Special Focus: Deepening Kenya’s Integration in the East African Community (EAC)
4. The EAC – A dynamic economic community

The EAC is a vibrant economic community, which now trades more with itself than with any other region of the World. Kenya can improve its trade balance, lower prices for a variety of goods and services and create jobs by reducing non-tariff barriers to trade and strengthening exports, particularly services. Although Kenya’s export performance has improved over the last decade, its imports have grown much faster. Kenya’s service sector has experienced recent growth, and there is room for further expansion. Kenya is in an excellent position to benefit from regional integration, and address the non-tariff barrier and regulatory reform agenda at both the national and regional levels.

4.1 Fast growth and a shift towards regional trade

The EAC is one of the fastest growing economic communities in the world. It has grown faster than all other economic communities in the last decade, except for ASEAN, which grew at 6.1 percent. The EAC grew at an average of 5.8 percent per year, between 2001-2009 (see figure 4.1) and over the last decade, each EAC country more than doubled its own GDP. The EAC also experienced unprecedented population growth – the region grew by 25 percent from 110 million people in 2002, to 138 million people in 2010. The region’s high population growth has been close to 3 percent per year over the last two decades, compared to the Sub-Saharan Africa’s average of 2.6 percent. The population in Kenya alone doubled over the last twenty-five years, and rapid population growth is set to continue.

Although each EAC country grew in the last decade, growth was unevenly distributed. Tanzania, Uganda and Rwanda grew at an average of over 7 percent per year between 2002 and 2010, compared to Kenya and Burundi which grew at 3 and 4 percent respectively. Kenya is the largest economy with a GDP of approximately US$ 32 billion in 2010, followed by Tanzania, Uganda and Rwanda, and finally Burundi with a GDP of only US$ 1.6 billion in 2010. Between 2002 and 2010, GDP per capita increased at an average of 112 percent across the region, and now ranges from over US$ 800 in Kenya, to under US$ 200 in Burundi. To reach middle-income status (GDP per capita of US$ 1,000) by 2020 – the ambition of most EAC countries – the region would have to grow at an average of 8.5 percent per year, for the rest of the decade. Rwanda, Tanzania and Uganda, with per capita income somewhat behind the regional average, would have to grow at 10 percent per year, in order to meet that goal, individually.

EAC partner states now export more within the EAC region than to any other region. Total goods and services exports from EAC partner states more than tripled over the last decade from US$ 6 billion in 2002 to US$ 19.5 billion in 2010. In 2010, goods exports comprised of US$ 12 million and service exports US$ 7.5 million. The share of total EAC exports traded within the region increased from US$ 1.8 billion in 2008, to US$ 2.2 billion in 2010; surpassing Europe as the region’s main trading block (see figure 4.2).

Figure 4.1: Average GDP growth in the EAC has been far ahead of most other economic blocks


Excluding Burundi from forecast, Regional Economic Outlook, IMF 2011.
In addition, there was a large increase in EAC trade with Asia – as expected, given ASEAN’s strong growth record over the past decade. The trend in EAC exports is reflected in the compound annual growth rates (CAGR), where intra-EAC exports exceed those of EAC exports to the rest of the world (see table 4.1). Kenya, Tanzania, and Uganda (the founding members of the EAC) are the main sources of such intra-regional export growth. Over the next few years, Rwanda and Burundi are expected to increase their exports to EAC countries (albeit from relatively low levels), and both countries are expected to see export growth exceed import growth from 2015 onwards (East Africa Corridor Diagnostic Study, 2011).

**EAC goods exports are mostly simple manufactured products.** Unlike EAC exports outside the region, which are mainly commodities, the bulk of intra-regional exports are manufactured goods (food products, beverages, tobacco, cement) and oil re-exports. There has been limited variation between 2000 and 2009, with the basket of top traded goods within the region remaining broadly the same (see table 1.2). Although a noticeable change is the reduction in the amount of oil traded between EAC countries, which comprised of 41 percent of the top 15 products in 2000 compared to only 11 percent in 2009. This is likely to change once investments in the recent oil discoveries in Kenya begin to come on-stream. Kenyan exports to the EAC have consisted mostly of manufactured goods, chemicals and machinery (see figure 4.3). The value of Kenya’s top three products exported to Tanzania and Uganda doubled during 2000-2010, from US$ 97m to US$ 175m, and US$ 31 to US$ 73m, respectively. These consisted of oil, plastics, construction materials, and soaps.

**Table 4.1: Dynamic intra-regional exports in East Africa gained in the last decade**

<table>
<thead>
<tr>
<th></th>
<th>Compound annual growth rates (CAGR) (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2000-4</td>
</tr>
<tr>
<td>EAC exports to the world</td>
<td>13</td>
</tr>
<tr>
<td>EAC exports to the EAC</td>
<td>11</td>
</tr>
</tbody>
</table>

Source: World Bank calculation based on WITS data.
Although still at low levels, there has been a notable increase in foreign direct investment in the EAC. On average, FDI flows to the EAC (2.5 percent of GDP in 2009) are below the SSA average (4.3 percent of GDP in 2009). However, FDI flows to the EAC have increased by threefold, from approximately US$ 590 million in 2000 to approximately US$ 1.7 billion in 2010. A recent FDI survey by Ernst and Young shows that Kenya topped the list of East African countries, with the highest growth in new investment projects between 2003 and 2011. Most FDI inflows have been directed towards natural resource sectors. In Tanzania, gold exports already account for more than a third of total exports of goods and services, in Uganda oil production is expected to account for close to 10 percent of GDP, and in Kenya recent oil discoveries have been made. A challenge for the EAC is to stimulate investments beyond natural resources, generate linkages in their economies, and put in place structures for intra-regional FDI. Furthermore, deepening regional integrated would attract more FDI inflows (much of which is likely to come to Kenya), reducing the importance of short-term capital flows for Kenya in offsetting its current account deficit.

4.2 Regional integration can bring substantive benefits

Intra-EAC trade can lead to lower prices for consumers and create more jobs for EAC citizens. Gains are expected from both traditional sources (e.g. economies of scale, increased and more diversified trade and investment), and non-traditional sources (e.g. commitment for domestic reforms, benefits from access to regional public goods, and increased bargaining power in wider trade negotiations). EAC integration will also contribute to greater regional food security. The stages, history and current status of EAC integration is explained in box 4.1.

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*FDI for 2009 and 2010 are approximately the same at US$ 1.7 billion, with investments in Uganda and Tanzania helping to prevent a regional downturn.

*Ernst & Young, Building Bridges in Africa Survey, 2012.

*This section is based on World Bank, Defragmenting Africa, 2012.

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**Table 4.2: Top 15 products traded between the EAC countries**

<table>
<thead>
<tr>
<th>Product</th>
<th>2000</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>USD 1,000</td>
<td>Percent</td>
</tr>
<tr>
<td></td>
<td>1. Petroleum oils</td>
<td>186,603 41.4</td>
</tr>
<tr>
<td></td>
<td>2. Cement and construction material</td>
<td>14,664 3.3</td>
</tr>
<tr>
<td></td>
<td>3. Vegetable oil</td>
<td>12,372 2.7</td>
</tr>
<tr>
<td></td>
<td>4. Medicaments including veterinary</td>
<td>11,986 2.7</td>
</tr>
<tr>
<td></td>
<td>5. Flat-rolled products of iron</td>
<td>11,738 2.6</td>
</tr>
<tr>
<td></td>
<td>6. Other crude minerals</td>
<td>11,185 2.5</td>
</tr>
<tr>
<td></td>
<td>7. Paper</td>
<td>9,884 2.2</td>
</tr>
<tr>
<td></td>
<td>8. Articles of plastics</td>
<td>8,903 2.0</td>
</tr>
<tr>
<td></td>
<td>9. Soaps/cleansers/polishes</td>
<td>8,144 1.8</td>
</tr>
<tr>
<td></td>
<td>10. Cut paper/paperboard and related articles</td>
<td>6,295 1.4</td>
</tr>
<tr>
<td></td>
<td>11. Maize except sweet corn</td>
<td>6,071 1.3</td>
</tr>
<tr>
<td></td>
<td>12. Rubber tyres</td>
<td>6,037 1.3</td>
</tr>
<tr>
<td></td>
<td>13. Glassware</td>
<td>5,945 1.3</td>
</tr>
<tr>
<td></td>
<td>14. Flour/meal wheat/meslin</td>
<td>5,191 1.2</td>
</tr>
<tr>
<td></td>
<td>15. Edible products</td>
<td>5,122 1.1</td>
</tr>
<tr>
<td></td>
<td>Total Trade</td>
<td>450,993 100</td>
</tr>
<tr>
<td></td>
<td>Product</td>
<td>USD 1,000</td>
</tr>
<tr>
<td></td>
<td>1. Petroleum oils</td>
<td>160,451 11.2</td>
</tr>
<tr>
<td></td>
<td>2. Cement and construction material</td>
<td>115,678 8.1</td>
</tr>
<tr>
<td></td>
<td>3. Paper</td>
<td>52,574 3.7</td>
</tr>
<tr>
<td></td>
<td>4. Manufactured fertilizers</td>
<td>47,037 3.3</td>
</tr>
<tr>
<td></td>
<td>5. Medicaments including veterinary</td>
<td>44,692 3.1</td>
</tr>
<tr>
<td></td>
<td>6. Soaps/cleansers/polishes</td>
<td>37,727 2.6</td>
</tr>
<tr>
<td></td>
<td>7. Alcoholic beverages</td>
<td>36,296 2.5</td>
</tr>
<tr>
<td></td>
<td>8. Made-up textile articles</td>
<td>34,286 2.4</td>
</tr>
<tr>
<td></td>
<td>9. Road motor vehicles</td>
<td>33,396 2.3</td>
</tr>
<tr>
<td></td>
<td>10. Cut paper/paperboard and related articles</td>
<td>32,789 2.3</td>
</tr>
<tr>
<td></td>
<td>11. Crude vegetable oil</td>
<td>32,065 2.2</td>
</tr>
<tr>
<td></td>
<td>12. Other crude minerals</td>
<td>28,638 2.0</td>
</tr>
<tr>
<td></td>
<td>13. Cut paper/paperboard and related articles</td>
<td>25,283 1.8</td>
</tr>
<tr>
<td></td>
<td>14. Iron and steel bars/rods/etc.</td>
<td>24,164 1.7</td>
</tr>
<tr>
<td></td>
<td>15. Articles of plastics</td>
<td>23,441 1.6</td>
</tr>
<tr>
<td></td>
<td>Total Trade</td>
<td>1,430,290 100</td>
</tr>
</tbody>
</table>

Source: World Bank computation based on Comtrade/WITS data.
More intra-EAC trade in agriculture would contribute to food security. The production of food staples for growing urban markets and food deficit rural areas, represents the largest growth opportunity for regional farmers. Given that there is population growth and increased urbanization, Africa’s demand for food staples will grow dramatically in the coming decade. Indeed, demand in Africa is expected to double by 2020, primarily in cities. But agricultural resources are not allocated equally across EAC countries, or even within them, so borders often artificially demarcate food surplus areas, from food deficit ones. Regional trade integration can have a substantial impact by better linking farmers to consumers across borders, and in ameliorating the effects of periodic national food shortages, and increasing global food prices. At this stage, however, regional trade in food staples remains far from free, despite efforts for policy and regulatory harmonization. The arbitrary and erratic imposition of barriers undermines private sector confidence to invest, and distorts incentives towards cash crop production away from food staples.

Intra-EAC trade in basic manufactured goods and regional production chains can reduce unemployment. Trade in basic manufactured goods such as plastics, chemicals, paints and cosmetics, construction materials and pharmaceuticals is beginning to materialize in East Africa, but non-tariff barriers are currently limiting such opportunities through increasing production and transport costs. Similarly, prospects for regional production chains driven by trade in parts and components (“trade in tasks”), remain limited due to trade and regulatory barriers, which raise transaction costs and increase uncertainty. The removal of such barriers would encourage vertical specialization, and the emergence of regional production chains, that create employment and promote export diversification.

Intra-EAC trade in services can have significant economy-wide benefits for all EAC countries. Trade in services is particularly important for maintaining the competitiveness of landlocked countries and Uganda is now exporting education services to East Africa and beyond. Over the past 10 years, exports of services from non-oil exporting land-locked countries in Africa have increased at a rate more than three times their exports of goods. For Kenya, firms have become successful exporters of business, financial and distribution services to the EAC region. Services are important for other sectors (agriculture and manufacturing), as services provide critical inputs for most economic activities. Opening up services sectors, through liberalization and reform, improves efficiency and helps attract greater levels of foreign direct investment.
Box 4.1: Regional integration and the EAC

What’s meant by regional integration?
There are four common stages of regional integration:
- A Customs Union is an agreement between governments to remove regional barriers to trade to form a duty-free trade area. The governments agree upon a common external tariff whereby partner states impose identical rates of tariff on goods imported from foreign countries. The intention is to increase regional economic efficiency, and establish closer ties between partner states. Examples include the European Union Common Customs Union (EUCU), and the Southern African Customs Union (SACU).
- A Common Market is a market established by governments where there is a free movement of capital, labour and goods. The intention is for partner states to be able to access factors of production without physical or regulatory constraints, and to improve resource allocation. Examples include the European Economic Area (EEA), and Common Economic Space (CES).
- A Monetary Union is an agreement between governments to use the same currency. The intention of a monetary union is often to reduce exchange rate risk and price variability, along with associated benefits of political union. Examples include the CFA Franc (West and Central Africa) and the Economic and Monetary Union (EMU) of the European Union.
- A Political Federation is an agreement between governments to operate under a centralized government recognized internationally as a single political entity. Article 5 of the EAC Treaty sets out the intention to form a political federation, but does not provide for its composition or structure. Examples of political unions include the United States of America and African Union.

A long history of EAC integration efforts
Kenya, Tanzania and Uganda have a long history of successive regional integration arrangements:
- 1927: Customs Union between Kenya, Tanzania and Uganda
- 1948-1961: East African High Commission
- 1967-1977: East African Community
- 1993-2000: East African Co-operation
- 1993: East African Co-operation
- 2000: East African Community
- 2005: East African Community Customs Union
- 2010: East African Community Common Market Protocol

EAC collapse in 1977 and lessons learnt
The collapse of the EAC in 1977 can be attributed to a number of reasons; including governance challenges, economic imbalances (in part arising from the socialist system in Tanzania and capitalist system in Kenya), political disagreements, and an extremely limited dissemination of information. Two reasons stand out, first, the relatively low engagement of stakeholders in civil society, the private sector and amongst EAC citizens, in the decision-making and management processes of community integration. And, second, a lack of a dispute resolution process for sharing the costs and benefits arising out of EAC integration. Since 1977, steps have been taken to address some of these problems, including a Mediation Agreement (1984) for determining and dividing EAC assets and liabilities, and an agreement for the establishment of the Permanent Tripartite Commission for East African Cooperation (1993). Nonetheless, citizen engagement, knowledge sharing and consensus building are, and will continue to be, key components for successful integration.

The EAC today: good progress but much remains to be done
Out of the four planned stages of EAC integration – Customs Union, Common Market, Monetary Union and Political Federation – the first two stages are currently in effect. The Customs Union protocol established a duty-free trade between the partner states (with the successful reduction of intra-regional tariffs), common customs procedures between the partner states and a common external tariff whereby an identical rate of tariff is imposed on goods imported from foreign countries. The next stage – the Common Market protocol - established a single market allowing the free movement of goods, capital and labour within the region. Partner states have been required to review domestic rules and regulations and ensure compliance with the protocol, in order to harmonize policies and regulations within the region. This involves the removal of restrictions on the free movement of factors of production, and on the right of establishment, and to pursue mutual recognition of academic and professional qualifications. The implementation of the Common Market protocol is still taking effect, with the free movement of goods, capital and labour across all partner states not an every-day reality for many EAC citizens. The third stage – Monetary Union – would bring a single currency to the region, and agreement on the Monetary Union protocol was planned for this year but is behind schedule. The fourth stage – Political Federation – would likely bring a centralized president and parliament, and is planned for 2015, but is perceived by many as too ambitious. Given delays in implementation of both the Customs Union and Common Market, it is expected that the Monetary Union and Political Federation protocols, might be postponed further.

Although EAC integration offers Kenya many opportunities, two key challenges remain: non-tariff barriers – rules and regulations that unduly restrict trade, continue to neutralize the impact from successful tariff reductions; and poor export growth and limited diversification – Kenya’s imports continue to outgrow Kenya’s exports, despite Kenya’s promising service sector. These challenges are set against a regional backdrop of physical infrastructure constraints that hinder competitiveness.

5. Challenges for Advancing the Regional Integration Agenda in East Africa

5.1 Non-tariffs barriers (NTBs)

NTBs protect domestic markets. Some of the most cited NTBs which impede regional trade of goods in East Africa are: import and export bans; multiple roadblocks; numerous weighbridges and corruption along the Northern Corridor (see box 6.4); burdensome import licensing requirements; lack of harmonization in regulations related to standards; and, rules of origin. There can be legitimate reasons for governments to introduce rules and regulations, however, such measures can also be imposed to protect domestic markets (as substitutes to tariffs) instead. Moreover, even without protectionist intent, private-sector surveys have repeatedly shown that unduly restrictive or poorly implemented rules and regulations can raise trade costs, divert managerial attention, and penalize small-exporters and those in low-income countries, especially where access to regulatory information is difficult to obtain. In these circumstances, rules and regulations can act as NTBs to trade (see figure 5.1).

NTBs in Kenya and partner states – across a high number of products – limit regional trade. The EAC Secretariat produced a report entitled the EAC Timebound Programme for Elimination of NTBs (the “EAC NTB Report”) in which it identified for elimination, approximately 33 NTBs in 2008, and 47 NTBs in 2010. However, majority of these NTBs were not eliminated by the EAC partner states within the agreed timeframe (see section 6 and annexes 5-7 for details). NTBs which were not eliminated predominately concern “soft” rules and regulations, rather than “hard” infrastructure, and range from charges on food products, non-recognition of health and safety standards, lack of harmonized import/export documentation and procedures, and delays in transit bonds cancellation. In contrast to the

Figure 5.1: Rules and regulations which can become NTBs

Source: UNCTAD Multi-Agency Support Team (MAST) Report on Non-Tariff Barriers 2009
In preparation for EAC integration, as well as in response to the Customs Union protocol, intra-regional tariffs in the EAC have been reduced dramatically. In the last two decades, the EAC partner states reduced the number of tariffs from approximately 26 percent in 1994, to 10 percent in 2011 (see figure 5.2). However, the Customs Union protocols calls for tariff-free trade amongst partner states, and it is clear that there is more to be done, until all intra-regional tariffs are removed.

The Common External Tariff (CET) 2007 requires partner states to impose identical rates of tariff on goods imported from foreign countries. However, this has not yet been uniformly applied in practice. An example is the preferential tariff treatment given to a list of approximately 135 imports for Uganda, such as paper board products, millstone, plastic tubes, cosmetics and cement, which would otherwise be subject to the CET 2007. The preferential treatment was agreed in 1994, following Uganda's civil war, however, Ugandan exporters are still able to benefit from that duty remission today, enhancing their competitive position vis-a-vis other partner states. The list was meant to end as the EAC region began to implement the Custom Union protocol in 2005, but it has continued in existence fueling discontent between EAC traders (allAfrica 2011). In addition to the need for uniform application of the CET 2007, the levels of tariff are also reviewed regularly by the partner states.

**Box 5.1: In contrast to NTBs, tariffs in the EAC have been reduced significantly**

In preparation for EAC integration, as well as in response to the Customs Union protocol, intra-regional tariffs in the EAC have been reduced dramatically. In the last two decades, the EAC partner states reduced the number of tariffs from approximately 26 percent in 1994, to 10 percent in 2011 (see figure 5.2). However, the Customs Union protocols calls for tariff-free trade amongst partner states, and it is clear that there is more to be done, until all intra-regional tariffs are removed.

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**Figure 5.2: Tariff reduction in the EAC**

![Tariff reduction in the EAC](source: Winston and Castellanos, IMF 2011)

Kenyan exports are poorly performing. Based on Kenya’s economic size and distance from other markets, it is possible to show both actual and predicted exports (see figure 5.3). Currently Kenya under exports to Tanzania, Uganda and the BRICS (and the countries above the diagonal line in figure 5.3) and has strong export performance to Rwanda and Malawi (and the countries below the diagonal line in figure 5.3). While the geographical distance between Kenya and the BRICS might explain the below par export performance to those countries, for Tanzania and Uganda, NTBs appear to be the binding constraints.

Kenya’s imports have grown much faster than exports and export composition remains largely the same. As shown in part I, Kenya’s exports have expanded but import growth has been faster reflected...
in the widening current account deficit. The ratio of Kenya’s total exports (goods and services) to GDP, fluctuated between 20 to 28 percent over the last decade, whereas Thailand’s ratio increased from 20 to 60 percent during the same period. In addition, Kenya’s composition of goods exports has changed little over time (see figure 5.4). Export diversification seems to have stalled since 2005, with the relative composition of exports in agriculture and amongst a variety of manufactured goods, remaining largely the same. Furthermore, export growth appears to have been driven primarily by existing products, in existing markets, with limited new product/new market discovery. Diversification is needed to provide a broader base for sustained export growth, less vulnerability to volatile world prices, and to spread the benefits of trade more widely.

**Box 5.2: Regional backdrop – Underdeveloped infrastructure, unreliable power and poor business environment**

**Increasing demand is exerting great pressure on existing road corridors.** In 2009, total traffic on the two corridors (Northern and Central) was estimated at 28.6 million tons, which is likely to almost double to 52.5 million tons, within the next three years. Rail transport lags behind road transport, especially for international traffic, and a process to arrive at a more integrated and balanced system is required. Dar es Salaam and Mombasa ports are characterized by high dwell times, inefficient operations and customs, and represent significant time and cost bottlenecks, in particular for the region’s landlocked countries. Matching capacity with demand in the ports, road and railway sectors will be key challenges to moving forward, if predicted growth rates in the EAC are to be attained.

**Power remains an important infrastructure challenge in the EAC.** In Kenya, it is currently estimated that unreliable electricity lowers sales revenues of firms by 7 percent, and reduces GDP growth by 1.5 percent annually. The high cost of supplied energy, and the even higher cost of back-up diesel generation has a significant impact on the ability of firms to be competitive. Power demand in the East Africa Power Pool (EAPP) area (comprising of Burundi, DRC, Egypt, Ethiopia, Kenya, Libya, Rwanda, Sudan and Tanzania) is expected to increase by 69 percent over the next ten years. Developing under-exploited hydropower potential in the region, through appropriate regional transmission networks and regulation, will be key to meeting demand, as well as improving security of supply, enhancing environmental quality, and ensuring better economic efficiency.

**Distances from global markets hinder the movement of goods, people and services.** The EAC’s landlocked countries, which must move goods long distances over land, are particularly reliant on their neighbors’ capacity and willingness, to supply substantial externalities and public goods in form of goods transit policies, regulations, infrastructure, and institutional arrangements. Current divisions associated with the impermeability of borders, and differences and inefficiencies in institutions, regulations, and currencies, exact a major cost on intra-regional trade. For example, it costs US$ 5,000 to transport a container from Mombasa to Bujumbura by road; compared to US$ 1,000 it costs to transport the original container from Japan to Mombasa.

**Although the EAC business environment improved in 2010 and 2011, the five economies still lag behind globally, in implementing institutional reforms to improve competitiveness**. The region’s governments implemented ten regulatory reforms last year, to improve the business environment and encourage entrepreneurship in the region. Rwanda led the way by improving its global ‘doing business’ ranking from position 50 to 45 last year, mostly through improvements for businesses to obtain credit and pay taxes. However, Kenya dropped three places from 106 to 109; Uganda dropped four places, from 119 to 123; Tanzania dropped two places, from 125 to 127; and, Burundi improved eight places to a still dismal 169. As a result, the EAC region as a whole is still struggling in ‘doing business’ reforms.

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10 Uganda, Rwanda, Burundi – and, if successful in its bid to join the EAC, South Sudan.

Kenya imposes a large number, and wide variety, of rules and regulations on its imports, particularly from EAC partner states. Where rules and regulations are poorly designed or poorly implemented, they become NTBs. In the food sector, if Kenya were to reduce NTBs it would ease domestic food prices and help the poor. To date, there has been a slow removal of NTBs, and the monitoring committees for NTBs have been largely ineffective. A broad dissemination of the price-raising effect of rules and regulations is needed to inform the review of existing measures, as well as the design and implementation of new rules and regulations. Action is required at both national and regional levels, with effective monitoring, sanctions and appeal mechanisms being put in place.

6.1 Rules and regulations

Kenya imposes a large number of rules and regulations, compared to other African countries. The countries chosen were Kenya, Uganda, Namibia, Mauritius, Madagascar and Senegal. Kenya and Uganda impose significantly more rules and regulations on their regional imports, than do the other Sub-Saharan African countries (see figure 6.1). As mentioned previously, rules and regulations are often imposed for legitimate reasons, such as protecting domestic consumers from counterfeits and sub-standard products – which are often cited; however, such measures can be overly burdensome in design, or well designed, but poorly implemented, unnecessarily constraining the daily operations of EAC producers and traders. In addition, Kenya is the only country compared that imposes more rules and regulations on imports from its regional partners (red column) than on imports from the rest of the world (blue column).

Kenya and Uganda may be over-regulating their trade. The frequency\(^1\) and coverage\(^2\) ratios for five different categories of rules and regulations were compared across a selection of SSA countries (see figure 6.2)\(^3\). The categories of rules and regulations, were (i) sanitary and phytosanitary (SPS), (ii) technical barriers to trade (TBT), (iii) pre-shipment, (iv) price controls and (v) quantity controls. For Kenya and Uganda, the occurrence of pre-shipment measures, SPS measures (intended to protect humans, animals, and plants from diseases, pests, or contaminants) and TBT (which arise when standards, regulations, and assessments systems intended to ensure safety are not applied uniformly), significantly exceeded the levels of other examined African countries. This suggests that Kenya and Uganda may be over-regulating, irrespective of how well designed and implemented the rules and regulations are.

Rules and regulations affect a wide variety of sectors in Kenya. Most rules and regulations are imposed upon metals, machinery and food products (see figure 6.3). For food products, it is somehow expected, since agricultural products which include food and feed — and their control — is essential.

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\(^{1}\) The frequency ratio shows the percentage of import transactions covered by a selected group of rules and regulations for an exporting country. It accounts only for the presence or absence of an NTB, without indicating the value of imports covered.

\(^{2}\) The coverage ratio gives the percentage of trade subject to rules and regulations for an exporting country at a desired level of product aggregation. It allows weighting the frequency ratio with the value of imports for the affected tariff lines.

\(^{3}\) Annex 3 sets out the number of products covered by at least one rule or regulation.
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for ensuring health and well being of consumers, and protection of the environment. These rules and regulations are normally sanitary and phytosanitary (SPS) measures (which cover 75 percent of food products in Kenya). However, TBT measures – which result from poor application of rules and regulations – cover 60 percent of food products in Kenya (while usually the average for other countries is 20 percent). TBT measures are the most common rules and regulations in Kenya, with prevalence across a wide range of products (woods, paper, textile, footwear etc). Common types of TBTs include rules for product weight, size, and packaging, as well as mandatory labeling, shelf-life restrictions, and import testing.

6.2 Stabilizing food prices in Kenya

Despite Kenya being a food deficit country, rules and regulations are prevalent on food products, thereby deterring food imports, and raising the price of domestic foods. Kenya’s food sector is mostly affected by SPS, TBT, and inspection rules and regulations (see figure 6.3). SPS and TBT measures raise domestic prices by increasing production costs for domestic and foreign producers. Their price-raising effect is typically a by-product, rather than, the main objective of the measures, which have non-trade objectives, such as public health. Because SPS measures can be justified by non-trade objectives, assessing their impact requires a cost-benefit analysis. For example, when the price-raising effect of a SPS measure is strong, it must bring substantial benefits, in order to be justified. The statistically significant price-raising effects of SPS measures on food categories in both Kenya and Uganda\(^{15}\) is shown in figure 6.4. From this it is clear that the price of rice and bread in Kenya is 42 percent higher, and the price of fresh fruit and vegetables over 30 percent higher, than they would be otherwise\(^{16}\). As a result, Kenyan consumers are significantly losing out and domestic producers benefiting only to the extent of their limited production.

\(^{15}\) Annex 4 sets out in more detail the estimated price-raising effect of NTBs, by product, for Kenya and comparator countries.

\(^{16}\) The estimated “price gaps” refer to the difference between domestic prices and the sample average at the product level.
2011 will be remembered for the challenging economic times, when food and fuel prices soared not just in Africa but globally. The drought in the horn of Africa unmasked the region’s vulnerability to recurrent droughts. In Kenya, more than 3.7 million people were affected by the drought. The country also had an influx of refugees from neighboring Somalia, in Dadaab refugee camp, creating an additional burden to the country.

The food crisis put the spirit of EAC regional integration to the test. Tanzania is one of the countries in the region, which often produces more than its food requirements (see box 6.1). The EAC maize balance sheet was in fact positive in 2006-2008 (see figure 6.5).

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The food crisis put the spirit of EAC regional integration to the test. Tanzania is one of the countries in the region, which often produces more than its food requirements (see figure 6.5). In 2011, Tanzania produced 1.1 million tons of maize, more than its domestic requirements, while Kenya faced a food crisis. However, in July 2011 Tanzania placed an export ban on maize to the EAC region, and beyond. At this time 100,000 tons had been earmarked for export to the region.

The end result was a lose-lose. Prices in Tanzanian fell, so the farmers lost the producer prices they would have otherwise enjoyed. Prices peaked in other countries, so the consumers lost. Figure 6.6 shows the unfolding scenario between Kenya and Tanzania; in Kenya prices peaked to US$ 513 per ton, while in Tanzania prices dropped to US$ 284 per ton. The prices shown here are retail prices, so presumably producer prices for the Tanzanian farmers were much lower. It is not clear if the ban remains, or if it has been lifted.

Poorest households in Kenya are mostly affected by rules and regulations on food. The number of rules and regulations on food products rank a close third after those on metals and machinery. In Kenya, as with most countries, low income groups consume relatively more of food products, and are more vulnerable to inflation (see figure 6.7). The price-raising effect of rules and regulations can be seen on

**Box 6.1: Openness to regional trade can be a win-win……East Africa can feed itself**

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**Figure 6.4: Significant price-raising effect of SPS on food types in Kenya and Uganda**

**Figure 6.5: Food surplus and deficit countries in the EAC**

**Figure 6.6: Restricted trade resulted in a recent lose-lose for Tanzania producers and Kenyan consumers**

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Source: Cadot and Gourdon, World Bank 2012.

Source: World Bank computations based on data from RATIN.

different income groups (figure 6.8). For example, due to SPS measures, the poorest 20 percent of households in Kenya will experience on average a 23 percent rise in goods they purchase, compared to only a 14 percent rise in goods purchased for the 20 percent richest households. These findings demonstrate that the NTB agenda is not only extremely important for Kenya’s trade competitiveness, but also for poverty reduction (see box 6.2 on NTBs for maize in the EAC).

Certain rules and regulations have become NTBs in Kenya’s food sector. There are legitimate reasons for governments to introduce rules and regulations in order to protect consumers (such as food safety regulations), but where rules and regulations are unduly restrictive or poorly designed or implemented, NTBs result. The EAC NTB report\(^\text{17}\) identified NTBs for elimination, and those which relate to the region’s food sector and have not been eliminated,\(^\text{18}\) are set out in table 6.1. The NTBs range from non-recognition of SPS certificates by Kenya on Ugandan tea, administrative delays in maize clearance, cumbersome processes for food products, and other charges and bonds (see box 6.3 for a diary standards case study).

6.3 Institutional failures

The established reporting mechanisms and monitoring committees for NTBs have so far been ineffective. Raising awareness and improving transparency are necessary steps but it is becoming increasingly apparent that they are not sufficient, due to lack of progress in removing identified NTBs. Only 50 percent of the NTBs identified by EAC in 2008, and approximately 30 percent in 2011, were eliminated by partner states within the agreed timeframe (see annex 6-8 for details). In addition, in 2008 there were more NTBs in higher categories\(^\text{19}\) (requiring less than 6 months for removal), whereas in 2011 there were more NTBs in lower categories, especially in category D, where over one year is required to eliminate each NTB (see figure 6.9); reflecting possibly an increased political resistance to consider NTBs for more rapid removal. To date, the approach to eliminate NTBs has focused on establishing national monitoring committees and publicizing specific NTBs, but without sufficient attention being paid to the actual reduction efforts. The absence of a clearly defined monitoring mechanism with time limits for action, means that each partner state is responsible for

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\(^{17}\) EAC Secretariat, Draft EAC Timebound Programme for Elimination of Identified NTBs.

\(^{18}\) As at the time of publication of the EAC NTB report.

\(^{19}\) The EAC Secretariat has defined 4 categories of NTBs (categorized on the basis of ease of removal, and degree of trade distortion): Category A – To be addressed immediately; (ii) Category B – To be addressed in 1-6 months; (iii) Category C – To be addressed in 6-12 months; and (iv) Category D – To be addressed in >12 months. Annex 5 shows a line item analysis of each identified NTB, its period for elimination and whether or not it was eliminated on time.
<table>
<thead>
<tr>
<th>NTB summary description</th>
<th>Affected countries</th>
<th>Ministry, Department, or Agency responsible</th>
<th>Impact to businesses</th>
<th>Action required</th>
<th>Bottlenecks preventing action</th>
<th>Latest update from EAC Secretariat Time Bound Publication</th>
</tr>
</thead>
<tbody>
<tr>
<td>Charges on plant import permit (PIP) at Malaba on Ugandan tea destined for auction at Mombasa.</td>
<td>Uganda and Burundi.</td>
<td>Kenya Plant Health Services.</td>
<td>Adds to cost of doing business.</td>
<td>Abolish charges.</td>
<td>Resistance from issuing authority.</td>
<td>SP certificate required for tea destined for Mombasa auction. Other issues will be addressed once the EAC draft protocol on SPS is finalized. Timeframe pushed to December 2012.</td>
</tr>
<tr>
<td>Ugandan ban on beef &amp; beef products from Kenya.</td>
<td>Kenya.</td>
<td>Uganda Departments of Veterinary Services; Ministries of livestock development and Agriculture.</td>
<td>Ban on market entry and loss of potential markets.</td>
<td>Political goodwill to mutually recognize inspection procedures, inspection reports and certificates.</td>
<td>Pressure from businesses not to recognize products from within EAC due to fear of loss of markets.</td>
<td>Uganda to report when it will lift the ban.</td>
</tr>
<tr>
<td>Uganda’s certification procedures on exports of milk from Kenya.</td>
<td>Kenya.</td>
<td>Uganda dairy board.</td>
<td>Denial of market entry. Loss of potential market valued at USD 1 million for one Kenyan milk processor.</td>
<td>Political goodwill to mutually recognize inspection procedures, inspection reports and certificates.</td>
<td>Pressure from businesses not to recognize products from within EAC due to fear of loss of markets.</td>
<td>Uganda to report when it will lift the ban.</td>
</tr>
<tr>
<td>Requirement that to export herbal products to Tanzania one must either be a member of the Tanzania Herbalists Organization or declare the formulas used.</td>
<td>Uganda.</td>
<td>Tanzania Herbalists Organization.</td>
<td>Ban of products.</td>
<td>Abolition of the requirement.</td>
<td>Unknown.</td>
<td>Tanzania to report back.</td>
</tr>
<tr>
<td>NTB summary description</td>
<td>Affected countries</td>
<td>Ministry, Department, or Agency responsible</td>
<td>Impact to businesses</td>
<td>Action required</td>
<td>Bottlenecks preventing action</td>
<td>Latest update from EAC Secretariat Time Bound Publication</td>
</tr>
<tr>
<td>----------------------------------------------------------------------------------------</td>
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<td>---------------------------------------------</td>
<td>-------------------------------------------------------------------------------------</td>
<td>--------------------------------------</td>
<td>------------------------------</td>
<td>----------------------------------------------------------------</td>
</tr>
<tr>
<td>Cumbersome registration, testing and certification procedures for food products.</td>
<td>Kenya.</td>
<td>Tanzania Food and Drug Administration.</td>
<td>Delays in food trade.</td>
<td>Need to harmonize national export / import procedures under one body.</td>
<td>Insistence by TFDA to duplicate efforts of the Bureau of Standards.</td>
<td>Need to harmonize the procedures.</td>
</tr>
<tr>
<td>Konyagi has been refused entry into Kenya for not meeting international standards of alcohol content (37.5%) vs 35%.</td>
<td>Tanzania.</td>
<td>Kenya.</td>
<td>Increases cost of doing business.</td>
<td>Mutual recognition of standards to be adhered to.</td>
<td>Kenya must be willing to accept Konyagi standard.</td>
<td>Urge Kenya to comply with regional standards.</td>
</tr>
</tbody>
</table>

Special Focus: Deepening Kenya’s Integration in the East African Community (EAC)

voluntarily removing NTBs, without being subject to possible sanctions for non-compliance (R. Kirk, Defragmenting Africa, World Bank 2012).

With the high prevalence and price raising effects of rules and regulations, trade in food products in the EAC remains restricted. Kenya is a maize deficit country, yet interventions such as those by the National Cereals and Produce Board (NCPB) (see box 6.2) serve to discourage the development of intra-regional trade and do little to support job creation amongst smallholders, who have little interaction with the NCPB, and who buy most of their maize from large farms in the Rift Valley. Any reforms where the status-quo benefits a small group, and the costs are borne by many, are difficult. The challenge to activate a critical mass for consensus and reforms is often huge. Groups in danger of losing their privileges will be determined to prevent restructuring. Nevertheless, the potential gains to the economy and to producers and consumers of food, are substantial.

Export taxes impose costs and inhibit the development of regional chains and export diversification. A case in point is the illegal imposition of cess charges by county and local councils, on export products which affect the competitiveness of Kenya’s horticulture sector, by raising the costs of doing business. These authorities are governed by directives from the Ministry of Local Government, and efforts by the Ministry of Agriculture to prevent the practice, are not successful. In addition, levies, taxation, licenses and permits differ between local authorities, and can be revised without consultation with the business community. A producer who was interviewed, said that government bodies seem to look upon the export horticulture sector, as a cash-cow that is easily milked. Cess charges at road blocks can add up to KES. 40,000 per month for a single truck, with one grower estimating that his lorries spend a total of 45 hours each month at roadblocks, between Nairobi and Naivasha (World Bank discussions with traders, 2012). Such charges increase the cost of

Maize policy in Kenya is characterized by efforts to support and stabilize prices through the operations of the National Cereals and Produce Board (NCPB). In the 1980s, the NCPB played a major role in the domestic maize market, purchasing 600,000 to 800,000 tons annually. Since then, maize markets have been liberalized and private sector trade plays a much larger role. However, NCPB continues to purchase maize to defend a floor price. Since 2000, NCPB purchases have been 30,000 to 190,000 tons per year. NCPB operations are estimated to have increased domestic maize prices by 20 percent during 1995-2004. Its purchases had a large effect on prices, because they account for 25 to 5 percent of all maize sold by the agricultural sector in Kenya. Most of the maize purchased has been directly from large-scale farmers in the Rift Valley. To defend high maize prices, the government has limited maize imports. In mid-2001, a temporary ban was imposed on cross-border imports of maize, because of low prices associated with a good harvest. Another temporary ban was introduced in 2004, in response to an outbreak of aflatoxin poisoning argued to be caused by imports from Uganda. And recently Kenya prevented Tanzanian trucks carrying maize, from entering Kenya, forcing them to off-load and reload onto Kenyan trucks. The main beneficiaries from high maize prices within the country have been the farms, while the main losers have been the net buyers, i.e. urban consumers and maize purchasing rural households.

Kenyan goods, making farmers less competitive than they would normally be in the EAC market. Also, these charges are illegal, and only compound national efforts to remove NTBs agreed regionally.

**Standards need to be specific to the market.** The development of an appropriate standard may be desirable at a regional, rather than national level, in order to exploit economies of scale in regulatory expertise, prevent fragmentation of the market by differences in standards, and to limit the scope for regulatory capture. However, it is important to tailor those standards to the specific preferences and needs of regional actor, in order to avoid non-compliance or unnecessary implementation costs (see box 6.3).

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**Box 6.3: Case Study – Harmonized EAC dairy standards are a potential NTB**

Consistent with developed country norms, the newly developed EAC standards focus on pasteurization as the key to ensuring product safety. This technology is widespread in developed countries, but is difficult and expensive to apply in the context of smallholder dairying, which is the dominant form of production in East Africa. While smallholders in Africa can, and do supply perfectly good raw milk for pasteurization, the infrastructure and quality control systems needed for delivery of smallholder supplies to a processing plant, results in consumer prices that are four to five times higher than for raw milk traded through informal channels.

Moreover, consumers in East Africa have found an alternative to reducing health hazards not recognized in the EAC standards, which is to consume raw milk after boiling. This practice reduces the otherwise high bacteria levels found in East African milk, to safe levels, a point not recognized during the harmonization process, because the Codex standards were developed for Western countries, which consume pasteurized milk.

As a result of setting the regional standards too high, the EAC’s harmonized dairy standards have been difficult to implement, and provide little practical guidance for farmers, dairy traders, and large processors, on how to upgrade their operation. According to the letter of the law, more than 95 percent of the EAC’s milk supply is technically illegal because it does not comply with the new standards requirements, and could be stopped from regional trade at any time.

This case study is based on the experience of thirteen drivers who made fifteen trips along the Northern Corridor. Thirteen trips transported imports from the port of Mombasa, and two of the trips transported exports back to the port.

At the port of Mombasa and its licensed Container Freight Stations drivers can wait for more than 5 hours to load their trucks unless they pay ‘facilitation’ fees. The longest waiting duration along the entire corridor is at the port of Mombasa. If trucking companies are large enough, they may be able to build warehouses in Mombasa, to cut down on the loading duration and inefficiency. However, this response further entrenches the cartel structure of the trucking industry.

Queues can take between 1 to 2 hours at each weighbridge. There are 6 weighbridges in Kenya, and 3 in Uganda. It takes approximately 20 minutes to weigh a truck but the greatest challenge is the long queues before reaching the weighbridge. As a result, there is a clear incentive for truck drivers to pay bribes in order to skip the queues.

Travel costs are significantly affected by fuel costs. Fuel cost accounts for about 20 percent of the transport cost. In addition to the direct cost of fuel, trucks have to pay for the weight of the fuel on weighbridges. A Mombasa-Kigali journey requires 1,000 litres of fuel, which translates to 1 ton in weight. This takes the space of one ton of the payload and if the truck is overloaded there is a fine of US $115 and the truck is detained at the weighbridge.

Overloaded trucks damage the Kenyan roads. The Kenyan authorities impose a maximum axle load requirement to protect their roads; however, the limit has become a controversial issue in the EAC region. In practice, many overloaded trucks manage to avoid being caught at weighbridges with drivers paying a small price (e.g. 500skh) in individual bribes, compared to the significant cost to the Kenyan economy of the damaged roads.

Competition amongst industry players, and recklessness amongst some truck drivers, contributes to many road accidents. Some truck drivers rush to make deliveries so that they can return quickly for more business. Should an accident occur and the driver not be injured, a lot of time is spent waiting for the police to respond and, since the police lack the necessary equipment for moving damaged trucks, waiting for the truck company to send a towing vehicle.

Trucks have been prevented from carrying return cargo – which acts as a NTB – but rules are changing. Protectionist policies have prevented trucks from carrying return goods, even if it is within the EAC – leading to idle capacity, inefficiencies, increased levels of transit traffic and associated higher transport costs. However, late last year, KRA announced that this rule will be reversed, to permit cargo to be carried, but only if trucks are fitted with an electronic tracking system. The Kenyan Transport Association has raised concerns on whether or not the policy will be applied evenly amongst EAC partner states.

7. Growing and Diversifying Kenya’s Exports – Services Matter

Although Kenya’s export performance has improved over the last decade, imports have grown much faster. Kenya’s top exports consist of traditional agriculture (tea and coffee) and horticulture products, as well as manufacturing and services. Kenya’s services have experienced dynamic growth and the sector has further potential for expansion. However, regulatory barriers restrict services, particularly in the banking, professional and business sectors. Services trade liberalization and regulatory reform are needed to build compatibility, harmonize standards, recognize qualifications, and strengthen the business environment to enable Kenya to benefit fully from EAC integration.

7.1 Kenya’s promising service sector

Kenya’s exports can be classified into four categories. Traditional agricultural exports (tea, coffee), non-traditional agricultural exports (horticulture), manufacturing and services. While Kenya has historically depended upon tea for export earnings, manufacturing and services have grown in recent years. Dependent upon oil imports, Kenya’s manufacturing sector is vulnerable to trade shocks, and global competitiveness depends upon infrastructure investments and reducing NTBs, and the ability to modernize and strengthen the port of Mombasa as a coastal hub.

Kenya’s trade in services has experienced recent growth. In 2010, Kenya’s services exports as a percentage of GDP were higher than the ratios registered by countries at similar levels of development, implying that the country’s services exports are above the sample average conditional on the level of per capita income. This suggests that Kenya has a comparative advantage in the export of services. Services exports in Kenya increased from less than 8 percent in 2001-2003 to 11 percent of GDP in 2008-2010 (see figure 7.1), and registered a positive balance throughout the last decade (see figure 7.2).

Furthermore, Kenya has additional scope to develop its services sector, and the compound average growth rate (CGAR) for Kenya’s services exports in 2000-2008 was almost 15 percent, whereas for services imports it was 10.5 percent. The EAC region as a whole, has also performed strongly in service exports; Rwanda’s CGAR for services exports over the same period was 19.5 percent (albeit from a lower base), and for services imports was 14.6 percent; while Uganda’s CGAR for services exports was 17 percent and for services imports was almost 15 percent.

*Figure 7.1: Service exports have increased for all EAC countries, but particularly Kenya*

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20 Trade in services takes four different forms: (i) cross-border supply—similar to trade in goods—that involves services flows from one country to another such as banking services transmitted via email; (ii) consumption abroad that refers to situations where a consumer—a tourist or a student—moves to another country to obtain the service; (iii) commercial presence that implies that a service supplier of one country establishes a territorial presence, including through ownership or lease of premises, in another country to provide a service (for example, domestic subsidiaries of foreign insurance companies or hotel chains); and (iv) presence of natural persons that consists of persons of one country entering the territory of another country to supply a service (for example, doctors or teachers).
Kenya is in early stages of exporting higher value added services. Kenya’s revealed comparative advantage in services exports is in four sub-sectors: transportation, communication, financial and cultural services (see table 7.1). These figures suggest that consistent exports of other higher value added sectors such as business process outsourcing (BPO), information communication technology (ICT), and insurance services have yet to fully emerge. But anecdotal evidence suggests that Kenya has already started to take advantage of the growing opportunities, in these areas.

### Table 7.1: Kenya has a revealed comparative advantage in services shown in bold (2010)

<table>
<thead>
<tr>
<th>Services</th>
<th>RCA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial</td>
<td>0.82</td>
</tr>
<tr>
<td>Transportation</td>
<td>1.30</td>
</tr>
<tr>
<td>Travel</td>
<td>0.62</td>
</tr>
<tr>
<td>Communication</td>
<td>1.80</td>
</tr>
<tr>
<td>Insurance</td>
<td>1.02</td>
</tr>
<tr>
<td>Financial</td>
<td>2.09</td>
</tr>
<tr>
<td>ICT</td>
<td>0.02</td>
</tr>
<tr>
<td>Personal, cultural &amp; recreational</td>
<td>1.68</td>
</tr>
</tbody>
</table>


7.2 Unleashing Kenya’s services

**Financial services**

Kenya-based banks are leading regional integration in the EAC banking sector... About eleven multinational and Kenyan owned banks, use Kenya as a hub to expand their operations in the EAC region. There are four indigenous Kenyan banks with branches within the region. These banks include Kenya Commercial Bank (KCB), Equity Bank, Fina Bank, and Commercial Bank of Africa. These banks have a total of 63 branches outside Kenya (16 in Tanzania, 31 in Uganda and 16 in Rwanda). A 2009 World Bank survey revealed that 56 percent of the banks operating in the East African region are hubbed in Kenya. Most of the banks surveyed have yet to achieve full integration of their operations in the region, but partial integration has taken place in the areas of ICT, risk management, customer service, and treasury operations. Two-thirds of the banks state that regionalization has facilitated the introduction of financial products and services, which would not have been possible in the absence of scale.

...but differences in regulations limit their benefits from regional integration. The establishment of a single licensing regime, which would remove barriers to entry posed by separate capitalization requirements for each subsidiary, and enable cross-border branching, is favored by a majority of the banks as a measure which would promote deeper integration. Major impediments to attaining full integration cited by banks are: the lack of a common tax regime; resistance from bank supervisors (particularly in Tanzania and Uganda, who are averse to banks under their jurisdiction, being managed by Kenyan parents); differing regulatory requirements; restrictions on the mobility of labor; and, the existence of differing capital movement polices within the EAC.

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21 The index of revealed comparative advantage (RCA) initially introduced by Balassa (1965) can be used to assess the structure of a country’s exports. The RCA for a services sector is the country’s share of world exports of a service divided by its share of total world services exports. A value of the index greater than unity implies that a country is relatively specialized in the services sector and thus has a revealed comparative advantage in such exports compared with the world average.

22 The section, including policy recommendations, is based on Wagh, Lovegrove and Kasangaki, World Bank, Defragmenting Africa 2012.
**Distribution services**

Kenyan supermarkets began establishing foreign operations in the EAC in about 2002 and have since stepped up their efforts to penetrate the regional market. Currently, the three largest Kenyan supermarkets have a combined total of seven branches in Uganda, and two in Rwanda. The main market entry strategy employed by these supermarkets has been the acquisition of existing supermarket chains. In 2011, Tuskys acquired the Ugandan supermarket chains, Good Price and Half Price, and has now four stores in Uganda. The estimated Kenyan FDI in the East African supermarket segment amounts to about US$ 22 million (see table 7.2). Total Kenyan FDI outflow in distribution services is estimated to be around US$ 26 to 32 million, over the period 2002–2009. Expected investment in the EAC distribution services sector over the next five years is projected to be between US$ 30 to 50 million.

Kenya’s presence in the distribution sector of the East African economies has been made possible by extensive trade liberalization measures, adopted by the EAC, but regulatory barriers remain. Major drivers of investment in East Africa include the adoption of the EAC Common Market Protocol, and the harmonization of tax regimes, and customs import regulations. Although all East African countries have made progress in removing explicit restrictions to trade, the lack of regulation in critical areas, and onerous regulation affecting the entry and operation of firms, continue to pose serious problems to competition, and affect trade and investment in the distribution sector.

**Business services**

Kenya has several world class firms that already provide and export business services to the region, and beyond. A recent survey of over fifty Kenyan business services exporters undertaken by the World Bank reveals that the subsectors with greatest export turnover totals are insurance, accounting, non-banking financial, and BPO services. The substantive scope for trade in certain professional services, such as accounting is further confirmed by the heterogeneity of professional endowments across countries. Kenya has a relative abundance of professionals, whereas in Rwanda, there is a relative scarcity of professionals, suggesting a good potential for intra-regional trade, based on comparative advantage (see figure 7.3).

Kenyan firms are starting to export higher value business services. Despite the novelty of exporting business services, and in contrast with most developing countries that tend to export to formal retail trade facilities, with monthly sales reaching the US$ 700 million mark, and selling space reaching close to 40 million square feet, up from 15 million square feet today (Nakumat CBC, 2011).

### Table 7.2: Kenyan Supermarkets with EAC Presence

<table>
<thead>
<tr>
<th>Kenyan Supermarket</th>
<th>No. of Branches in EAC Countries</th>
<th>Estimated FDI Investment Flows* (US$ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nakumatt</td>
<td>2 Uganda, 2 Rwanda</td>
<td>8.25</td>
</tr>
<tr>
<td>Tuskys</td>
<td>4</td>
<td>11</td>
</tr>
<tr>
<td>Uchumi</td>
<td>1</td>
<td>2.75</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>7</td>
<td>22</td>
</tr>
</tbody>
</table>

*Source: World Bank (2011).*

With a population of approximately 140 million people, the East Africa region provides a vast retail market for formal retail traders, with important benefits for consumers and producers. According to Nakumatt Holdings Research, the current regional population has an opportunity to sustain at least 10 major retail stores in each town. In the next ten years, Nakumatt Holdings is forecasting that close to 25 million customers across the region will have access

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23 The section, including policy recommendations, is based on Dihel (2012), World Bank, Defragmenting Africa 2012.
24 Average investment required for establishing a supermarket in EAC is US$ 2.75 million. This figure was calculated using past investment spend of Kenyan supermarkets in EAC. Nakumatt invested about US$ 3 million for each of its Uganda branches, US$ 2.5 million of their Rwanda branch. Uchumi invested about US$ 2 million for its branch in Uganda, and are poised to spend US$ 2.5 million for their planned branch in Tanzania.
25 This section, including policy recommendations, is based on World Bank, Exporting Services 2012 and World Bank, Developing Professional Services in Africa, 2011.
26 Business services are generally provided on a private sector basis and require a high level of skills that are usually certified, and include accounting, architectural, engineering, legal, BPO, ICT, information communication technology enabled services (ITeS), and more.
basic business services (such as back office tasks, or low value offshoring), Kenyan firms are starting to export higher value offshoring services, such as product development, R&D, business ventures, and transformational sourcing (see box 7.1). There could be substantial gains for Kenya’s economy from expanding the number of these firms.

The recent success of Kenyan services exporters has occurred at both the regional and international levels. At the regional level, Kenyan firms are premium quality service providers, especially in countries which lack skilled professionals. Kenyan firms are perceived as superior, and offer better services compared to local counterparts, and at lower rates compared to international or developed countries’ providers. Kenyan firms have a competitive advantage in understanding target markets in the East Africa region, due to their knowledge of soft or cultural issues, such as the slow pace of conducting business or the insistence on face to face meetings. South African and developed countries’ service firms that do not possess such skills, have failed to penetrate the EAC market. At the international level, Kenyan firms are value service providers, able to provide quality services at lower costs, compared to providers from the foreign market.

But Kenyan exporters of business services are facing a variety of challenges. At the regional level, numerous barriers limit the mobility of professionals, and differences in regulation, further segment the markets for business services in East Africa. Skills mismatches and skills shortages, pose as a significant challenge to many Kenyan exporters. Another factor that constrains service providers from exporting, is a widespread lack of knowledge about exporting opportunities, markets, and processes, and a lack of awareness, on how to acquire such knowledge. Very often, Kenyan service providers - especially smaller ones - lack international networks, and find it very difficult to obtain market intelligence on foreign markets (see box 7.1). Finally, difficulties in penetrating foreign markets, also come from Kenya’s low international brand equity, as a business service provider.

**Box 7.1: Knowledge sharing for service sectors**

To assist with the implementation of MRAs, the World Bank Professional Services Knowledge Platform for Eastern and Southern Africa is being developed to provide:

- Information and analysis of the current situation regarding the performance of the particular sector, and its impact on other sectors, and the wider economy. This may require surveys of both users and providers of the service.
- An assessment of barriers to trade and foreign investment, and current regulatory policies in the form of a trade, and regulatory audit together with an assessment of their impact on entry and conduct in the market.
- A review of the necessary steps to remove explicit barriers to trade, and the regulatory options for an integrated services market, including measures that can be pursued at the national level, and those that are likely to be more effective in collaboration with partner countries, at the regional level.
- An assessment of capacity building that will be necessary for effective implementation, and monitoring of outcomes in the sector, and the impact of current regulation.

In pursuing these outputs, the platform aims to support a process that ensures regular consultation between private and public stakeholders; effective communication between the regulator, sector specialists, and government ministries; and extensive dissemination of information at national and regional levels, for increased awareness of policy issues.

*Source: World Bank.*
8. Policy Recommendations

**Non-Tariff Barriers at the National Level**

Establish a trade regulatory committee to review existing rules and regulations – removing those that cannot be justified – and inform the design and implementation of new rules. More specifically the trade regulatory committee should oversee the implementation of new rules and regulations which affect regional trade, and facilitate the inter-ministry coordination that is essential to address a wide range of non-tariff barriers.

Inform firms and individuals. An inclusive and transparent process for the design and implementation of rules and regulations is crucial for deeper regional integration. The political economy constraints and vested interests can make the removal of NTBs a challenging task, particularly when consumers lack sufficient information, and fail to organize themselves. The case studies show that it is important to consult with the private sector and other stakeholders, and develop a framework for providing information to them.

Introduce an appeal mechanism to allow affected stakeholders – both domestic and foreign – to contest decisions made by civil servants. There should be a channel to allow firms and individuals to dispute the decisions made by officials, in implementing regulations, especially for small producers, who do not have access to the mechanisms that are available to large firms, to influence decisions (World Bank, Defragmenting Africa, 2012).

Review capacity of government ministries and agencies to address the regulatory reforms. Assessing capacity gaps that undermine the effective and efficient implementation of new rules and regulations. There are clearly critical gaps in the standards and conformity assessment infrastructure, which need to be identified and prioritized. For example, are there sufficient officers at the border to apply SPS requirements? – A lack of staff can lead to long delays and spoilage.

**Non-Tariff Barriers at the Regional Level**

Disseminate the price-raising effect of rules and regulations. A significant number of SPS or TBT measures that are unnecessarily burdensome to trade are still in place in many EAC countries, including Kenya. It is important for the Government of Kenya to put in place procedures to ensure that SPS and TBT measures are designed and implemented, in the least trade-restrictive way, without compromising legitimate public policy objectives, and set an example for EAC partner states to follow.

Develop an effective monitoring mechanism with possible sanctions for non-compliance. The EAC Secretariat has already identified NTBs for removal, but implementation is not adequately taking place. The COMESA-EAC-SADC Tripartite online reporting and resolution system is showing signs of encouraging progress and good practice. The binding dispute settlement process of the WTO, and the experience of the EU in establishing a legally binding mechanism with sanctions for non-compliance, provide additional relevant models for the EAC to consider.

Consider the development of appropriate standards at a regional, rather than national, level. This would exploit economies of scale in regulatory expertise, prevent fragmentation of the market, by differences in standards, and limit the scope for regulatory capture. However, it would be important to tailor those standards to the specific preferences and needs of regional actors, in order to avoid non-compliance, or unnecessary implementation costs.
**Service Exports at the National Level**

Eliminate regulatory barriers that limit the development of service markets. Domestic regulations on the entry, and on the operations of services firms often undermine competition, and constrain the growth of strong services sectors in the EAC. Reforms should focus on eliminating such disproportionate entry requirements, or regulatory measures that limit competition. For example, in distribution services, lengthy registration procedures, multiple licenses, or inadequate zoning regulations, need to be addressed. Price controls imposed across the region, and the cartels in place in several East African countries, represent a serious impediment to competition and should be removed. Furthermore, rules and regulations which strengthen the business environment, have to be put in place. Inadequate codes on investment, commerce, labor, and taxation, as well as the lack of bankruptcy procedures, create significant uncertainty and burden for firms which are trying to conduct business operations, in the formal distribution sectors of East African countries.

Reduce costs of access to, and improve quality of, education. Encourage collaboration between universities, professional associations, and the private sector. Education-related reforms that address skills-shortages and skills-mismatches need to be encouraged. Solutions that equip students with market-relevant skills, and address the absence of institutions which offer specialized courses, need to be addressed.

Involve the Export Promotion Council. The EPC can collect and disseminate to Kenyan service firms market information, and highlight available opportunities. Most Kenyan service exporters feel that direct incentives to exports, such as tax incentives, are unnecessary. Rather, what they consider to be crucial is for the government to facilitate access to foreign markets. The Government of Kenya could, through its trade supporting institutions, and in collaboration with business and professional associations and the private sector, develop a services export strategy and play an important role in helping to reduce the barriers that Kenyan service firms face in their export development efforts.

**Service Exports at the Regional Level**

Remove remaining trade in services barriers. Examples of these barriers include restrictions on the free movement of labor, including visa and immigration laws and regulations, and labor policies preventing the mobility of professionals. The EAC Common Market Protocol has initiated the integration process in services in East Africa. All five EAC partner states have scheduled commitments in seven services sectors, and have adopted the annexes on removing restrictions, on the free movement of workers and on the right of establishment. But barriers affecting trade, investment and labor mobility remain in place.

Encourage regional education-related reforms to address skills-shortages and skills-mismatches. This could take the form of establishing regional education hubs, in order to address the fragmented market.

Align regulatory and supervisory frameworks and reporting requirements in financial services. Banks surveyed cite single licensing as an important aid to further integration. Adopting single-licensing will have to be accompanied by mutual recognition among regulators, and this will require that national regulators converge around some broadly defined international principles\(^2\). It is also important to build-up regionally compatible financial infrastructure. Kenya, Tanzania and Uganda have already made substantial progress in integrating their real time gross settlement systems. Rwanda and Burundi also need to align their payments systems with the regional system. Deepening links between financial institutions warrants a similar deepening of cooperation between supervisors. Home-host supervisory communication, and consolidated supervisions are important, to ensure that weaknesses in one financial institution/market, do not put the regional financial system at risk.

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\(^2\) For example, the Basel core principles for bank supervision developed by the Basel Committee on Banking Supervision, which is an international committee of banking supervisory authorities established in 1974, the International Organization of Securities Commissions (IOSCO) and others.
Recognize professional qualifications in professional services. The free movement of EAC professionals across the borders needs to be complemented by the recognition of their qualifications. The implementation of full-fledged mutual recognition agreements that cover areas such as education, examinations, experience, conduct and ethics, professional development and re-certification, scope of practice, and local knowledge, would likely benefit Kenyan service firms (as well as firms in neighboring countries), in their exports of services to the region. The five EAC partner states have taken the first steps towards mutual recognition in professional service, in the context of the EAC Common Market negotiations – they have already signed MRAs in accounting and architectural services, and additional MRAs are expected to follow in engineering and other sectors.