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Trade Notes

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INSIDE

As a member of the African, Caribbean and Pacific (ACP) group of countries, Kenya has had formal trade arrangements with the European Union since 1975 under the four Lomé Conventions between 1975 and 2000, and the Cotonou Partnership Agreement between 2000 and 2007. These agreements were non-reciprocal in the sense that even though most exports from ACP countries entered the Europe Union duty-free, imports from the EU to Kenya faced tariffs. Other members of the World Trade Organization (WTO) contested this preferential treatment of exports from ACP countries because the preferences were discriminative against them. Brazil, Australia and Thailand challenged preferences for sugar exports from ACP countries, and Latin American countries challenged preferences for banana exports. These challenges at the WTO prompted the EU to seek a reciprocal arrangement with ACP countries. In the Cotonou Agreement, ACP and EU members committed to negotiating a reciprocal Economic Partnership Agreement (EPA) compatible with WTO rules. The EU carried out negotiations with the following regional groups within the ACP: the Caribbean; Pacific; South African Development Community; East African Community (EAC); Eastern and Southern Africa; Central Africa and West Africa. Kenya was part of the EAC Party, which also included Uganda, Tanzania, Rwanda and Burundi.

THE EAC - EU ECONOMIC PARTNERSHIP AGREEMENT: Context, Content and Consequences

By Leon Ong'onge

Introduction

The EAC-EU EPA negotiations lasted twelve years, coming to a head when the European Union unilaterally set October 1, 2014 as the deadline after which exports from the EAC states to the EU would lose their preferential treatment and revert to the less generous Generalised System of Preferences (GSP). Products of export interest to Kenya faced higher tariffs, ranging from 5% to 22%; those from the other four EAC Partner states continued to enter to the EU under the Everything but Arms (EBA) arrangement, a component of the EU GSP that allows Least Developed Countries (LDCs) to access the EU market duty-free quota-free. Kenya could not enjoy these preferences because she is classified as a developing country. Negotiations were concluded shortly after the deadline and the agreement was initialled on October 14, 2014; Kenyan exports were put back on the preference list on December 25, 2014. In the period of the higher tariffs, some Kenyan exporters shut down temporarily because of the higher cost to access the EU market.

Presently, the EPA that was agreed on by the two parties is undergoing legal scrubbing by EAC member states, but substantial revisions can only be made to the text when the agreement comes under review five years after the beginning of its implementation. Some of the objectives of the EPA, as listed in Articles 2 and 3 include: promoting regional integration, economic cooperation and good governance in the EAC; promoting gradual integration of the EAC into the world economy; improving EAC capacity in trade policy and trade-related issues; and establishing an agreement consistent with Article XXIV of the General Agreement on Tariffs and Trade (GATT).

Predicated on the Cotonou Agreement, the EPA has two important defining principles- reciprocity and asymmetry. Whereas reciprocity here refers to the liberalization of market access for goods from the EU into the EAC market, that liberalization is asymmetric because EAC exports will gain duty-free quota-free (DFQF) access for substantially all exports to the EU immediately upon entry into force of the EPA, while only 82.6% of EU exports to the EAC will be liberalized, and this over a 25-year period. The EPA contains agreements on the following issues: trade in goods; agriculture; fisheries; economic and development cooperation; and institutional arrangements and a dispute settlement mechanism. The issues that were put off for future negotiations, listed in the Rendezvous Clause, include: trade in services; and trade-related issues such as competition policy; investment and private sector development; intellectual property rights; transparency in public procurement; and trade, environment and sustainable development.

i. Market Access

Market access issues make up a significant portion of the EPA. As indicated above, all exports from EAC except arms and ammunition will continue to enter the EU duty-free quota-free. On the other hand, 82.6% of European exports to the EAC (by value, not tariff line) will be liberalized in phases over a period of 25 years. Kenyan manufacturers and farmers were initially apprehensive of the agreement, fearing that the introduction of cheaper manufactured and agricultural imports could erode their market in Kenya, within EAC and in the Common Market for Eastern and Southern Africa (COMESA), which makes up a large share of Kenya's export market. The tariff reduction schedule reveals a different picture. As shown in Table 1, the 17.4% of the products that are excluded from the reduction schedule include mostly agricultural and other goods that are of strategic value to EAC member states. Further, 65.4% of items of the reduction schedule already face an MFN rate of zero. Essentially, only 17.2% of imports from the EU will be liberalized, and the majority of these are intermediate rather than finished goods. The aim of this arrangement was to allay concerns that liberalized EU imports would hamper development efforts in the EAC region. Table 1 further provides a breakdown of the market liberalization.

Table 1: Summary of EAC Market Access offer for Liberalization

Category of Products	No. of tariff lines	EAC CET Tariff lines	Period	Tariff phase down and rate	% of trade (in value)	Rationale used in negotiations
Exclusion List	1,323	-	-	Will not be opened up to EU imports	17.4%	Protection of agriculture, food security and rural development, industry and regional integration
Raw material/ capital goods	1,950	0%	T_0[1]	2010-Tariff already at zero so no further reduction	65.4%	Already zero rated under EAC Customs Union
Intermediate products	1,040	10%	(T_0+7) to (T_0+15)	Tariff phase down at annual incremental rate of 10% of tariff at T0	14.6%	Industrial inputs which EAC Industries import from EU but which are not at the moment produced in EAC
Finished products	960	25%	(T_0+12) to (T_0+25)	Tariff phase-down at annual incremental rate of 5% of tariff at T0	2.6%	Non-strategic products in the context of EAC industry and agriculture sector development
Total EAC trade to be liberalized					82.6%	

Source: Ministry of Foreign Affairs and International Trade, Kenya

[1]T_0=year of entry into force of the EPA after ratification by both EAC and EU

ii. SPS & TBT

There are two main kinds of barriers to free trade: tariffs and non-tariff barriers (NTBs). Duty free quota free market access seeks to eliminate the former. There has been a general decline in tariff barriers, but many countries have resorted to creating non-tariff barriers to protect their domestic markets. The most significant non-tariff barriers include Sanitary and Phytosanitary (SPS) measures and Technical Barriers to Trade (TBTs). SPS measures aim to safeguard human, plant and animal health, while TBTs are standards and technical regulations on testing, labelling, packaging, marketing and certification of goods. Over the last few years, standards, for which compliance is voluntary, have been gaining higher prominence in the EU compared to technical regulations, for which compliance is mandatory. African countries have had difficulty keeping up with the upward revision of standards and technical regulations for exports to the EU.

The articles that deal with SPS and TBT issues in the EPA do not have any notable deviations from the WTO Agreement on SPS measures and WTO Agreement on TBTs. States party to the EPA agreement reserve the right to implement SPS measures and TBTs as long as these measures are consistent with the WTO SPS and TBT agreements, have scientific justification, and are implemented transparently.

Similar to exporters from many developing countries, Kenyan exporters have faced challenges in compliance especially with SPS measures because a large percentage of the goods exported to the EU is unprocessed food and beverages, and other agricultural products. It is for this reason that the EU has committed in Article 121 of the EPA to provide technical assistance to build EAC members' capacity in SPS control, risk analysis, harmonization, compliance, testing, certification, residue monitoring, traceability, and accreditation, with the aim of improving domestic production practices to levels that are compliant with the standards and regulations of the EU market. In addition, Article 39(2) mandates the establishment of a system of relaying advance notice of new SPS measures to EAC states, a measure that would hopefully reduce the number of consignments intercepted by the EU authorities for non-compliance.

Regarding TBTs, the EU committed in Article 125(ii) to provide "support for capacity building in standardization, metrology, accreditation and conformity assessment, including support in the upgrading and setting up of laboratories" in addition to providing the necessary technical support.

iii. Trade Facilitation

At the Ministerial Conference held in Bali in 2013, WTO members concluded the Agreement on Trade Facilitation (TF), whose main objective was to ease customs procedures related to export out of, imports into, and transit through territories of member countries. As of July 2014, that agreement is yet to come into force because it has not met the two-thirds ratification threshold. Kenya has already carried out an assessment of how to categorize the measures of the TF Agreement, noting measures that Kenya is ready to implement immediately upon entry into force of the agreement, and those that Kenya requires time and/or financial support to implement.

The section on trade facilitation in the EPA is largely similar to the TF Agreement on issues such as harmonization of customs practices, cooperation among customs agencies, sharing of information on custom-related legislation and policies, and utilization of electronic systems. One notable deviation is that although the TF Agreement allows members to unilaterally set timeframes within which to implement it components, Article 25 of the EPA sets a maximum of five years for EAC states to implement TF measures some of which those members may have classified in their WTO categorization as requiring a longer period to fulfil. Some observers have claimed that the EU used the EPA to strong-arm EAC states to implement policies that the EU and other developed countries could not convince other WTO members to include in the WTO Agreement on Trade Facilitation. The five-year timeframe is not only constrictive, but could also interfere with the temporal and institutional frameworks that EAC states have set for themselves as they implement the TF Agreement.

iv. Agriculture

Agriculture is an important trade issue for both the EAC and the EU, and the mainstay of the EAC economies. In Kenya, for instance, 75% of the labour force is involved in agriculture, many as small-scale subsistence farmers. The EPA acknowledges this significance of agriculture to the development of the EAC, and creates a framework for cooperation to promote its sustainable development. The Comprehensive Dialogue on Agriculture and Rural Development Policy, to be integrated within the Committee of Senior Officials, will monitor the implementation of the objective set out in the agriculture section which focus on matters like food security, increase in opportunities for gainful employment, encouraging value-addition practices, and environmentally-friendly production among others.

The EAC and EU agree in the EPA to cooperate on the following issues related to agriculture: development of necessary national and legal policies and frameworks; development of market systems and market development strategies; strengthening handling, processing, marketing, distribution and transportation of agricultural products; development of infrastructure for research, training, agro-processing, irrigation, grading, agro-meteorology; developing, strengthening and linking early warning systems; enhancing value-addition throughout the supply chain; and capacity building in multiple agriculture-related fields. Proper implementation of these aspects of the agreement could increase both the productivity and production levels in the agriculture sector, of which the cascading effects could boost EAC economies.

The EU has faced criticism at the WTO for its Comprehensive Agricultural Policy that allows for trade-distorting subsidies to farmers. To allay fears that subsidized agricultural exports from the EU would enter the EAC, the EU committed in Article 78 (2) not to subsidize agricultural exports to the EAC. Whether and how this commitment will be practicable e.g. in the separation of produce for domestic use and for export remains to be seen.

Institute of Economic Affairs

v. Fisheries and Aquaculture

Marine and inland fish make up a significant portion of exports to the EU (see table 2). Titles II and III, which focus on fisheries and aquaculture, endeavour to promote effective exploitation, conservation and management of fish sources-inland and within the Exclusive Economic Zones (EEZ) of the EAC states, and to ensure that the region derives equitable benefits from the fish harvested in their territories. The backdrop to this objective is that fishermen from other countries have exploited the dearth of monitoring capacity and surveillance resources by the EAC states to conduct illegal, unreported and unregulated fishing within in the EEZs, depriving these states of revenues and depleting their fish stocks.

The Parties agree in the EPA to establish a Vessel Management Systems (VMS) and Monitoring, Control and Surveillance (MCS) and to develop and modernize transhipment infrastructure in the ports of the coastal EAC states. In addition, the EU commits to support capacity building and training programs to improve the competitiveness of the inland fisheries, management of export market chains. Other EU commitments include development and improvement of infrastructure, development of financial support mechanisms for Micro Small and Medium Enterprises, transfer of relevant technology, and support towards developing legal and regulatory frameworks particularly pertaining intellectual property rights among others.

vi. Miscellaneous

a) Title VII of the EPA deals with trade defence measures, namely safeguards, anti-dumping duties and countervailing measures. The objective of these measures is to prevent or correct domestic injury to specific industries, sectors or economies caused by increased quantities of imports.

b) One of the major issues in the EPA agreement that drew sharp criticism from the civil society in the EAC was that the agreement precluded the EAC and EU from imposing export tariffs. This criticism was faulty on two accounts. First, Kenya has employed export tariffs very few times and on few tariff lines, the most significant of which is hides and skins. The main concern about the perceived preclusion of export taxes was based on the discovery of oil and gas in the EAC region, and the worry that these resources would be shipped out and not benefit the region. Second, the Article 15(2) and 15(3) of the EPA agreement actually allows EAC states to impose temporary export tariffs to foster development of domestic industry, to maintain currency value stability, and with regards to revenue, food security and environmental protection, as long as they inform the EU. The EPA council will review these exports tariffs for renewal 48 months after they are affected.

c) Regarding the institutional structure, the EPA provides for three primary groups: the EPA Council made of the ministers from the member states, a Committee of Senior Officials composed of Permanent Secretaries or Principal Secretaries, and an EPA Consultative Committee with representatives of the private sector, civil society and academia.

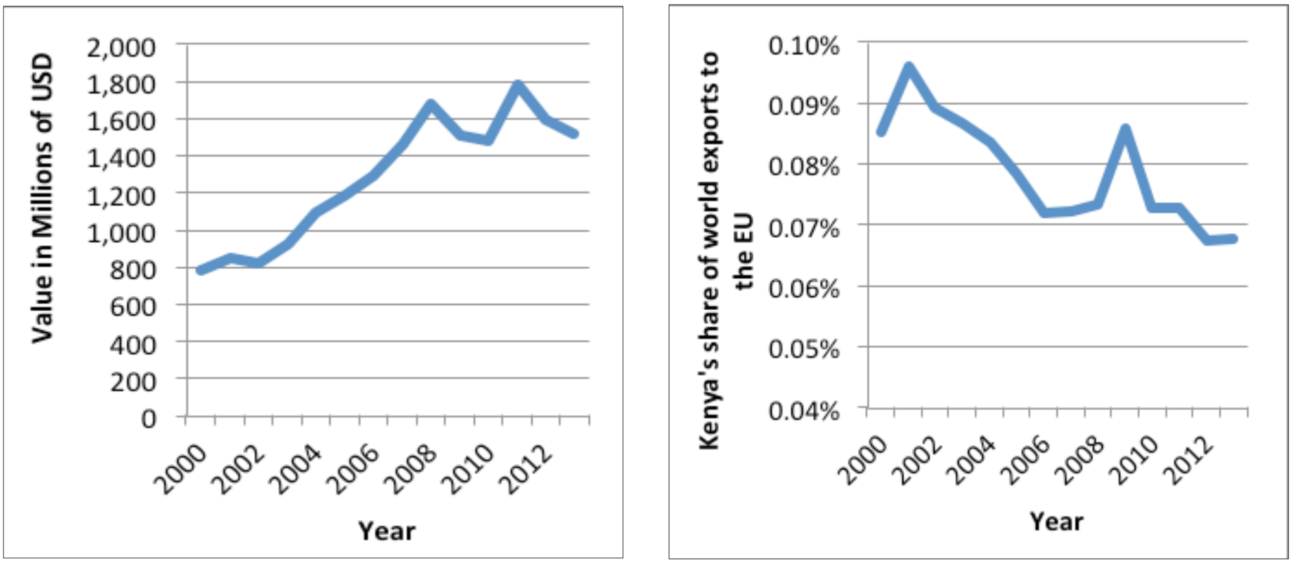
d) Article 181 provides for a regular review of the agreement every five years after it enters into force. This provision is beneficial because it allows for the improvement of the terms of the agreement in line with changes in circumstances.

e) Should any member state party to the agreement feel unsatisfied by the EPA, the agreement's exit clause requires that the member give a one-year written notice of withdrawal from the agreement.

Kenya-EU trade profile

The EPA negotiation aside, it is necessary examine the extent to which Kenya utilized the previous preferential agreements. The illustration below contains two revealing charts. Figure 1(a) shows that the value of Kenya's exports to the European Union increased from USD 0.7 billion in 2000 to USD 1.5 billion in 2013. However, Figure 1(b) shows that even though the value of exports increased, the value of Kenya's exports as a proportion of the total world exports to the EU was not only minuscule (less than one tenth of one per cent) but also declined over the same period.

Figure 1: Value and share of Kenyan Exports to the European Union



(a) (b)

Source: UN Comtrade

In addition, Kenya did not adequately utilise all the preferences that were accessible to her. The basket of exports to the EU has barely changed, with horticultural products (especially cut flowers) accounting for a large percentage of the exports. Other exports include fish, tea, coffee, beans and peas. Table 1 shows that most of Kenya's exports to the EU are agricultural products whose production can be affected greatly by adverse weather conditions.

Table 2: Kenya's major exports to the EU

	Average value of exports to the EU (2007-2010) in million €	EPA tariff	MFN tariff	GSP tariff
Roses and carnations	264	0%	12%	8.5%
Coffee/tea	247	0%	0-3.2%	0.0%
French beans	103	0%	10.4%	6.9%
Peas	39	0%	8%	4.5%
Avocadoes	18	0%	5.1%	1.6%
Roasted coffee	4	0%	7.5%	2.6%
Nile perch (fresh/frozen)	18	0%	9%	5.5%
Tuna (frozen fillets)	3	0%	18.5%	14.5%

Source: Delegation of EU to Kenya

Trade Concerns under EPAs for Kenya

i) Agricultural subsidies:

Some observers are apprehensive about the EU's commitment to prevent subsidized agricultural products from being exported to the EAC, considering the pervasive subsidization allowed by the EU's agricultural policy.

ii) Ratification:

For the EPA to come into full force, it will have to be ratified by all five EAC member states, the EU Parliament, and all EU member states. This multiplicity of ratifying authorities could delay the implementation of the agreement. The EU has indicated that in the event that the EAC states do not ratify the agreement in time, then all EAC states will revert to the GSP. Of the EAC states, Kenya stands to lose the most as she is classified as a developing country and Kenyan exports would face higher duties compared to those from the other EAC states whose products will still enter the EU under favourable Everything but Arms (EBA) for Least Developed Countries. The onus is therefore on Kenya to lobby the other states to ratify the agreement, so that her exports can continue to enjoy preferential access to the EU, in addition to all EAC states receiving EU aid to develop their trade infrastructure.

iii) Implementation:

Related to the issue of ratification is the date of implementation of the agreement. The date of the beginning of implementation is unclear to the EAC members-whether the implementation period begins in 2014 when the document was initialled, or in 2015 as is being pushed for by the EU, or after all the EAC and EU members ratify the agreement.

iv) Development Matrix:

One of the advantages of the EPA is that the EU commits to support EAC members states in improving their trade infrastructure and capacity. A development matrix has been drawn up noting the projects that the EU has undertaken to support. All the projects that have been earmarked for EU support are hard infrastructure projects such as improvement of road and pipeline networks, and bolstering of the energy and ICT infrastructure. Even though the text of the agreement indicates that the EU will support enhancement of soft infrastructure issues such as capacity building on SPS and TBT issues, the commitment is not in definite Euro amounts as is the case with the hard infrastructure.

v) Sensitization:

There is little information within the legislative arm of the government about the EPA and other trade agreements. Many trade agreements require ratification by parliament, and it would therefore be prudent for the executive and other civil society to engage parliament and the citizenry during the course of negotiations so that parliamentarians do not merely rubberstamp trade agreements that have significant effects on their constituents. Moreover, research institutions should carry out comprehensive studies that will assist negotiators and government officials to understand the impact of agreements that they enter.

vi) Liberalization:

The decline of some industries due to liberalization in the 1980s and 1990s has been the basis of opposition of the EPAs, with the fear that imports from the EU would wipe out the manufacturing industry. A contrary view to this opinion is that the value of imports from countries like China and India has already overtaken that of imports from the EU, but Kenyan manufacturing has scarcely been affected.

vii) FDI from EU:

Another concern that has been voiced regards the impact of the EPA on investment by EU citizens and firms in the EAC. Considering that some products will eventually enter the EAC duty-free, some observers worry that EU firms would be less willing to set up industries in EAC because they will still be able to access the market under favourable terms, and that the local economies would then lose out, for example on employment opportunities

Conclusion

Theoretically, trade liberalization is meant to have a net positive impact such that the benefit of availing cheaper goods of a higher quality to the domestic consumer exceeds the cost of lost jobs and revenue from less efficient local enterprises. However, some have questioned the utility of the EPA to Kenya on account of the largely negative impact of the liberalization that Kenya went through in the 1980s and 1990s, which resulted in closures of factories, loss of jobs and little economic development.

The primary benefit of the EPA is that the horticultural industry will continue to enjoy preferential access to the EU, warding off competition from other countries like Colombia, Ethiopia and Ecuador. Flower exports to the EU account for close to one half of the KSh 100 billion worth of Kenya's exports to the EU. Another benefit is that the EAC members will receive aid from the EU to improve their trade infrastructure, which will address some supply side constraints and enable compliance with standards and technical regulations in export markets.

One argument against the EPA is that lower tariffs will translate to lower revenue for the government. Even though governments should ideally not rely on tariffs as a major source of their revenues, World Bank data indicates that about 8% of Kenya's tax revenue is derived from customs and import duties. Liberalization of imports from the EU, which accounts for about 15% of the total value of imports to Kenya, could lead to loss of a significant source of revenue for the government.

The complete effect of the EPA remains to be seen during its implementation. In the meantime, Kenya would do well to eliminate supply side constraints that have seen low preference utilization rates in the EU market. In addition, Kenya should seek maximum benefit from ongoing bilateral, regional and multilateral negotiations like Doha Round and the Tripartite Free Trade Area (TFTA), which presents opportunities for increased trade opportunities between Kenya and at least six other African countries.

Kenya should not rest on her laurels on account merely of the existence of preferential market access to the EU. Non-ACP states have also been negotiating trade arrangements with the EU. In the long run, these agreements could erode the preferences that Kenyan exports receive as the tariffs levied on other countries decline over time. It is therefore incumbent on Kenya to eliminate constraints such as high cost of energy and poor infrastructure that place her exports at a comparative disadvantage absent the preference. An improvement of production capacity will also enable Kenya to expand the basket of exports from raw agricultural commodities to higher-value goods that will reap higher revenues, and will be less vulnerable to the vagaries of international commodity markets and weather.

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Trade Notes

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