries should therefore insist that development cooperation provisions in the EPAs should be made binding and development support levels commensurate to revenue loss as a result of EPA being transferred to the EAC parties. This should be able to guarantee the continued funding of development programmes for EAC partner states without disruption. Similarly, mechanisms and procedures of delivering this adjustment assistance and trade related support should be improved because it has a bearing on effective implementation of the resultant EPA.

Therefore, in order to address the challenges of expected revenue loss by EAC signatories to the EPA, both parties need to: (i) identify the associated adjustment costs (ii) agree to mechanisms of addressing these costs; and (iii) make the mechanisms part of a bound agreement between the parties. Whether this is in the form of trade-related assistance or development cooperation should be linked to the process of liberalisation and therefore legally binding for both parties.

## **4.2 Leveraging the Agriculture Sector Through Trade**

The research by Julian Mukiibi (2009a), shows that livelihood as much as employment of a greater number of EAC's population is linked both directly and indirectly to the region's agricultural sector; 80 percent of East Africans live in rural areas and depend largely on agriculture. As the current EPA negotiations aim to promote sustained growth, increase the productivity and supply capacity of EAC as well as foster their structural transformation and diversification, critical questions have to be addressed on opportunities and challenges it shall present the EAC's agriculture sector. How can EAC's trade with the EU be leveraged to exploit the opportunities it presents for the EAC's agriculture sector, and at the same time, address the challenges of the sector?

As noted earlier, past preferential trade arrangement with EU did not support value addition and diversification of EAC exports to EU – largely, these were in the areas of agriculture. This was partly and

largely due to several supply-side constraints not only within the domestic economic systems but also due to unfavourable rules of exporting value-added agricultural products to the EU market – one of the most protected agricultural market in the world. For example, one of the reasons for low value addition and diversification of EAC's export sector was due to the tariff escalation and stringent SPS and other standards such exports faced in the EU market.

The first opportunity in the present EAC-EU EPA is the zero-rating of all imports into EU market from the EAC and the promise by EC to support EAC in improving their supply capacity and compliance with EU's stringent health-related and market standards. In terms of opportunities, it is anticipated that the development assistance component of the EAC-EU EPA will enable the EAC countries to overcome supply side constraints and diversify and enhance the competitiveness and trading capacity of their economies. In addition, the EPA could be a conduit for the region to benefit from advances in biotechnology and other new forms of production techniques. It could also provide a link to international food markets which are always rapidly changing and also present vast opportunities because of ever-increasing global food demand. When combined, all these developments would assist the region to exploit its comparative advantage in the agricultural sector, especially in tropical agricultural products.

Apart from its supply side constraints, the EAC region's agricultural sector faces other significant challenges. These include the EU's domestic and export subsidies that have the effect of depressing world market prices in agricultural products – the prospective market for EAC under the EPA. In addition, the EU's stringent technical and product standards could limit EAC agriculture export potential in EU. Moreover, the EU is presently engaged in similar negotiations of FTAs with other stronger and more competitive countries where it is dangling the same preferential treatment it has granted to its market for EAC products. This will erode the value of preferences EAC had attained under its EPA agreement with the EU. There is no denying that EAC's agricultural export chains are currently linked to a large extent to the EU market and growth of the sector is still dependent on its preferential treatment when exporting to the EU.

In order to be able to maximise the benefits and opportunities in the EPA, EAC negotiators must make sure that trade related support provisions are binding and geared towards addressing the development of agricultural supply capacity, especially enhancing the participation of small holder farmers into the global value chain as a means to reduce poverty. Such capacity enhancement would include the ability of these farmers to access a variety of production technologies (inputs), product quality enhancements and direct linkages to the market (linking them to export value chain), in which case the EAC-EU EPA should help promote productivity, competitiveness and diversity of the EAC's agriculture sector, thus laying a stronger foundation for reducing the incidence of rural poverty in the EAC.

The following are some of the recommendations on how the EU's support and trade potential of an EPA could be leveraged to support the growth of EAC's agriculture sector:

- (a) *Supporting growth of nascent agro-processing and manufacturing*: Further support should go to the nascent agro-processing and manufacturing plants, technical assistance to the EPZs, measures that will enhance EAC value addition efforts and improvement of its terms of trade for agricultural products (i.e., a shift in composition for EAC agricultural exports to the EU).
- (b) *Strengthening rural finance*: Trade related support in EPA should go further to boost rural finance in the region. This should complement the efforts of the current rural microfinance schemes, rural savings and credit cooperatives and strengthen them institutionally while providing them with the necessary infrastructure to increase their effectiveness as part of a comprehensive development component of the EPA.
- (c) *Supporting rural infrastructure networks*: As part of development cooperation of the EPA, the development support should focus on accumulation of productive capital, such as a network of physical infrastructure in the rural areas that connects production centres. These roads, railways,

inland ports, warehouses, storage facilities, and cold rooms, which are all essential for the value addition in agricultural trade, will transform EAC rural life and improve livelihoods of EAC citizens. This should be complemented by a boosted rural and region-wide market infrastructure, information and telecommunication networks as well as irrigation infrastructure, where applicable, to reduce the dependency of the sector on nature.

- (d) *Establishing a scientific infrastructure:* The EU should support EAC member states to build the necessary scientific infrastructure and human resource capacity to comply with SPS standards that meet consumer preferences (and packaging, shape, labelling standards etc.) in the EU market. These factors have become significant barriers to agricultural products entering the EU market from EAC countries and progress of negotiations in this sector should be commensurate to existence of this capacity.
- (e) *Organising production agents:* Technical assistance should also be extended to organise farmer organisations in the EAC. This should include training in basic organisational management, financial management and seed capital to establish the basic office infrastructure, such as computers.
- (f) *Supporting technical reforms in EAC's agriculture:* In the same vein, technical assistance should be extended to EAC member states to harmonise and reform their legal and regulatory framework in the agriculture sector in order to prevent unscrupulous business agents that jeopardise standards and service provisions in the sector.
- (g) *Reforming EAC land tenure systems:* Focus should also be placed in reforming land tenure systems in the EAC as a priority if any leverage in the agriculture sector is to be achieved. It should be noted that the current land tenure system in the region is anti-investment/anti-commercialisation of agriculture sector, which has an effect of perpetuating poverty in rural areas.

In summary, the *EAC-EU EPA Chapter on Agriculture* should aim for an EPA that guarantees the EAC member states: (i) food security; (ii) eradication of rural poverty; (iii) enhancement of agricultural sector competitiveness; (iv) the transfer of production technology to the sector; (v) the protection of the environment; (vi) to build EAC scientific infrastructure to meet EU agricultural product supply standards; (vii) EU reform of its agricultural sector to eliminate trade distorting domestic support, export subsidies and dumping in EAC markets; and (viii) establishment of monitoring mechanisms such that the above outlined benchmarks are achieved in the EAC and that the EU's Common Agricultural Policy is reformed to permit fair competition for EAC products in the EU markets.

The EAC's agricultural sector should be placed at the centre of the EAC-EU EPA if the much anticipated development benefits of the partnership are to be achieved. This is because the agricultural sector constitutes the largest number of poverty intensive sub-sectors (sector that employs the largest number of the poor but also with greater capacity to eliminate rural poverty) in the region and therefore appropriate reform here will be transformative for the economies of the region as a whole.

### **4.3 The Most Favoured Nation Provision in the EAC-EU EPA and its Implications**

The research by Julian Mukiibi (2009b) deals with the MFN clause, contained in Article 16 (2) of the interim EPA between EAC and EC. In trade language, this mandates EAC to extend to EU any more favourable treatment that it might give to a "major trading economy" in future. Accordingly, this shall apply to both parties and shall not only cover tariffs but also RoO. There is an advantage of including an MFN principle in FTAs to the extent that it protects the value of concessions received from future erosion, since any subsequent preferences entered into with third parties are automatically extended to their original parties as well. However, inclusion of MFN clause in FTAs is neither required nor proscribed by the WTO. In the present negotiations towards a comprehensive EPA, its inclusion remains one of the most politically sensitive issues.

The key challenges for the EAC countries with regard to inclusion of an MFN clause are how to deal with the moral ground of fairness as argued by EC; how to rectify the constraining definition of who is a “major trading country” with respect to the increasingly changing global trade dynamics and patterns, especially regarding South-South trade relationship, and the lack of clarity about the potential benefits of MFN clause. This clause in EAC-EU EPA exempts any country within the ACP group from an obligation to extend to the EU any more favourable treatment that may be agreed upon with EAC countries regardless of the trade threshold.

Therefore, one of the possible consequences of the MFN clause in the EAC-EU EPA will be making the EAC less attractive for other Southern trade partners outside the ACP who would not want a clause that takes away their possible preferences or subjects their products to competition with EU goods as a result of opening their domestic markets to the EAC. Therefore, the clause makes the EAC market opportunities for other countries less attractive and would discourage the rapidly increasing South-South trade.

Another key challenge is the controversy between the EPA MFN clause and the multilateral enabling clause. The “Enabling Clause” permits the exemption of developing countries from the MFN principle, allowing them to enter into regional trade agreements among themselves. The contentious issue here is whether the “Enabling Clause” is an alternative legal basis for the formation of an FTA among developing countries, and hence whether the “MFN clause” in the EPAs effectively takes away this right from the developing countries defined as “major trading economies” since any market access offered to third parties would have to be offered to the EU as well.

The research further notes that the views held by some of the major trading nations from the South are that if the clause remains in the EPAs, it would violate the Enabling Clause whose main objective was to enhance trade among developing countries on a preferential basis. It also notes that the MFN clause came into the EPAs at the time when South-South trade is expanding.

**Box 7: Moral vs. Substantive Implications of  
an MFN Clause in the EPAs**

As presented in Mukiibi's (2009b) study, EU understands "major trading economy" to include all developed countries and any country accounting for a share of the world trade merchandise exports above one percent, or any group of countries acting individually, collectively or through an economic integration system accounting for a share of merchandise exports above 1.5 percent.

From the EAC side, an MFN clause is not acceptable as a matter of principle as it unnecessarily constrains their future trade agreements with third parties. The view of the EC is, however, based on the principle of "fairness": the EU has granted DFQF entry into its market for all EAC goods while EAC has been allowed to exclude sensitive sectors from liberalisation; therefore, if EAC would be in a position to extend more generous concessions to any major third parties then only it would be fair that it extends the same to EU.

According to a study by Sanoussi Bilal and Isabelle Ramdoo (2010), much as EU advances its argument to include an MFN clause in the EPA on account of fairness and the need to protect the value of concessions received from future erosion, on its side, African and Pacific regions have a different perception of the likely implications of an MFN clause in the EPA, in particular on their scope for future trade negotiations. In effect, the inclusion of the MFN provision leaves very little policy space for countries to negotiate ambitious trade agreements, in particular with other developed countries (e.g. US, Australia) and major trading economies (e.g. China, India, Brazil) or with other major regional groupings (e.g. MERCOSUR, ASEAN).

They feel that by committing to extend to the EU preferences it might give in the future, will weaken their negotiating power *vis-à-vis* any important trading partner, in particular, given the increasing importance of new trading partners from the south. This has triggered a big political debate in most of the regions about the willingness of countries and regions to bind themselves to the EU on future trade agreements, whose terms are not yet known.



Therefore, the MFN clause in the EPAs has the potential of undermining these initiatives and creating constraints to the development of South-South trade further hindering the integration of developing countries in the world trading system, which is one of the central objectives of the Doha Round and the EPAs themselves.

Given these challenges of an inclusion of MFN clause in the EAC-EC EPA, Mukiibi's research recommends as follows:

- (a) Moving forward with the EPA negotiations would require that the implications of an MFN provision in the EPAs on the meaning and intent of the "Enabling Clause" would need to be assessed. In this case, it will be important to wait and seek legal interpretation of the significance of the two clauses (MFN clause in the EPA and the "Enabling Clause") at the multilateral level within the WTO.
- (b) EAC countries need to study how other EPAs are treating the demands of the EU with regard to inclusion of an MFN clause in their EPAs so that lessons can be learnt and provisions of the clause can be drafted accordingly.
- (c) Further research is needed to determine the potential adverse impacts of the MFN clause by undertaking a line-by-line analysis, particularly on tariff lines where the EAC has not given deep concessions to the EU in the EPA market access negotiations. This would be useful in determining whether a better comparative advantage of EU (either due to subsidies or terms of trade or other reasons) compared to the "major trading economies" would deter the latter from entering into bilateral/regional trade concessions with the EAC/ACP countries. Such an analysis would then be the basis upon which the MFN clause should or should not be included in the final EPA.
- (d) In addition to the above, the Africa Trade Policy Centre recommends that the MFN clause should be resisted by the EAC countries not only on the grounds of its conceptual difficulties and contradictions but also because of its minimal utility for the EAC countries<sup>51</sup>.

#### 4.4 Trade in Services in the EPAs: The Way Forward for the EAC

The analysis and recommendations on this sub-section is based on the BIEAC research conducted by Ogalo and Rabinowitz (2009). According to the research, the EAC partner states face a series of significant challenges in their services sector which should be considered in the current EAC-EU EPA negotiations. These challenges are as follows:

- i) The EAC faces the EC in these negotiations, which is a stronger and unrelenting negotiator mandated to aggressively seek global concessions for EU's services trade. This is in addition to the known fact that the EU is also one of the world's most competitive services exporter accounting for a significant share of global services exports. Considering that comparative advantage in manufacturing is increasingly drifting to the Asian economies, future growth and economic leadership of EU will mainly come from its services sector. Therefore, trade in services remain EU's key offensive sector in the EPA negotiations.
- ii) The current EAC services sector is one of the weakest in the world, suffering from a poorly regulated and non-competitive environment. This is emphasised by the limited level of regulatory development and lack of functioning competition law in the EAC countries which limits the contribution of the sector to development and poverty eradication in the region.
- iii) The EAC also suffers from deficiencies in organisation and competitiveness of the local services providers including lack of international experience in service export. There is lack of market information relating to the size of the regional market for service sub-sectors of offensive interest to EAC. Similarly, there is lack of information about potential of such sub-sectors in the EAC's export market.
- iv) There is limited or lack of preparation by the EAC negotiators to negotiate on trade in services and the limited knowledge on the readiness of services sectors for liberalisation (no

knowledge of which services to offer and which ones to request for market access in the EU) by all Partner States of the EAC.

- v) The poor state of infrastructure in the EAC Partner States does not permit competitive services exports by EAC.
- vi) In the current state of services development in the EAC states, they have limited export interests in market access in services due to capacity constraints, even though it could do well in mode 4 of supply and this mode should be raised to the level of significance it deserves in the negotiations. The challenge of exploiting this comparative advantage of EAC is that it can succeed in the supply of semi-skilled and unskilled labour to the EU, which has low returns, especially given the stringent EU rules governing exportation of high-skilled services to the EU, such as economic needs test and non-recognition of certain qualifications, especially, if they are deemed less equivalent to EU's standards.

There is no doubt EAC countries need accessible and affordable infrastructural services like water, transportation, energy, information and communication technology services as well as education and health to improve their productivity and competitiveness in the global services export market. The deficiencies of the sector highlighted above, therefore, call for a thoughtful consideration of inclusion of the services sector in the EPA negotiations. The daunting challenge for the EAC negotiators would, therefore, be to determine upfront how an agreement with EU on trade in services could affect the growth of the sector and basic-service provisioning in the region.

Before such determination is made, in consultation with all relevant parties including civil society, it would be important for the EAC negotiators to exercise due diligence in advancing negotiations on this sub-sector. As both parties agreed in the FEPA to conclude negotiations in services, the key challenge for the negotiators would certainly be how to design their offensive and defensive strategies in view of the EU's global strength on services trade and EC's experience in services negotiations globally.

The study as a way of conclusion makes the following observations:

*Preparing to negotiate:* Preparation is the key to success in negotiations. For the services negotiations, this should involve in-depth services sector studies, assessment of implications of sub-sectoral services market opening as well as identifying knowing which sectors to request and offer to the EU during the negotiations.

*Regulatory reforms:* Organisation of regulatory and institutional services framework within the region should be part of the preparatory process to negotiate to liberalise the sector. Failure to reform regulatory and institutional constraints will lead to a repeat of the experience of the last two to three decades in which liberalisation of services did not promote competition nor lead to efficiency gains and consumer welfare improvement as had earlier been anticipated by the liberalisation proponents, but instead will continue to make the EAC services market less attractive to foreign investors<sup>52</sup>.

*Human resource development:* Legal parameters and implications of the services negotiations need to be fully understood by the EAC since the resulting commitments will have serious implications for the future of their services sectors and poverty eradication efforts in the region.

*EU's engagement:* EU may use its negotiation chest particularly in this sector to force the EAC to make more significant commitments (offers) than they may under the ongoing multilateral trade negotiations in the Doha Round. This is because reaching a comprehensive EPA with the EAC before the multilateral negotiations are completed will confer to the EU a first-mover advantage in market opportunities in the EAC relative to its competitors. Having already shown its hand in the EPA, the EAC offers in the multilateral negotiations may appear unattractive to other bilateral partners.

The study notes that in the texts submitted by the EC so far, it requires the EAC states to eliminate measures affecting trade in services. This is good if the focus is on reform of the regulatory framework to make the EAC trade in services more competitive regionally by

removing the structural bottlenecks. But the EC also pushes for national treatment to European companies supplying services locally. This should not be done at the outset of the EPA. Instead, it can be gradual in some services sectors where local supply potential is essential to develop the necessary domestic capacity and local job creation (national treatment could be opened up on subsector by subsector approach, not omnibus of the services sectors<sup>53</sup>).

Given all the above, the study makes the following recommendations:

- (a) *Consider some benchmarks to guide negotiations:* Firstly, EAC states should consider starting negotiations on trade in services with the EC on the basis of EC's commitment to support to raise the supply capacity of the EAC service providers, reform the regulatory framework and ensure an environment that will boost the emergence of EAC local service providers and exporters. A commitment to support addressing the supply-side constraints and structural inefficiencies in the service industry in the EAC should be secured first as the benchmark condition for the negotiations to proceed before market opening starts on the side of EAC.

Second, a phased approach to negotiations should be implemented: (a) Phase I: support conducting of studies and sectoral analysis of EAC potential sectors, development implications for liberalisation of services and identifying defensive and offensive sectors for request and offer process; (b) Phase II: regulatory and institutional reforms to create an enabling environment for EAC local services providers to compete; in this phase, EU development and technical assistance should be secured to be extended to EAC states and should be an EAC benchmark for initiation of negotiations; (c) Phase III: prepare texts for negotiations. Focus on what it wants from the EC first and then define its market access requests.

Third, harmonisation and coordination of EAC member states' national and regional development plans and policy initiatives in the sector should be undertaken to ensure a coherent strategy in the run up to negotiations with the EC on trade in services.

- (b) *Capacity building for EAC entrepreneurs on the nature and potential of EC services market:* EAC member states need to demand technical assistance from the EC about educating EAC entrepreneurs on EU potential market for EAC service providers, restrictions on EC market access and review of EU laws that may be relevant to enable EAC services suppliers in exporting services and possible areas of national treatment. This should also include provisions for joint ventures between EAC and EU services providers with intent to increase technology transfer, knowledge spillover.
- (c) *Initiatives to attract FDI in the services sector:* EAC member states should be open to the idea of opening up sectors that have high international export potential but need FDI to establish a competitive infrastructure and build a competitive capacity or need competition to increase efficiency and regional competitiveness relative to other EU services suppliers.
- (d) *Policy lessons:* EAC states should be encouraged to bring forward lessons from other EPAs services negotiations that are in progress or have already been concluded.
- (e) *Forward looking requests:* EAC member states should anticipate change in trade in services dynamics with consequent increases in competitiveness in the region and press for forward looking requests during the negotiations. They should include in their offensive list services sectors where EAC is weak but could attract investments from abroad into areas that will aim to take opportunity for an open market in the EU services industry.

Overall the trade in services negotiations in the EAC-EU EPA must aim to achieve: (a) the development and poverty reduction objectives of EAC states; (b) build and strengthen the service sector industry in the EAC to attain international competitiveness; (c) guarantee flexibilities to the EAC as enshrined in GATS article V; and (d) should take into account the adjustment costs of liberalisation of services industry and use the adjustment assistance to create winners and minimise losers.

#### **4.5 Standards and Market Access under EPAs: Implications and Way Forward for EAC**

This sub-section is based on the research by Othieno and Ogalo (2009). The research notes that EAC diversification and growth of its export basket has been limited both by its supply-side constraints and stringent “internal market conditions” of the developed countries in particular the EU, which has been the major EAC trading partner for years.

The “internal market conditions” that constrain EAC exports to EU market include: (i) EU stringent food safety requirements; (ii) SPS measures; (iii) labelling requirements; (iv) private standards; (v) negative perception by EU consumers on the quality of African products in general; (vi) varied consumer tastes and preferences; and (vii) environmental and labour standards.

Product standards in general including health hazards, food safety requirements, environmental protection, concerns of human rights abuse in the production process, stringent technical requirements and production techniques as well as private standards have evolved rapidly in the recent decade and are becoming the major sources of trade costs in international trade. The study notes that these standards, including the ever increasing importance of private standards in international trade, are subject to be used for trade protectionism. They also note that African exporters and countries have limited capacity to use multilateral instruments like the WTO Dispute Settlement mechanism to resolve these protectionist tendencies. It is to be noted that the WTO also allows its members to have their own justifiable national standards, which are sometimes more stringent than the multilateral standards.

Furthermore, EAC and EU have agreed in the current EAC-EU comprehensive EPA negotiations to cooperate to safeguard human, animal, and plant health and life, ensuring transparency in the application of SPS measures to each other’s trade and promoting technology transfer. More fundamentally, therefore, the parties will have to work together to enhance EAC member states scientific infrastructure and capacity to implement and monitor SPS standards in accordance with international best practices.

This arrangement should ensure that as the two parties negotiate and enter a free trade area, they should see that they harmonise their product standards and agree to a mechanism to address ever evolving standards on each other's territories. This should also include capacity building in both public and private sector for SPS control through technical assistance, transparent information exchange and enactment of mutual recognition agreements in the area of product standards.

EAC member states should identify their infrastructural priorities in the area of standards compliance and make capacity in these priorities as a benchmark for progress of negotiations in other areas. Without doing this it will be self defeating if they negotiate market access for the products that can not meet the standards.

Deep analysis should be conducted on the current complete EAC-EU EPA text on the SPS and TBT to identify capacity gaps, find out whether the above benchmark objectives have been met at this stage, and generate advocacy issues before negotiations begin.

EAC member states should take advantage of the process to boost their product standards and innovation since standards inherently promote technological progress and as companies make efforts to comply, they will innovate by acquiring advanced production capabilities and learning by doing (see Grossman & Helpman, 1989).

Standards are market entry costs. The research notes that buyers have imposed many requirements informally through individual supply chains, raising the bar for new entrants into the market (Jaffe & Henson, 2004). Hence, exporters are concerned about the cost of monitoring a large number of small holders for compliance with increasingly strict regulations.

Despite the DFQF access of EAC goods into the EU, as negotiated in the EPAs, EAC exports will still face restrictions in accessing the EU market. This is further exacerbated by the fact that standards are constantly changing and, therefore, require constant upgrading of both skills and premises and might result in adding to transaction costs of the EAC exporters.



As pointed in the study, standards, particularly those that require independent certification, intrinsically fulfil many of the broader requirements for producers to participate in global supply chains or compete in high value products. For example, detailed record keeping of production inputs, traceability and third party monitoring that are required for independent certification are also useful for improving chain competitiveness and ensuring more effective participation in lucrative markets. EAC member states should see an opportunity in fair trade standards. These guarantee minimum prices considered as fair to producers and provide a fair-price premium that the producer must invest in projects enhancing its social, economic and environmental development (Othieno and Ogalo, 2010).

Some of the key recommendations of the study include the following:

- (a) Comprehensive studies need to be undertaken on those EU product standards that affect EAC member states exports to the EU market. These studies should also be able to establish a unit cost of additional transaction costs an EAC exporter incurs to comply with these costs (even under DFQF market access) and this information should be published for awareness of all EAC exporters.
- (b) As a priority, the EU should extend technical support and infrastructure support based on the findings of the studies particularly in the sectors more significantly affected by standards barriers. This should be a benchmark requirement for EAC negotiators as the only way to achieve meaningful market access, through knowledge of effectively applied standards and the infrastructure (both physical and scientific) to meet these standards. It presents an opportunity for EAC partner states to invest in supply chain modernisation, adoption of better safety and quality control in agriculture and food manufacturing.
- (c) Lastly, the two parties should initiate and negotiate mutual recognition agreements in the areas of product standards as part of EAC-EU EPA for products of EAC export interest. Such agreements would guarantee predictability for EAC export suppliers to the EU and also enable the region to attract foreign investment as a result of predictable market access.

#### 4.6 Export Taxes and EPAs – Another Policy Tool Under Threat for the EAC?

One of the areas of contention in the interim EAC-EC FEPA has been the insertion of a clause outlawing export taxation. Policy makers and also producers, particularly the producers and exporters of primary products, have argued for the need to maintain policy space by EAC to be able to determine its future industrialisation. Policy makers argue that in future, EAC may want to use a trade measure to respond to particular economic development challenges, such as value addition, infant industry development or promotion of industrialisation in general. In this regard, it is felt that the current provision in the interim EAC-EAC FEPA would constrain an important industrial policy instrument for EAC.

According to Sanoussi Bilal and Isabelle Ramdoo (2010), the specific request from the EU in bilateral negotiations for the elimination of export taxes and the prohibition of their use in the future as well as the removal of NTBs to EU's exports and investment is part of the latter's broader external policy as defined in 2006 in its policy document "Global Europe: Competing in the world: A Contribution to EU's growth and job strategy." It has, since then, been an important policy actively pursued by the EU in all its FTAs, in particular with a view to securing access to resources such as energy, hides and skins, primary metal raw materials and certain agricultural raw materials.

According to the research by Richard Watts (2009) and a briefing paper by Richard Watts, 2009, an export tax is one of the trade policy instruments at the disposal of a nation to maintain its policy space for a number of functions. Specifically, it is a duty applied by countries to products before export. Although it can take several forms, one of them is a standard rate which can vary depending on world prices of the product or it can be a complete ban on exports of that particular product. They note that export taxes can play a number of roles including: (i) improving the development objectives of EAC countries; (ii) promoting value addition; (iii) protecting infant industries; (iv) improving agricultural productivity; and (v) acting as a source of real revenue for the exporting government (though this happens at the expense of exporter and importing countries consumer).

While the GATT/WTO itself does not explicitly prevent countries from applying export taxes, it can be argued that since export taxes are also part of the family of “customs duties”, members may commit to reduce or eliminate them as part of the trade liberalisation process. So far at the WTO, most countries have taken commitments to reduce duties only on imports. But some recently acceding members (such as China, Vietnam, Saudi Arabia and Ukraine) were asked to take commitments to progressively eliminate restrictions on exports. In the context of an FTA notified under Article XXIV of the GATT 1994, countries are required to “eliminate duties and other restrictions of commerce on substantially all trade”. By definition, “duties” implies charges and levies applied both to imports and exports and “trade” covers both imports and exports. Thus, any agreement notified under Article XXIV should, in principle, also cover export duties. However, the article requires restrictions to be eliminated on “*substantially* all trade”, and not on “*all* trade”, implying that some restrictions, including some export taxes, can still be maintained.

The main disadvantage of export taxes lies on their negative impact on the welfare of producers at home and consumers on the international markets, depending on the proportion of exports that the imposing country has in global trade. They cause reductions in the supply of a good on the international market and increase its availability at home in the domestic market<sup>54</sup>. This depresses domestic prices leading to gains in domestic consumer welfare and a welfare loss for domestic producers (except where producers are also consumers like in family farm units). In principle, the increased availability and reduced cost of a good may encourage the processing of that particular good, promoting industry and job creation in other sectors, for example, cocoa pods to cocoa powder. This generates forward and backward linkages and expansion of services associated with the value chain of this value addition.

EAC countries share of world trade is small and it may not influence world prices significantly. Until now export taxes have not been a major policy tool for the region, with the exception of Kenya which only imposes export taxes on scrap metal and hides and skins as a tool to encourage value addition within the country<sup>55</sup>. Furthermore, the EAC Customs Management Act of 2004 provides a legal basis

for the restriction of certain exports under use of export taxes within the partner states.

The ideology behind EU's push for export tax disciplines and rules both within the EAC-EU EPA and at multilateral level, is that export taxes create distortions to international trade, especially by artificially transferring gains from trade between countries ("beggar-thy-neighbour") and create unfair advantages to domestic industries hurting consumers from the country's trading partners.

From an economic efficiency view point, EU concerns are that the implementation of export taxes by countries with monopolistic positions of global supply will create rising commodity prices for consumers all over the world with potential global supply problems and increased risk of food insecurity. Indeed a precedent of this scenario exists as in the use of export taxes and restrictions during the recent food crisis (2008) which was widely criticised. They are also criticised for creating inefficient industries only dependent on subsidies within the developing countries. This leads to misallocation of resources as well as encouragement of rent seeking behaviour like corruption and increased administrative costs.

The use of export taxes to pursue development objectives is compelling. If EAC-EU EPA is to serve the purpose of not only market access for the parties, but also enhance development opportunities for EAC and African countries in general, the EU should refrain from pushing any form of export tax disciplines within the current negotiations and permit the EAC countries to retain their flexibility to use this essential development policy tool to meet their ends. The pros and cons of the use of export taxes can be widely debated, irrespective of whether they are good or bad for EAC. It could be argued that the policy choice of taking such measures by EAC, deemed appropriate for their future development, should remain theirs and not for the EC to lecture EAC on what is good for the latter.

The EAC must be mindful of the potential dangers of permitting the EC to set a precedent for a multilateral approach toward disciplines in export taxes. This would be hard for small African economies to reverse or challenge at a multilateral level since numerous interests

between countries at this level make leverage of weak economies complex and difficult.

In an event of EU hard-lining, the EAC countries could demand that where an export tax is a revenue measure, the EU should at least replace the revenue by a binding commitment to provide foreign aid or FDI for the sector in question and commit to be subjected to sector performance goals set by EAC partner states.

Additionally where export tax is for R&D the EU should commit itself to provide scientific and technical assistance as well as technology transfer toward this goal for the EAC partner countries.

# 5

## Policy Recommendations

The EAC integration process faces formidable challenges. However, if well handled, an inclusive, optimal integration has the potential to deliver significant opportunities to improving the welfare and livelihoods of EAC citizens and lift many in the region out of abject poverty. This synthesis paper, based on case study research findings has highlighted some of these key challenges broadly categorised as: (a) inadequate political will to effectively implement the goals of EAC treaty; (b) slow ceding of sovereignty to the EAC supranational authority; (c) fragmented public policy making/formulation within the member states; (d) limited public (citizens, non-state actors) participation and ownership of the integration processes; (e) structural and capacity constraints to implement EAC treaty; and (f) inadequate arrangements for equitable and proportionate sharing of benefits (and burdens) among member states.

On EAC negotiating an EPA with EAC, the research notes broadly the following challenges: (a) inadequate preparation of the region for negotiations in some sectors; (b) limited use of empirically backed policy options in the negotiations, like impact studies for regional trade liberalisation with a global competitive producer and exporter; (c) structural constraints like poor infrastructure of the regional economies; and (d) EU use of divide and pressurise with a threat of tariff increase particularly for non LDCs (Kenya in this case) if a comprehensive EPA is not reached regardless of whether the outcome EPA does meet the development criteria desired by EAC member states.

The synthesis paper puts forward a number of recommendations for achieving an inclusive EAC integration. The key recommendations relating to sustainable EAC regional integration and EAC-EU EPA negotiations are compiled below.

### **5.1 Policy Recommendations on Sustainable Regional Integration**

*Migration:* First, there is need to educate the public to appreciate the benefits and opportunities of EAC deeper integration. There is need to publicise the provisions of the EAC treaty and its protocols concerning free movement of people in the region, specifically individual's rights and obligations regarding work, business establishment and residence within each of the member states of EAC. This will reduce xenophobic tendencies within the destination member states of intra-regional migrants.

Second, there is a need to harmonise social policies, employment laws and regulations, and social protection laws and remove all other barriers that prevent smooth movement of EAC citizens within the region or discriminate against them in any of the member states. This should be followed by issuing of a regional identification document to complement national identity cards.

Third, establishment of a mechanism for transparent information collection, processing and sharing especially on work opportunities and also coordination of regional migration statistics for planning purposes is needed. There should also be regional programmes for skill development for regional competitive labour force.

*Informal Cross-Border Trade:* First, there is need to eliminate transaction costs related to differing, complex and slow procedures of licensing business, time consuming customs procedures and standards verification procedures. This can be done by harmonising and coordinating the business environment at regional level. There is also need for public education on the meaning of the common and identification of opportunities by small holder producers and traders within EAC.

Second, there is need to support the growth of small scale enterprises (bottom-up entrepreneurship) and facilitate their integration into the mainstream formal economy. This will call for design of programmes that encourage and provide incentives for small scale enterprises to formalise their businesses and also be supported to grow and expand using public policy instruments like government guaranteed credit for start-up capital, training programmes etc. This provides a quicker way out of poverty for many in the region.

*Tax harmonisation:* First, EAC member states should move to coordinate or harmonise all their tax rates and or tax bases, to ensure equality of taxation for all economic agents, avoid segmentation of the market, reduce incidences of tax evasion, corruption and tax competition within the region. This should be followed by development of a common VAT model, where the tax bases are jointly agreed and rules and practices of VAT refunds are harmonised.

Second, efforts should be made to harmonise tax administration procedures, strengthen tax payers' rights, harmonise regional structure of tax incentives, corporate income tax, withholding taxes on dividends, interest payments, royalties and services fees as well as incentives in the EPZs and SEZs in member states.

Third, there is a need to strengthen the regional human resource capacity in tax administration, encourage rotation and exchange of national tax administration staff among member states to encourage ownership of the harmonisation process and the spirit of cooperation within the member states. There is also need to encourage coordination between revenue authorities of member states in establishing a joint mechanism to monitor performance and efficiency of each member state revenue authority.

Fourth, the member states should encourage transparency, information exchange and conduct tax education to all economic agents within the single member countries and EAC Secretariat. In the EAC Secretariat more efforts have to be made to improve the information base and the statistics for regional tax planning.

*Non-Tariff Barriers:* First, there is need to harmonise business regulations, licensing procedures, business documentation, tax



systems, standards and safety rules, including mutual recognition of standards and safety requirements for adopting common regional standards.

Second, there is need to tackle infrastructure related non-tariff barriers, including upgrading road, railway networks, energy and telecommunications, reduce border checkpoints, increase inland ports container handling facilities for land locked EAC member states to reduce cost of doing business.

Third, coordinating regional integration initiatives and discouraging multiple memberships to regional groupings, will ease trading procedures, like proof of RoO and its administration.

Fourth, there is a need to establish an active NTB monitoring body at the EAC Secretariat that will act as enforcing machinery for all policy initiatives aimed at facilitating intra-regional trade.

*Implications of Accession on Private Sector Development:* First, there is need to speed up the process of macroeconomic and fiscal convergence, harmonise commercial legal and business regulatory framework and upgrade regional physical infrastructure aimed to improve the region's competitiveness and business environment for the private sector growth.

Second, scaling up efforts to facilitate free flow of business persons, skilled labour especially to Burundi and Rwanda to encourage skills transfer and learning by sharing experience by these member states private sector is called for.

Third, member state governments should take an active role to coordinate the growth of the private sector in the region, i.e. there is need to encourage bottom-up development of small scale enterprises in Burundi and Rwanda using public supported programmes for instance granting small business government secured credit, establishing performance goals for government supported enterprises and reward high performing entrepreneurs periodically in the region to encourage positive and best practices.

*Competition:* A national competition policy should be a first step toward a regional competition policy, i.e. there is need to harmonise the regional competition regime to ensure harmony in all member states. It should take into account the level of national development as well reflect the regional development aspirations. It should conspicuously be linked to other pro-poor policy initiatives in each member state. It should not antagonise the industrial policy being pursued by each of the member states. It should emphasise the promotion of a culture of fair competition for all economic agents and encourage innovation by local and foreign firms.

Second, it should protect and promote the welfare of consumers in the region. It should guarantee presence of a monitoring body to enforce the implementation of the policy and enforce the competition law – a body that is independent of government interferences both at regional and within domestic member states.

Third, it should encourage the inflow of favourable FDI, together with the associated foreign technology transfer to the region.

*Policy Challenges and Opportunities in a Resurgent EAC:* First, as a priority, EAC member states should coordinate and harmonise their domestic trade related policies as well as their external trade. They should be able to speak with one voice in trade negotiations at regional and multilateral level. They should establish an EAC permanent mission in Geneva for WTO negotiations.

Second, mainstreaming trade and trade policies jointly in national development plans through a harmonised regional trade policy that is coordinated at the regional level by the “EAC Trade Commission” for instance is needed.

Third, there is need for continuous monitoring and evaluation of the impact of trade policies being implemented jointly in the EAC with a view to continuously improve and make necessary adjustments for the betterment of the EAC people.

## 5.2 Policy Recommendations for Maximising EPA Negotiations Outcome

*Technical Preparation:* First, as a priority there is need for adequate technical preparation, including development of regional negotiating positions based on empirical and impact studies in specific sectors and subsectors on schedule for liberalisation within the EAC-EU EPA. Details should include numbers on how opening up of these sectors to the EU economic actors is going to affect the people of EAC, who will be losers, and who will be winners and by how much. What will be the adjustment costs for each member state over time as a result of the EPA that establishes a FTA with the EU?

Second, there is need to secure the participation of CSOs to input in the negotiations process. Member state governments of EAC must ensure that their CSOs have adequate capacity and avenues to contribute quality inputs in the negotiating positions. This constitutes one sure way of having the resultant EPA being pro-poor and meeting the standards and the spirit of the CPA and development aspirations of EAC rather asymmetrically serving the interest of the EU.

Third, there is need to sensitise and support the EAC private sector with regard to the evolving negotiations and increase their preparedness by identifying business opportunities and enhancing their capacity to take advantage and maximise these business opportunities from the resultant EPA.

*Revenue Implications of EPA:* First, EU development support provisions be made binding. Development support should be linked to the sectors that will be liberalised and be commensurate to the resulting adjustment costs of Tanzanian (and other EAC member states) liberalisation. Thus, Tanzania and EAC member states that will lose revenue from removal of import duties, should be compensated dollar for dollar with EU adjustment/development assistance and this should be made binding.

Second, there should be a deliberate effort to develop supply capacity within the weaker sectors of EAC member states, i.e. development assistance should be directed to sectors that are weak relative to EU exporters to strengthen their competitiveness and minimise possible

sectoral losers and maximise winners as a result of EAC trade liberalisation with the EU.

Third, mechanisms and procedures of delivering adjustment assistance and trade related support should be improved for effective implementation of the resulting EPA.

Fourth, there is need for a sectoral liberalisation approach. Sectoral analysis should be done to identify the sectors that bring in more revenue for Tanzania and criteria for sectoral liberalisation adopted. This can include: (i) compensatory adjustment assistance transferred by EU to Tanzania (or any EAC member state) for loss of this revenue; (ii) technology transfer and technical assistance transferred to these sectors and hence their realised competitiveness especially in the infant manufacturing and agro-processing sectors of EAC member states; (iii) growth of the sector (in terms of exports to the EU) or domestic market shares; or (iv) these sectors should be excluded altogether from liberalisation for the moment.

Fifth, there is need for EAC member states to demand that EU make binding commitments to transfer technology as part of capacity building and development support to EAC member states in the EPA as well as targeted investments to increase the competitiveness of EAC economies.

*The Agriculture Sector:* First, EAC member states should demand that EU reforms its Common Agricultural Policy especially for agricultural products of EAC export interest. This would include removal of domestic support and export subsidies on a list of EAC products of export interest in the EU market.

Second, EAC member states should demand that progress in negotiations in agriculture hinge on EU extending timely support for building of scientific and technical infrastructure to comply with EU standards on SPS measures as well as other product standards.

Third, EAC member states should insist on delivery of development assistance to upgrade the regional physical infrastructure, especially roads and railways, energy, water and telecommunications, irrigation

systems and rural infrastructure networks to world standards if the agricultural sector is going to be an engine of growth for the region.

Fourth, EAC member states should demand technical assistance and development support to harmonise the regulatory framework within the agricultural sector, reforming the land tenure systems and strengthening farmers' organisations.

*The Most Favoured Nation Provision:* First, the EAC member states need to draw lessons from other EPAs on how they treated the EU demands to include an MFN clause in the EAC-EU EPA, so that lessons can be learnt and provisions of the clause drafted accordingly.

Second, there is need for EAC member states to wait and seek legal interpretation of the significance of the two (MFN clause in the EAC-EU EPA and the multilateral "Enabling Clause") and the implications for each of them in the EPA.

Third, EAC member states can resist the MFN clause on the grounds of its lack of conceptual clarity and contradictions and of its limited utility for the EAC member countries in the EPA.

*Trade in Services:* First, EAC member states should explore the option of reaching an agreement only on development cooperation in trade in services sector. Such an option would entail EU delivering development assistance to support the necessary institutional reforms, harmonisation of the regulatory framework among EAC member states as well as building the capacity of EAC service providers to compete with EU service providers at home and EU market.

Second, EAC member states should conduct services sector studies, to assess EAC service providers' capacity and competitiveness, identify the capacity gaps, prepare their request and offer schedules and also explore potential legal and economic implications and opportunities of signing an EPA with the EU.

Third, EAC negotiators should be encouraged to bring forward lessons from other EPAs services negotiations that are in progress or have already been concluded.

Fourth EAC negotiators should anticipate change in trade services with respect to the rapidly changing technology; therefore, they should demand EU market access in services in which the region is likely to acquire competitiveness in the near future. This can be done by expanding the request list of services to include sectors where EAC may become competitive in the near future. Opening up of such sectors may also spur investments in those sectors.

Fifth, EAC member states should ensure that development and poverty reduction objectives remain central to the negotiations, as demanded by the CPA. Hence, negotiators in EAC should insist on retaining maximum flexibilities in the spirit of GATS article V and for development purposes.

*Standards:* First, EAC member states need to conduct comprehensive studies to identify which EU product standards affect which EAC products. Thus, a list of affected products, and list of EU standards should be produced together with the associated additional transactional unit costs for compliance. This information should be published on each product for awareness of all EAC exporters in EU market.

Second, EU should extend technical support, scientific infrastructure support based on the findings of the studies particularly in the sectors more significantly affected by the standards barriers to build EAC capacity to comply. This should be a benchmark requirement for EAC negotiators as the only way to achieve meaningful market access.

Third, EAC member states should demand to negotiate mutual recognition agreements in the area of product standards as part of the comprehensive EAC-EU EPA for products of EAC export interest.

*Export Taxes:* First, EAC negotiators should resist the demands of the EU to subject export taxes to rules and disciplines. The EAC member states should insist on retaining the flexibility to use this essential development policy tool to their end especially with the increasing global demand for raw materials for industrial production. EAC member states should also draw lessons from other EPAs

ongoing or concluded on how the issue of export taxes has been handled.

Second, EAC member states should also explore the option of demanding that where an export tax is a revenue measure, the EU should compensate revenue loss dollar for dollar, by a binding commitment in the EPA.

Third, EAC member states should demand to exchange export taxes for capacity building in long-term R&D and technology transfer and this commitment should be made binding in the EAC-EU EPA.

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## Endnotes

- 1 See Treaty for the Establishment of the EAC (Amended Version, August 2007) available at: <http://www.afrimap.org/english/images/treaty/EACTreaty.pdf>
- 2 EPAs as instruments for development will serve to strengthen regional integration, increase the regions business environment and competitiveness in a credible and sustainable way. Additionally, development support measures will complement the EPA outcomes and must note that EAC market liberalisation is not a panacea for the development. See, for example, the press release issued after the last round of negotiations on June 09, 2010 available at [www.eac.int](http://www.eac.int).
- 3 It is envisaged that the region's non state actors are consulted and integrated in negotiation process
- 4 Full implementation of the EAC common market
- 5 The transaction costs and regulatory barriers largely cost-increasing barriers do distort the welfare effects of regional integration (see Baldwin, 1997)
- 6 Further a single economic space as increased market size offers a number of advantages to economic actors, i.e. accelerated acquisition of technology, enterprise specialisation & exploitation of niche markets, boost in region's manufacturing capacity, increased profit margins, low prices for goods, variety of goods, variety of inputs source, wage employment and overall improved economic welfare for the region and poverty reduction. It would also facilitate learning of regional firms before starting to export in international markets
- 7 See FAO (2003)
- 8 See the EAC treaty (Amended in August 2007) preamble
- 9 Supra note 7
- 10 While there is significant political will within the EAC partner states' political leaders, the political support from the wider population is not readily forthcoming. There is need to prioritise publicity of gains from the integration to the ordinary people as well as the corporate actors
- 11 Mattli Walter (1999) notes that lobbying by large corporations was essential in transforming the EU treaty from a treaty binding on nations, to one

which binds all legal persons and entities, both public and private (in the case of EAC this implies harmonising the EAC law to improve fair competition in all member states), i.e. the demand by member states for improved economic performance and the demand by firms for increased profits worked together to assist in the establishment and development of the EU

- 12 Regional leaders and organisations should look to involve regional corporations to a greater extent in the integration process, since the EU experience shows that corporate “buy-in” is helpful in accelerating the pace of implementation of regional agreements
- 13 See FAO (2003) on the discussion on importance of regulatory coordination/harmonisation within a regional block
- 14 Additionally this would call for harmonising the testing and enforcement procedures in each of the partner states to avoid relocation of firms to partner states with more lax regulatory jurisdictions or threats to relocate from high to low standard partner states which can lead to unbalanced regional growth that can threaten its stability in the long run
- 15 See Cooks and Sachs, 1999
- 16 Overall what matters is that at least one member state must take charge of integration efforts, especially those relating to income distribution, policy formation and institution building. In EAC Kenya should be in the position of a regional leader, ready to contribute a great deal financially to the maintenance of EAC integration
- 17 See Duina, Francesco (2006)
- 18 *Ibid*
- 19 See Simms & Simms (2007) “The Building Blocks of Successful Regional Integration: Lessons for the CSME from other regional integration schemes”, Conference paper available at: <http://sta.uwi.edu/conferences/salises/documents/Simms%20R%20-%20Simms%20E.pdf>
- 20 Supra note 17
- 21 See De Melo Jaime and Panagariya Arvind (1993)
- 22 See Mattli, Walter (1999)
- 23 The WTO notes that many countries are now members of more than one RTA, what Bhagwati (1995) called the “Spaghetti bowl”. This is not to say that the Tripartite Arrangement being developed among COMESA, EAC and SADC is a bad move, as the effort is to enlarge a similarly situated set of countries into an even larger common market with the entailing positive consequences for the sub-region
- 24 Supra note 7

- 25 Baldwin (2007)
- 26 It's noted that the unrecorded trade in EAC reflects the arbitrage process at work because of structural, administrative as well as transaction costs and significant differences in policy regimes on either side of the borders of EAC partner states
- 27 Vein, Cook and Sachs (1999) note that transaction costs for creating institutions to manage regional public goods can be prohibitively high
- 28 See Schiff & Winters (2002)
- 29 See Kanyangoga (2010)
- 30 Tax harmonisation can be said to refer to the coordination of the taxation systems of the member states for the purpose of preventing any national tax measures that could have a negative effect on the functioning of the common market i.e., on the free movement of goods, services and capital and that could distort competition (Price Water Coopers, 2009)
- 31 It is important to understand where all the state's efforts should converge, in order to ensure a people centred development strategy. It would be more appropriate trying to develop local small business in the region rather than focusing entirely on the promotion of FDIs
- 32 Mutsotso (2010) notes that to legitimise the informal sector is to allow for tax holidays and tax exemptions, provide government secured credit etc especially in low yield sectors like agriculture, at least for a specific period after which a low flat rate is charged before they graduate into relative higher income groups.
- 33 See Hans-Georg Petersen (2010)
- 34 *Ibid*
- 35 In every case, there was a consensus, that it would be important to involve SMEs as important stakeholders in developing taxation regimes if it seeks to benefit them as this will also create a sense of ownership by the SMEs, hence increased compliance
- 36 This is generally because the standard taxation regimes in these countries are very complex and the simplified tax regime only applies to few taxes. For SMSEs, the standard taxation regime requirements are often expensive and sometimes exceed the skills and capacity of small business
- 37 The turnover based system also mandates basic bookkeeping obligation for small firms, a good example of this is Tanzania, which facilitates the future transition towards formalisation of these businesses
- 38 There will be need for common tax compliance enforcement mechanisms as well a joint watchdog institution for the tax compliance issues

- 39 Mutsotso (2010) notes that, harmonisation should not be misconstrued to mean sameness in tax rates; rather it should be regarded as a measure towards reaching a convergence on domestic taxation policies and laws in EAC partner states. In this case, there would be situations of differences in the tax rates (values), except that the tax ranges set should be as narrow as possible so as not to confer any undue advantages or create distortions that may defeat the essence of EAC regional integration. We recognise that partner states are in different levels of development and use domestic tax policies and laws to achieve certain goals within their economies
- 40 Monica A. Hangi (2010) cites EAC Development Strategy 2001-2005 “having identified NTBs related to administrative and bureaucratic inefficiencies; standards and technical requirements to be the major impediments to trade within the region, including poor infrastructure & communication networks”
- 41 Such a monitoring mechanism already exists in the EAC which identified 41 NTBs and resolved to address them, but an effective implementation of the mechanism remains to be achieved
- 42 CUTS policy brief BIEAC (No 6/2010)
- 43 See World Bank/IFC Doing Business Report, 2009)
- 44 Including market infrastructure and value chain infrastructure
- 45 Emergence of large firms with greater productive efficiency with ability to cut prices that benefits regional consumers hence gains in regional welfare
- 46 Empirical evidence suggests that diversification towards manufacturing requires: scale, low transaction costs, “investment friendly” and “noticeable” economic space
- 47 Burundi & Rwanda accession may lead to attraction of FDI from the region as well outside the region, as a result of market enlargement particularly for industries that need a certain market size to be efficient (industries with increasing returns to scale production possibilities)
- 48 Competition policy here is functionally defined as “ a set of laws, regulations and measures employed by governments aimed at ensuring that markets remain competitive through maintaining a fair degree of competition by eliminating restrictive business practices by private enterprises” (see, CUTS, 2010)
- 49 The definition of substantially all trade is found in Article XXIV (8.a) of the General Agreement on Tariff and Trade (GATT). This article stipulates that countries have the right to negotiate FTAs that would allow them to extend more favourable treatment to each other, without extending the same to other WTO members, provided that “...duties are eliminated with respect to substantially all the trade between the constituencies”, and that

this occurs “within a reasonable length of time” [GATT Article XXIV (5.c)], which, according to the formal understanding adopted by WTO members “should exceed 10 years only in exceptional cases”

- 50 Karingi et al (2005) notes a loss of US\$32.5mn while Milner et al (2005) finds a loss of Tshs36.9bn based on 1990s trade data
- 51 The Enabling Clause was agreed between GATT parties on November 28, 1979, see document L/4903 dated December 03, 1979; titled “Differential and More Favourable Treatment: Reciprocity and Fuller Participation of Developing Countries”, available at [http://www.wto.org/gatt\\_docs/English/SULPDF/90970166.pdf](http://www.wto.org/gatt_docs/English/SULPDF/90970166.pdf)
- 52 Ogalo & Rabinowitz (2010) notes that the necessity of such complementary reforms and the delicate challenge of creating effectively functioning and equitable markets mean that services market opening in EAC should be undertaken gradually. It should be sequenced (negotiation approach should be phased beginning with preparatory work in which EC should provide technical assistance and resources to conduct legal, regulatory and institutional reforms) with other necessary reforms and informed by knowledge of legal gaps that need to be addressed. This highlights the importance of undertaking comprehensive assessments of the services sector to identify what their capacities are and what regulatory and institutional measures will best support their development
- 53 This approach preserves the spirit of GATS Article XX
- 54 The export tax will increase the world price and international consumers would bear the cost of the tax in increased prices, unless this lowers the relative marginal cost of production for its trading partners which would start to produce the good or its substitute
- 55 Uganda also levies a tax on hides and skins



### **Building an Inclusive East African Community (BIEAC): Another Initiative of CUTS**

CUTS Geneva Resource Centre (CUTS GRC) joined hands with CUTS Africa Resource Centre in Nairobi to implement the BIEAC project with support from Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ). The project supported a range of civil society organisations (CSOs) in the EAC member countries to examine the implications of external trade policies on the welfare and livelihood of people and provide a better understanding of both challenges and opportunities of regional integration.

It supported these CSOs in their effort to raise the awareness of the general public on relevant issues, gather their concerns and carry out advocacy to highlight them to the policy makers. The BIEAC project follows the Fostering Equity and Accountability (FEATS) project of CUTS GRC aimed at multi-stakeholder capacity building in Kenya, Malawi, Tanzania, Uganda, and Zambia through organically linked research, advocacy and networking activities.

CUTS has been actively working on trade and related issues in a number of sub-Saharan African countries since 2000. Working with local partners on issues such as trade, development and poverty linkages, and competition, investment and regulation, it has established itself as a research based advocacy organisation assisting in achievement of the development aims of countries in the continent through south-south partnerships and raising their voices across the globe wherever international trade and development policies are being forged. CUTS signed a Memorandum of Understanding with the East African Community in 2010 to collaborate on various issues of mutual interest. The BIEAC project has contributed to such initiatives of CUTS, and will be followed by many more.

CUTS GRC was established in 2008. Among many other activities, it has launched the quarterly EAC Forum for Geneva based delegates of the East African Community Member States to facilitate discussions on issues of interest to them with technical inputs from CUTS.

*<http://www.cuts-grc.org/BIEAC-Projects.htm>*



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