Report No. 40978-AFR

Options for Strengthening East African Community's Trade Integration

September 24, 2007

PREM 2
AFRCI
Africa Region

Document of the World Bank and East African Community

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CURRENCY EQUIVALENTS
(September 24, 2007)

US$1.00	=	1108.15 Burundi Francs
US$1.00	=	66.89 Kenya Shillings
US$1.00	=	546.87 Rwanda Francs
US$1.00	=	1231.50 Tanzania Shillings
US$1.00	=	1747.50 Ugandan Shillings

FISCAL YEAR

Burundi, Rwanda:	January 1—December 31
Kenya, Tanzania, Uganda:	July 1—June 30

WEIGHTS AND MEASURES
Metric System

ABBREVIATIONS AND ACRONYMS

ACP	African, Caribbean, and Pacific Group of States
AGOA	Africa Growth and Opportunity Act
BLNS	Botswana, Lesotho, Namibia, Swaziland
CET	Common External Tariff
COMESA	Common Market for Eastern and Southern Africa
CU	Customs Union
EABC	Eastern Africa Business Council
EAC	East African Community
EBA	Everything-But-Arms
EPA	Economic Partnership Agreement
ESA	Eastern and Southern Africa Group
EU	European Community
FTA	Free Trade Area
GSP	Generalized System of Preferences
IGAD	Inter-Governmental Authority for Development
MAT	Mozambique, Angola, Tanzania
MFN	Most Favored Nation
NTB	Non Tariff Barrier
PSRO	Product Specific Rules of Origin
REC	Regional Economic Communities
ROO	Rules of Origin
SACU	South African Customs Union
SADC	South African Development Community
T&C	Textiles and Clothing
TDCA	Trade, Development and Cooperation Agreement
S&DT	Special and Differential Treatment

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ACKNOWLEDGEMENTS

This report was prepared by a team led by Sumana Dhar (AFTP2) and comprising Fahrettin Yagci and Manuel de la Rocha. The work was initiated under Christiane Kraus (now WTO). The report provides the EAC Secretariat with options for strengthening EAC trade integration through (i) consolidating the CU; (ii) developing a common trade policy; and (iii) rationalizing overlapping commitments.

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OVERVIEW

1. The Treaty for the Establishment of the East African Community (EAC) was signed in November 1999 by Kenya, Tanzania, and Uganda.[1] The Treaty, which entered into force in June 2000, aims a comprehensive integration process comprising of trade, economic, and political integration. The ultimate objective is to establish a Political Federation in 2015 through a progression of trading and economic arrangements (customs union, common market, and monetary union) as well as a host of joint projects to develop regional infrastructure, manage regional commons, and produce regional public goods. Given the small size and the low income level of the member countries, aiming for a comprehensive integration is the right strategy, which will enable them to pull their resources together, broaden their markets, harmonize their policies, and enhance their competitiveness collectively to be able to expand their productive capacity and regional and global trade to accelerate growth. Burundi and Rwanda were accepted as new members of the EAC in November 2006. Their membership is expected to be effective in the second half of 2007.

2. The EAC is one of the regional economic communities (REC) in Africa, who has a great potential for establishing an effective deep integration and cooperation because the member states have a common history, small size, and similar resource endowment and trade interests. A successful EAC integration would also have important demonstration effect on other RECs in Africa.

3. Compared to other RECs in Africa, the EAC has progressed relatively fast in regional integration with close cooperation with the private sector. After extensive negotiations, a process of creating a free trade area (FTA) and a customs union (CU) between Kenya, Tanzania and Uganda was begun in January 2005, and discussions are now starting to establish a common market by 2010. Discussions are also under way with a view to fast tracking the establishment of a Political Federation, the final stage of the integration process. Meanwhile, the member states are negotiating an Economic Partnership Agreements (EPA) with the EU which will replace the non-reciprocal Cotonou Agreement and provide the legal framework for the trade between the EU and the EAC – and other African, Caribbean, and Pacific (ACP) countries. The EAC members also participate in COMESA and SADC FTAs who aim to pursue an integration strategy in part similar to the EAC's (Table 1). In addition, they are members of other schemes such as the Inter-Governmental Authority for Development (IGAD) or the Great Lakes Initiative, which aim to enhance cooperation and harmonization of regulations among the member states. However, none of these initiatives is comparable to the EAC in terms of scope, legal status, ambition of the objectives, and political commitment.

[1] The previous East African Cooperation dated from the colonial times and collapsed in 1977.

Table 1: Membership in Regional Agreements and Key Dates of Integration Initiatives

	COMESA	SADC	EAC	ESA EPA	SADC EPA
			Membership		
Angola		x			x
Botswana		xx			x
Burundi	xx		x	x	
Comoros	xx			x	
Congo, DR	x	x		x	
Djibouti	xx			x	
Egypt	xx				
Eritrea	x			x	
Ethiopia	x			x	
Kenya	xx		xx	x	
Lesotho		xx			x
Libya	xx				
Madagascar	xx	xx		x	
Malawi	xx	xx		x	
Mauritius	xx	xx		x	
Mozambique		xx			x
Namibia		xx			x
Rwanda	xx		x	x	
Seychelles	x			x	
South Africa		xx			x
Sudan	xx			x	
Swaziland	x	xx			x
Tanzania		xx	xx		x
Uganda	x		xx	x	
Zambia	xx	xx		x	
Zimbabwe	xx	xx			
Total	19	14	5	15	8

x indicates membership; xx indicates participation in FTA

		Key Dates of Regional Integration Initiatives			
Free Trade Area	2000	2008	2005		
Adoption of CET	2008	2010	2005		
Common Market	2014	2015	2009		
Monetary Union		2016	2010		
Economic Union	2025				
Federation			2015		

4. EAC is trying to deal with this enormous agenda as best as it can with limited institutional capacity and financial resources both at the regional and country level. This report forms part of technical assistance to the EAC Secretariat to help clarify the challenges ahead to achieve deeper integration and assist them in setting policy priorities, particularly in the area of trade. In particular, it aims to provide options for strengthening EAC's trade integration through (i) consolidating the CU; (ii) developing a common trade policy; and (iii) streamlining overlapping commitments. EAC's internal border posts which are maintained at a high enforcement cost, among other things, the rules of origin (ROO) and non-tariff barriers (NTB), prevent free circulation of goods in the common customs area. The report suggests measures

how to phase out ROO and NTBs, substantially reducing the role of internal border posts. A common trade policy necessitates all member states participate in the same EPA and other trade arrangements. Therefore, the report also provides recommendations about the EAC's priorities in EPA negotiations and streamlining of member states' overlapping trade arrangements.

5. The emphasis is on trade integration.[2] Some important related issues such as harmonizing behind the border policies and liberalizing trade in services are only marginally covered for the sake of comprehensiveness. In these cases, the issues are highlighted, appropriate references to the existing studies given, and further work and activities suggested for a full coverage of these issues. Other important issues such as cooperation in building shared infrastructure, creating supranational institutions to manage the CU and the common market, setting up investment – friendly institutions, etc. are left out because they fall outside of the scope of this study.

REPORT'S MAIN RECOMMENDATIONS

6. The report suggests a list of core priority areas and recommends broad direction of reforms. Its analysis and recommendations would serve as a useful contribution to the ongoing negotiations among the member states for an EAC Common Market as well as to efforts to harmonize programs between COMESA, SADC, and EAC.

7. The high priority areas that the EAC needs to focus on in the next 12-18 months are the following:

- **Conclude EPA Negotiations:** EPA negotiations are the single most urgent trade issue the EAC needs to address in the next few months. The technical discussion in the report suggests that it is advisable for the EAC member states to negotiate an EPA together either as the EAC group or as a part of the Eastern and Southern Africa (ESA) Group. An EPA signed by all EAC member states would present an excellent opportunity for the EAC to start establishing a common trade policy, a key requirement for consolidating the CU. In addition, it is not clear whether Tanzania's trade interests could be best protected in the SADC EPA group which now includes South Africa as a member of the SADC EPA. The report also suggests that, in EPA negotiations, the EAC should focus on the following key areas in order to make the best of an EPA: (i) Concentrate on market access in three main sectors where EU preferences matter – agriculture, textiles and clothing (T&C), and fisheries. Duty-free and quota-free access already obtained, greater access to the EU market in these sectors will be determined by relaxing stringent ROO and strengthening member states' capacity to meet EU's sanitary and product standards; (ii) Push for centrality of the aid for trade in the EPA and prepare costed detailed projects for aid for trade in areas such as trade facilitation, improving sanitary and phytosanitary standards (SPS), etc; (iii) Include services in negotiations with a view to encourage domestic reforms, harmonize policies within the EAC, gain access in the EU market, and increase the availability to businesses and consumers of cheaper and higher quality services, and (iv) Avoid a long list of sensitive products and a long implementation period.

[2] See Booth et al (2007) for a discussion of political economy and institutional aspects of the EAC integration in a historical context.

- **Improve and Harmonize the Business Environment in the EAC Zone:** Deep integration is not an end in itself. Its objective is to increase investment and growth through broadening the domestic market, taking advantage of scale economies, and improving competitiveness. Unless the business environment is substantially improved in the common customs area, investment and growth cannot be stimulated even if all elements of deeper integration are in place (The Doing Business Index developed by the World Bank ranks the EAC members among the bottom 50 percent of business-friendly countries in the world). It is essential therefore for the EAC to develop (with assistance from International Financial Institutions) a program to reduce the cost of doing business in the EAC zone and make it an investment friendly destination to encourage foreign and domestic investment in export-oriented sectors.

- **Liberalize Services Trade:** Services are critically important in every economy because they make a large direct contribution to national income (43 percent in the EAC in 2005 and rising) and a powerful indirect contribution through their impact on the competitiveness and performance of other sectors of the economy. Therefore, improving the quality and reducing the cost of the backbone services (transport, finance, and communications, in particular) and widening access to them are essential to improve competitiveness of the member states' economies. Services sector could also play an important role in export growth and diversification particularly in tourism and temporary migration of workers. A diagnostic exercise should be launched as quickly as possible to take stock of services policies and performance in the member states, identify policy constraints and inadequacies, and recommend remedial actions that can be undertaken individually by the member states or collectively as the EAC.

- **Eliminate the Remaining NTBs:** Intra-EAC trade is still hampered by a large number of NTBs. Removal of these barriers is therefore necessary to establish a full EAC FTA. The EAC Secretariat and the Eastern African Business Council (EABC) have jointly developed a mechanism to identify, report, and monitor elimination of all NTBs. The EAC-EABC study also proposed a monitoring system at the country and regional level for elimination of the NTBs. Financial resources are urgently needed to operationalize the findings of this study.

8. Other areas of priority that need to be addressed in the longer-term include the following:

- **Explore an EAC Regional Fund.** Addressing economic imbalances among the member states and ensuring equitable distribution of benefits are important objectives of the EAC integration. But a satisfactory mechanism is yet to be put in place to realize these objectives. The EU has been addressing the issue of large gaps in economic conditions among regions with various regional or structural funds and other redistribution mechanisms to establish equity among the members and ensure economic convergence. A similar regional policy may be explored for the EAC to help alleviate the current regional imbalances and encourage more equitable development among members. One option to achieve this objective is to create an EAC Regional Fund in collaboration with the donor community (a good candidate for aid for trade, particularly from the EU), and use it to assist the poorer regions to ensure economic convergence within the EAC.

- **Reduce the role of EAC's Internal Border Posts and Develop a Common EAC Trade Policy – Two Key Requirements for Consolidation of the EAC CU.** It is recommended that (a) arrangements be made for the member states to collect their import revenues at the point of entry to the common customs area rather than at the internal border posts; (b) the member states phase out their bilateral FTAs with COMESA and SADC; and (c) the EAC signs FTAs with COMESA and SADC to maintain the benefits of earlier arrangements by the member states. These three measures will make the implementation of ROO in the EAC common customs area unnecessary. This, in turn, will reduce the role of internal border posts significantly resulting in substantial cost saving and ensuring freer circulation of goods in the EAC zone. Note that (b) and (c) above and an EPA signed by all member states would be essential components of a common EAC trade policy.

- **Coordinate Programs among RECs.** The COMESA-SADC-EAC Tripartite Task Force was set up to harmonize their programs and remove policy inconsistencies arising from overlapping commitments. It agreed to harmonize their activities in the nine broad areas without prioritization. This is a very useful initiative and deserves strong support from the donor community. However, to have tangible results from these efforts, priorities need to be set and resources allocated to harmonize programs in the priority areas. Setting up one-stop border posts and harmonizing and improving cargo transit regulations would be two areas of high priority because a large number of countries participating in these RECs are small landlocked countries.

- **Avoid a Merger between the EAC and COMESA CETs.** After five years of negotiations the COMESA member countries have recently reached an agreement on the COMESA CET. An important implication of the COMESA CET for the EAC is that a merger of the EAC CET with the COMESA CET may be pressed for to avoid two CUs in the COMESA FTA zone. The resulting compromise CET is very likely to be significantly inferior to the present EAC CET. If accepted, such merger would stall the establishment of a full EAC CU and furthering deeper EAC integration. Therefore, the EAC should not agree to a merger.

9. The rest of the report is organized as follows. Chapter 1 reviews the integration the EAC has achieved so far and identifies the areas that require closer attention. This review follows an introductory assessment of impact of the economic conditions of the EAC region and its member states for its integration strategy. Annex A describes the current economic conditions in the EAC region and its member states. Chapter 2 focuses on elimination of the EAC's internal border posts and establishment of a common EAC trade policy, the main steps that need to be taken to consolidate the EAC CU. It also considers the issues concerning negotiations of an EPA and rationalization of overlapping trade arrangements, two important components of a common trade policy. Based on the earlier discussions, Chapter 3 provides a list of priority areas and suggests appropriate sequencing of policies for furthering EAC's regional and global integration. The report includes two other annexes. Annex B provides a glossary of commonly used trade and regional integration terms for easy reference. Annex C compares EAC, COMESA, SADC, and SACU in terms of objectives, programs, and implementation results (prepared with assistance from Mary Mbithi).

1. EAC'S REGIONAL INTEGRATION SO FAR

1.1 The economic conditions of the EAC region and its member states are reviewed in Annex A. They point to the following three principle pillars that an effective EAC regional integration and development strategy need to be built on.

- ***Open Deep Integration***. A development strategy based solely on the member countries' own limited resources may not be viable, particularly for smaller land-locked countries, because of the small size of their domestic markets. The objective of deeper integration adopted by the EAC, which aims to progress gradually from a FTA/CU to a monetary union and eventually to a Political Federation, is the right one. It will enable the member states to pull their resources together, broaden their markets, benefit from externalities, and take advantage of scale economies through implementing joint infrastructure projects. In time, the EAC will also need to bring down its CET towards the East Asian levels.
- ***Export-orientation***. Expansion and diversification of extra-EAC exports have to be placed at the core of EAC's development strategy because the combined purchasing power of the EAC and the potential for intra-EAC trade are not high enough to support sustained high growth. The primary objective of deeper trade integration should therefore be improving competitiveness in the EAC region as a useful stepping-stone on the way to greater integration in the world economy. Hence, an export-oriented and private sector-led strategy is the most appropriate development strategy for the EAC zone.
- ***Competitiveness.*** Competitiveness in the EAC zone needs to be substantially increased in order to arrest and reverse the marginalization of the region in world trade, and start the process of global integration. This, in turn, would require strengthening trade facilitation services, improving the investment climate, harmonizing the regulatory framework across member states, liberalizing trade in services and enhancing infrastructure services to reduce the cost of doing business in order to encourage domestic and foreign investment in export-oriented sectors.

1.2 The EAC has already made good progress towards laying out a regional development strategy based on these principles. We review below the regionalism envisaged in the EAC's legal and policy documents and the progress made so far to achieve it.

1.3 The EAC's vision, objectives, and the legal and administrative structures are spelled out in (a) The Treaty for the Establishment of the EAC (signed on November 30, 1999, and entered into force on June 7, 2000); (b) The Protocol for the Establishment of the EAC Custom Union (signed on March 2, 2004, and entered into force on January 1, 2005); and (c) The EAC Customs Management Act (enacted on December 16, 2004). The implementation has been guided by three EAC Development Strategies (1997-2000, 2001-05, and 2006-10) and the Report on the Committee on Fast Tracking East African Federation (November 2004).

1.4 The Treaty entered into force in July 2000. Its ultimate objective is to establish a Political Federation built on a single market with free circulation of goods, services, and factors of production, and harmonized economic policies and regulatory arrangements. This will be realized through a progression of trade and economic integration arrangements starting with a custom union followed by a common market and monetary union leading to a Political Federation (Treaty, Article 5). Addressing economic imbalances among the member states that may arise in these arrangements, ensuring equitable distribution of benefits, and observing variable geometry and asymmetry in integration (Treaty, Article 7) are adopted as important principles of the Treaty.

1.5 The process of integration gathered momentum when the EAC CU between Kenya, Tanzania and Uganda was launched on January 1, 2005. The establishment of the CU will be progressive in the course of a transition period of five years ending on December 31, 2009 (Protocol, Article 11). Burundi and Rwanda were accepted as new members in November 2006, and were admitted to the EAC in July 2007. They are presently negotiating the terms and conditions of joining the customs union.

1.6 Encouraged by the good progress so far, the EAC is exploring options for fast tracking the establishment of a Political Federation. The approach adopted allows parallel implementation of programs whereby the timeframe for completion of the CU will remain unchanged (January 2005 to December 2009) but during this period the implementation of the CU and preparations for the Common Market and the Monetary Union would be accelerated sufficiently to lay the conditions for the Political Federation. Negotiations are expected to start in September 2007 to establish a Common Market and allow for free movement of labor between the current members plus Burundi and Rwanda by 2009, a Monetary Union by 2010, and a Political Federation by 2015. A background study which will provide the initial basis for negotiations for a Common Market was completed in July 2007 and adopted by the EAC.

TRADE REGIME[3]

The regime is defined by the following articles of the Protocol:

1.7 Common External Tariffs (Article 12 of the Protocol): The EAC Common External Tariff (CET), adopted as from January 1, 2005 has two non-zero bands (10 percent for intermediate products and 25 percent for final products) with a simple average of 12.9 percent. The move to the CET has reduced average tariff protection in Kenya and Tanzania, and increased it in Uganda. Rates above 25 percent apply to some 58 lines of sensitive products (about one percent of tariff lines). These lines are related to dairy products, wheat, and sugar. The CET contains 5,429 lines at the HS 8-digit level, of which 99.8 percent carry ad valorem duties; the other lines carry compound tariffs. Agriculture, hunting, forestry, and fishing have the highest tariffs (17.3 percent), followed by manufacturing (12.8 percent), and mining and quarrying (5.8 percent). The food industry has the highest rate of protection. The EAC members

[3] For more detail, see WTO (2006).

are to review the maximum rate of the CET after January 1, 2010. The Council of Ministers of the EAC are mandated to review the CET structure and approve measures to remedy any adverse effects on any member state induced by the implementation of the CET or by exceptional circumstances.

1.8 There are few national exemptions from the CET: for a period of 2 years ending on June 30, 2008, Kenya is allowed to impose lower tariffs on rice imports from Pakistan. Over the same period, Tanzania is allowed to impose lower tariffs on imports of wheat and barley. The EAC members apply an export tax of 20 percent on raw hides and skins to encourage local processing of these goods. The EAC members have agreed to harmonize their duty and tax exemptions and concession schemes. However, these have not yet been harmonized and are still laid down in national laws.

1.9 In May 2007, COMESA member states including Kenya, Uganda, Burundi and Rwanda agreed on a COMESA CET which will be implemented in January 2009. This will have important implications for the EAC CU. This issue will be taken up in Chapters 2 and 3.

1.10 Internal-tariffs (Article 11 of the Protocol): The FTA component of the EAC CU is being established through asymmetric dismantling of tariffs on intra-EAC trade. Trade between Tanzania and Uganda, as well as exports from Tanzania and Uganda to Kenya, have been duty free since January 1, 2005. Exports from Kenya to Tanzania and Uganda are divided into Category A and Category B goods. The Category A goods have been treated duty free. Internal tariffs on the Category B goods (880 tariff lines at six-digit level in the case of Tanzania, and 443 lines in the case of Uganda) are to be phased out as follows: they will be reduced to a 10 percent tariff rate in 2005, 8 percent in 2006, 6 percent in 2007, 4 percent in 2008, 2 percent in 2009, and zero in 2010. Differences exist between mainland Tanzania and Zanzibar in certain trade policy instruments such as domestic trade and export promotion that also needs to be eliminated.

1.11 Import and Export Prohibition and Licensing: The Second and the Third Schedules to the EAC Customs Management Act contain a list of prohibited imports and exports. In addition, it allows EAC member states to maintain their import and export prohibition in force for a transitional period. It also contains import and export permit requirements for certain products.

1.12 Other Duties and Charges: Imports and locally produced goods are also subject to VAT and excise duties at different rates in the member countries. Standard VAT rate is 16 percent in Kenya, 20 percent in Tanzania, and 18 percent in Uganda. Member states individually impose other small duties and charges.

1.13 Non Tariff Barriers (NTB, Article 13 of the Protocol): Members agreed to remove all existing NTBs on intra-EAC trade and not to impose any new ones. The EAC Secretariat and the East African Business Council (EABC) have completed work to identify all NTBs and developed a monitoring system at the country and the regional level to remove them (EAC and EABC 2006). Financial resources are needed to operationalize the proposed monitoring system.

1.14 Trade in Services: EAC negotiations on trade in services are expected to be part of the EAC common market negotiations.

1.15 Sectoral Policies: Although much work has been done by the Secretariat in harmonizing various sectoral (agriculture, transport, telecommunication, power, industry, etc) and export promotion policies, more efforts are still needed to ensure that these initiatives are carefully coordinated among individual members and fully implemented.

1.16 Contingency Measures (Articles 16-20, and 24 of the Protocol, and Annex VI to the Protocol): The Protocol provides for the establishment of an EAC Committee on Trade Remedies. This Committee is to handle any matters pertaining to anti-dumping, safeguard, and countervailing measures against material injuries caused by the imposition of the CET and the FTA as well as measures taken by the third countries. While the EAC has adopted regulations on contingency measures, no anti-dumping, countervailing and safeguard actions have yet been taken.

1.17 Export Incentives and Assistance (Articles 25-30 of the Protocol, EAC Customs Management Act): Member states are allowed to establish manufacturing under bond, export processing zones (EPZ), and duty drawback schemes. The sale of goods produced under any such scheme in the customs territory is limited to 20 percent of production. While regulations have been put in place for operation of EPZs, the export incentives regimes of the member states have not yet been harmonized at the EAC level. The EAC member states are members of the Africa Trade Insurance Agency (ATIA) which provides insurance against political risk.

1.18 Rules of Origin (Article 14 of the Protocol and Annex III of the Protocol): Goods are defined as originating in the country where they are wholly produced or undergo substantial transformation. The criterion of substantial transformation is satisfied if the imported content of the goods is no more than 60 percent of the c.i.f. value of the cost of materials used in their production, and the value-added resulting from the production process (that should lead to a change in tariff heading) accounts for at least 35 percent of the ex-factory cost of the goods. These rules which are very similar to COMESA's, are reasonably liberal.

1.19 Standards: The EAC members increasingly adopt joint voluntary standards (670 standards have been adopted as of July 2007). In addition, they individually have technical regulations; Kenya is the only EAC member with a certain capacity to enforce its technical regulations. The East African Standards Committee aims to develop new standards or harmonize the existing ones. While a SQMT Bill was enacted in 2006, progress in setting up a regional infrastructure for developing accredited laboratories and mutual recognition of standards has been slow.

1.20 Customs Procedures: The EAC Customs Management Act 2004 defines the principles of EAC customs procedures and valuation. An EAC Customs Manual is under preparation, but the customs procedures have not yet been fully harmonized by the EAC member states. Customs valuation is based on the transaction value as provided for by the WTO.

1.21 Competition Policy (Article 21 of the Protocol): The Protocol prohibits anti-competitive practices. The EAC Competition Act, enacted in 2006, establishes an EAC Competition Committee to implement the policy. For the time being, Kenya and Tanzania each has its own competition policy, and Uganda is preparing its own legislation. These national initiatives should be coordinated with regional efforts to develop a common competition policy.

Institutional Framework

1.22 Article 9 of the Treaty established the main organs and institutions of the EAC. They are: the Summit of Heads of States or Government; the Council of Ministers; the Coordination Committee of Permanent Secretaries responsible for regional cooperation; Sectoral Committees; the East African Court of Justice; the East African Legislative Assembly; and the EAC Secretariat as the executive organ of the EAC[4]. There is also the Committee on Trade Remedies, established by Article 24 of the Protocol, to handle the trade issues such as contingency trade remedies, rules of origin, dispute settlement, etc. The EAC has the following autonomous institutions: the East African Development Bank, the Lake Victoria Basin Organization, the Lake Victoria Fisheries Organization, and the Inter-University Council for East Africa. At the national level, member states established Ministries to focus exclusively on EAC affairs indicating the importance given to regional integration by the member states. Close coordination with the Ministry of EAC Affairs and the Ministry of Commerce is essential because the policies concerning EAC are the integral part of the member states' overall trade strategies.

1.23 These are necessary institutions for deeper integration. However, it will take some time to clarify their respective roles and responsibilities, division of sovereignty between national and supra-national authorities, and getting them fully operational. The institutional capacity at the regional and national level has to be strengthened. A number of steps have already been taken. An Institutional Development Fund (IDF) grant from the World Bank has been utilized to strengthen the EAC Secretariat and implementation of the CU. Studies have been undertaken to assess the capacity needs of the EAC[5]. In light of their recommendations, the EAC is hiring new staff.

Joint Projects in Other Areas

1.24 The EAC cooperation goes beyond trade integration. To take advantage of scale economies and jointly manage regional commons, the EAC also implements joint projects. These projects include: Sustainable Development of Lake Victoria Basin, Lake Victoria Transport Project, Joint Concessioning of Railroads, East African Power Master Plan, East Africa Submarine System (EASSy), joint tourism marketing and standardization of hotels, etc. The EAC has also identified five major road corridors for development and rehabilitation under the East African Road Network Project. The East Africa Trade and Transport Facilitation Pilot Program is supported by the World Bank. Ten Protocols and Agreements have been signed since 1997 in areas such as double taxation, inland waterway transport, air safety, etc. to improve cooperation among member states, and steps have been taken to harmonize policies in areas such as fiscal policy, agriculture, tourism, etc. These are very useful initial steps towards deeper cooperation and harmonization of policies.

[4] For the responsibilities of these organs see Articles 11-72 of the Treaty.
[5] African Capacity Building Foundation (2005), Condes (2006), Stephens (2006).

Private Sector

1.25 A unique feature of the EAC that separates it from other RECs in Africa is its close cooperation with the private sector. The East African Business Council (EABC) was established in 1997 as an apex body to represent the private sector interests at the regional level. It works very closely with the EAC Secretariat. The EABC, in collaboration with the EAC Secretariat and with financial support from the World Bank, prepared a Private Sector Development Strategy in 2003 to identify the main barriers to promotion of business sector. The measures identified were later incorporated in the Third EAC Development Strategy (2006-10). As noted earlier, the EABC in collaboration with the EAC Secretariat also conducted a study on NTBs and organized a workshop to discuss the EPA issues with all stakeholders and made recommendations (EABC 2006). In addition to the EABC, there are also sector specific East African private sector associations, such as the East African Tourism Council, and the Association of Tea Growers in East Africa. The strong participation of the EABC in EAC integration process ensures the shared interests of the private sector are articulated and taken account of.

Implementation Status of Trade Integration

1.26 Table 1.1 depicts the taxonomy of the progression in deeper regional integration and, against this background, provides a summary of the progress the EAC has made so far. The following points stand out.

1.27 Flexibility in sequencing of reforms. The four level of integration shown in Table 2 suggests a logical sequence from FTA to economic union with each stage characterized by a set of specific policies. The experience is more complex than this simple taxonomy suggests. For example, the EAC implemented the FTA and the CET at the same time. SACU is a CU but it still allows its member states to maintain NTBs. The parallel implementation of programs adopted by the EAC in fast tracking of the establishment of a Political Federation is also a good example of the flexibility possible in sequencing of policies. However, achieving efficiency in regional integration necessitates some sequencing of objectives and reforms. For example, completion of the FTA (removal of the remaining NTBs and other duties and charges; harmonization of customs procedures, exemptions, tax systems, regulatory frameworks, competition policies, and export incentives) is preferable before attempting to implement the difficult aspects of a CU such as pooling the tariff revenues and transferring sovereignty of making some of the policies to the regional institutions.

1.28 Substantial progress in a relatively short period of time6. In terms of the objectives adopted, measures already taken, and progress made so far in implementation, the EAC is a remarkable success compared to other RTAs in Africa. Close collaboration with the private sector in policy making and implementation is particularly commended. Such progress has been done in a relatively short period of time and with limited institutional capacity at the regional and country level, a clear indication of strong political commitment. If the present momentum continues, there is a strong possibility that the EAC will be an institutionally coherent and economically integrated core group, which could be gradually expanded to integrate more countries in the region, particularly in COMESA (more on this later).

[6] For more details, see World Bank (2006).

Table 1.1: Forms of Regional Economic Integration and Implementation Status of EAC

	Free Trade Area (FTA)	Customs Union (CU)	Common Market (CM)	Economic Union	Implementation Status of EAC
Aims and objectives / **Types of reforms**	Increasing market size and competition	FTA plus elimination of RoO which would substantially simplify internal border controls and establish free movement of goods	CU plus elimination of all remaining internal border controls and establishment of free movements of services, people, and capital	CM plus unification of monetary and some other behind the border policies by supra-national institutions	Ultimate objective is forming a political federation (by 2015) through a progression of a CU, CM (by 2009), and Monetary Union (by 2010).
1. Removal of internal tariffs and non-tariff barriers, (increasing) liberalization of services	X	X	X	X	A process of removing intra-EAC tariffs started in January 2005 on an asymmetric basis. It is expected to be completed by 2010. The member states will maintain their import and export prohibitions for a transitional period. VAT and excise duties at different rates in member states apply both imports and locally produced goods. A program to remove NTBs has been prepared but not yet implemented. Close collaboration with the private sector has been established,
2. Adoption of common external tariff and common trade policies		X	X	X	CET was introduced in January 2005 with a short list of sensitive products and a few national exceptions, which will be eliminated in two years. Customs procedures, duty exemptions, tax regimes, and export incentives have not yet been harmonized. Regulations on safeguards adopted. Internal border posts are maintained to ensure that ROO are enforced and import revenues collected
3. Adoption of free movements of capital and labor , freeing trade in services, harmonization of standards			X	X	Some progress has been made in harmonization of standards. Liberalization of services will be part of Common Market negotiations, which is expected to start in September 2007. An EAC Competition Bill was enacted. A draft of a model investment code was prepared but investment incentives have not yet been harmonized.
4. Adoption of single currency and harmonization of behind the border policies				X	Central Banks and Ministries of Finance are actively discussing harmonized monetary and fiscal policies. Convergence criteria were set but not yet met.

1.29 We observe that EAC would need to strengthen the policy making in the following aspects.

1.30 Prioritized policy actions. The EAC Development Strategies have too many very ambitious objectives and policy actions covering a very wide range of issues without any sense of priority. For example, the Second EAC Development Strategy (2001-05) includes 145 policy measures in its Action Matrix. The number of proposed measures was increased to 190 in the Third EAC Development Strategy (2006-10). These measures are spread over 22 broad policy areas from macro economics and trade policy to gender and science and technology issues. The programs are treated equally important. Lack of prioritization means spreading EAC's scarce human, institutional and financial resources very thinly over too many activities. Such a broad and overloaded agenda frequently results in slow progress, missed deadlines, and a weakening of credibility of the EAC and the EAC Secretariat. It is absolutely necessary for the EAC to prioritize its objectives and planned actions and allocate all its resources to implementation of the agreed priorities to make maximum impact. This would allow to maintain the momentum created in the past few years and build confidence in the EAC Secretariat and the member states.

1.31 Specific and realistic targets. A large number of targets in all three Development Strategies are not specific enough and not realizable within the specified timeframe. For example, actions in the Second Development Strategy such as "harmonize macroeconomic policies", "harmonize trade policies towards global level agreements and organizations", and in the Third Development Strategy such as "rationalize East Africa land policies", "strengthen and integrate banking systems" are very broad and not very useful guides for policy implementation. The timeframe set for implementation of the actions is very unrealistic in most cases. A few examples would suffice to make the point. The Second Development Strategy set the following targets: establishment of an East African Stock Exchange by June 2002, harmonization of the exemption regimes of the partner states by June 2001, harmonization of the duty drawback and other export promotion schemes by June 2002, and adoption of an EAC Model Investment Code by partner states by June 2002. After 5-6 years of the deadlines, all of these actions yet to be completed. Similarly, the Third Development Strategy has the following targets: centralize customs collections at the first point of entry by December 2006, rationalize multiple memberships in regional organizations and negotiate as a block by January 2007, finalize setting regional standards by January 2007, ensure application of S&P measures by January 2007, and harmonize labor policies and legislation and investment incentives by June 2007. All of these deadlines have already been missed and targets have not been met. It is also not clear whether these targets may be realized during the Third Development Strategy period. As noted above, too many unrealistic targets may result in slow progress, missed deadlines, and a weakening of credibility of the EAC and the EAC Secretariat. It may also be interpreted as weak political commitment by the member states.

2. CONSOLIDATING THE EAC CUSTOM UNION

2.1 To consolidate the EAC CU and realize the full benefits of it, actions are needed on two fronts; significantly reducing the role of the internal EAC border posts and developing a common trade policy. This chapter focuses on these two important issues.

REDUCING THE ROLE OF EAC'S INTERNAL BORDER POSTS

From FTA to CU

2.2 A key reason why RECs move from a FTA to a CU is to eliminate the internal border costs associated with enforcement of ROO in a FTA and ensure free circulation of goods within the common customs area. A FTA, which has zero internal tariffs but no harmonization of external tariffs, faces the problem of "trade deflection"; the redirection of imports from outside countries through the FTA member with the lowest external tariff, to exploit the tariff differentials. Trade deflection causes political strain among the FTA members because it redistributes the tariff revenue (high-tariff members lose tariff revenue, as imports come in through the low-tariff members) and reduces the effective tariff of every member to that of the lowest plus the transportation cost involved in indirect importing. To constrain the harmful effects of trade deflection, RECs apply ROO; the criterion for establishing that goods qualifying for tariff-free intra-REC trade should be produced in a member country, rather than just passing through it.

2.3 Introduction of ROO mitigates the harmful effects of trade deflection, but the costs of enforcing them are very high. First, the internal customs controls have to be retained to ensure compliance and to collect customs duties that are due if the goods are not originating in the REC. The costs of retaining internal customs were estimated at 3 to 5 percent of f.o.b. prices for EFTA – EU trade (WB 2000, p. 75). Second, the rules are usually complex, hard to negotiate and administratively costly to implement. The product specific ROO of the EU and SADC are good examples of that. Third, the rules can be used particularly by the dominant partner for protective purposes (e.g., the EU in the EBA Initiative and South Africa in the SADC Trade Protocol) which would shift trade and investment patterns from lower- to higher-cost sources within the RECs.

2.4 Hence, the great benefit of moving to a CU is that adopting a CET would eliminate the need for ROO and significantly simplify internal border formalities. If tariffs are collected at the point of entry to the CU and allocated to the members according to an agreed formula, with the adoption of a CET, internal customs are not needed for enforcing the ROO and collection of revenues. However, internal border formalities would still be needed to ensure that other requirements for importing members are met. To fully eliminate internal borders additional steps such as harmonization or mutual recognition of standards, elimination of visa requirements among member states, harmonization of taxes, strengthening of VAT administration, etc are also needed, to ensure free circulation of goods as practiced in the EU.

2.5 If managed effectively a CU ensures greater market integration and more efficiency, but it also brings with it other complexities related to (a) setting up a budgetary mechanism to distribute the tariff revenue among member countries, (b) agreeing to a common trade policy, and (c) placing tighter constraints on individual member policies and national sovereignty thereby requiring greater political commitment. It is politically contentious and divisive to distribute the tariff revenues among the member states generated by the CET. There is no CU other than the EU that has resolved the revenue pooling issue satisfactorily. SACU, the oldest CU in the world, has not yet resolved the revenue sharing issue (see Box 2.1). Agreeing to a CET and harmonizing external trade policy are particularly difficult when the member countries are markedly different and the benefits of a CU are not evenly distributed. In addition, common external policy requires adequate supra-national administrative capacity, and means a loss of national sovereignty. Because of these complexities only a few RECs are notified to WTO as CUs.

Features of the EAC CU

2.6 Two key features adopted in the EAC necessitate application of ROO and maintenance of internal border posts preventing the EAC to fully benefit from free circulation of goods, a key benefit of a CU. The first feature is allowing the member states to collect and keep their import duties. This is called the "destination principle" in allocation of revenues in a CU as opposed to the "entry principle" where import duties are collected at the point of entry to the common customs area, pooled, and distributed among the member states according to an agreed formula. In the case of the destination principle, the ROO has to be applied in order to determine whether the imported goods qualify for duty-free intra-EAC trade. And, internal border posts have to be kept to enforce the ROO and collect import duties.

Box 2.1: Revenue Sharing in SACU

SACU pools both customs revenues and excise taxes and divides the pool among member states according to revenue-sharing formulas agreed under the new SACU Agreement signed in October 2002 and implemented in July 2004. The excise pool is divided on the basis of member states' shares in the combined SACU GDP and poses no implementation difficulty.

However, there are implementation difficulties in sharing the customs revenues. The customs revenues are shared on the basis of intra-SACU trade measured net of re-exports of goods imported from non-SACU countries. Sharing customs revenue on the basis of this formula requires a clear definition of intra-SACU trade and consistent and mutually agreed intra-SACU trade data. Both do not exist.

Currently, the intra-SACU trade shares are calculated from the data reported by the member states which show large inconsistencies because there is no mechanism in place to verify and reconcile the data. Inconsistencies are from two sources. First, because the SACU Agreement does not adequately define intra-SACU trade, member states use expanded interpretations of intra-SACU trade (e.g., include certain services in imports). Second, the formula creates perverse incentives for member states (incentive to overstate imports in order to increase their shares in customs revenues) and a "zero sum game" situation. This is a cause of continuing tension among the member states, since some members are heavily dependent on these revenue transfers.

2.7 The second feature is allowing member states to have FTAs with other countries. Article 37 (1) of the EAC Customs Union Protocol states that the EAC member states will honor their commitments to other regional organizations they belong. The EAC is taking steps to deal with this issue (more on this later), but as long as member states have FTAs with other countries the EAC needs to implement ROO and maintain internal border posts to be able to establish whether the goods imported are produced in the member states to qualify for the duty-free intra-EAC trade.

2.8 Any of the above two features necessitates implementation of ROO and maintenance of internal border posts. Therefore, both need to be addressed to be able to establish free circulation of goods in the EAC customs area.

How to Reduce the Role of EAC's Internal Border Posts

2.9 Because of the politically sensitive and divisive nature of pooling and distributing import revenues, the EAC is not advised to try to switch to the entry principle for a foreseeable future -- until such time that the share of revenues from imports in total public revenues in the member states is very low and all such revenues are allocated to finance the administrative expenditures of the management of the CU (e.g., contribution to the EAC Secretariat's budget), as is the case in the EU.

2.10 A possible alternative to the present destination principle is to allow the member states to collect their revenues from imports at the entry points into the CU rather than at the internal border posts7. This would mean border posts at the entry points will need to be managed collectively by all member states and the role of the internal border posts be reduced substantially to manage the border matters other than the revenue collection – the matters that will need to be gradually harmonized making it unnecessary to keep the internal border posts. This would eliminate the need for implementation of the ROO arising from the application of the destination principle and substantially reduce the large costs of maintaining internal border posts.

2.11 Regarding the membership of the member states to other FTAs, all bi-lateral trade arrangements by the member states need to be phased out as required by the EAC CU Management Act Article 112 (2). However to maintain the benefits of the member states' earlier trade arrangements the EAC should sign FTAs with COMESA and SADC. In addition, the EAC member states should sign the same EPA with the EU (more on these issues later in the context of mainstreaming regional arrangements).

2.12 To recap, it is recommended that (a) arrangements should be explored for the member states to collect their import revenues at the point of entry to the common customs area rather than at the internal border posts; (b) the member states move towards phasing out their bilateral FTAs with COMESA and SADC; (c) the EAC signs FTAs with COMESA and SADC to maintain the benefits of member states earlier FTAs with these RECs; and (d) all EAC member states sign the same EPA. These measures will make the implementation of ROO unnecessary. This, in turn, will reduce the role of internal border post significantly (border posts will not be needed for enforcing the ROO and collecting import revenue) resulting in substantial cost saving

[7] Technical analysis is needed to work out how this would work and made consistent with collection of excise taxes and VAT at the entry points and national economies.

and ensuring free circulation of goods in the common customs area, a key reason why RECs move from a FTA to a CU. Note that additional steps such as harmonization or mutual recognition of standards, elimination of visa requirements among member states, harmonization of excise taxes, strengthening of VAT administration, etc are also needed to fully eliminate internal border formalities. Because effective implementation of these measures requires significant improvement in institutional structure of the member states and development of supra-national agencies, full elimination of internal border formalities is seen as a longer-term objective rather than a near-term priority.

2.13 Note that (b), (c) and (d) above are also necessary for the EAC to establish a common trade policy which will be discussed next.

DEVELOPING A COMMON TRADE POLICY

2.14 The CET is the principle component of a common trade policy. The EAC's effort to establish an effective CET in such a short period of time is commendable. Other components of a common trade policy include: (a) common negotiating positions with regard to trade relations with third parties and in multilateral trade negotiations (EPA negotiations and participation in the WTO); (b) harmonization of commitments made by the member states in their earlier preferential agreements with third countries which may conflict with the agreed CET (EAC's relations with COMESA and SADC); and (c) harmonization of export incentives, trade remedy measures, standards, and licensing requirements, etc. In this section, issues concerning only (a) and (b) will be considered.

EPA Negotiations

2.15 EPA negotiations are the single most important trade policy issue that the EAC needs to focus on in the next six months because of three reasons. First, the EU is the largest trading partner of the EAC; its share in EAC's exports and imports amounts to 36 percent and 26 percent, respectively. EU's dominance in EAC's trade is likely to continue in the foreseeable future. A well negotiated EPA (a North-South arrangement) can therefore help expand and diversify EAC's exports to the EU accelerating growth in the region. Second, the reciprocal opening of the EAC market under an EPA would create incentives for improving the investment climate and business environment in the EAC area and attracting foreign and local investment in export oriented sectors. Third, EPA negotiations can be a catalyst for the EAC to develop a common trade policy.

2.16 The current arrangements for EPA negotiations (members negotiating EPAs in different groupings) pose a serious challenge for the EAC and would seriously complicate the establishment of a common EAC trade policy.

2.17 The EAC members, individually and as a group, have to carefully consider the following three questions. If they decide not to conclude an EPA what alternatives they have to trade with the EU? What is the best EPA country configuration for the EAC? What are the main elements of a good EPA for the EAC?

2.18 Alternatives to an EPA. There is no obligation for countries to enter into an EPA. It is therefore essential for the member states to review the strengths and weaknesses of the alternatives to an EPA, compare them to a likely EPA, and decide under what conditions an EPA would be superior to its alternatives. The alternative to an EPA for the LDCs is the EU's Everything-But-Arms (EBA) Initiative. That is, if Uganda, Tanzania, Burundi, and Rwanda chose not to conclude an EPA, they would trade with the EU under the EBA Initiative when the Cotonou preferences expire at the end of December 2007. Kenya's alternative is EU's Generalized System of Preferences (GSP) or its new superior tranche (GSP+) adopted in June 20058. In case Kenya decides not to enter into an EPA, it would trade with the EU under the EU's GSP when the Cotonou preferences expire (See Box 2.2 for EU's trade preferences).

2.19 Table 2.1 provides a comparison in broad terms of a likely EPA with its two alternatives. Because we don't know what the final EPA would look like, the features of an EPA presented in this table are the anticipated features based on the progress made so far in negotiations and statements made by various EU bodies. The comparison is likely to change as the negotiations progress and as we know more about the final EPA. Of the three, the GSP/GSP+ option seems to be the least favorable option, which is the option that Kenya will revert to if EPA negotiations cannot be successfully concluded. It is non-reciprocal9 and has no revenue affect, but it is inferior to an EPA in all other features. In particular, it is not a legally binding arrangement, and can be withdrawn or changed any time unilaterally by the EU creating uncertainty in the trade regime adversely affecting investment. It also has very restrictive ROO.

[8] Currently, Kenya is not eligible for GSP+.

[9] A trade negotiator would consider this as a "benefit". In practice, it may be a "cost" if it ends up protecting inefficient companies adversely affecting competitiveness and integration into the world trading system.

Box 2.2: EU Trade Preferences

Generalized System of Preferences GSP)

EU's GSP offers the developing countries market access duty-free or at a rate lower than the MFN rate on about 6,900 of the 9,000 non-zero MFN tariff lines (of the approximately 11,000 tariff lines in the EU, about 2,000 are duty-free under MFN). Over the 30 years, the GSP has been reviewed and adapted several times, most recently in June 2005. The new GSP, which will last for 10 years (2006-15) with a review in 2008, has two significant innovations: a new formula for graduation and a new superior tranche (commonly known as GSP+). The GSP+ offers substantially improved preferences over the standard GSP, and covers a broader range of products, but the restrictive ROO remains unchanged. The product coverage was increased from 6,900 tariff lines to 7,200. The new products are mostly in agricultural and fishery sectors. Simple ad valorem or specific duties are suspended on all products covered by the GSP. For items subject to an ad valorem and a specific duty, all ad valorem elements are suspended. In order to benefit from these additional preferences, a developing country must have ratified and effectively implemented ILO's several core labor standards and human rights and be classified as "vulnerable."

Everything-But-Arms (EBA) Initiative

The EBA Initiative is part of the EU's GSP and compatible with the WTO's Enabling Clause, as it grants special preferences to a permissible group of countries – the least developed countries (LDCs). It offers duty-free and quota-free access to LDCs to all products excepting arms. It was introduced in March 2001. Implementation was immediate except for a transition period allowed for bananas, rice, and sugar, for which tariff-quotas restricting LDC exports to the EU market are to be phased out by the end of January 2006, September 2009, and July 2009, respectively. The EBA Initiative also has very restrictive ROO.

Economic Partnership Agreements (EPA)

From 1975 to 2000, the trade and aid relationship between the EU and its 77 ex-colonies (ACP countries) were governed by successive Lome Conventions. Under these Conventions the ACP countries had non-reciprocal access to the EU market. When these non-reciprocal preferences were found by the WTO discriminating against other developing countries and violating the Enabling Clause in June 2000, the EU and the ACP counties signed the Cotonou Agreement as the successor to the Lomé IV Convention. During an eight-year period, the Cotonou Agreement maintains Lomé IV non-reciprocal preferences while the EU and the ACP countries as regional groupings or individually negotiate EPAs which, if successful, will enter into force by 1 January 2008 and be phased in over a period of 10-12 years. The EPAs have four main objectives: replacement of unilateral preferences with reciprocal free trade area arrangements to make the EPAs WTO-compatible; differentiation in the treatment of the LDCs and non-LDCs; strengthening regional integration among the ACP countries; and provision of aid by the EU to finance adjustment costs. In addition to trade in goods, EPAs could also cover trade in services as well as other trade-related areas such as investment, competition, protection of intellectual property rights, trade facilitation, government procurement, standardization and certification, and sanitary and phytosanitary measures.

Table 2.1: EPA and its Alternatives

	Coverage								
	Legal Status	**Reciprocity**	**Goods**	**Services**	**Singapore Issues**	**Rules of Origin**	**Revenue Effect**	**Development Assistance**	**Regional Integrated**
EPA	binding	reciprocal	EU: 100%, ACP: to be negotiated	likely to be covered	EU wants to include	to be negotiated	may be high	covered	covered
EBA	not binding	not reciprocal	EU: 100%	not covered	not covered	restrictive	no revenue effect	not covered	not covered
GSP/GSP+	not binding	not reciprocal	EU: 80%	not covered	not covered	restrictive	no revenue effect	not covered	not covered

2.20 The EBA Initiative suffers from the same weaknesses as the GSP/GSP+. While it offers better market access (100 percent liberalization by the EU), the restrictive ROO prevents the LDCs to take advantage of EBA benefits. Utilization of EBA preferences has been s very low mainly because of its restrictive ROO (Brenton 2006).

2.21 Regarding the EPAs, the EU (a) has already agreed to granting full duty-free and quota-free access to the EU market including agricultural products and will observe the principles of asymmetry and flexibility in the scale of liberalization and the length of transition period for the ACP countries; (b) has initiated work on reforming its system of ROO; (c) has recognized the need for workable safeguard mechanisms allowing ACP countries to counter surges in imports from the EU; (d) is considering the ways of financing of the "development dimension" of the EPAs that will be available beyond the 10th European Development Fund (EDF); and (e) has been supporting regional integration in the ACP regions. These principles have not yet been reflected in the EPA agreements but they are good indications of what can be achieved under EPAs. If they are fully incorporated in the final agreement, an EPA is clearly superior to its two alternatives. The EAC should therefore make every effort to negotiate hard and successfully conclude an EPA. An additional advantage of an EPA over its alternatives is that it provides an opportunity for the EAC member states to sign the same EPA, a necessary condition for developing a common trade policy.

2.22 EPA Country Configuration. As a customs union, the EAC is expected to negotiate its most important trade agreement as a group as part of its common trade policy. Yet, Kenya, Uganda, Burundi, and Rwanda negotiate with the Eastern and Southern Africa (ESA) Group while Tanzania is a member of the SADC EPA Group. The ESA Group consists of 15 COMESA members10, 11 of which are LDCs. This is a relatively homogenous group with countries of similar economic structure and trade interests. The COMESA Secretariat serves as the secretariat of the ESA Group. This group has made good preparatory work for the negotiations11. Negotiations, based on the draft text prepared by the ESA Group, are at a relatively advanced stage. The SADC Group is comprised of SACU and Mozambique, Angola, and Tanzania (MAT). Of the 8 members, 4 are LDCs (MAT and Lesotho). Progress in negotiations in this group has been very slow.

2.23 Initially, South Africa was not included in EPA negotiations, but had an observer status in the SADC EPA Group because it has a separate bilateral FTA with the EU (The Trade, Development, and Cooperation Agreement - TDCA), of which the Botswana, Lesotho, Namibia, and Swaziland (BLNS) are also de facto participants due to their SACU membership. Following South Africa's continuous efforts, the EU decided in February 2007 to include South Africa in the EPA negotiations in the SADC EPA Group (see Box 2.3).

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[10] Burundi, Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Uganda, Zambia, Zimbabwe.

[11] The World Bank contributed to the preparatory work with a number of background papers on trade in services, ROO, etc., and made extensive comments on the draft negotiations text prepared by the ESA Group.

Box 2.3: South Africa and EPA Negotiations

Initially, South Africa was only an observer in the SADC EPA Group because it already had the bi-lateral TDCA with the EU. South Africa's objective has been to use the EPA negotiations to improve on the TDCA. In February 2006, SADC EPA Group submitted the following proposals to the EU: (a) include South Africa in the EPA negotiations; (b) include BLNS in TDCA as *de jure* members, and base market access on provisions in the TDCA with appropriate modifications to accommodate the BLNS interests; (c) give EBA preferences on a statutory basis to MAT under the EPA to continue non-reciprocal trading arrangements; and (d) exclude trade related issues such as investment, competition, services, procurement, labor and environmental standards, etc. from the EPA negotiations.

The EU, in its response in February 2007, agreed to (a) and (b) with the qualification that the market access conditions of South Africa and BLNS will be differentiated due to South Africa's level of economic development and degree of competitiveness, but rejected (c) because it would be incompatible with WTO rules as EBA is not a reciprocal trading arrangement. Regarding (d) while rejecting the SADC EPA Group's proposal in principle, the EU adopted a more flexible approach in engaging in these issues focusing more on cooperation and assistance to put the right structure in place.

2.24 South Africa's inclusion has significantly changed the nature of EPA negotiations in this group. While it provides a new legal and institutional basis to align the TDCA and the SADC EPA to promote regional integration in Southern Africa, the inclusion of South Africa in EPA negotiations raises new challenges. How could the objectives of the TDCA and an EPA be aligned? The principle of differentiation between South Africa and other members of the SADC EPA Group is agreed but what degree of differentiation can be achieved in an EPA that includes South Africa with a relatively well developed and diversified economy, non-LDC SACU members, and LDCs (one of the LDCs is Lesotho, also a SACU member)? Will the necessary compromises reached acceptable to Tanzania? South Africa is likely to use its negotiating capacity to improve on the TDCA. Do the LDCs have their own capacity to negotiate their differentiated positions?

2.25 It is a concern to Tanzania and other LDCs in the SADC EPA group that South Africa's inclusion may effectively mean that the TDCA will become the starting point of the EPA negotiations, and the EPA process will turn into a re-negotiation of the TDCA in favor of South Africa with some adjustments to accommodate the interests of the BLNS and MAT. This would not serve the trade interests of Tanzania (and other LDCs in the SADC EPA Group) because of the following reasons:

- The excluded products on both sides in the TDCA (14 percent of all products by South Africa, and 6 percent by the EU) that were agreed after a long period of hard negotiations between the two parties reflect their defensive positions vis-à-vis each other, but have nothing to do with the trade interests of Tanzania.
- Tanzania will have to levy high taxes on a large number of capital and intermediate goods that it currently imports from the EU duty-free because these products are on South Africa's sensitive products list and are heavily protected. This would result in trade diversion (replacement of imports from the EU with more expensive imports from South Africa) and loss of competitiveness for Tanzania.
- The TDCA does not cover trade in services because South Africa does not want to include services in the agreement. An agreement on services would be beneficial for Tanzania. It could prompt domestic reforms that are necessary to reinforce the

competitiveness of domestic firms (high cost of input services is a major source of lack of competitiveness) and create new trading opportunities abroad.

2.26 Given the disadvantages of being a member of the SADC EPA group, it is important for Tanzania to explore the alternatives. It has four options. A choice among them is a political decision. The following discussion of the costs and benefits of these options is intended as a contribution to the ongoing debate in Tanzania and the EAC, and to assist the concerned parties to make an informed decision.

- First, Tanzania could stay in the SADC-EPA group, but negotiate (in collaboration with Mozambique and Angola) a significantly different EPA compared to the one negotiated by SACU. It would take the EBA Initiative as its starting point and try to improve on the EBA preferences by negotiating the following: a separate sensitive products list; shallower liberalization on imports from the EU; simpler and more liberal ROO; more generous aid for trade; and inclusion of services trade in negotiations. A key disadvantage of this option is that it could stall the development of a common EAC trade policy and may be interpreted by other members of the EAC as a lack of political commitment by Tanzania to the EAC CU. Also, it is not clear what degree of differentiation Tanzania could be granted in an EPA that includes South Africa. This option requires substantial strengthening of the negotiating capacity of Tanzania to develop its own negotiating position.
- Second, Tanzania could decide not to enter into an EPA and, as a LDC, continue trading with the EU under the EBA Initiative. However, as discussed earlier, EBA is not a legally binding arrangement and can be withdrawn unilaterally by the EU. And, there are problems with the EBA: the rules of origin and cumulation provisions are very restrictive. A well negotiated EPA would be superior to EBA preferences. Therefore, it is in Tanzania's interest to have a legally binding agreement with its principal trading partner.
- Third, Tanzania could withdraw from the SADC EPA Group and negotiate EPA with its EAC partners[12]. The main advantage of this option is that it would provide a solid basis for development of a common EAC trade policy. It would also be a strong indication of political commitment by the member states to the EAC CU and strengthen solidarity among them. This option requires other EAC members also to withdraw from the ESA Group. Withdrawing from the SADC EPA and the ESA Groups would not affect EAC members' participation in the SADC and COMESA FTAs until the EAC establishes a common trade policy, but it should be recognized that they are politically sensitive moves. This option requires substantial strengthening of the EAC's negotiating capacity. The EAC could draw on the preparatory work and the negotiations conducted so far by the ESA Group.
- Fourth, Tanzania could pull out from the SADC EPA group and join the ESA-EPA configuration. Many ESA countries have trade interests similar to Tanzania's. This option would not violate the common trade policy because all member states sign the same EPA. One benefit of this option is that four members of EAC do not have to

[12] This is the option recommended by the representatives of the private sector (EABC 2006).

withdraw from the ESA group. Because ESA is already at an advanced stage in EPA negotiations, Tanzania needs to join as quickly as possible, if this is its preferred option, so that its interests are incorporated into ESA's offers to and requests from the EU. This would not affect Tanzania's participation in the SADC FTA, and also Tanzania does not have to join COMESA FTA until the EAC establishes a common trade policy.

2.27 Making the best of the EPAs. The EPAs cover a wide range of issues and the process of negotiations is complex. But all issues are not of the same importance. The key elements of a good EPA can be grouped in a few critical areas. They are:

- Areas of offensive interests: market access, rules of origin, aid for trade.
- Areas of defensive interests: degree of liberalization, length of the transition period, trade in services.[13]

2.28 Market Access: the EU has recently offered the EBA preferences (duty-free and quota-free access in all goods except arms) to all ACP countries except South Africa. Opportunities for securing additional market access for goods exports to the EU market provided by this offer are limited because the EU's MFN tariffs are very low (average 5.8 percent) with the exception of agriculture, textiles and clothing (T&C), and fisheries. Excluding the special ACP regimes of bananas, beef, rice and sugar, almost entirety of the EU's trade preferences to COMESA is accounted for these three sectors (Table 2.2). Therefore, these are the sectors where EPA negotiations could hope to keep some preferential access over the alternative of MFN or GSP, and where the EAC negotiators should focus their attention. Duty-free and quota-free access already obtained, greater access to the EU market in these sectors will be determined by relaxing stringent ROO and strengthening member states' capacity to meet EU's SPS.

Table 2.2: COMESA: Value of Preferences in the EU Market (000 euros)

	LDCs (12)	Non-LDCs (4)
Value of imports under preferences	300,000	360,000
Value of preferences of special regimes (banana, beef, rice, sugar)	66,000	65,000
Value of other preferences	32,000	48,000
Of which , agriculture	22,000	15,000
Fisheries	3,000	20,000
T&C	7,000	12,000

Source: de Melo, Yagci, Dijofack (2007).

2.29 There is a disagreement between the EU and the ACP countries on how to negotiate fisheries. The ACP prefers a two-pronged approach. This would involve negotiating the broad conditions under which trade, sustainable development, management of fisheries resources, investment, etc may take place in the fisheries sector, as part of the EPAs (Fisheries Framework

[13] Some type of services such as Mode 4 services may be both defensive and offensive interest.

Agreement), leaving the country specific details to the bilateral agreements between the EU and the ACP countries. The EU prefers keeping the fisheries out of the EPAs and maintaining the current bilateral Fisheries Partnership Agreements (the EU has 18 of them in the ACP group) under which the EU makes market access for the ACP fishery products conditional on granting the EU access to the ACP fishery resources.

2.30 A successful EPA should adequately cover fisheries because along with agriculture fisheries is a vital sector for some ACP countries including Tanzania and Kenya. Fisheries is one sector where the ACP has real bargaining leverage. The two-pronged approach proposed by the ACP would allow them to take a common position on broader issues safeguarding their common interest while the bilateral agreements would cover the widely different country specific matters.

2.31 Another area of market access interest of the EAC is the Mode 4 services (temporary transfer of natural persons). This would allow the citizens of the EAC member states work in the EU on a temporary basis. There are indications that the EU may be prepared to include Mode 4 in EPA negotiations. The EAC can offer market access in other modes of services for concessions from the EU for Mode 4 (see Box 2.4 on trade in services).

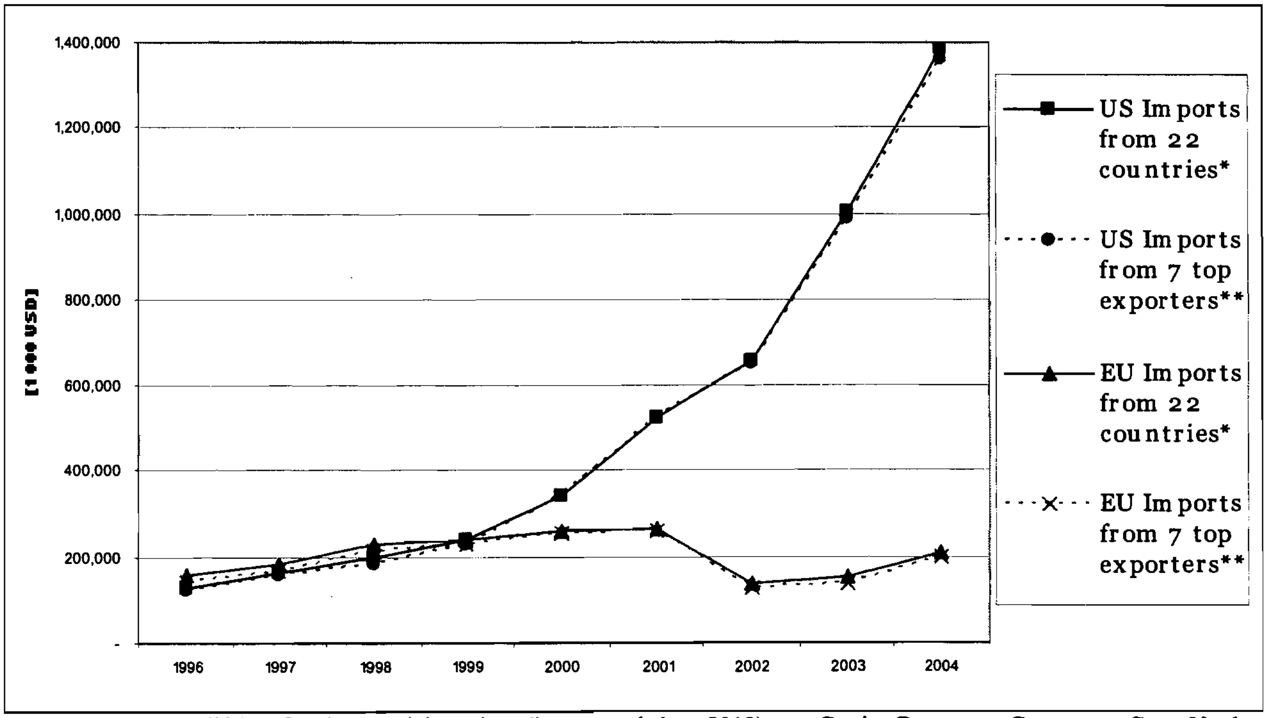
Box 2.4: Different Forms of Services Trade

Services trade is not as transparent as trade in goods. The GATS has identified four modes of supply for services which represent different forms of international trade

- Cross border (Mode 1): Trade takes place from the territory of one country into that of another, e.g., information and advice being transmitted electronically or cargo transportation.
- Consumption abroad (Mode 2): Consumers of firms make use of services in another country, e.g., tourism, education, health.
- Commercial presence (Mode 3): A firm from one country sets up in another in order to supply service. Establishment can take several forms: incorporation, branches, representative offices, joint ventures. It is a particularly common mode to supply financial and communication services.
- Presence of natural persons (Mode 4): natural persons from one country stay in another for a limited period in order to supply services. Includes the self-employed and employees of service providers, e.g. construction and professional services.

2.32 Rules of Origin: As noted, one way to obtain greater access to the EU market under an EPA is by relaxing EU's very stringent ROO imposed under its Product Specific Rules of Origin (PSRO), particularly in T&C. Figure 2.1 shows the differences in exports in T&C to the US and the EU since the introduction of AGOA in 2001 under its special regime whereby 22 Sub-Saharan Africa LDCs can qualify for preferential access to the US market until 2013 with a simple single transformation rule (i.e., clothing must be manufactured of fabric that can come from any source). In spite of similar rates of preferential access, exports increased dramatically to the US and stayed flat to the EU because of EU's restrictive double transformation rule (i.e., clothing must be manufactured of fabric made in the exporting country or in the EU).

Figure 2.1: Exports from SSA to the US (under AGOA) and the EU (under EBA/Cotonou)



*The 22 LDCS qualifying for the Special Regime (just extended to 2013) are: Benin, Botswana, Cameroon, Cape Verde, Ethiopia, Ghana, Kenya, Lesotho, Madagascar, Malawi, Mali, Mozambique, Namibia, Niger, Nigeria, Rwanda, Senegal, Sierra Leone, Swaziland, Tanzania, Uganda, and Zambia.
**The top 7 exporters accounting for 90 percent of exports to the EU and US are: Botswana, Cameroon, Ghana, Kenya, Lesotho, Madagascar, Namibia, Nigeria, and Swaziland.
Source: de Melo, Yagci, Djiofack (2007).

2.33 Simplification might include removing ROO altogether for tariff lines where preferential market access is less than 3 percent (perhaps 5 percent for LDCs which would then cover 4 of the 5 EAC members). Another simplification might be to switch to a lenient value-content rule, again perhaps with a differentiation for LDCs who would be required to have a lower domestic value-content. To give more flexibility, a choice between two (uniform) rules would be preferable: a 10 percent value-added content rule as proposed by the Commission for Africa (Blair Commission proposal for a "super EBA") and a change of tariff classification, preferably at the heading (or sub-heading) level which would guarantee that a single transformation rule would apply.

2.34 Aid for Trade. The EAC member states cannot take full advantage of the trade opportunities created by an EPA unless their productive capacities are improved and diversified so that they are capable of producing goods and services competitively. This in turn would require the removal of their supple-side constraints, and their adjustment costs are financed. Therefore, the development dimension of EPAs is critically important. While both the EU and the ACP countries agree on the need for aid for trade, the negotiations have so far failed to reach a common understanding of the concept. So far, the EU has re-labeled the existing resources available under the EDF 10 (22 billion euros for the period 2008-13) and promised an additional 2 billion euros a year until 2010 for all ACP countries as financial support, while the ACP countries have asked for more without clearly specifying how it is going to be used. So, the EAC should develop detailed and costed proposals on how and for what purpose the EPA-related funds could be spent. The possible areas would include: the regulatory framework, investment climate, trade facilitation, compensatory financing, revenue compensation and reforms, compliance with the SPS standards, and infrastructure, while continue urging the EU to make the 'development dimension' sufficiently central to EPA negotiations by providing additional funding to the EDF 10 and simplifying the cumbersome EDF procedures to ensure the funds are disbursed fully and in a timely manner. Because the EU preferences are eroding rapidly, the aid for trade has to come as quickly as possible so that the ACP countries improve their productive capacity and expand exports to the EU market while the preferences last.

2.35 Degree of liberalization by the EAC and the length of the transition period. WTO's Article XXIV governing all FTAs requires that tariffs be completely eliminated on "substantially all trade" by the participants in a FTA within a "reasonable length of time". Precise definitions of these conditions have not been established. The TDCA between the EU and South Africa provides for the EU to eliminate about 94 percent of its imports from South Africa and for South Africa to eliminate tariffs on about 86 percent of its imports from the EU to reach an average coverage of about 90 percent of total EU-South Africa trade. It allows a 12-year implementation period. If a similar approach is followed in the EPAs, the EU would liberalize 100 percent of its imports from the ACP (it has already granted full tariff-free, quota-free access to imports from the ACP excepting South Africa); and the ACP would liberalize about 80 percent of its imports from the EU to arrive at an average liberalization of 90 percent. It is not possible to judge whether 80 percent liberalization and a 12-year implementation period are good defensive positions for the EAC without a detailed sectoral analysis and agreed common list of sensitive products for the EAC member states. The EAC needs to develop its common list of sensitive products, the degree of liberalization and the length of implementation period that it is comfortable with as quickly as possible. It is advisable for the EAC to avoid a long list of sensitive products and a long implementation period to encourage the companies in the common customs area to improve competitiveness as quickly as possible while there is still time to capture the benefits of the EPA preferences because these preferences will not last long. In time, the EU will have to reform its Common Agricultural Policy (CAP) and liberalize its T&C and fisheries sectors further eroding the EPA preferences.

2.36 Trade in Services. Fostering reforms in the services sector and liberalization of trade in services could be very beneficial for the EAC members because the high cost of services (transportation, finance, telecommunication, etc) is a major source of lack of competitiveness of the EAC companies. Services could also play an important role in export growth and diversification. Negotiations on services should therefore be an integral part of the EPA negotiations, and the EAC should elevate the position of services negotiations on its list of priorities. As noted earlier, the EAC should consider opening up some of its services sectors to the EU companies (liberalization on a MFN basis is preferable) in return of concessions in the EU market particularly for Mode 4 services. Negotiating trade in services is a highly specialized area and requires substantial preparatory work14. Because EPA negotiations have to be concluded by the end of December 2007, there may not be sufficient time to prepare for and conclude services negotiations. Therefore, the EAC should press for concluding negotiations

[14] Mattoo and Payton (2007) provide a good country case study for trade in services. See also Saez (2004) for a review of services arrangements in EU's bilateral trade agreements.

only on market access in goods and aid for trade in the remaining limited time, and including a provision in the EPA to negotiate services but leaving such negotiations for later (see below).

2.37 Limited time left to conclude an EPA. If an EPA cannot be concluded by the end of December 2007, options that are WTO compatible and would keep potential challenges in the WTO at bay, at least temporarily, have to be found to avoid disruptions of trade between the EU and the ACP countries. While both the EU and the ACP agreed to take all necessary measures to conclude the EPA negotiations by the end of December 2007, it is likely that all aspects of an EPA may not be finalized. The likelihood of an extension of the waiver is remote, and it would result in further erosion of preferences for the ACP countries15. Other options would include the following:

- Fine tune on reciprocity to be minimally WTO compatible, leaving out services trade and other trade-related issues altogether: Under this option the ESA countries would just carry out minimum opening of the goods market in return for full tariff-free and quota-free access to the EU market. This option is not in the interest of the ESA countries who would benefit from liberalization of trade in services.
- Conclude negotiations on only market access in goods and aid for trade, and include provisions in the EPA to commit upfront to negotiate services and other issues and provide a timetable for such negotiations. Under this option, the negotiations would concentrate only on trade in goods and aid for trade during the limited time remaining. Negotiations would continue on trade in services on a GATS plus basis and other issues later according to an agreed timetable. This should be the preferred option for the EAC.
- Revert to EBA and GSP (GSP +): As shown earlier, under this option, Kenya, the only non-LDC in the EAC, has more to lose than the LDCs who would revert to the EBA Initiative.

Participation in the WTO

2.38 The EAC member states are all WTO members. They accord at least MFN treatment to all their trading partners. Neither of them are signatories to any of the WTO plurilateral agreements.

2.39 The Doha Development Round negotiations are very important for the EAC members. Their priorities in the negotiations include the following: (a) improved market access for their agricultural products; (b) reduction of high tariffs and tariff escalation on non-agricultural products of interest to developing countries and LDCs; (c) greater opportunities in services particularly through the movement of natural persons; (d) strengthening the S&DT provisions; and (e) provision of technical assistance.

2.40 A common trade policy also entails harmonization of member states' multilateral commitments and bringing their trade regimes into greater conformity with WTO provisions. These commitments which should be in line with the outcome of the Doha Development Round

[15] The EU had to reduce the tariff rate for canned tuna from the Philippines and Thailand from 24 percent to 12 percent as part of the deal to secure the current WTO waiver for the Cotonou Agreement.

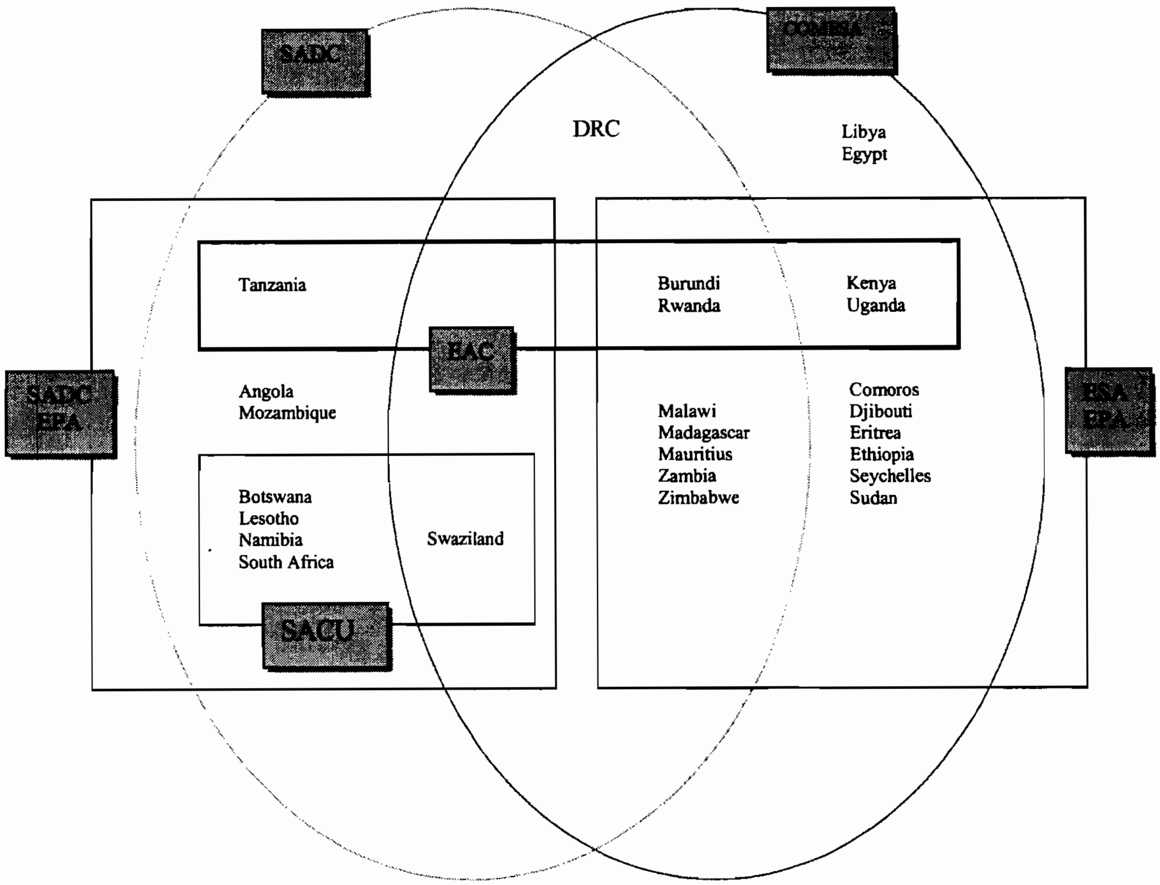
negotiations, include enlargement of the scope of bindings on goods and services, reduction of bound rates, elimination of applied compound rates, and removal of other duties and charges. While these changes are not very high on the priority list of the EAC, an improvement in these commitments would increase the credibility of the EAC trade regime.

Streamlining Overlapping Commitments

2.41 The EAC member states have multiple trade arrangements: Kenya, Burundi, and Rwanda participate in COMESA FTA while Tanzania is a member of SADC FTA. Uganda is a member of COMESA but not yet joined the COMESA FTA. In addition, Kenya, Uganda, Burundi, and Rwanda are negotiating an EPA with the EU as a member of the ESA group while Tanzania is a member of the SADC group (Figure 2.2). Multiple arrangements can tangle administrative procedures such as customs procedures, technical standards, rules of origin, etc and raise the costs for both companies and governments and are likely dampen investment. They violate a common trade policy, a key requirement for a fully fledged customs union, and limit the proper functioning of the EAC as a customs union. These obligations may also be conflicting because both COMESA and SADC aim to establish customs unions and a country can not be a member of two customs unions. This section will consider issues raised by multiple memberships of the member states, reviews their implications, and suggests ways to streamline these commitments.

2.42 Note that not all regional arrangements are legally binding. For example, the Cross Border Initiative (CBI), the IGAD, and the Indian Ocean Commission (IOC) which are forums for discussion and not legally binding agreements, are usually included in the discussion of overlapping arrangements. This makes the integration arrangements look like a tangled web -- more complex than they are. One should also note that the issue of contradictory arrangements arises only if overlapping arrangements are all customs unions. Multiple membership in several FTAs is not contradictory. For the EAC members, the major legally binding overlapping arrangements are COMESA and SADC. The EPA, when concluded and signed, will be the third major legally binding trade arrangement. Challenges related to an EPA were discussed in the previous section. This section takes up the EAC's relationship with COMESA and SADC.

Figure 2.2: Overlapping PTAs in the ESA Region



2.43 Application of variable geometry principle could considerably ease some of the tensions among various sub-regional overlapping arrangements in Africa and enhance the prospects for closer and fruitful regional cooperation. Variable geometry is a non-uniform method of integration which permits sub-groups move faster than the whole group or move to a deeper form. It involves heterogeneous strategies in design and implementation of regional arrangements. A good example is SACU, a customs union within the SADC FTA. Both COMESA and SADC agreed to apply the principle of variable geometry in their integration strategies.

2.44 Regarding COMESA, application of variable geometry means that only those COMESA members that are willing or ready will participate in the COMESA CU. When COMESA establishes a CU, Kenya, Uganda, Burundi, and Rwanda can stay out of it but continue to participate in the COMESA FTA until EAC establishes a common trade policy. As noted earlier, it is hard to justify a second CU within the COMESA FTA.

2.45 After five years of negotiations, the COMESA member states have recently reached an agreement on the COMESA CET which has four bands: raw materials, capital goods, intermediate products, and final goods. The decisions on the CET include the following: (a) the rates for raw materials and capital goods would be zero; (b) the target rates for the intermediate products and the final goods were set at 10 percent and 25 percent, respectively; (c) when the CU is launched in December 2008, all tariff lines carrying a rate above or below these rates will be placed in the sensitive product lists16; (d) each member state will have its own sensitive product list and timetable to adjust to the target rates in the medium to long-term; (e) the current HS system of product categorization will be reviewed and replaced by the UN Broad Economic Categories (BEC); and (f) if the region starts producing zero rated products (raw material and capital goods) in future, the agreed zero rate will be reconsidered.

2.46 The inclusion of such a long list of country-specific exceptions and the possibility of raising tariffs in future make the agreed CET both meaningless and costly. In addition, a long list of sensitive products and the absence of revenue pooling in the COMESA CET will necessitate implementation of ROO and maintenance of internal border posts, preventing COMESA to capture the main benefit of a CU. With only 58 products on the sensitive products list, no national exemptions (after 2008), and a commitment to further reduction in the current rates, the EAC CET is far superior to the COMESA CET. COMESA intends to launch the CET in December 2008, but it is not clear how many member states would join the new CU.

2.47 An important implication of the COMESA CET for the EAC is that a merger of the EAC CET with the COMESA CET may be pressed for to avoid two CUs in the COMESA FTA zone. The resulting compromise CET is very likely to be significantly inferior to the present EAC CET. If accepted, the merger would seriously stall the establishment of a full EAC CU and furthering deeper EAC integration. Therefore, the EAC should not agree to such a merger.

2.48 Regarding the EAC's relationship with SADC, application of variable geometry means that if SADC moves to a CU17, which is very unlikely, it would include only those members that are willing to join the CU. Tanzania may choose to stay out of the SADC CU but maintain its membership in the SADC FTA until the EAC establishes a common trade policy.

2.49 To have a common trade policy, EAC needs to harmonize the memberships of its member states in other RECs. There are two ways to do that18. First, the member states withdraw from SADC FTA (Tanzania) and COMESA FTA (Kenya, Uganda, Burundi, and Rwanda). Second, the EAC signs FTAs with COMESA and SADC to replace the present arrangements of the member states. The second option is preferable because it would further broaden the regional market and enable all EAC members to have access to the large South African market. The sequence of withdrawal of the member states from their bilateral FTAs and

[16] This means the present tariff systems of the member states would be the CET of COMESA with country-specific exemptions totaling over 1,000 goods.

[17] To avoid duplication of efforts, it is advisable for SADC to encourage its members that are willing to be a member of a CU to join SACU rather than to establish a second CU within SADC.

[18] The EAC CU Protocol and the Customs Management Act provide the legal basis for gradual elimination of member states' trade arrangements with other regional organizations. While the CU Protocol Article 37 (1) states that the Partner States will honor their trade commitments with countries and organizations outside the CU, Article 37 (3) provides that after signing the Protocol the Partner States will identify the issues arising from these arrangements in order to establish convergence on those matters for the purpose of the CU. In addition, the Customs Management Act Article 112 (2) states that preferential tariff treatment will not be applied to goods imported under the COMESA and SADC arrangements in the partner states after December 31, 2006. This provision has not yet been implemented.

signing of FTAs by the EAC with COMESA and SADC should be carefully arranged to minimize the likely costs of transition.

2.50 If, in addition, the EAC members collect their import revenues at the entry points into the common customs area, the EAC can eliminate implementation of RoO, taking an important step towards dismantling the intra-EAC border posts.

2.51 Cooperation among RECs. The Task Force which was set up by COMESA and SADC in 2001 to harmonize their programs and remove policy inconsistencies arising from overlapping commitments, gained momentum with the participation of the EAC in 2006. The Tripartite Task Force has met several times since then and agreed to harmonize their activities in the following nine areas without any sense of priority: regional customs bond guarantee system; one-stop border posts; FTAs, customs unions and issues of overlap; monitoring and eliminating non-tariff barriers; standards harmonization and implementation of SPS; competition policy; trade in services; capacity building and training in customs; and monetary convergence. This is a very useful initiative and deserves strong support from the donor community. However, to have tangible results from these efforts priorities need to be set and resources allocated to harmonize programs in these priority areas. Setting up one-stop border posts and harmonizing and improving cargo transit regulations would be two areas of high priority because a large number of countries participating in these RECs are small landlocked countries.

3. PRIORITIES IN FURTHERING REGIONAL INTEGRATION

3.1 Consolidation of the progress so far and preparing the EAC for deeper integration requires actions in a large number of areas. All of these actions cannot be taken at the same time because of EAC's limited institutional capacity and financial resources. While the EAC is making efforts to improve its institutional capacity at the regional and country level, it needs to set priorities in furthering its integration and allocate its limited resources to these priorities to be able to produce tangible results – and, maintain the credibility of its programs. The report suggests a list of core priority areas and, in each case, recommends broad direction of reforms. The analysis and the recommendations of the report would provide useful inputs in the ongoing negotiations among the member states for an EAC common market and efforts to harmonize programs between COMESA, SADC, and EAC.

3.2 The high priority areas that the EAC needs to focus on in the next 12-18 months are the following:

- **Conclude EPA Negotiations:** EPA negotiations are the single most urgent trade issue the EAC needs to address in the next few months because (a) the EU is the largest trading partner of the EAC and a well negotiated EPA can help EAC to boost and diversify its exports to the EU and serve as a catalyst for introduction of broader economic reforms in the EAC member states, (b) An EPA signed by all EAC member states would present an excellent opportunity for the EAC to start establishing a common trade policy, a key requirement for consolidating the CU, and (c) the EPA negotiations have to be concluded by the end of December 2007. Recognizing the political sensitivity of the issue, the technical discussion in the report suggests that it is advisable for the EAC member states to negotiate an EPA together either as the EAC group or as a part of the Eastern and Southern Africa (ESA) Group. It also suggests that EAC should focus on the following key areas in order to make the best of an EPA: (i) Concentrate on market access in three main sectors where EU preferences matter (agriculture, T&C, and fisheries). Duty-free and quota-free access already obtained, greater access to the EU market in these sectors will be determined by relaxing stringent ROO and strengthening member states' capacity to meet EU's sanitary and product standards; (ii) Insist on the centrality of the aid for trade in the EPA and prepare costed detailed projects for aid for trade in areas such as trade facilitation, improving SPS, etc; (iii) Include services in negotiations because liberalization of services would have a strong impact on the quality and the cost of services improving the competitiveness of the tradable goods; and (iv) Avoid a long list of sensitive products and a long implementation period. Given the limited time left, the EAC member states need to make their decision on the country configuration very soon and seek for technical assistance to prepare for negotiations.

- **Improve and Harmonize the Business Environment in the EAC zone:** Deeper integration is not an end in itself. Its objective is to increase investment and growth through broadening the domestic market, taking advantage of scale economies, and improving competitiveness. Unless the business environment is substantially improved in the common customs area, investment and growth cannot be stimulated even if all elements of deeper integration are in place (The Doing Business Index developed by the World Bank ranks the EAC members among the bottom 50 percent of business-friendly countries in the world).[19] It is essential therefore for the EAC to develop a program to reduce the cost of doing business in the EAC zone and make it an investment friendly destination to encourage foreign and domestic investment in export-oriented sectors. The policy areas to be covered would include: removing administrative barriers; improving regulatory frameworks governing infrastructure services and labor market; harmonizing investment and export incentives, competition and tax policy, customs administration and transit cargo regulations; and supporting the small and medium enterprise (SME) sector. The Investment Climate Surveys prepared by the World Bank for the member states, the FIAS report on harmonization of investment policies in the EAC area (FIAS 2005), the EAC study on business climate (EAC 2005), and the IMF report on tax incentives and harmonization (IMF 2004), Kenya's Private Sector Development Strategy (2006) would provide the necessary background information for developing a multi-country project and seek funding from the International Financial Institutions.

- **Liberalize Services Trade:** Services are critically important in every economy because they make a large direct contribution to national income (43 percent in the EAC in 2005 and rising) and a powerful indirect contribution through their impact on the competitiveness and performance of other sectors of the economy. Services include transport, communications, finance, distribution, health, education, and tourism. Services "trade" encompasses cross border trade in road and air transport; foreign direct investment in communication, banking, and distribution; consumption by foreigners of tourism services; and temporary migration of skilled and unskilled workers. Improving the quality and reducing the cost of these services and widening access to them are essential to improve competitiveness of the member states' economies. Services also have substantial potential to contributing to export growth and diversification particularly in tourism and temporary migration of workers. The required reforms include elimination of barriers to entry (preferably on a MFN basis), improvement and harmonization of regulations, and widening of access to the SME sector. A diagnostic exercise should be launched as quickly as possible to take stock of services policies and performance in the member states, identify policy constraints and inadequacies, and recommend remedial actions that can be undertaken individually by the member states or collectively as the EAC.[20] Technical assistance needs to be sought to finance this exercise.

- **Eliminate the Remaining NTBs:** Removal of tariffs on intra-EAC trade is not sufficient to establish a FTA. Intra-EAC trade is still hampered by a large number of NTBs. Removing these barriers is therefore necessary to establish a full EAC FTA.

[19] See World Bank (2007).
[20] For a country case study, see Mattoo and Payton (2007).

The EAC Secretariat and the Eastern African Business Council (EABC) have jointly developed a mechanism to identify, report, and monitor elimination of all NTBs.[21] They conducted a survey and identified the main NTBs under the following eight categories:[22] customs administration and documentation; immigration procedures; cumbersome inspection requirements; police road blocks; different trade regulations among member states; different, cumbersome and costly transit procedures among the member states, duplicated functions of agencies involved in verifying the quality, quantity and the dutiable value of imports and exports; and business legislation and licensing. The EAC-EABC study also proposed a monitoring system at the country and regional level for elimination of the NTBs. Financial resources are urgently needed to operationalize the findings of this study.

3.3 Other areas of priority that need to be addressed in the longer-term include the following:

- **Set up an EAC Regional Fund.** If economic conditions are widely different among the members of a REC, the benefits of economic integration may be uneven among the member states. Addressing economic imbalances among the member states and ensuring equitable distribution of benefits are important objectives of the EAC integration (The Treaty, Article 7). But a satisfactory mechanism has not yet been put in place to realize these objectives. The EU has been addressing the issue of large gaps in economic conditions among regions with various regional or structural funds and other redistribution mechanisms to establish equity among the members and ensure economic convergence. A similar regional policy may be explored for the EAC to help alleviate the current regional imbalances and encourage more equitable development among members. One option to achieve this objective is to create an EAC Regional Fund in collaboration with the donor community (a good candidate for aid for trade, particularly from the EU), and use it to assist the poorer regions to ensure economic convergence within the EAC.[23] However, given the difficulties in mobilizing funds for it and managing it, setting up such a fund should be a medium- to longer-term objective, should be considered together with other possible options for addressing regional disparities, and needs to take account of the differences in economic and institutional development between the EU and the EAC.[24]

- **Reduce the Role of EAC's Internal Border Posts and Developing a Common EAC Trade Policy – Two Key Requirements for Consolidation of the EAC CU.** It is recommended that (a) arrangements should be made for the member states to collect their import revenues at the point of entry to the common customs area rather than at the internal border posts, (b) the member states phase out their bilateral FTAs

[21] Article 13 of the Protocol obliges member states to remove all existing NTBs affecting intra-EAC trade and refrain from imposing new ones. It also provides that the member states will formulate a mechanism to identify and monitor the removal of them.

[22] EAC and EABC (2006).

[23] The EAC has a Common Fund established to finance the administrative expenses of the EAC Secretariat. It is also exploring the possibility of setting up an EAC Development Fund to assist regional infrastructure projects.

[24] A key difference between an EAC Regional Fund and similar funds in the EU would be the sources of financing the fund. The EU finances such funds from its own budget. In the case of the EAC, a large part of financing would need to come from the donor community. The EU who is very keen to assist the EAC CU, might support an EAC Regional Fund. It already provides financial support to COMESA Fund.

with COMESA and SADC as stated by the EAC CU Management Act Article 112 (2), (c) the EAC signs FTAs with COMESA and SADC to maintain the benefits of earlier arrangements by the member states. These three measures will make the implementation of ROO in the EAC common customs area unnecessary. This, in turn, will reduce the role of internal border posts significantly (border posts will not be needed for enforcing the ROO and collecting import revenues) resulting in substantial cost saving and ensuring free circulation of goods in the EAC zone. Note that additional steps such as harmonization or mutual recognition of standards, elimination of visa requirements among member states, harmonization of excise taxes, strengthening VAT administration, etc are also needed to fully eliminate internal border formalities. Because effective implementation of these measures requires significant improvement in institutional structure of the member states and development of supra-national agencies, full elimination of internal border formalities is a longer-term objective rather than a near-term priority. Until the internal borders are eliminated there are a number of measures that can be taken to streamline the trade and transport procedures within the common customs area such as development of a common transit system, simplification of procedures for internal trade and VAT accounting, harmonization and simplification of customs procedures, etc. Steps have already been taken in most of these areas by COMESA and SADC. They are also on the agenda of the Tripartite Task Force (see below). To avoid duplications and inconsistencies, the EAC is advised to press for acceleration of implementation of these initiatives rather than introducing parallel programs. Note also that (b) and (c) above and an EPA signed by all member states would be the essential components of a common EAC trade policy.

- **Coordinate Programs among RECs.** The Task Force which was set up by COMESA and SADC in 2001 to harmonize their programs and remove policy inconsistencies arising from overlapping commitments, gained momentum with the participation of the EAC in 2006. The Tripartite Task Force has met several times since then and agreed to harmonize their activities in the following nine areas without prioritization: regional customs bond guarantee system; one-stop border posts; FTAs, customs unions and issues of overlap; monitoring and eliminating non-tariff barriers; standards harmonization and implementation of SPS measures; competition policy; trade in services; capacity building and training in customs; and monetary convergence. This is a very useful initiative and deserves strong support from the donor community. However, to have tangible results from these efforts, priorities need to be set and resources allocated to harmonize programs in the priority areas. Setting up one-stop border posts and harmonizing and improving cargo transit regulations would be two areas of high priority because a large number of countries participating in these RECs are small landlocked countries.

- **Avoid a Merger between the EAC and COMESA CETs.** After five years of negotiations, the COMESA member countries have reached an agreement in May 2007 on the COMESA CET which has four bands: raw materials, capital goods, intermediate products, and final goods. The decisions on the CET include the following: (a) the rates for raw materials and capital goods would be zero; (b) the target rates for the intermediate products and the final goods were set at 10 percent and 25 percent, respectively; (c) when the CU is launched in December 2008, all tariff lines carrying a rate above or below these rates will be placed in sensitive product lists; (d) each member state will have its own sensitive product list and timetable to adjust to the target rates in the medium to long-term; (e) the current HS system of product categorization will be reviewed and replaced by the UN Broad Economic Categories (BEC); and (f) if the region starts producing zero rated products (raw material and capital goods) in future, the agreed zero rate will be reconsidered. The inclusion of such a long list of country-specific exceptions (over 1,000) and the possibility of raising tariffs in future make the agreed CET both meaningless and costly.[25] The EAC CET is far superior to the COMESA CET. An important implication of the COMESA CET for the EAC is that a merger of the EAC CET with the COMESA CET may be pressed for to avoid two CUs in the COMESA FTA zone. The resulting compromise CET is very likely to be significantly inferior to the present EAC CET. If accepted, such merger would stall the establishment of a full EAC CU and furthering deeper EAC integration. Therefore, the EAC should not agree to a merger.

[25] For a more detailed discussion see De Melo, Yagci and Dijofack (2007).

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ANNEX A: ECONOMIC PROFILE OF THE EAC AND ITS MEMBER STATES

The tables below present the background data for this analysis. (South Africa is included in some of these tables for comparison.) The following economic characteristics of the EAC region stand out:

- The EAC (5) has a combined GDP of $38 billion (about 20 percent of the GDP of South Africa) and an average per capita income of $325 (Table A.1), indicating a small domestic market and a level of purchasing power that is not high enough to support sustainable high growth in the EAC region to catch up with other developing countries. Hence, acceleration of growth in the EAC region has to rely primarily on export demand. Yet, the share of the EAC in world exports declined from 0.066 percent in 1990-92 to 0.059 in 2002-04 (Table A.2), indicating the failure of the region to take advantage of the trade opportunities created by rapid globalization since the 1980s[26]. In contrast, the share of all developing countries in world exports increased from 18.7 percent to 31.3 percent, in the same period.
- The composition of exports has not changed in an important way in the region; primary goods still constitute over 80 percent of total exports[27]. The data also show a high degree of export concentration. In all EAC members, 5 or fewer products account for at least 50 percent of total exports (Table A.3). This is an indication that the EAC region has not reached a sufficiently diversified economic structure to participate in the globalization of economic activity.

[26] There is no sufficient data to assess the trade performance before and after the introduction of the CU.
[27] Yagci and Aldaz-Carroll (2004, p. 21).

Table A. 1: Selected Variables (2002-05 averages)

	Kenya	Tanzania	Uganda	Burundi	Rwanda	Total/ Average
GDP (current mil. $)	16,522	11,238	7,264	686	1,891	37,601
GDP growth (%)	2.4	4.2	6.4	0.6	1.9	3.8
GNP pc ($)	480	320	253	93	213	325
Composition of GDP (%)						
Agriculture	28	45	32	38	42	32
Industry	18	17	22	19	21	17
Services	54	38	46	43	37	42
Domestic savings/GDP (%)	12	9	7	-11	1	9
Gross Investment/GDP (%)	17	19	21	12	20	18
Revenue/GDP (exc. grants, %)	24	11	12	20	13	17
Expenditure/GDP (%)	22	18	23	34	24	21
Fiscal balance/GDP (%)	2	-7	-11	-14	-11	-4
Exports GNFS/GDP (%)	26	18	13	9	10	20
Imports GNFS/GDP (%)	32	27	27	32	29	30
Cur. account balance/GDP (%)	-1	-3	-4	-21	-3	-3
Population (million)	33.5	37.6	27.8	7.3	8.9	115.1
Land size (000 sq km)	569	884	197	26	25	1,701

Source: WDI Data Base.

Table A. 2: Main Trends in Trade (percent)

	Growth Rates (1990-2004)			Share in World Exports		Share in World Imports	
	Exports	Imports	GDP	1990-92	2002-04	1990-92	2002-04
EAC	4.4	4.5	3.5	0.066	0.059	0.110	0.109
Kenya	2.8	5.5	1.7	0.040	0.035	0.054	0.056
Tanzania	5.9	2.3	4.0	0.013	0.014	0.023	0.030
Uganda	10.9	6.5	6.5	0.006	0.007	0.012	0.016
Burundi	11.7	6.9	-0.4	0.003	0.001	0.005	0.002
Rwanda	-0.1	5.4	1.6	0.004	0.003	0.006	0.005
COMESA	4.4	2.8	3.4	0.549	0.472	0.699	0.634
Developing Countries	8.4	7.0	3.9	18.45	31.05	18.68	28.28

Source: UN COMTRADE

- There has been a marked change in the direction of trade (Table A.4). The share of the EU, the largest trading partner of the region, fell considerably in region's export (from 52 percent in 1990-92 to 36 percent in 2002-04) despite the EAC member states' non-reciprocal preferential access to the EU market under the Lome Convention and the Cotonou Agreement. The EU's share in region's imports also fell from 44 percent to 24 percent in the same period. The share of all other major trading partners of the region as well as the share of intra-EAC trade increased, indicating significant geographic diversification.

- The share of intra-EAC trade in total trade of the EAC group increased substantially, but it remains low (though the largest among the RECs in Africa). The share of intra-EAC exports in total exports were up from 7.9 percent in 1990-92 to 14.7 percent in 2002-04, while the share of intra-EAC imports in total imports increased from 4.2 percent to 8.5 percent, in the same period (Table A4). The low volume of intra-block trade is explained primarily by the limited opportunities for trade among the member states because they have similar resource endowments producing similar products (lack of complementarity)[28]. Remaining NTBs and lack of competitiveness in the member states are also important causes of low intra-EAC trade. There are two important implications of this. First, the primary objective of deeper integration will be improving competitiveness in the EAC region by integrating fragmented national markets as a useful stepping-stone on the way to greater integration in the world economy rather than focusing solely on expanding intra-EAC trade. Second, effective cooperation on joint regional projects that has strong externalities and spillover effects is as important as trade integration in improving competitiveness of the EAC region.

Table A. 3: Share of Five largest Export Items in Total Exports in 2004 (%)

KENYA		TANZANIA		UGANDA		BURUNDI		RWANDA	
Coffee, tea, spice	19.4	Fish, crustaceans	16.0	Coffee, tea, spice	30.6	Coffee, tea, spice	75.0	Coffee, tea, spice	53.0
Live trees, plants	14.0	Mineral fuels, oil	11.9	Fish, crustaceans	26.6	Pearls, prec. stones	14.6	Ores, slag and ash	39.2
Mineral fuels, oil	8.9	Tobacco	8.8	Tobacco	12.5	Live trees, plants	1.5	Raw hides, skins	1.5
Clothing	8.8	Ores, slag and ash	8.1	Live trees, plants	8.1	Wood products	1.4	Elect. machine.	0.7
Vegetables	7.8	Spices	7.8	Cotton	6.1	Clothing	1.1	Man-made fibre	0.7
Total	58.9		52.6		83.9		93.6		95.1

Source: UN COMTRADE

[28] Similar factor endowments of countries do not necessarily mean that they have no scope of trade. Trade among such countries is of intra-industry nature, which is dominant among industrialized countries in sectors producing technology- and skill-intensive manufactures closely integrated production networks, or consumer goods for niche markets.

Table A. 4: Destination of Exports and Sources of Imports (%)

	EAC				COMESA			
	Exports to		Imports from		Exports to		Imports from	
	1990-92	2002-04	1990-92	2002-04	1990-92	2002-04	1990-92	2002-04
Intra-Region	7.9	14.7	4.2	8.5	4.1	3.6	2.7	4.5
Extra-Region	92.1	85.3	95.8	91.5	95.9	96.4	97.3	95.5
Rest of Africa	1.5	2.0	1.0	0.4	1.5	1.5	1.4	1.0
USA	5.0	7.4	4.6	5.8	17.6	19.9	13.9	10.6
EU	51.9	35.8	44.3	23.6	49.7	29.5	45.0	31.8
East Asia & Pacific	8.1	8.5	19.5	19.5	9.8	16.4	14.7	19.5
South Asia	7.4	7.1	4.4	8.5	2.8	1.5	2.2	4.0
Rest of the World	18.1	24.5	22.1	33.7	14.6	27.6	20.1	28.5
World	100	100	100	100	100	100	100	100

Source: UN COMTRADE

- An interesting feature of the EAC is the asymmetry of Kenya's exports and imports in intra-EAC trade. Kenya accounts for 86 percent of intra-EAC exports but only 4 percent of intra-EAC imports (Table A.5). As a result, Kenya runs a large trade surplus with all other members. This is explained by the fact that Kenya has a larger, more developed and diversified economy compared to other EAC members. As Table 2 shows inter-country variations are wide in terms of features discussed above. Kenya leads the pack in almost all indicators. These imbalances may lead to uneven distribution of benefits of integration and create conflict among members, which may slow down integration thereby reducing benefits for all. The EU has been addressing the issue of large gaps in economic conditions among regions with various regional or structural funds and other redistribution mechanism to establish equity among the members and ensure economic convergence. Designed appropriately (taking account of the differences in economic and institutional development between the EU and the EAC) and implemented effectively a similar regional policy in the EAC would help alleviate regional imbalances and lead to a more equitable development. An EAC Regional Fund can be created for this purpose to be financed by donor funding (more on this later).

- The rates of domestic savings and investment (an important determinant of longer term growth), 9 percent and 18 percent of combined GDP (Table A1), respectively, are very low and cannot support sustained high growth in region's productive capacity. Foreign direct investment (FDI), also very low, cannot fill the region's large investment gap. Low domestic and foreign investment is explained by high-cost of doing business in the EAC region and lack of availability of infrastructure services (particularly transport, power, and communications) at internationally competitive prices. The Doing Business Index developed by the World Bank ranks the EAC members among the bottom 50 percent of business-friendly countries in the world (Table A.6). The EAC member states do not fair well also in provision of infrastructure services (Table A.7). Improving the investment climate, business environment, and infrastructure services accompanied by liberalization of backbone services to enhance competitiveness in the common customs area in order to attract domestic and foreign investment has to be very high on the EAC's reform agenda.

Table A. 5: Intra-EAC trade Flows and Balances (million $), average 2003-05

TRADE FLOWS

		Exporting Countries					
		Burundi	Rwanda	Kenya	Uganda	Tanzania	Total
Importing Countries	Burundi		0.93	36.99	11.75	23.37	73.04
	Rwanda	2.99		90.45	29.09	6.85	129.38
	Kenya	0.04	0.17		13.67	24.13	38.01
	Uganda	0.03	0.68	486.84		13.72	501.27
	Tanzania	0.04	0.07	248.26	8.16		256.53
	Total	3.10	1.85	862.55	62.67	68.07	998.24

TRADE BALANCES

		Exporting Countries					
		Burundi	Rwanda	Kenya	Uganda	Tanzania	Total
Importing Countries	Burundi		-2.06	36.95	11.72	23.33	69.94
	Rwanda	2.06		90.28	28.41	6.78	127.53
	Kenya	-36.95	-90.28		-473.17	-224.13	-824.54
	Uganda	-11.72	-28.41	473.17		5.56	438.60
	Tanzania	-23.33	-6.78	224.13	-5.56		188.46
	Total	-69.94	-127.53	824.54	-438.60	-188.46	

Source: UN COMTRADE

Table A. 6: Doing Business Rankings and the Business Competitiveness Index

	Doing Business Ranking		Business Competitiveness Index
	2005	2006	2003/04
Kenya	80	83	67
Uganda	103	107	74
Tanzania	150	142	68
Rwanda	158	158	na
Burundi	160	166	na
South Africa	28	29	27
Mauritius	32	32	44
Namibia	39	42	55
Botswana	44	48	54

Note: Doing Business rankings cover 175 countries with the first place being the best. The Business Competitiveness Index, prepared by the World Economic Forum, covers 171 countries.

Table A. 7: Selected Indicators of Infrastructure Services (2002-4)

	Kenya	Tanzania	Uganda	Burundi	Rwanda	South Africa
Firms identifying transport as a major or very severe obstacle to business operations and growth (%)	37.4	22.9	22,9	na	na	10.1
Telephone subscribers (per 1,000 people)	85.0	32.2	44.4	12.5	18.2	473.1
Cost of phone call to the US (US cents per 3 minutes)	436	528	351	371	na	58.3
Electric power consumption (kw per capita)	119.7	67.8	68.5	18.0	19.9	4559.5
Price of electric powers to industry (Us cents per kwh)	6.7	8.6	6.6	na	na	2.0

Source: Africa Development Indicators 2006, World Bank

ANNEX B: GLOSSARY OF TRADE-RELATED TERMS

ACP. African, Caribbean, and Pacific countries, a group of mostly former European colonies.

Ad Valorem. An ad valorem duty is based on the value of dutiable item and expressed in percentage terms: e.g., a duty of 30 percent on the value of clothing.

Ad Valorem Equivalents (AVE). A calculation of the level of a specific tariff, which converts a rate expressed as a fixed monetary value per unit of product, into a value expressed as a percentage of the value of the product.

Additive Regionalism. The process of establishing a complex system of interlinking PTAs, as opposed to a single all-encompassing regional trade agreement.

Antidumping. Trade policy used by importing governments to counteract dumping, for example by imposing duties or negotiating price increases.

ASYCUDA. Automated System for Customs Data. A computerized customs management system developed and implemented by UNCTAD that covers most foreign trade procedures and handles manifests and customs declarations, accounting procedures, transit and suspense procedures.

Contingent Protection. Trade barriers that are imposed if certain circumstances (contingencies) are met. Examples include antidumping or countervailing duties (to offset subsidies) and safeguards.

Cotonou Agreement. A partnership agreement between the EU and the ACP countries signed in 2000 to replace the Lome Convention. During an eight year period, it maintains Lome IV non-reciprocal preferences while the EU and the ACP countries, as regional groupings, negotiate Economic Partnership Agreements (EPA).

Countervailing Duty. Duty levied on imports of goods that have benefited from production or export subsidies. The duty is intended to offset the effect of the subsidy.

Cumulation. A set of rules of origin allowing, to various degrees (depending on the type: bilateral, diagonal or full), the use of inputs from preferential producers located in countries others than the one from which the final product is shipped. Full cumulation is the most liberal, bilateral the least.

Customs Union (CU). A preferential trading arrangement in which partners have no tariff barriers among themselves and share a common external trade policy (including a common external tariff (CET)). In a full CU the ROO and internal border posts are eliminated allowing for free circulation of goods.

Deep Integration. Designates forms of integration going beyond tariff reductions to cover other trade and non-trade areas such as cooperation over common resources, harmonization of policies and regulations, and the development of supra-national bodies in areas of common interest.

Double Transformation Rule. A rule of origin applied in the Textile and Apparel (T&A) sector whereby products must be twice transformed in the area (say, from yarn to fabric and from fabric to garment) in order to qualify for preferential treatment.

Effective Rate of Protection (ERP). A measure of protection afforded to the value added in the product concerned. Takes into account the protection on output and the cost-raising effects of protection on inputs.

Enabling Clause. It allows WTO members to accord differential and more favourable treatment to developing countries, without according such treatment to other contracting parties.

Free Trade Area (FTA). A preferential trading arrangement in which partners have no tariff barriers among themselves, but keep their own external trade policy. This implies that rules must be established to identify origin (ROO) to prevent transhipment via the partner with the low external tariff.

Generalised System of Preferences (GSP). Gives goods from developing countries a preferential margin in the tariff rates they face in the markets of developed countries. Entered into force in 1971. Since then has diminished in importance owing to the general reduction in tariff rates worldwide.

Graduation. Concept linking the rights and obligations of a developing country to its level of development. Generally used in the context of GSP and similar types of preferential treatment of low income countries as a mechanism or set of criteria to determine when countries cease to be eligible for preferences.

Harmonized System (HS). Harmonized Commodity Description and Coding System. Nomenclature developed by the World Customs Organization for customs tariffs and international trade statistics.

Lome Convention. This agreement was between the EU and the ACP countries on trade concessions, development aid, and general cooperation. Replaced by the Cotonou Agreement in 2000.

Most-Favoured Nation (MFN) Principle. The rule that a country must give each of its trading partners the best treatment it gives to any of them in a given product. In the WTO, MFN is the binding general obligation that any concession must immediately be extended to all other members, with limited exceptions including FTAs or CUs.

Multifiber Arrangement (MFA). The Agreement that regulated trade in certain textile products between signatories by means of negotiated bilateral quotas. Superseded by the WTO Agreement on Textiles and Clothing (ATC) in 1995, which specified that all quotas are to be abolished by 2005.

Mutual Recognition. The acceptance by one country of another country's certification that a product has satisfied a product standard. Often based on formal agreements between countries if the standards are mandatory.

National Treatment. Principle that foreign goods, services, and persons, once they have entered a country and satisfied any formalities that are required, are treated in exactly the same way as national goods, services, or persons. In particular, they face the same internal taxes and no additional restrictions.

Negative List. In an international agreement, a list of those items, entities, products, and so on to which the agreement will not apply, the commitment being to apply the agreement to everything else. Contrast with positive list.

Nominal Rate of Protection (NRP). The proportion by which the (tariff inclusive) internal price of an import exceeds the border or world price.

Non-tariff barrier (NTB). Any measure other than taxes that restricts trade. Includes licensing requirements, technical norms, safeguard levies, variable import levies, tariff quotas.

Non-discriminatory trade policy. A trade policy in which a country adopts tariff and non-tariff measures with respect to all of its trading partners, with no preferential arrangements.

Open Regionalism. A form of regional integration emphasizing continued adherence to MFN principles and the promotion of open trade between the preferential zone and MFN partners outside the zone (e.g. low MFN tariffs).

Pass-through coefficient. The rate of transmission of a change in tariff into a change in price.

Plurilateral Agreement. In WTO, an agreement to which membership is voluntary, dealing with an issue that is not covered by the WTO.

Preferential Margin. The difference between the duty that would be paid under a system of preferences in a PTA of some sort and the duty payable on a MFN basis.

Preferential Trading Arrangement (PTA). A trade arrangement under which one party agrees, either unilaterally or through negotiation, to grant one or more other parties preferential treatment in trade in goods or services.

Preshipment Inspection. Mechanism under which goods are inspected and certified in the country of origin by specialized inspection agencies or firms. Often used by importing governments to combat over- or under-invoicing of imports by having the value of consignment determined by independent entities.

Price-reaction coefficient. The rate of transmission of a change in the price of a good from partner B into a change in the price of a good from partner A.

Quad. Refers to the participations in the quadrilateral meetings – that is, Canada, the EU, Japan, and the US.

Quantitative Restriction (QR). A limit or quota on the amount of a particular product that can be imported or exported during a given period.

Regional Trade Agreement (RTA). An FTA, CU or Common Market consisting of two or more countries.

Remedy. Legal term to describe a measure recommended by a WTO dispute settlement panel that aims to bring the policies of a member found to have violated WTO rules or disciplines into compliance with its obligations.

Request-Offer Procedure. Negotiating procedure based on the tabling, by each party, of a list of concessions requested of other parties, followed by an offer list of the concessions that could be granted if its request were met.

Revealed Comparative Advantage. An index intended to capture the pattern of trade a country would have in the absence of its (and its trading partners) restrictive trade practices.

Rules of Origin (ROO). A set of laws or regulations applied by governments to determine the country of origin of goods, services or investment. Preferential RoOs determine the eligibility of goods for preferential tariff under PTAs and are usually spelled out in voluminous annexes to the trade agreements.

Safeguard Action. Emergency protection to safeguard domestic producers of a special good from an unforeseen surge in imports to protect a country's external financial position and balance of payments or to protect an infant industry in a developing country.

Sanitary and Phytosanitory Standards (SPS). A technical requirement specifying criteria to ensure food safety and animal and plant health. Many international SPS are set by the FAO/WHO.

Small Open Economy (SOE). Describes an economy that cannot affect the prices at which it trades on world markets, both for imports and for exports.

Special and Differential Treatment. The principle in WTO that developing countries be accorded special privileges, either exempting them from some WTO rules or granting them preferential treatment in the application of WTO rules.

Tariff Binding. Commitment by countries in WTO not to raise particular tariff items above a specific or bound level.

Tariff Equivalent. Measure of the protective effect of an NTB – the tariff that would have the exact same effect on imports as the NTB.

Tariff Escalation. The setting of a tariff in such a way that it rises with the increasing transformation of a product. It is used to favour the import of simple manufactures in order to promote an increase in domestic manufacturing.

Tariffication. Conversion to and binding of tariff equivalents of non-tariff measures.

Tariff Peak. Tariffs that are particularly high, often defined rates that exceed 15 percent or the average nominal tariff by a factor of more than three.

Tariff Rate Quota (TRQ). Measure under which a good is subject to a MFN tariff, but a certain quantity (the quota) is admitted at a lower, sometimes zero tariff. TRQs are mainly applied to agricultural trade and can be seasonal.

Technical Barriers to Trade (TBT). Regulations, standards, administrative or licensing requirements that raise the cost of producing or importing foreign goods.

Total Factor Productivity Growth (TFPG). The efficiency with which an economy uses its inputs (labor, capital, skills etc.). TFPG is one of the potential sources of the GDP growth, the other being the accumulation factors (through investment, immigration or education). It is measured by cross-country regression analysis.

Trade Creation. One of the criteria used for assessment of FTAs or CUs. A preferential reduction in tariffs by a country with respect to a trade partner leads to Trade Creation when the partner was the efficient supplier and was exporting to the country before the tariff reduction.

Trade Deflection. A process by which the country having the lowest external tariffs of an FTA serves as port of entry for the whole area, thus reducing tariff revenue for other members.

Trade Diversion. One of the criteria used for assessment of FTAs or CUs. A preferential reduction in tariffs by a country with respect to a trade partner leads to Trade Diversion when there is a shift in the sources of imports from the Rest of the World towards the (inefficient) partner.

Utilisation Rate. The ratio of the value of goods receiving preferences to the value of goods eligible for preferences.

Waiver. Authorized deviation from a previously undertaken and legally binding obligation. Conditions under which waivers are granted are generally negotiated and limited in time.

ANNEX C: STATE OF TRADE INTEGRATION AMONG COMESA, EAC, SADC, AND SACU

	COMESA	EAC	SADC	SACU
Objective	Economic Community in 2025 through FTA (2000), CU (2008), and CM (2014).	Political Federation in 2015 through CU (2005), CM (2009), and MU (2010).	Monetary Union in 2018 through FTA (2008, 2012), CU (2010), CM (2015)	Customs Union established in 1010.
Intra-Block Trade in Goods	FTA was initiated in 2000. 13 of its 19 members now trade duty free. Eritrea, Ethiopia, and Uganda trade with others on reduced rates. DRC, Seychelles, and Swaziland have not yet joined the FTA.	Asymmetric tariff dismantling was introduced in 2005. Goods exported from Tanzania and Uganda to each other and to Kenya are duty free. Tariffs on goods exported from Kenya to Tanzania and Uganda will be phased out by the end 2009.	Asymmetric tariff phase down started in 2000. Substantial liberalization (85%) will be achieved by 2008 and full FTA by 2012. SACU agreed to liberalize faster. Non-SACU members have two phase-down offers: one to SACU and one to other non-SACU members, the latter being slower. Malawi, Mozambique, Tanzania, and Zimbabwe are behind the schedule in implementation.	FTA was introduced in 1010 with the CU.
Non-Tariff Barriers (NTB)	A roadmap and monitoring mechanism for elimination of NTBs prepared but not yet implemented.	A program to identify and monitor elimination of NTBs prepared but not yet implemented.	Contact points at the member states has been established but no program has yet been prepared for elimination of NTBs.	No plan for elimination of NTBs.
Rules of Origin	Relatively simple and liberal rules with five origin conferring criteria. Rules for a number of products still being negotiated.	Very similar to COMESA's rules of origin.	Restrictive product-specific ROO. Malawi, Mozambique, Tanzania, and Zambia are allowed to export textiles and clothing to SACU (within quota limits) subject to single transformation until the end of 2009. ROO for a few products yet to be agreed upon.	No ROO for intra-SACU trade.
Intra-Block Trade in Services	National assessments of services sector were completed and a framework for liberalization of services prepared, but not yet negotiated.	Negotiations on liberalization of services will be part of EAC Common Market negotiations that is expected to start in September 2007.	A draft Protocol on trade in services was prepared which allows progressive liberalization of specified services. It has not yet been negotiated.	The SACU Agreement does not cover services.
Free Movement of Persons	A Protocol for gradual introduction of free movements was prepared but not yet ratified by member states.	Free movement of persons will be included in negotiations on the EAC Common Market.	A Protocol on facilitation of movement of persons prepared but not yet negotiated.	There is no visa requirement for member countries within SACU.
Trade	A common customs administration document was prepared and used by most	A common customs administration document is used	A common customs administration document was introduced and used by most	A common customs administration document

	COMESA	EAC	SADC	SACU
Facilitation	members. Work ongoing to introduce a single border post at Zambia-Malawi border on a pilot basis. Others are planned. Common vehicle insurance, transit charges, carrier licenses, and axle load limits were introduced and implemented by most countries.	by members. Work ongoing to introduce a single border post at Kenya-Uganda border. As its members, Kenya and Uganda implements COMESA's trade facilitation policies.	members. A single border post is introduced at South Africa –Mozambique border. Others are considered.	was introduced. Work ongoing on introduction of single border posts.
Harmonization of Behind the Border Policies	Duty exemptions, tax regimes, export incentives, and costume procedures have not harmonized. Limited progress made in harmonization of standards. A Competition Bill was prepared. Member states are establishing Competition Commissions to implement it. A Regional Investment Agency was established. A common Investment Code is negotiated. A Payment and Settlement System being established.	Duty exemptions, tax regimes, export incentives, and costume procedures have not yet harmonized. Some progress made in harmonization of standards. A Competition Bill was prepared. A draft model Investment Code was prepared but investment incentives have not yet been harmonized.	Duty exemptions, tax regimes, export incentives, and costume procedures have not harmonized. A limited number of standards have been harmonized. The Finance and Investment Protocol which aims at fostering harmonization of policies has been ratified by 10 members. Various committees are established to implement the protocol. Work initiated towards improvement and harmonization of Competition Policy.	Harmonization of policies is an objective of the new SACU Agreement, and it is necessary for establishment of a full CU. Despite this little progress made in harmonization of policies.
Common Trade Policy	A CET with two non-zero target rates (10 and 25 percent) to be introduced in December 2008. Each member has its own long sensitive product list and time table to adjust to the target rates. Most members negotiate EPA with the EU as a group.	A CET with two non-zero rates (10 and 25 percent) with a limited number of products on the sensitive product list was introduced in January 2005. Discussions ongoing how to negotiate an EPA with the EU. Streamlining member states' earlier bilateral FTAs is planned.	Work has not yet started to develop a common trade policy for the planned CU.	A CET in place since 1010. Negotiating an EPA with the EU as a group.