IMPACT OF TRADE LAW ON COMMON MARKET IN EAST AFRICA

A CASE STUDY OF KENYA

BY

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MAY, 2011

DECLARATION

"I declare that, this dissertation is the work of Nyaberi Ruth Nyaboke alone, expect where due acknowledgement is made in the text. It does not include materials for which any other university degree or diploma has been awarded."

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APPROVAL BY SUPERVISOR

"I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate in scope and quality as a research work in partial fulfillment for the award of a degree of Bachelor of Law of Kampala International University,"

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DATE:.............31/5/2011.............

DEDICATION

I dedicate this dissertation to my beloved family members especially my parents Mr. Lawrence Nyaberi and Mrs. Jane Nyaberi, brothers, sister and also friends.

ACKNOWLEDGEMENT

I thank my almighty God for the strength and good health which has enabled me to come this far and achieved the long awaited dream of accomplishment of the degree.

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LIST OF ACRONYMS

CBK	Central Bank of Kenya
CET	Common External Tariff
CMA	Customs Management Act
COMESA	Common Market for Eastern and Southern Africa
CU	Customs Union
EAC	East African Community
ECOWAS	Common Market for West and South Africa
EU	European Union
FCC	Fair Competition Commission
FDI	Foreign Direct Investment
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GSP	Generalized System of Preferences
IGAD	Inter Governmental Authority on Development
KPA	Kenyan Port Authority
LDC	Low Developed Countries
LPI	Logistics Performance Index
MTTI	Ministry of Trade and Industry
MDGs	Millennium Development Goals
OAU	Organization of African Unity
ROO	Rules of Origin

SADC	Southern Africa Development Community
SSA	Sub-Saharan Africa
TTRI	Tariff Trade Restrictiveness Index
VAT	Value Added Tax
WTO	World Trade Organization

LIST OF LEGISLATIONS

ACT Supplement No 1, 1st January 2005 to the Gazette of East African No. 001 Vol. Printed by the Government Printer, Dar es Salaam, by order of East African Community.

Articles 10 and 11 of the EAC Customs Union Protocol

Civil Aviation Regulatory Authority Act, 2003 and the Communications

Energy and Water Utilities Regulatory Authority Act, 2001

Fair Competition Act, 2003

Imports, Exports and Essential Supplies Act, Cap.502 of the Laws of Kenya

Regulatory Authority Act, 2003

Restrictive Trade Practices, Monopolies and Price Control Act of 1989

Surface and Maritime Transport Regulatory Authority Act, 2001

Trade Licensing Act, Cap. 497

ABSTRACT

The research on "the impact of trade laws on common market in East Africa was based on Kenya basing on the Ministry of Trade and Industry. The research involved both quantitative and qualitative methods data collection. The study was mainly based on internet and library research. the research had five chapters, chapter one which included, the general introduction, statement of the problem, objectives of the study, scope of the study, hypotheses, methodology, justification of the study and the literature review.

Chapter two looked at adoption of the competition policy and law, impact of trade law on east Africa common market, impact of trade laws on Kenyan economy, impacts of the trade laws on regional trade, transit within the east African community. Chapter three looked at Kenyan trade policy, the impact of custom union on Kenya's revenue performance, Kenya's investment performance.

Chapter four looked at performance of Kenyan trade policies, legislative challenges to trade in Kenya. Chapter five looked at general conclusions and offered recommendations.

CHAPTER ONE

GENERAL INTRODUCTION

1.1 Background

The East African Community (EAC) is the regional intergovernmental organization of the Republics of Kenya, Uganda, the United Republic of Tanzania, Republic of Rwanda and Republic of Burundi with its headquarters in Arusha, Tanzania[1]. The EAC was originally founded in 1967, collapsed in 1977, and was officially revived on July 7, 2000. In 2008, after negotiations with the Southern Africa Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA), the EAC agreed to an expanded free trade area including the member states of all three. The EAC is one of the pillars of the African Economic Community.

The EAC is a potential precursor to the establishment of the East African Federation, a proposed federation of its five members into a single state. In 2010, the EAC launched its own common market for goods, labor and capital within the region, with the goal of a common currency by 2012 and full political federation in 2015.

The main instruments of the EAC are contained in the Protocol, the EAC Customs Management Act (CMA) and the EAC Customs Management Regulations. Together, these provide for the implementation of a number of

[1] EAC, 2010.

measures including, but not limited, to transitional ones and gradual elimination of internal tariffs, establishment of a common external tariff (CET), introduction of EAC Rules of Origin (ROO) and other trade-related aspects and legal and institutional arrangements, a customs valuation system and harmonized customs laws, procedures and documentation. The Treaty establishing the EAC recognizes asymmetry as a core principle underpinning the EAC customs union. In that regard, Articles 10 and 11 of the EAC CU Protocol provided for the elimination of all internal tariffs and other charges of equivalent effect on trade amongst partners states as well as a progressive approach to implementation of the customs union through a five year transitional period. The inclusion of asymmetry is justified on the basis of the understanding that the EAC Partner States are at different levels of economic development and that the existing imbalances, which could indeed be exacerbated by the customs union, need to be addressed. In that regard, the Protocol provided that:

(a) Goods to and from the Republic of Uganda and the United Republic of Tanzania were to be duty free;

(b) Goods from the Republic of Uganda and the United Republic of Tanzania into the Republic of Kenya were to be duty free, while

(c) Goods from the Republic of Kenya into the Republic of Uganda, Rwanda, Burundi and the Burundi Republic of Tanzania were to be categorized into two categories i.e. Category A goods, which were eligible for immediate duty free treatment and Category B gods which were eligible for gradual tariff reduction during the five-year transitional period.

1.2 Statement of the problem

The East African countries realized that the major impediments to trade in the region are Non-Tariff Barriers related to administrative and bureaucratic inefficiencies. Poor infrastructure and communication are among the obstacles to the growth of trade. The EAC committed itself to promote projects and strategies that lead to the elimination of obstacles to trade, with serious attention being given to the implementation of identified infrastructure programmes and projects to improve efficiency[2]. They agreed to take measures, including introducing regulations that would ensure that products accepted in one Partner State are also accepted in the market of the other Partner States. This elimination of trade tariffs has helped the now five countries to freely mover their products from one country to another so that they can be freely consumed from member states.

[2] Evarist Mugisa, Chris Onyango (2009) Implementation and Impact of the East African Community Customs Union.

Asymmetry principle adopted by the EAC partner states was aimed at addressing the economic development imbalances that existed or could be exacerbated following implementation of the customs union. The programme of elimination of internal tariffs started in 2005 in Uganda and Tanzania and ended in December 2010 when full implementation of the customs union commenced[3]. The EAC Partner States have continued to apply uniformly the EAC common external tariff without serious hindrances since the launch of the customs union in 2005 and 2010.

The adoption of the EAC Common External Tariff for example has brought about a number of advantages to the region. First, it has greatly liberalized the EAC region. For instance, the average applied tariff presently is 11.6% compared to 16.8% for Kenya before the customs union came into force. The researcher therefore intends to find out the impact of trade laws on common market in East Africa[4].

1.3 Objectives of the study

The general objective of the study is to find out the impact of trade laws on the common market of East Africa and Kenya in particular. Their main goal is to liberalize and promote cross-border trade among the member states. Thus, in design and effect, customs unions have basic features that aim at fully utilizing

[3] EAC, 2010

[4] Evarist Mugisa, Chris Onyango (2009) Implementation and Impact of the East African Community Customs Union. Final Report,

the existing potential of member states for promoting economic cooperation in various areas. A customs union provides an opportunity to optimize complementarities in trade, investment, production, etc of the member states. The EAC Customs Union is not any different. According to Article 3 of the Protocol on the Establishment of the EAC Customs Union, its objectives are:

1.4 Hypothesis of the study

Trade laws are trade tools that limit the economic development of East African countries and thus responsible for the trade imbalance between East African countries and COMESA, ECOWAS and EU countries. Trade laws enacted by individual countries are responsible for the growth and development of infant industries through external trade barriers and this has protected many small industries from external competition.

1.5 Methodology

This involved both quantitative and qualitative methods data collection. The study was mainly based on internet and library research. Library research would be done through analyzing existing data and official documents of the international trade conventions and other established documents for example WTO among other trade related laws governing international trade. All these would be reviewed so as the researcher can have a deeper insight of the set approaches and procedures for the International trade law and the local approaches on tackling the international trade barriers[5].

Before data collection, the researcher first reviewed literature which ensured availability of data and also help the researcher get a better understanding of the problem Data was analyzed thematically Quotation of some key writers would be used to give effect and back some key analysis. This would be presented in a descriptive form in a final report.

The researcher made request of recorded information such as those records from ministry of trade, revenue authority body, business documents and those records from that would help in the research project. The researcher made a request of those records, which were read by the researcher hence providing vital information for the research project.

1.6 Scope of the study

The research was based on the ministry of trade-Kenya which was the case study for the study. The Ministry of Trade is responsible for the promotion of trade domestically, regionally and internationally through creation of an enabling business and investment environment. Trade Sector plays a crucial role towards attainment of national development objectives particularly as

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[5] WTO (2003). Annex 1 S/DCS/W/KEN. WTO Website www.wto.org.

envisaged in the Vision 2030 and in addition, realization of the Millennium Development Goals (MDGs) one and eight on eradication of Extreme poverty and Developing Global Partnership for development through improved market access respectively[6].

The Ministry has been in existence since independence as the Ministry of commerce and Industry. Over the years, the Ministry has separated, renamed and finally adopted the name the ministry of Trade in April 2008. The Ministry derives its mandate from the Presidential Circular No. 1/2008 dated 30th May 2008 on organization of the Government of the Republic of Kenya. The Ministry has been mandated to execute the following functions:- Trade Development Policy, promotion of Retail and Wholesale Markets, development of Micro and Small Business, fair trade Practices and Consumer Protection, private Sector Development, international Trade Affairs – COMESA, WTO.

1.7 Justification of the study

The research will help recommend on better policies on trade internationally between countries within and beyond East Africa. The research will also help the relevant ministries of East African countries and other ministries having a uniform and acceptable trade laws that will favor both developed and developing countries. In addition, the research will streamline trade facilitation

[6] http://www.trade.go.ke/index.php?option=com

iii. Higher real returns on capital goods

iv. Higher rates of domestic and foreign saving

v. Reduced opportunities for rent seeking, previously generated by trade restrictions

vi. Greater incentives for innovation and entrepreneurship due to competition

vii. Openness to ideas and innovations generated by openness in trade.

Sachs and Warner[8] attributed the different export performance of Asia, Africa and Latin American countries in processed and high valued added agricultural goods to openness. Another study by Dollar and Kraay (2003, in MTI, 2003) examined economic growth for a large sample of countries (both developed and developing) with large tariff cuts and found that, over the 1990's, the countries with the fastest growth rates were the developing countries which had enacted tariff cuts (average growth in GDP of 5% per annum)[9]. Next best performers were developed countries (2.2% annual growth) and least were the other developing countries (1.4% growth).

[8] Sachs, J.D and Warner, A.M. (1995) *Economic Reform and the Process of Global integration. Harvard Institute of Economic research working paper No. 1733. Cambridge MA: Harvard Institute of Economic Research.*

[9] Dollar, D. and Kraay, A. (2003) *Institutions, Trade and Growth: Revisiting the Evidence.* World Bank Policy Research Working Paper No. 30 Washington, DC: World Bank

Other evidence suggests that the relationship between trade liberalization and growth is not straightforward and that it depends on a number of external and country specific factors[10] including the existence of complementary and consistent macroeconomic and structural policies to foster adjustment and growth[11] agree that complementary interventions are important, as are a country's initial conditions and the way in which it implements trade reform. In addition, while openness can stimulate growth it is also associated with considerable risks. For countries with highly specialized economies, openness can be negative, as they are exposed to risks concerning changes in the price of the goods and the inputs used in the production of those goods. So for them, openness may threaten rather than promote growth.

The development of non-traditional exports has been supported by Kenya's investment climate, which is good in comparison with many other African countries. An element of this has been the government's relatively liberal policies on foreign investment and investment by local businesses[12]. Macro-economic stability during the 1960s and 1970s encouraged investment in

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[10] Rodriguez, F., and Rodrik, D. (1999) *Trade Policy and Economic Growth: A S Guide to the Cross-National Evidence*. NBER Working Paper No. 7089. Cambridge, MA: National Bureau of Economic Research.

[11] Harrison,A and Hanson, G.H (1999) *Who Gains from Trade Reforms? Some Remaining Puzzles*. NBER working paper no. 6 915. Cambridge, MA: National Bureau of economic research

[12] Minot, N and Goletti (1998) 'Export Liberalization and Household Welfare: The Case of Rice in Vietnam', *American Journal of Agricultural Economics*, Vol. 80, No 4., Nov.: pp. 738-749.

productive capacity, and inflation and exchange rate overvaluation during 1980s was modest in comparison with neighbors (e.g. Tanzania and Uganda). Kenya had stable government and stable policies over a long period. In addition, Nairobi's role as an international air transport hub has provided exporters with competitive access to markets. The government has allowed (and in some cases promoted) the development of a wide range of private marketing institutions and has allowed experimentation with a wide range of institutional arrangements between farmers and buyers.

A study by the WTO Secretariat, which compiled 45 case studies of mainly developing countries, found that WTO members have experienced a range of challenges in participating in the multilateral trading system. Both rich and poor countries with a good understanding of the WTO system were reported to have found that they could work within the system to support their interests. Trading success (or failure) was found to be strongly influenced by the quality of communication between national governments and the private-sector. Domestic decision-making can generate opportunities or undermine the potential benefits from a rules-based international environment that promotes open trade. This has implications for Kenya, where communication between different actors in trade policy formation is weak.

1.9 Synopsis of Dissertation

Chapter two discusses impact of trade law on East Africa common market, impact of trade laws on Kenyan economy, impacts of the trade laws on regional trade. Chapter three looks at Kenyan trade policy, Kenya's investment performance. In chapter four, the researcher discussed the performance of Kenyan trade policies. It also looked at cases levied against East African products, more especially Kenya, and in chapter five, there were recommendations and conclusions. This was based on the findings that are reflected in the rest of the paper.

CHAPTER TWO

IMPACT OF LAWS ON EAST AFRICAN COMMON MARKET

2.1 Introduction

This chapter focuses on the related literature of the study topic on trade law of Kenya. It looks at the documentary material and journals and reports that was useful on the study.

22. Trade and the Kenyan Economy

The EU, COMESA and Asia are key Kenyan export markets, and remained so throughout the 1990s. The most important single agricultural commodity exported to the EU in 2001 was plants and flowers (22% of all agricultural exports to the EU) followed by tea (17%), vegetables (14%) and coffee (11%)[13] Kenya continues to be the most important supplier of vegetables to the EU despite increased competition from Côte d'Ivoire, Morocco, Zimbabwe, South Africa and Cameroon. Most of Kenya's imports come from Asia (51% in 2000), followed by the EU (31%) and South Africa (7%).[14]

The EU, COMESA and Asia are key Kenyan export markets, and remained so throughout the 1990s. The most important single agricultural commodity exported to the EU in 2001 was plants and flowers (22% of all agricultural exports to the EU), followed by tea (17%), vegetables (14%) and coffee (11%).

[13] CBS (2001) `Economic Survey'. Nairobi: Central Bureau of Statistics, Ministry of Finance and Planning. Government of kenya

[14] CBS (2006) `Economic Survey'. Nairobi: Central Bureau of Statistics, Ministry of Finance and Planning. Government of Kenya.

Kenya sources the majority of its imports in Asia (51% in 2000), followed by the EU (31%) and South Africa (7%).[15]

Kenya's main imports are industrial supplies (36% of total imports) followed by machinery and capital equipment (15%). It imports mainly capital goods and machinery from the EU. However, recent trends indicate a shift away from investment-related capital to imports of consumer goods, with food items, clothing and embroidery gradually increasing in importance. Since the mid-1990s imports of second hand clothes has been one of the most stable imports from the EU. As a result, signing of an EPA with the EU is likely to increase the import of consumer goods, potentially damaging Kenya's manufacturing sector, but benefiting the poor (especially those not employed in manufacturing) through access to cheaper products[16].

2.3 Adoption of the Competition Policy And Law

To guarantee fair competition, EAC adopted a competition policy which prohibits any practice that adversely affects free trade. Further in 2006, an EAC Competition Act was enacted. However, these laws are only applicable for cross-border trade while national competition laws and institutions remain to regulate domestic trade. In Kenya competition law is contained in the

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[15] [15] CBS (2001) `Economic Survey'. Nairobi: Central Bureau of Statistics, Ministry of Finance and Planning. Government of kenya

[16] Ikiara M.M and Ndirandu L (2003) "Developing a rival Strategy for Kenya's cotton textile industry: A value chain approach. KIPPRA publication.

Restrictive Trade Practices, Monopolies and Price Control Act of 1989. The law seeks to allow the Government to rely more on competitive elements and less on direct control. The Act provides for the control of restrictive business practices, the control of monopolies and concentration of economic power and the control and display of prices. The legislation assigned the Monopolies and Prices Commission based in the Ministry of Finance as the primary enforcement body of the competition policy. The approach is such that specific-sector regulators combine technical and economic regulation and also have some or all competition law enforcement functions. Thus, the competition authority has no jurisdiction over regulated sectors or advocacy power. However, sector regulators increasingly coordinate with the competition authority, although they are not obliged to do so. Awareness, domestication of the EAC Competition Act and their subsequent enforcement remain a major challenge[17].

The situation is not much different in Tanzania where the Fair Competition Act, 2003 is the main legislation which regulates unfair competition. The Act created the autonomous Fair Competition Commission (FCC) as well as the Fair Competition Tribunal to hear appeals, and the National Consumer Advocacy Council. The Commission can order companies to stop engaging in anticompetitive behavior and pay compensation for damages. It can also

[17] EAC (2002), East African Customs Union: Information and Implications, Published by the EAC Secretariat in conjunction with GTZ, Arusha

impose fines on those who commit offences under the Act. FCC has mandate to promote and protect effective competition in trade and commerce and to protect consumers against unfair and misleading market conduct throughout Tanzania[18]. As for the regulated sectors, there are sector-specific legislative frameworks introduced in Tanzania to support transformation of the economy from a centrally-planned one into a market-driven economy that have responsibility to regulate unfair competition. They include the Energy and Water Utilities Regulatory Authority Act, 2001; the Surface and Maritime Transport Regulatory Authority Act, 2001; the Civil Aviation Regulatory Authority Act, 2003 and the Communications Regulatory Authority Act, 2003. On the other hand, Uganda has taken steps to adopt and domesticate the EAC competition law, but progress remains quite slow. The main instrument for this domestication is the Competition Bill.

The first draft of the Bill was sent for first reading in 2007, but was returned to the Ministry of Tourism, Trade and Industry (MTTI) in order for the latter to answer queries which had been raised by the Cabinet. The Ministry is still working on this preparing it for the second reading. With regard to the policy, Uganda has not yet prepared a competition policy. In its absence, sector policies are being applied to address trade issues in the context of the EAC

[18] EAC (2007) The East African Community Trade Report. Prepared by EAC Secretariat.

region[19]. The free movement of people in the EAC is set to be improved with the introduction of "third generation" ID cards. These cards will identify the holder as a dual citizen of their home country and of "East Africa" and will apply even in countries where dual nationalities are not allowed (such as Kenya). Third generation cards are already in use in Rwanda with Kenya set to introduce them in July 2010 and the other countries following afterwards. Mutual recognition and accreditation of higher education institutions is also being worked towards as is the harmonization of social security benefits across the EAC[20].

In the common market, Articles 10 and 11 of the EAC Customs Union Protocol provided for elimination of all internal tariffs and other charges of equivalent effect on trade amongst Partners States as well as a progressive approach to implementation of the customs union through a five year transitional period. Under Article 13, the EAC Partner States have agreed to remove all existing non-tariff barriers to trade and not to impose any new ones; under Article 81 of the Treaty Establishing the Community, the EAC Partner States recognized the importance of standardization, quality assurance, metrology and testing for the promotion of trade and investment and consumer protection, among other things.

[19] EAC (2008) Progress of Implementation of the EAC Council Decisions and Directives Related to Common Market Operations as at end of February 2008. Draft Report April, 2008.

[20] EAC 2010.

This was establishing the Common External Tariff (CET), in which the EAC Partner States recognize asymmetry as a core principle underpinning the EAC customs union. The inclusion of asymmetry is justified on the basis of the understanding that the EAC Partner States are at different levels of economic development and that the existing imbalances, which could be exacerbated by the customs union, need to be addressed. Other important instruments implemented by Partner States include: the EAC Customs Management Act 2004 (CMA) and the EAC Customs Management Regulations, transitional measures and gradual elimination of internal tariffs, establishment of the CET, introduce Rules of Origin (ROO) and other trade-related aspects and legal and institutional arrangements, a customs valuation system and harmonized customs laws, procedures and documentation[21].

2.4 Impact of Trade Law on East Africa Common Market

The East African Community (EAC) brings together five countries (Uganda, Kenya, Tanzania, Rwanda and Burundi) into one regional economic block. All the five countries are currently pursuing market-oriented economic policies and have implemented structural adjustment reforms. The reforms in Uganda started way back in 1987 and have included public sector reforms, market and price reforms, (exchange rate and interest rates), and trade liberalization. Kenya and Tanzania took a similar path at about the same time. Rwanda and

[21] Cadot, O. and J. de Melo (2008). "Why OECD countries should reform rules of origin." *The World Bank Research Observer.* 23(1):77–105.

Burundi introduced reforms following the return of political stability fairly recently.

The differences in overall GDP and per capita GDP have narrowed among the three leading economies over the past decade, with stronger economic performance in Tanzania and Uganda and sluggish growth in Kenya. For example, in 1990 – 2001, Kenya's real GDP grew on average at a rate of 2.2% per annum. This was well below the average GDP growth rate of 6.8% recorded by Uganda, 3.1% by Tanzania, and 2.6% by Sub-Sahara Africa.

The sectoral distribution of GDP indicates that agriculture contributes a larger share of Uganda's GDP, followed by Tanzania. All the five countries share a number of similarities, arising from their common location (common borders, the Lake Victoria natural resource, etc, climate and history. Notably, Uganda, Rwanda and Burundi are landlocked, relying on access to the seaports in Kenya (Mombasa) and Tanzania (Dar es Salaam). They are members of the World Trade Organization (WTO), belong to other regional trade agreements – Uganda, Kenya, Rwanda and Burundi are also members of COMESA, and Tanzania is also a member of SADC[22]. The EAC Partner States have a similar trade pattern, with commodity exports focused on extra- EAC markets, especially the EU. In recent years an average of 3-10% of the exports of the

[22] WTO (2003) Kenya's Commitments in the WTO. Annex 1 S/DCS/W/KEN. WTO Website www.wto.org.

EAC members have gone to Sub-Saharan Africa (SSA) markets outside the REC, and 31% to 82% to markets outside SSA. An average of 9% to 14% of the imports of members has been received from SSA outside EAC, while imports from the rest of the world have been in the range of 40% to 60%.

Although the EAC Partner States are quite similar in their trade outside the region, there has been a steady increase in intra-EAC trade in recent years. Generally, trade in agricultural products remains dominant for all Partner States, except Kenya. The latter accounts for less than 10% share in this category of exports. In addition, trade within this group of commodities is seasonal, is largely informal and, therefore, remains inadequately captured in official national statistics. Manufactured products are increasingly becoming the most traded. Intra-EAC trade is increasingly diversifying into more specialized manufactures in all the three countries, but more so in Kenya. Chemicals remain important in Kenya's exports and have increased significantly for Tanzania. Fuels and lubricants, and machinery and transport equipment, are significant in range of goods that Kenya exports to the rest of EAC.

2.5 Impact Of Trade Laws On Kenyan Economy

Kenya's exports to the region have been increasing. They rose from about US$ 650 million in 2002 to about US$ 920 million in 2005 and reached US$ 1,300 million in 2007. The imports from partners have also been relatively low with modest increments of 25% and 23% recorded during 2006 and 27% respectively. Overall, Kenya had a favorable trade balance within the EAC and this has gradually been increasing over the years.

Kenya's trade with the EAC has been increasing over the years. During 2007, Kenya's total exports to the Partner States were 22% while imports from them stood at a mere 1%. Major exports to Uganda included mineral fuels, mineral oils and related products (salt, sulphur, earths and stone and plastering materials), paper and paperboard, plastics and articles thereof, iron and steel, beverages, spirits and vinegar, and pharmaceutical products. On the other hand, exports to Tanzania composed largely of wood and articles of wood, wood charcoal, paper and paperboard, articles of paper pulp, cotton, copper and articles thereof, textile articles, sets, worn clothing and worn textile articles, rags, etc.

In Kenya, the leading export commodities in the recent past have been horticulture (20.6%), tea (17.03%), textiles and apparel products (5.89%), coffee (3.8%) and tobacco (3.11%)[23]. The main markets for horticulture and tea are the Netherlands and Pakistan respectively, while the USA is a major export destination for textiles and apparel products. On the other hand, the main export destinations by country were Uganda (33.56%), United Kingdom

[23] Republic of Kenya (2007) Economic and Social Council (NESC) Nairobi, Kenya.

(28.8%), Tanzania (22.3%), Netherlands (21.9%), USA (19.2%), Pakistan (13.5%), Sudan (11.6%) and Egypt (9.1%).

While Uganda and Tanzania are among the leading export destinations for Kenyan exports, it is worth noting that a big percentage of the exports to the two countries constitute re-exports. For instance, Kenya's re-exports to Uganda reached about 60% in 2003 prior to the customs union, but stabilized at about 10% of total exports in recent years. The main re-export products have been petroleum products, chemicals, machinery, transport equipments and manufactured goods. On the other hand, re-exports to Tanzania accounted for about 45% of total exports in 2003 and has since been declining in the recent past reaching 6% in 2007. Major re-exports to Tanzania have been machinery & transport equipments, chemicals and manufactured goods.

Likewise, imports into Kenya from the Partner States have been increasingly marginally over the recent years. Tanzania is the largest exporter to Kenya and has seen her import figures rising over the years. Kenya's imports from Tanzania in 2006 amounted to US$ 62.7 million compared with US$ 41.0 million in 2005. Major imports from Tanzania include wood and articles of wood; paper and paper products; cotton; copper and articles thereof and plastics and articles thereof. On the other hand, imports from Uganda declined by 24.5% in 2004, after a steep rise of 74.5% in 2003. In 2006, Kenya imported goods worth US$ 18.0 million from Uganda compared with US$ 14.6 million in the previous year. However, imports from Uganda accounted for less than 1% of total imports from 2003 to 2006. The major imports from Uganda included animal and vegetable fats, cereals, cotton, oil seeds and oleaginous fruits, furniture and wood and wood products[24].

2.6 Impacts of the Trade Laws on Regional Trade

While regional trade has increased, nonetheless, overall it has been affected by the Custom Union through a rise in import duty on some inputs, removal of exemptions on foods of economic importance, and trade facilitation.

Rise in import duty on raw materials and inputs: It will be recalled that before the Custom Union the tax structures were able to support investments and value addition to manufactured export products. The Custom Union brought about a number of changes, especially in the tax rates. While for some imported goods these rates declined, for others they went up for example, including those that fall within the category of sensitive products. The increase for import duties (especially for inputs and raw materials), has had the effect of raising the cost of production and ultimately the price of final product, rendering it less competitive on the market (both local and foreign).

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[24] Meredith A. McIntyre (2005), Trade Integration in the East African Community: An Assessment for Kenya. IMF Working Paper, WP/05/143

Harmonization of taxes: Although the customs union was launched in 2005, the main taxes affecting the business community fore example, VAT, withholding tax, excise, etc), the definition of tax laws, assessment procedures, dates of implementation clauses, etc – have all not been harmonized. For example, while Uganda charges a VAT of 18%, in Kenya it stands at 16%, while in Tanzania it is at 20% (and i8% in Rwanda) Uganda charges *ad valorem* (whereby the tax chargeable is a percentage of the value/ price of the product, while Kenya charges specific taxes. Similarly, Uganda imposes excise duty on cement, while Kenya and Tanzania do not; Uganda also offers no tax incentives, while Kenya and Tanzania do not, etc. These disparities in the tax regimes result into distortions and have a negative impact on cross-border business activities[25]. In particular, they increase the cost of compliance; affect the decisions by investors with regard to where to invest and where to source finance. This is a contradiction of the goals of the EAC Treaty since no efficient allocation of resources is guaranteed. [26]

Customs facilitation: With regard to customs, the main concern expressed by the business community talked to during this study has to do with claiming of duty drawback. The process of claiming the duty drawback remains quite cumbersome and unnecessarily long. This has the impact of tying up working capital and affecting business cash flow. In this regard, even the *Customs*

[25] UBOS (2007),

[26] Article V, GATT 1994

Union Management Act has not been helpful. Provisions on duty drawback, for example, do not indicate a period within which a refund can be received. Similarly, there is no provision for interest payable in the event of delays in effecting refunds.

2.7 Transit Within The East African Community

'Freedom of Transit' is the title given to Article V, GATT 1994. [27]This Article defines 'transit' and provides for freedom of transit, regulation of traffic in transit (urging Members to avoid unnecessary delays or restrictions), setting reasonable charges and regulations for traffic in transit, non-discrimination – with regard to like products as well as air transit of goods[28]. It is clear that some of these transit issues go beyond the strictly Customs domain. The following paragraphs will put more emphasis on those transit aspects in which Customs is strictly present, which have not yet been addressed in section III above, and which have a significant impact on trade facilitation in the EAC.

Unfortunately, transit procedures are some of the troubling non-tariff barriers to the intra-EAC trade. The fact, for instance, that there are differences in axle load and Gross Vehicle Mass amongst EAC Partner States leads to a situation whereby Tanzanian trucks transiting through Kenya, en route to Uganda, have

[27] Article V, GATT 1994.

[28] Cadot, O. and J. de Melo (2008). "Why OECD countries should reform rules of origin." *The World Bank Research Observer.*

to strip off excess cargo to avoid financial penalties for overloading. Of course, this is costly in terms of time and money.

Delays at roadblocks are also a reality in the EAC. This is mostly connected with the corruption issue which was elaborated above. Many traders report that police officers stop vehicles with goods in transit at various roadblocks, yet officially, they are only supposed to stop vehicles based on proof that goods being transported are suspicious. Additionally, although this is an infrastructural problem and hence, out of the scope of the concept of trade facilitation followed in this article, it is noted that transit is very much affected by the poor transport systems in the region. However, there are some positive developments in the region which are related to transit. The establishment of the Malaba joint border post (on the Kenya/Uganda border) is a good example of improved coordination and cooperation amongst authorities in the EAC. Moreover, with the credits from the World Bank (approved on 24 January 2006), there is progressive improvement in transit matters in the EAC through, *inter alia*, the setting up of more joint border posts[29].

To strengthen their access to international markets, Burundi, Kenya, Rwanda, Tanzania, and Uganda, have each joined the World Trade Organization (WTO), thus agreeing, at least in principle, to a core set of trading rules between

[29] IDS (2008) Study on Impact of the EAC. Consultancy study done for EABC, Arusha, Tanzania.

nations and to use the WTO as a forum for resolving trade disputes[30]. Ethiopia applied for admission to the WTO in 2003 and, as of spring 2009, its qualifications for membership remain under consideration[31]. Under the WTO's Generalized System of Preferences (GSP), as well as a number of bilateral agreements, a wide range of East Africa's manufactured products are entitled to preferential duty treatment in the developed markets of the United States, Japan, Canada, New Zealand, Australia, and Switzerland, Norway, Sweden, Finland, and Austria, as well as other European countries. However, the challenge and potential of regional trade are of increasing interest among policymakers and business people in East Africa. Trade among East African countries in agricultural goods for food security, services that could foster more vibrant entrepreneurship and locally manufactured products represent significant opportunities in the region.

Two trade agreements dominate two trade agreements dominate East Africa's regional trade system: the East African Community (EAC) and the Common Market for Eastern and Southern Africa (COMESA). The member states of EAC are Burundi, Kenya, Rwanda, Tanzania, and Uganda[32]. The member states of COMESA are Angola, Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius,

[30] EAC, 2010.
[31] World Bank and MTTI (2006), Trade Integration Study.

[32] S tahl Heinz-Michael (2005) Tariff Liberalisation Effects on the EAC Customs Union in Perspective. Tralac Working Paper No. 4.

Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, and Zimbabwe. Tanzania withdrew from COMESA in 2000, citing concerns that diminishing tariffs charged to all member countries, pursuant to an anticipated common tariff agreement, would represent too great a fiscal sacrifice. On the other hand, Tanzania belongs to the South African Development Community (SADC), another large trade pact (19 countries). Trade within both the EAC region and the larger COMESA region represents a critical portion of imports and exports for all of the countries discussed here—in the range of 30–50%.

The process of structural adjustment and economic reform at the national level make it more likely that regional integration measures will succeed, in that countries are now no longer operating under the constraints of import-substitution, industrialization strategies. Countries which have removed exchange control restrictions, reduced tariff barriers to trade, reduced the bureaucratic obstacles to doing business (including obstacles to cross-border investment and movement of factors of production), allowed interest rates to be set by the market and implemented other fiscal, financial and structural reforms are now better placed to achieve economic integration with each other.

2.8 Kenya And External Tariff

The EAC Partner States have continued to implement the three-tier external tariff band structure of 0%, 10% and 25% consistent with the arrangement under the EAC Customs Union. Under the zero-tariffs, Kenya imported goods worth US$ 4,602.2 million in 2006 compared to US$ 3,871.1 million in 2005 representing an increase of 18.9%. Imports under the 0% band accounted for 63.6% of total imports in 2006[33]. Major import products included mineral fuels and products thereof; vehicles other than railway and parts and accessories thereof; boilers, machinery and mechanical appliances; aircraft, spacecraft; and electrical machinery and equipment. All the items listed registered increases in value between 2005 and 2006, with the exception of the aircraft category which declined by 2.3 percent (EAC Secretariat, 2008). For Uganda, the value of goods imported under the 0%-band accounted for 67.9%.

The top three imports in the 0% band were medicaments, radio/TV transmission apparatus, and palm oil. These were imported mainly from India, South Africa, the USA, United Kingdom, Japan, Netherlands, Germany and Malaysia. The value of imports under the 10% fell by 1.7% and its contribution to total imports value was 9.8%. These were primarily pneumatic tyres for buses and lorries, vehicle parts, and rolled iron and steel, imported mainly from India, South Africa and China. The 25% tariff band accounted for 19.3% of total import value and increased by 5.0%. The top three imports in the 25%-band were vehicles of cylinder capacity exceeding 2,250 cc but below 3,000 For Tanzania, total imports under the CET rose to US$ 4,160.6 million in 2006 up

[33] Republic of Kenya (2008) Statistical Abstract. Published by the Kenya National Bureau of Statistics, Nairobi, Kenya.

from US$ 2,802.3 million in 2005, accounting for 96% of total imports[34]. An estimated 57.3% of EAC CET imports were under the 0% tariff band and these were mostly industrial raw materials and capital goods. The surge of imports of such goods is attributed in part to the current macroeconomic reforms, which have continued to attract large investments in manufacturing, mining, communication, tourism, and transportation[35].

2.9 Conclusion,

The impact of laws on east african common market has gradually increased for import duties (especially for inputs and raw materials), has had the effect of raising the cost of production and ultimately the price of final product, rendering it less competitive on the market (both local and foreign).

Kenya's exports to the region have been increasing. They rose from about US$ 650 million in 2002 to about US$ 920 million in 2005 and reached US$ 1,300 million in 2007. The imports from partners have also been relatively low with modest increments of 25% and 23% recorded during 2006 and 27% respectively. Overall, Kenya had a favorable trade balance within the EAC and this has gradually been increasing over the years.

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[34] EAC Secretariat (2006b), The East African Community Management Regulations.

[35] EAC Secretariat (2006), Manual on the Application of East African Community Rules of Origin

CHAPTER THREE

KENYAN TRADE POLICY AND INVESTMENT PERFORMANCE

3.1 Introduction

This chapter focuses on the methodology of the study which is he tools of trade laws in Kenya. This involved both quantitative and qualitative methods data collection. The study was mainly based on internet and library research. Library research would be done through analyzing existing data and official documents of the international trade conventions and other established documents for example WTO among other trade related laws governing international trade. All these would be reviewed so as the researcher can have a deeper insight of the set approaches and procedures for the International trade law and the local approaches on tackling the international trade barriers

3.2 Kenyan Trade Policy

Kenya's view is that transit is not only for landlocked countries as many of Kenya's exports and imports have to transit through other neighboring countries. Additionally, given the number of landlocked LDCs relying on the port of Mombasa, Kenya is a key transit country for neighboring states and transit goods account for about 20% of total entries at the Port of Mombasa[36].

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[36] See KRA 2004.

article v trade licensing act [37]addresses freedom of transit and states that traffic in transit should not be subject to unnecessary delays or restrictions and should be exempt from customs duties, transit duties and other charges. With regard to the present mandate of Article V, Kenya does not charge any fees for transiting goods however transit roads convenient for traffic are limited to one corridor which is designated for commercial traffic. Kenya provides freedom of transit with no distinction between the flag of the vessel; place of transport origin, departure, entry, exit, and destination or on any circumstances relating to the ownership of goods, of vessels or of other means of transport.

Kenya embarked on a process of rapid industrialization and indigenization of the economy on the attainment of independence on 12th December 1963 through the setting up of import substitution industries to meet Kenyan and East African Community requirements and the transfer of non-citizen firms to Kenyans[38]. To this end, the independent Administration of Kenya enacted the *Trade Licensing Act, Cap.* 497 which legalized the take-over of non-citizen firms by citizens of Kenya through denial of Trading Licenses to certain Trades and Businesses. The Administration also legalized the control of the importation and exportation of goods of any description and the control of supplies essential to the life or well-being of the community through Legal Notice No.

[37] article v trade licensing act.

[38] Stahl Heinz-Michael (2005), who will gain from East African Community Customs Union? In: African Business, December 2005

303 of 1964 under the Imports, *Exports and Essential Supplies Act, Cap.*502 of the Laws of Kenya[39].

Briefly, therefore, the commercial activities of Kenya were regulated mainly through instruments provided under the *Price Control Act, Trade Licensing Act* and *Imports, Exports and Essential Supplies Act* which included among others the following instruments:

i) Fixing of prices of certain goods and services.

ii) Transfer of certain businesses from non-citizens to citizens of Kenya.

iii) Establishment of imports substitution industries.

iv) Imports and Exports licensing.

v) Establishment of import quotas for certain goods.

vi) Complete banning of imports of certain goods.

vii) Letters of No Objection.

viii) Allocation of Foreign Exchange.

ix) Fixed Exchange Rate.

In recent years, Kenya has incorporated international and regional agreements into its legal and regulatory frameworks and created or strengthened a variety of institutions charged with implementing these agreements. The country is a founding member of the WTO, a charter member of the EAC, and an active

[39] The First EADS (1997 – 2000).

member of COMESA. Recently, Kenya joined the effort to integrate the EAC with COMESA with a goal of eliminating the agreements' redundancies, an initiative that will take considerable dedication, coordination, and follow-through. The Mombasa Port facilities, managed by the Kenyan Port Authority (KPA), are fundamental to the movement of international trade, not only for Kenya but also for the region. Port throughput continues to increase and exceed capacity. At the same time, the rate of empty throughput, at 31% of total volume, is significantly above the global average of 21%. This fact reflects the trade imbalance between imports and exports, which doubles import transport costs[40].

Kenya's trade policy objectives include moving towards a more open trade regime, strengthening and increasing overseas market access for Kenyan products, especially processed goods, and further integration into the world economy. These policy objectives have been pursued through unilateral liberalization, and regional and bilateral trade negotiations, in particular within the African region, as well as through its participation in the multilateral trading system. Kenya is a member of the Common Market for Eastern and Southern Africa (COMESA), the East African Co-operation (EAC), the Organization of African Unity (OAU), and the Inter Governmental Authority on Development (IGAD)[41].

[40] Cadot, O. and J. de Melo (2008). rules of origin.

[41] EAC, 2010.

Kenya is a founding member of the WTO; it accords at least MFN treatment to all its trading partners. Provisions of the WTO Agreements cannot be invoked before national courts. Kenya is not a signatory to the plurilateral agreements on Government Procurement and Trade in Civil Aircraft. Kenya is amending some pieces of its legislation, including on anti-dumping, countervailing and intellectual property, to bring them into conformity with the WTO Agreements.

Kenya encourages foreign investment and grants national treatment to foreign investors. Most business activities are open to foreigners, except those related to matters of security or health. In order to attract investment, Kenya offers tax incentives to local and foreign investors in the form of tax holidays, accelerated depreciation, investment allowances, lower duties on intermediate capital goods, and gradual reduction of corporate tax rates. Despite these incentives, Kenya has been unable to attract much investment, due to reasons noted earlier. Wide discretionary powers in the administration of laws and regulations highlight the need to ensure full compliance with the rule of law and to address governance issues. The Government has taken, and continues to take, steps to address these problems.

Tariffs have become Kenya's main trade policy instrument. Since the previous Review in 1993, Kenya has reduced the overall level of protection of its economy. It has dismantled most non-tariff restrictions, except for moral, health, security, and environmental reasons, or under international conventions to which it is a signatory. The tariff structure has been simplified through the reduction of the number of bands from eight in 1994 to five (0, 5%, 10%, 15%, and 25%), and the lowering of maximum ad valorem rates from 60% in 1992 to 25% in 1999. Mixed duties apply to around 10% of all tariff lines and specific duties to 30 lines at the eight-digit level of the Harmonized System (HS); virtually the same products, including mainly agricultural and petroleum products, are subject to mixed or specific duties as at the time of the previous Review. The conversion of these duties into ad valorem rates would reduce the complexity and enhance the transparency of the tariff[42].

In addition to tariffs, "suspended" (stand-by) duties ranging up to 70% increase to 95% the maximum import duties on wheat flour, meslin flour, and certain types of sugar. The suspended duties replaced variable duties on food and currently apply to some 17% of all tariff lines at the HS eight-digit level, in agriculture and manufacturing. The maximum suspended duty of 70% also applies to maize, rice, and milk. The simple average rate of Kenya's non-specific import duties (inclusive of applied suspended duties) is 18%. Some 3.7% of all tariff lines are duty free while 38% carry rates higher than 15%; except paper, paperboard, cards, and office stationery, rates higher than 35% apply to

[42] EAC (2008) Report of the Meeting of the Sectoral Committee on Customs. East African Hotel, Arusha, Tanzania 23rd -25th April, 2008. Report No. EAC/SR/15/2008.

agricultural products and their transformations[43]. An import declaration fee (IDF) of 2.75% is collected on all imports – including those not subject to the preshipment inspection that is required for all imports worth at least US$5,000. The inclusion of the fee raises to 20.75% the average rate of import duties. In the aggregate, the positive escalation of Kenya's tariff (highly pronounced on products such as textiles, wearing apparel, leather, and metallic, rubber, petroleum, and chemical products) means that the effective protection provided to most industries is higher than the nominal rate. A value-added tax of 15% and excise duties ranging up to 135% (the excise duties are mixed or specific on certain products) are levied both on imports and locally produced goods.

3.3 The impact of Custom Union on Kenya's Revenue Performance

Prior to the launching of the Custom Union, there were concerns that the application of the Custom Union provisions would lead to imbalances in the performance of the economies of the Partner States. It will be recalled that Articles 75 and 76 of the EAC Treaty provide for introduction of measures to address the imbalances that may arise from the application of the provisions of the Treaty. Similarly, the second Development Strategy casts the problem of imbalances in terms of costs and benefits and underlines the need for

[43] Schiff M. and Winters A. (2003), Washington, DC: World Bank. Oxford University Press.

measures to address these imbalances arising from the process of establishing a Custom Union and a Common Market[44].

Total tax revenues have been increasing in Kenya despite the initial fears that implementation of the CET would affect government revenues. Available statistics indicate that although the contribution of import duties to total revenues has marginally declined the value of import duties increased from US$ 274 million in 2001/02 to US$ 408.8 million in 2006/07. Import duties increased by 34% between 2005/06 and 2006/07[45]. This may be attributed improved economic performance and reforms in revenue administration, including the introduction of electronic tax registers as well as the increased trading activities with the rest of the world, following the tariff reductions initially averaging 35% for Kenya. In addition, recent reforms have seen greater reliance by Kenya on income, VAT and excise duties for revenue generation as opposed to import duties. For instance, in August 2008 the composition of Government receipts was as follows: import duty (6.8%); excise duty (15.3%); income tax (32.5%) and VAT (29.7%).

3.4 Kenya's Investment Performance

Foreign direct investment (FDI) continues to be one of the cornerstones of economic development in the EAC. Although FDI has flowed to the region over

[44] EAC Secretariat, EAC Development Strategy 2006-2010.

the years, it is only recently that the Partner States have increased their focus on its growth. Investors are increasingly responding to the unfolding single market and investment area in an enthusiastic manner[46]. Within the period 2002-2007, inflows of FDI have almost tripled from US$ 692 million in 2002 to US$ 1,763 million in 2007 with Uganda and Tanzania receiving the largest proportion. In fact the two countries ranked among the 10 top destinations for FDI inflows among the African LDCs in 2007. [47]

3.5 Conclusion

Kenya has been experiencing a dismal performance over the years despite being the strongest and most diversified economy in the region. For instance, FDI flows into Kenya stood at US$ 51 million in 2006 compared US$ 522 million for Tanzania and US$ 400 million for Uganda. However, in 2007 Kenya received significantly higher inflows (US$ 728 million) due mainly to large privatization sales in the telecommunications sector and investment in the railway. Again Kenya has taken the lead in investing in Tanzania. It is only second to the UK in trade with, and investment into, Tanzania. About 270 Kenyan companies operate in the country, providing more than 100,000 jobs. Only 3 Tanzanian companies have invested in Kenya[48].

[46] United Nations (2005) An Investment Guide to the East African Community: Opportunities and Challenges. United Nations, New York and Geneva, 2005.

[47] CBK, 2008

[48] Tanzania Investment Centre (2006), Tanzania Investment Report 2006, Published by the Tanzania Investment Centre, Dar es Salaam

CHAPTER FOUR

PERFORMANCE OF KENYAN TARDE POLICIE AND CHALLENGES

4.1 Introduction

This chapter presents the finding of the study from different areas of the study on trade law of Kenyan Economy basing on the Ministry of Trade and Industry. The research involved both quantitative and qualitative methods data collection in investigating the impact of Trade Law on Common Market in East Africa a case study of Kenya.

4.2 Performance Indicators

After progressively liberalizing its trade regime since the mid – 1980s Kenya's MFN Tariff Trade Restrictiveness Index (TTRI) is currently 8.2 percent, indicating a more open economy than that of an average

Sub-Saharan Africa (SSA) or low-income country (11.3 percent and 11.6 percent, respectively) Based on the TTRI, it ranks 84th out of 125 countries (where 1st is least restrictive). With the government's objective of attaining food security, the agricultural sector is given a higher degree of tariff protection (19.9 percent) compared to the non-agricultural sector (6.8 percent). Following the implementation of the Common External Tariff (CET) of the East African Community (EAC) in 2005, Kenya's average MFN applied tariff has remained largely unchanged and is currently 12.6 percent.[49]

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[49] Europa. 2009. —Fact Sheet on the Interim Economic Partnership Agreements—The Eastern African Community (EAC). Europa. January 2009

With a Market Access TTRI including preferences of 3.9 percent, Kenya's access to international markets is comparable to that of an average Sub Sahara Africa (SSA) country and only slightly more favorable than that of an average low-income country (5.6 percent). The weighted average rest of the world tariff, including preferences, faced by Kenyan exports is 1.9 percent, with non-agricultural exports having easier access to world markets (1.0 percent) than agricultural exports (2.6 percent). One of the most stable currencies in East Africa, the Kenyan shilling's exchange rate against the U.S. dollar changed little in 2008 relative to 2007. The exchange rate was KSh69.2 to US$1 in 2008 compared to KSh67.3 to US$1 in 2007[50].

In a further boost to Kenya's market access, in November 2007, the EAC initialed an interim Economic Partnership Agreement (EPA) with the EU, under which its members' exports are allowed duty-free and quota-free access to the EU market. The EAC is in talks with the EU for a full EPA.

Kenya ranked 95th in the world of doing Business index in 2009, which compares the business environment of 183 countries. Surpassingn the Sub Sahara Aferica (SSA) and low-income group averages of 2.35 and 2.29, respectively, Kenya's score on the Logistics Performance Index (LPI), which measures the extent of trade facilitation in the country, is 2.52 out of 5,

[50] U.S. Department of State. 2009. —Background Note: Kenya. Washington, DC. July 2009.

earning it a spot on the list of the top 10 countries in the low-income group[51]. Among the LPI subcategories, the country is doing well in ensuring the timeliness of shipments in reaching their destination but there is significant room for improving its trade-related infrastructure. To avoid loss of business to rival ports as a result of the global downturn and a surge in piracy attacks off the coast of Somalia, the Kenya Port Authority has announced reductions in some fees at the Port of Mombasa.

4.3 Trade Outcomes

After averaging 11.6 percent over the 2005–07 periods, the real growth rate (in constant 2000 U.S. dollars) of trade sharply declined to 3.5 percent in 2008, and is expected to fall even further to 2.1 percent in 2009. Exports grew at an average rate of 6.3 percent during 2005–07 but ended up dropping by 4.2 percent in 2008[52] with mixed performance from the country's major export products; tea and coffee export volumes declined, while horticultural exports increased. Imports fared better, although growth still slowed from 15.3 percent in 2005–07 to 8.2 percent in 2008. Exports are expected to pick up in 2009

[51] Central Bank of Kenya. 2009. *Monthly Economic Review*. Central Bank of Kenya. May 2009.

[52] Business Daily. 2009a. —Millers, Bakers Decry Increase of Duty on Imported Wheat.|| June 17, 2009.

with an estimated growth rate of 2 percent, while imports are expected to register a lower growth rate of 2.2 percent in 2009 compared to 2008[53].

In nominal terms, trade growth remained relatively stable, growing at an estimated rate of 17.6 percent in 2008 compared to 17.7 percent in 2007, driven by strong growth in both exports and imports (15.8 percent and 18.8 percent, respectively). The country's trade as a percentage of its GDP has remained mostly unchanged over the past few years and was an estimated 64.4 percent in 2008. Goods exports grew at an estimated 18.3 percent, compared to an 11.9 percent growth rate for services exports which were hurt by a fall in tourism receipts due to the post-election violence in 2008[54].

The country's main export products continue to show mixed performance in 2009. Coffee production increased by 41.1 percent in the period January to April 2009 compared to the same period in 2008, responding to improved export prices, but tea output fell by 14.3 percent due to late rainfall, while horticultural export volumes fell by 11.1 percent as a result of lower demand in Kenya's export markets[55]. In total, goods exports contracted by 15.5 percent in

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[53] Office of the United States Trade Representative. 2009. —Kenya.||

<http://www.ustr.gov/sites/default/files/
uploads/reports/2009/NTE/asset_upload_file10_15484.pdf

[54] World Trade Organization (WTO) *Trade Policy Review—Kenya*. January 3, 2000. WTO, Geneva, 2000

[55] Central Bank of Kenya 2009, pp. 16–19.

nominal terms in 2009. Tourism income also fell by 6.5 percent[56]. With exports already exhibiting lackluster performance in the beginning of the year, goods exports are expected to plummet by 10.9 percent in 2009, while the growth rate of services exports is expected to slow down by about 7 percentage points to 2.9 percent. Imports are also expected to fall by 11.8 percent, and in the first half of 2009 imports fell by 8.3 percent. Foreign direct investment inflows, as a share of GDP, dropped in 2008 to 0.3 percent from 2.7 percent the year before.

4.4 Legislative Challenges to Trade in Kenya

According to the study, in an institutional review undertaken by the UK Department for International Development, legislative barriers were found to hamper rather than facilitate trade in Kenya. These barriers include lengthy legislative processes, which resulted in delays in creating laws conducive to trade and investment. It was also found that there was no existing legal framework to facilitate trade. Additionally, some laws were outdated and out of touch with current realities. On the implementation and interpretation of laws, this was found to not always be clear and transparent. Additionally, there was weak enforcement of some laws due to human and financial capacity constraints and lack of political will. On customs matters, it was found that there were numerous amendments to laws for example Customs and Excise [57]Act, which created confusion for traders.

[57] Article 10 Customs and Excise Act

4.5 Illicit Trade and related challenges

A 2005 report by the Kenya Institute for Public Policy Research and Analysis (Kippra) on Illicit Trade in East Africa estimates that cigarette smuggling cost the Kenya Government an estimated Sh1 billion annually. The study also estimated that 40% of the products in the East African market are either substandard products or did not follow the proper channel at one point during their production and distribution[58]. Illicit trade is carried out to maximize profits, evade taxes, dominate the market, tap into lower-end consumer markets and profit on consumer ignorance. Further, illicit trade is carried out in various ways including under declaration of goods, fictitious import/export schemes, false documentation. Lack of a unified legal and regulatory framework to deal with illicit trade, such as the Trade Marks Act, Competition policy etc is a concern for Kenya. Additionally, there is a need to strengthen enforcement agents, use modern technology to track goods in transit and promote public-private partnerships for information sharing to address this issue holistically. While the concerns do not pertain to customs alone, there is a critical need to strengthen regulatory mechanisms and improve the awareness of all border personnel.

4.6 Security Challenges

On transit, crime and security is a serious concern for the private sector and impacts largely on the movement of goods and their security in doing so. Crime was the third most common complaint among firms. A third of firms studied

[58] KIPPRA, *Illicit Trade in East Africa* (2005)

experienced a crime in 2002. The direct loss to crime was large (4 per cent of annual sales revenue) but the indirect cost of security[59] (i.e. security measures) was also burdensome (2.7 per cent of sales). Less than a fifth of the crimes were solved, and more than half of firms judged police services to be poor or very poor. Crime and insecurity also negatively affects the image of Kenya in the international investment community. Rail transportation in Kenya is more expensive and slower than road transport and in fact the movement of goods to Nairobi from Mombasa can take up to three weeks[60]. However, rail transportation is used on occasion due to perceived security benefits in comparison to road security and road accidents, given that any congestion on the roads may also create security problems where stranded vehicles are prone to attacks from highway robbers.

4.7 Conclusion

This chapter looked at performance indicators of trade laws in Kenya and also legislative challenges of trade in Kenya. Trade laws have helped Kenya perform better in terms of trade in East Africa as compared to other countries in the region. This is viewed through Kenya's increase in exports over the years for example the increase in exports from 6.3 percent during 2005–07 but ended up dropping by 4.2 percent in 2008. However, despite of the improvement in the performance of Kenya's economy, many trade laws have equally been affected illicit trade and other trade hiccups like smuggling which has cost Kenya a lot.

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[59] The indirect cost of security 2002.
[60] Ibid 4

CHAPTER FIVE

GENERAL CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusion

The influence of trade policy on growth performance introduces a paradox in the structure of protection for an economy in the process of development. On the one hand there was a perceived need to protect infant industries — perceived as a road map to industrialization through high tariffs and non-tariff barriers, while generating the much needed revenue for the government. On the other hand the price raising effect even for intermediate inputs and the distortions created by the protective barriers increase inefficiency in the domestic market particularly in manufacturing and agriculture, reducing their competitive potential and the growth prospects envisaged. This paradox is clearly reflected in the effective structure of protection in Kenya.

Ideally trade liberalization is intended to increase the price of exportable relative to importable to switch production in favor of exports away from import competing goods. The price incentive is also intended to constrain domestic demand to increase the scope for exports. However the outcomes from policy changes are at best unpredictable particularly given the other policy changes which may lead to conflicting signals, the most import one in this case being the exchange rate policy which might inadvertently reverse the trade policy intent.

Kenya also plays an important role in facilitating transit trade into the Great Lakes region, through the Port of Mombasa, which is the gateway to several Eastern and Central African countries including Uganda, Rwanda, Burundi, DRC Congo, and Sudan among others. A recent study conducted by UNCTAD shows that the international transport costs for imports of sub-Sahara landlocked countries accounts for an average of 20.7 per cent of the value of imports, as compared to the world average of 5.1 per cent and the average for other African countries of 12.7 per cent.

With little productivity advantage, Kenya's large trade surplus with East Africa is likely driven by size and perhaps historical and geographical advantages. Meanwhile, Chinese and Indian firms achieve similar or better labor productivity to Kenyan firms, but do so with much lower levels of capital and transportation costs. Additionally, Kenyan productivity has been stagnating, while firms in India and China advance. These dynamics illustrate that the growth rate of the region as a whole is critical and hence the expedited and cheaper movement of goods would provide an added benefit for East Africa in the competitive global economy.

5.2 General Recommendations

The recommendations below identify what the government of Kenya can do to make the most of comparative advantage by reducing country-specific constraints, thereby responding to the increasingly competitive trading environment:

5.2.1 Supporting export diversification

The researcher recommends that Kenya needs to support export diversification if the country is to gain more because export diversification is a slow process which requires appropriate and coherent policies and an enabling environment, including a stable macro-economic environment, the removal of anti-export biases, and the creation of appropriate incentives to support efficient and internationally competitive value addition, processing and manufacturing.

5.2.2 Creation of international trading

There is also need to create international trading opportunities by securing free or to foreign markets. Kenya should look forward to other business environment beyond East Africa if she is to enlarge her trading opportunities. Exports are very paramount for any country and Kenya should focus more on exports other than looking at imports because she can trade better when her exports overweigh her imports.

5.2.3 Conducive macroeconomic conditions

Given the fact that Kenya needs to widen her business base, there is still need for her to maintain conducive macroeconomic conditions (that transmits correctly to producers the relation bet domestic prices). The laws governing business in Kenya should be fair for both the international and local business people like the local producers in country so that they are not over bent by high taxes that might accrue from high costs of production due to high taxes on raw materials among others.

5.2.4 Rational tariff structure

In addition, there is need of establishing a rational tariff structure that encourages efficient specialization according to comparative advantage. This will help Kenya explore the domestic market in East Africa other than just looking at export. Laws of comparative advantage states that countries be allowed to produce what they can better produce given the access of raw materials. Kenya should therefore concentrate on the production of maize and wheat and let Tanzania produce rice and Uganda, matooke which they can do better.

5.2.5 Protect infant countries

"Picking winners" rather than simply protecting producers and manufacturers at the expense of consumers – to enable Kenya to protect appropriate "infant industries", making the most of the relative protection and trading opportunities offered by membership of EAC and COMESA.

5.2.6 Strengthen institutional capacity

Strengthening institutional capacity for testing and certification in trade-related quality, safety, health and environment issues, to ensure that Kenyan products can meet importer requirements. The ministry of trade and industry should ensure that quack products should not be allowed in the market at any time because they constitute health and other related problems. So all products should be inspected to allow only better products in the market for consumption.

5.2.7 Increase technical understanding

Increasing technical understanding of the rule-based multilateral trading system under the WTO. This will strengthen Kenya's ability to participate in WTO activities and strengthen negotiating capacity. Kenya should not distance WTO but she should rather ensure that she works well with WTO since she is already a signatory in WTO and this will help her export to WTO member countries.

5.2.8 Promoting agriculture

Enabling small-scale agricultural producers and the private sector to support product diversification and the identification of new trading partners

In order to foster trade within the region, there is need for a unified and simple regional trade policy document that would then be implemented uniformly in the region; such a document would then be mainstreamed in the National policies of the EAC member States for implementation.

5.2.9 Increase trade facilitation

The national trade policies should ensure that trade facilitation is enhanced in order to allow for faster and cheaper costs of business transactions within the country and thereby improving peoples livelihoods through trade. The concerned authorities through the ministry of trade and industry should ensure that Kenyan nationals are not suppressed by repressive trade laws so that local people can be favored to fully participate in trade in the county.

5.2.10 Operational Custom Union

Furthermore, with a fully operational Customs Union, a common external tariff and the common market to commence in July 2010, the EAC Member States have to speak with one voice in trade negotiations both at the regional and multilateral levels. Indeed the on-going EPA negotiation is a good beginning since the region is negotiating as a block; this should be replicated in other forums including at the WTO where all the member states are still maintaining individual missions.

5.2.11 Harmonize policies

In Conclusion The country also needs to harmonize all policies especially those dealing with trade and trade related aspects should be hastened; this would make the region more attractive to investors and coupled with its potential of abundant raw materials, labor force, political stability and the emerging big market, enable faster development through trade led policies that would enhance its peoples livelihoods.

5.2.12 General Conclusion

Kenya's commitments under the East African Community (EAC), Common Market for Eastern and Southern Africa (COMESA) and World Trade Organization (WTO) influence Kenya's trade policies. They create a strong push to increase openness and reduce tariffs – although both the EAC and COMESA encourage the construction of an external tariff wall to encourage within-group trade. Both the EAC and COMESA provide Kenya with trading opportunities and for the growth of semi-protected 'infant industries'. This illustrates how important it is that the Kenyan government 'picks winners' rather than simply protecting producers and manufacturers at the expense of consumers

Kenyan producers and exporters have been negatively affected by the cyclical changes in international primary commodity prices. Furthermore, domestic markets are becoming more competitive as Kenya brings its tariffs in line with WTO, EAC and COMESA requirements. Retaining market share will require greater production, transport and marketing efficiencies.

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