Policy Brief

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TOWARDS THE COMPREHENSIVE REVIEW OF THE EAC CET:

A Perspective of Kenya's Private Sector

Key Recommendations

1. **Enhancing Kenya's trade performance in EAC:**

   Timely resolution of NTBs with high impact on Kenya's trade performance in the EAC

2. **Enhancing EAC's external trade performance:**

   Support implementation of EAC export development and promotion strategies and national and EAC Industrial Development Strategies.

3. **CET Review:**

   CET review should take into account domestic production value chains and should be aligned with Kenya's industrial and agricultural policies.

4. **Treatment of different goods in the CET bundles:**

   Ensure the CET structure is supportive of Kenya's industrialization goals and the needs of local manufacturers along the whole value chain.

Introduction

Successful regional trade co-operation arrangements – customs unions, free trade areas, special economic zones, and transport and trade corridors – contribute to the economic and social development of the countries involved. Fully cognizant of the advantages and potential gains from regional cooperation and integration, the EAC is implementing a comprehensive regional integration programme comprising of a Customs Union (2005), Common Market (2010), Monetary Union (2012) and Political Federation.

The Customs Union is the first transitional stage of integration and is an entry point for deeper economic integration. It provides for the elimination of customs duties on intra EAC imports, the removal of non-tariff barriers to trade and the establishment of a common external tariff (CET) on goods imported into the partner states from foreign countries (EAC CU Protocol 2(4)).

The EAC integration efforts are guided by its mission and vision statements which are enshrined in the Treaty and policy documents. While the EAC mission is to widen and deepen economic, political, social and cultural integration in order to improve the quality of life of the people of East Africa through increased competitiveness, value added production, enhanced trade and investment, under the brand "One People, One Destiny", it's vision is to attain a prosperous, competitive, secure and politically united East Africa.

The Government of Kenya has successfully, pushed ahead on the implementation of EAC integration policies.

EAC AND KENYA'S TRADE PERFORMANCE

		2011	2012	2013	2014	2015	Percentage Change			
							2012	2013	2014	2015
Imports	Uganda	692.6	646.9	616.6	684.6	630.2	-6.6	-4.7	11.0	-8.0
	Tanzania	378.1	678.6	397.0	709.8	278.6	79.5	-41.5	78.8	-60.7
	Kenya	302.9	364.3	334.5	416.9	407.8	20.3	-8.2	24.6	-2.2
	Burundi	160.8	168.1	346.4	126.1	151.1	5.3	6.3	6.3	7.3
	Rwanda	385.1	457.8	412.5	465.1	473.8	18.9	-9.9	12.7	1.9
	Total	**1,919.5**	**2,315.7**	**2,107.0**	**2,402.5**	**1,941.4**	**20.6**	**-9.0**	**14.0**	**-19.2**
Exports	Uganda	503.7	580.3	627.4	642.2	771.6	15.2	8.1	2.4	20.1
	Tanzania	409.0	613.3	1,118.0	779.5	924.8	49.9	82.3	-30.3	18.6
	Kenya	1,544.4	1,593.0	1,451.0	1,430.8	1,285.9	3.2	-8.9	-1.4	-10.1
	Burundi	25.9	24.9	35.19	25.45	27.04	-3.7	41.3	-27.7	6.2
	Rwanda	81.2	343.5	467.0	352.4	118.9	323.2	36.0	-24.5	-66.3
	Total	**2,564.1**	**3,155.0**	**3,698.6**	**3,230.4**	**3,128.3**	**23.0**	**17.2**	**-12.7**	**-3.2**
Total EAC Trade value	Uganda	1,196.4	1,227.2	1,244.0	1,326.9	1,401.8	2.6	1.4	6.7	5.6
	Tanzania	787.1	1,291.9	1,515.0	1,489.3	1,203.4	64.1	17.3	-1.7	-19.2
	Kenya	1,847.2	1,957.3	1,785.5	1,847.7	1,693.7	6.0	-8.8	3.5	-8.3
	Burundi	186.7	193.0	381.6	151.5	178.1	3.4	97.7	-60.3	17.6
	Rwanda	466.2	801.3	879.5	817.5	592.7	71.9	9.8	-7.0	-27.5
	Total	**4,483.6**	**5,470.7**	**5,805.6**	**5,632.9**	**5,069.7**	**22.0**	**6.1**	**-3.0**	**-10.0**

Source: EAC Trade report 2015

According to the EAC trade database, the implementation of the Customs Union facilitated remarkable trade expansion with overall intra-EAC trade expanding from US$4,483.64 million in 2011 to US$5,069.7 million in 2015, representing a 13 per cent growth. However, after a substantial growth by 22 per cent in 2012 (US$5,470.7 million) over the 2011 value, intra-EAC trade growth decelerated to 6.1 per cent in 2013, and decreased in absolute terms from the peak of US$5,805.6 million in 2013 to US$5,632.9 million (-3%) in 2014 and US$5,069.7 million in 2015. Intra-EAC exports amounted to 19.6.per cent of total exports. The composition of intra-EAC trade was mainly dominated by agricultural commodities namely; coffee, tea, tobacco, cotton, rice, maize, and wheat flour and manufactured goods such as, cement, petroleum products, textiles, sugar, confectionery, beer, salt, vegetable fats and oils, iron and steel, paper, plastics, and pharmaceutical products as in previous years.

The bulk of EAC exports were destined to the European Union (US$2,401.64 million in 2015), COMESA (US$2,334.49 million) and SADC (US$1,495.7 million) (See Annex I). During 2015, total EAC imports fell by a modest 2.5 per cent to US$39,371.71 million in 2015 from US$40,376.59 million in 2011. Overall, the region registered a trade deficit with the rest of the world. In 2015, the trade deficit for the EAC grew by 11.3 per cent to US$23,380.4 million up from a deficit of US$21,002.3 billion in 2013. Most of the exports to the rest of the world constituted primary commodities and mineral ores.

Kenya with an annual average of US$1,826.3 million during 2011-2015 accounted for the largest share (35 per cent) of intra-EAC trade but in terms of annual growth Kenya recorded an average negative growth rate (-1.9 per cent per annum) during 2011-2015.

The decline in Kenya's exports to the regional market can be attributed to several factors including market access impediments resulting from trade facilitation challenges and the resurgence of Non-Tariff Barriers (NTBs) to trade. Over the period between March 2012 and June 2016, Kenya was affected by the highest number of NTBs imposed by other EAC Partner States, followed by Uganda and Rwanda.

The EAC is implementing comprehensive programmes for elimination of NTBs including the EAC Time Bound Programme for elimination of identified NTBs, and passed an EAC NTBs Act which is presently undergoing assent by the Heads of State. Kenya and Uganda have already assented.

To eliminate trade facilitation-related NTBs there is urgent need for the comprehensive implementation of the National and Regional Action Plans on the WTO-Trade Facilitation Agreement (TFA).

Under the WTO TFA signatory Member Countries undertake commitments that promote 'best practice' trade facilitation rules and procedures which when fully implemented would reinforce the EAC's efforts to reduce trade costs and therefore trade more efficiently and enhance the price-competitiveness of it exports in the global markets.

The OECD (2014) estimates that full implementation of the WTO TFA has the potential to reduce trade costs by 14.1 per cent for low income countries, 15.1 per cent for lower middle income countries and 12.9 per cent for upper middle income countries

The Importance of CET in EAC Regional Integration

By adopting a Common External Tariff (CET), the EAC Partner States apply substantially the same duties and other regulations of commerce to imports coming from non EAC countries.

The EAC currently has a three band CET tariff comprising of 0 per cent (raw materials and capital goods), 10 per cent (intermediate goods) and 25 per cent (finished products). Presently, 37 per cent of the tariff lines in the EAC CET are duty free, 21 per cent have a 10 per cent duty and 41 per cent have a duty rate of 25 per cent.

The EAC CET also contains a number of exceptions in the form of sensitive products list which have CET rates set above 25% (EACCU Protocol Annex I).

The benefits that arise from the implementation of a CET would include:

- ☑ Larger domestic market within the EAC
- ☑ Increased intra-regional trade
- ☑ Transparency in the process of international trade
- ☑ Creation of competitiveness and foreign direct investment

The disadvantages include; loss of national trade policy space for each Member State, low level tariffs which can lead to dumping and negative effect on revenue for government for partner states that generally had higher customs tariffs than the corresponding CET rates.

KENYA'S EXPERIENCE IN THE IMPLEMENTATION OF THE CET

Stays of application/exemption regime

The EAC has undertaken periodic reviews of the CET after the coming into force of the Customs Union. The first review was carried out in 2010 and a second comprehensive review is ongoing. The ongoing CET review aims to address: inconsistencies in the CET; alignment of CET to tariff rates that reflect the dynamics including regional shortages of raw material and intermediate products; address the "stay of application of CET"; review the criteria for classifying goods; and overhauling the Duty Remission Scheme and exemptions regime.

The EAC CU allows for Member States to request exemptions ('temporary stays of application of the CET') which entail application of temporary new CET upon request, to the EAC Council of Ministers, by a Partner State. The merit of exclusions and exemptions is that they allow accommodating domestic political and economic interests which otherwise could have worked against or even prevented the pursuit of EAC integration. However, the stays of application reduce the coherence and integrity of integration and further complicate its implementation.

The repeated requests by the EAC Partner States for stays of application of the CET, suggest that the high tariff protection has not successfully fostered regional industries. Since 2009, Kenya has annually requested for stays of application on either rice, wheat or both. This list was extended in 2015 and 2016 to include other products. See Table 1.

Table 1: Products where stay of Application have been granted to Kenya

Year	Legal Notice No.	Description of Goods
2009	EAC/7/2009	Wheat and Rice
2010	EAC/11/2010	Rice
2011	EAC/30/2011	Rice
2012	EAC/28/2012 EAC/30/2012	Wheat
2013	EAC/37/2013	Rice and Wheat
2014	EAC/21/2014	Rice
2015	EAC/31/2015	Rice, Paper and Paperboard products, other electronic intergrated circuit, bars,rods, sections,angles,shapes, made up fishing nets, Other bars and rods of iron and steel, Towers and latice masts, Screws and bolts,whetehr or not with their nuts or washers, Aluminium alloys in sheets, Aluminium milk cans, Smart cards, Other flat rolled products of iron or non alloy steel, Bridge and bridge sections, Equipments for scaffolding, shuttering, proping or pit proping, Containers for compressed or liquified gases, of iron or steel, Other, of free cutting steel, Other, bars and rods, Oil or petrol filters for internal combustion engines, Intake air filters for internal combustion engines, Other prefabricated building.
2016	EAC/32/2016	Worn clothing and other worn articles, Revenue Stamps, Rice, Paper and Paperboard products, Bridges and Bridge Sections Other structures of Iron and Steel, Containers for compressed liquefied & compressed gases (LPG), Nuts and Screws

Source: Customs committee reports.

Due to the need to address the distortions created on the EAC tariff regime through the stays of application, the EAC Sectoral Council meeting of June 2014 adopted a roadmap for the removal of stays of application. In addition, the SCTIFI of June 2015 also directed that the comprehensive review of the EAC CET should come into effect from 1st July 2017.

Efficacy of the sensitive listing (treatment of different goods in the CET bundles i.e. the case of palm oil).

Partner States designated 64 products as "sensitive" products and these are contained in Schedule 2 of Annex I of the Customs Union Protocol. Sensitive products are those that Partner States perceive to have the potential to be sufficiently regionally produced. The EAC sensitive products tariffs range from 35%-100% (WTO, 2013:15 Paragraph 74). Partner States have periodically submitted requests to waive the application of these higher rates in order to be able to import sensitive products when regional supply has not been able to fulfil demand.

Among the sensitive products are agriculture and agro-processing products such as, dairy products (HS04.01 and HS04.02), wheat and meslin (HS10.01), maize (HS10.05), wheat or meslin flour, maize flour (HS11.02), cane or beet sugar and chemically pure sucrose of heading 17.01 and tobacco products of headings 24.02 (e.g. cigarettes) and 24.03 (e.g. smoking tobacco). The non-agriculture products include cement, matches, textiles, crown corks, primary cells and batteries.

The Case of Palm Oil:

Palm oil is an important raw material that is used in the manufacture of various food and non-food products in Kenya. For instance, it is used in the manufacture of margarine, frying fat, soap, candles, cosmetic or toilet preparations, among others. The CET distinguishes palm oil, derived from the pulp of the fruits of the oil palm (heading 15:11) and palm kennel oil derived from the kennel of the nut (heading 15:13).

Both palm oil and palm kennel oil are currently not designated as sensitive products and the following tariff rates apply as follows: (i) Palm oil: crude oil-0 %, palm olein, fractions -10 per cent, Palm stearin, fractions- 10 per cent Palm stearin, RBD-10 per cent, Palm olein, RBD-25 per cent and refined palm oil-25 per cent. (ii) Palm kennel oil: crude oil-0 % and refined- 25 per cent.

A recent study undertaken by the EAC (October/November 2016) on edible oil manufacturing in Kenya, Uganda and Tanzania showed that refined palm oil constitutes the greatest percentage of edible oils manufactured in the region and its price is cheaper compared to other oils, such as sunflower, corn oil and soya bean oil. The crude palm oil used in manufacture is either locally sourced or imported from Malaysia and Indonesia because local supply cannot meet demand. The study also noted that Tanzania had been granted to stay application of the CET and apply a 10 per cent duty rate on crude palm oil and this made the final products expensive in the local market compared to the same products sourced from Kenya and Uganda which were benefitting from the 0% CET tariff on crude palm oil.

CONCLUSION

Implementation of the EAC Customs Union Protocol has created opportunities for Kenya's trade expansion into the regional market. The private sector actors are a key driver of effective implementation and deeper economic integration within the EAC region. In particular, the Kenyan private sector's regional expansion in the finance, telecommunications, and retail sectors is contributing to a stronger and better-connected regional economy.

As a result, the Kenyan private sector has been advantaged in the EAC integration arrangement since its firms are well positioned to export to the region. However, Kenya's trade performance has been on the decline due to a multiplicity of factors. The implementation of a systemic strategy to address trade distortions and market access impediments is an urgent imperative in order to reverse Kenya's declining trade performance since 2013.

Key Policy Recommendations:

1. **Enhancing Kenya's trade performance in EAC:**

   Conduct an elaborate assessment on impact of various unresolved NTBs on Kenya's trade performance in the EAC; prioritize the urgent resolution of outstanding NTBs in the EAC Time bound Programme on Elimination of NTBs, undertake private sector training on implementation of the SMS-based NTBs Reporting System; Undertake specialized Non-Tariff Measures training on classification and uploading of NTMs to enhance transparency on applicable national regulations, consider policy option of resorting to the dispute resolution mechanisms in order to obtain speedy resolutions to long lasting NTBs, support the enactment and implementation of the NTBs Act, support the national and regional implementation of the WTO-Trade Facilitation Agreement and full implementation of the Single Customs Territory by removal of all impediments to free flow of goods and services and support policy measures for improving the cost of doing business and the investment climate and Undertake sensitization and awareness campaigns on a sustainable basis on trade and investment opportunities available through regional and bilateral agreements.

2. Enhancing EAC's external trade performance:

Implement EAC export development and promotion strategies, enhance value addition for EAC export products through implementation of national and EAC Industrial Development Strategies which target several priority value chains (agricultural, pharmaceuticals and mineral products), improve the policy framework for investment through application of the EAC Model Investment Framework, support implementation of signed Agreements including the Tripartite FTA, conclude the ongoing trade negotiations with the key trade partners e.g. EAC-US, improve the cost of doing business and implement the national and regional Action Plans on implementation of the WTO-TFA.

3. CET Review:

Ensure that the Common External Tariff review takes into account the domestic production value chains particularly in textiles, iron, steel and juice and that the revised CET is aligned with Kenya's industrial and agricultural policies and goals. Support the need for making a case during the process of the CET review whether the products frequently subjected to stay of application should continue being protected under the sensitive product's list. This is due to the fact that Kenya has frequently applied for stay of application on the products on table 1 above.

4. Treatment of different goods in the CET bundles:

Advocate for and ensure that the method of classification of products into various tariff bands and categories is supportive of the needs of local industry and consumers. Additionally, support the development of a common duty remission scheme that should be applied by all Partner States so as to level the playing field, instead of the current scheme where each Partner State applies and is granted duty remission for its manufacturers.

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