

Tariff Liberalisation Impacts of the EAC Customs Union in Perspective

by

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Abstract

This paper analyses the impacts of the EAC Customs Union (CU) Protocol which entered into force on 1 January 2005, after its ratification by the EAC Partner States – Kenya, Tanzania and Uganda. The EAC common external tariff took effect on 1 January 2005; at the same date, tariffs on intra-EAC trade were partially liberalised and will be fully eliminated by end 2009.

The analysis of the impacts of EAC CET and intra-EAC tariff liberalisation reveals that the CET effects strongly dominate. Impacts of intra-EAC tariff liberalisation and associated welfare effects of EAC regional integration will, therefore, be relatively small.

The relevance of non-tariff barriers (NTBs) to EAC trade and EAC's strategies to eliminate them are analysed. NTBs are considered clearly more critical obstacles to enhance EAC trade, than tariffs. Policies to address them effectively are considered a prerequisite to reap EAC-CU welfare gains.

The paper concludes that EAC CU benefits will not be evenly distributed among EAC Partner States. It recommends EAC should implement compensatory policies to address, in particular, supply constraints and infrastructure bottlenecks in the Partner States less benefited by the CU to ensure the stability of the Community.

A. Background and Introduction

On 30 November 1999, the (new²) East African Community (EAC) Treaty was signed by the EAC Partner States of Kenya, Tanzania and Uganda; it came into force on 7 July 2000 upon ratification by the three Partner States. The Treaty states that 'the Partner States undertake to establish among themselves ... a Customs Union, a Common Market, subsequently a Monetary Union and ultimately a Political Federation...' (Art. 5.2) In line with this undertaking, the EAC Customs Union Protocol was signed on 2 March 2004, ratified end December 2004 and came into force on 1 January 2005.

Thus, only 5 years after the new EAC was established, the Customs Union Protocol took effect. EAC disposed of the intermediate step of first establishing a free trade area. EU integration serves as an example for the EAC integration process; but while it took the European Union decades to establish a Customs Union, EAC adopted a very tight schedule to manifest its resolve to implement the EAC Customs Union as a milestone towards a political federation.

The study is structured as follows: In section B, this paper analyses important EAC Customs Union tariff provisions and discusses the implications of overlapping membership of EAC Partner States in EAC, COMESA and SADC, respectively. Section C contains a presentation of EAC Partner States' trade and tariff profiles and undertakes to compare the likely impacts of intra-EAC tariff elimination and of third-country Common External Tariff (CET) tariff harmonisation in the unified EAC customs territory as a consequence of the implementation of the EAC Customs Union Protocol. Section C also analyses the significance of CU tariff impacts on each of the three EAC Partner States individually as well as on EAC as a whole; the possible effects of enlarged EAC membership; the impact of higher than regular CET tariffs on sensitive product imports; post-January 2005 tariff adjustments; and the role of the CU for EAC to strengthen its competitiveness as a supplier to neighbouring countries. In section D, the paper analyses the impact of non-tariff barriers to trade in EAC and compares their relevance for free trade in the EAC Customs Union with the role of tariffs as barriers to EAC trade. Section E summarises the major findings of the study and draws conclusions regarding the way forward.

² Between 1967 and 1977, Kenya, Tanzania and Uganda pursued the first East African Community regional integration agenda, which, however, collapsed due, among others, to political and personal differences (I. Amin of Uganda versus J. Nyerere of Tanzania), economic policy divergences (Kenya followed market-oriented economic policies, while Tanzania implemented a socialist policy stance) and problems of dominance and divergent notions of equity (Tanzania and Uganda felt that Kenya was the principal winner of EAC integration).

B. Important EAC Customs Union Protocol Tariff Provisions

This section summarises and analyses the EAC Customs Union (CU) Protocol's most important tariff provisions.

B.1 Intra-EAC Tariff Liberalisation

B.1.1 Pre-Customs Union intra-EAC Tariff Preferences

Tanzania terminated its COMESA³ membership in 1999. Nevertheless, all three EAC Partner States continued to apply COMESA tariff preferences on imports originating in the two other EAC Partner States respectively. Consequently, between 1999 and end 2004, both Tanzania and Uganda granted tariff preferences of 80% on their intra-EAC imports (relative to their MFN tariffs prevailing at the time such preferences were agreed upon), while Kenya granted a 90% MFN tariff preference on imports from Tanzania and Uganda. Thus, further tariff liberalisation of intra-EAC trade as a consequence of EAC CU Protocol implementation was effected departing from COMESA tariff preferences already in place, i.e. from an already relatively low level of intra-EAC tariffs.

B.1 EAC-internal Tariff Liberalisation⁴

Intra-EAC tariff liberalisation started with Protocol implementation on 1 January 2005 and will be completed 5 years later, creating a fully fledged EAC Customs Union by January 2010.

CU Protocol provides that Kenya eliminate its tariffs on imports originating in Tanzania and Uganda respectively, with immediate effect on day 1 of the Protocol implementation, i.e. on 1 January 2005.

Tanzania's and Uganda's trade in category A products⁵ is also liberalised with immediate effect on day 1 of Protocol implementation; tariffs on both countries' category B imports originating in Kenya are phased out gradually over a period of 5 years (asymmetrical liberalisation), starting 1 January 2005.

Annex II CU Protocol provides for Tanzania's tariffs on 880 category B products originating in Kenya to be gradually reduced to 0%, starting 1 January 2005. The tariff liberalisation is effected at a different pace for the respective products within the

³ Common Market for Eastern and Southern Africa

⁴ Article 10 & 11 and Annex II EAC CU Protocol

⁵ Art.11.3: 'Category A goods ...shall be eligible for immediate duty free treatment; and category B goods shall be eligible for gradual tariff reduction.'

5-year phase-down period, depending on the level from which tariff liberalisation starts, and will be completed for all 880 products by 2010 (for some already in 2007).

Up to end of 2004 Tanzania levied suspended duties⁶ on selected imports from Kenya and Uganda; suspended duties were eliminated, both with respect to intra-EAC- and third-country imports, effective 1 January 2005.

Art. 11.4 and Annex II CU Protocol provide that Uganda's tariffs on 443 category B products originating in Kenya be gradually reduced to 0% over 5 years, starting 1 January 2005, as follows: year 1: 10%; year 2: 8%; year 3: 6%; year 4: 4%; year 5: 2%; year 6: 0%. In cases where such tariffs would be less favourable than those preferences Uganda extends to Kenya under the COMESA trade regime (cf. B.2.3 below), intra-EAC preferences should match those under the COMESA trade liberalisation scheme⁷.

Up to end of 2004, Uganda also charged excise duties of 10% on selected imports from Tanzania and Kenya, discriminating between national products and respective intra-EAC imports. Discriminatory excise duties were phased out, effective 1 January 2005.

B.2 Common External Tariff (CET)⁸ and CET exceptions

B.2.1 CET bands

A three-band CET on EAC imports originating in third countries (countries outside the EAC common customs territory) was agreed upon in the context of the EAC CU Protocol: 0% on raw material imports; 10% on intermediate product imports and 25% on finished imports. The CET entered into force on 1 January 2005, but was effectively applied as of February 2005, after reconfiguration of Partner States' customs systems.

At the end of the 5-year transition period, the highest CET band of 25% is to be reviewed and possibly reduced to 20 %, subject to approval by Partner States.

The adoption of the common external tariff (CET) by all three EAC Partner States, ending the practice of Partner States charging different national tariffs, is expected to contribute significantly towards enhanced simplicity, rationalisation, transparency and user-friendliness of EAC Partner States' tariffs. The same applies to the elimination of surcharges and excise duties by Tanzania and Uganda⁹ respectively.

⁶ In the EAC region, the term 'suspended duties' is used for duties on imports levied on a case to case basis for protection purposes

⁷ Art. 37 3 (a) provides for convergence of EAC CU Protocol provisions with arrangements agreed upon under other regional integration initiatives to which Partner States are members.

⁸ Art. 12 CU Protocol

⁹ Compare section B 1 above.

B.2.2 Treatment of sensitive products¹⁰

For 59 products (HS 8-digit product lines) included in EAC's sensitive products list, EAC Partner States charge CET tariffs on imports originating in third countries in excess of the maximum CET band of 25%, but lower than WTO tariff bindings. The significance and implications of EAC's treatment of sensitive products is analysed in section C.5 below.

B.2.3 COMESA and SADC trade preferences

Once COMESA's FTA graduates to a customs union, Kenya would be a member of two customs unions, EAC and COMESA. The same may, by then, also apply to Uganda¹¹. This is technically impossible, unless these customs unions' CETs and rules of origin, among other provisions, are identical.

Kenya is a member of the COMESA Free Trade Area (FTA), to which 11¹² out of the 21¹³ COMESA Member States belong. As such, it exchanges free-trade preferences with 10 COMESA FTA partner countries, as compared to less far-reaching tariff preferences exchanged with non-FTA COMESA members.

Tanzania is a member also of SADC¹⁴ and extends tariff preferences on imports originating in SADC Member States as a member of the SADC FTA Trade Protocol. EAC Partner States have agreed to uphold tariff preferences granted to third countries, as a temporary exception of EAC CET, provided such preferences had been agreed upon before the ratification of the EAC CU Protocol. This applies to Kenya's, Uganda's and Tanzania's tariff preferences under the COMESA FTA, COMESA and the SADC FTA. Later, EAC, as a bloc, intends to negotiate preferential trade agreements with COMESA and SADC respectively to overcome WTO inconsistent trade arrangements and address the problem of overlapping membership in various regional integration initiatives.

Once the SADC FTA graduates to a customs union, planned for 2010, Tanzania's membership in two customs unions will run into a similar problem as Kenya's (and possibly Uganda's – cf. footnote 11) with respect to the COMESA CU, discussed above. It would appear that the EAC CU can, in the long run, only be sustained as a fast-track option of a more slowly materialising COMESA CU, if all EAC Partner

¹⁰ Annex VI CU Protocol.

¹¹ Reports from the COMESA Council of Ministers meeting held in June 2005 in Rwanda indicate that Comoros and Uganda may join the COMESA FTA in the near future.

¹² Burundi, Djibouti, Egypt, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Sudan, Zambia and Zimbabwe.

¹³ In addition to the 11 COMESA FTA: Angola, Comoros, DR Congo, Eritrea, Ethiopia, Namibia, Seychelles, Swaziland, Uganda,

¹⁴ Southern African Development Community.

States belong also to COMESA. This would make it indispensable for Tanzania to rejoin COMESA and leave the SADC FTA¹⁵. It is worth noting that the differences between COMESA's envisaged and EAC's approved CETs and rules of origin are much less pronounced, than those between SADC's¹⁶ and EAC's.

Table 1 Origin of EAC Partner States' Imports 2003 1)

EAC Partners' trade with	Kenya's Imports		Tanzania's Imports		Uganda's Imports	
	USD Millions	%	USD Millions	%	USD Millions	%
TOTAL	4,148.9	100	2,321.7	100	1,371.7	100
EAC	133.41	3.22	121.85	5.25	368.12	26.84
Kenya			115.43	4.97	357.33	26.05
Tanzania	47.13	1.14			10.79	0.79
Uganda	86.28	2.08	6.42	0.28		
COMESA						
Egypt	28.73	0.69	6.35	0.27	6.43	0.47
Ethiopia	2.05	0.05	0.83	0.04	0.06	0.00
Rwanda	0.25	0.01	0.05	0.00	0.54	0.04
Zambia	6.16	0.15	145.06	6.25	0.21	0.02
OTHER AFRICAN COUNTRIES						
South Africa	361.16	8.70	228.86	9.86	98.98	7.22
INDUSTRIAL COUNTRIES						
Australia	20.77	0.50	37.96	1.64	31.98	2.33
Japan	204.58	4.93	85.17	3.67	90.36	6.59
Switzerland	22.61	0.54	6.98	0.30	7.06	0.51
United States	216.48	5.22	72.71	3.13	78.13	5.70
EU	996.62	24.02	505.24	21.76	258.33	18.83
Belgium	83.75	2.02	31.45	1.35	23.09	1.68
France	112.24	2.71	63.79	2.75	15.67	1.14
Germany	174.60	4.21	91.45	3.94	39.15	2.85
Italy	90.71	2.19	55.72	2.40	23.33	1.70
Netherlands	105.01	2.53	47.36	2.04	25.02	1.82
United Kingdom	309.59	7.46	101.63	4.38	86.14	6.28
ASIA						
China P.R. Mainland	265.88	6.41	210.60	9.07	70.25	5.12
India	242.11	5.84	176.17	7.59	102.16	7.45
Indonesia	31.07	0.75	77.78	3.35	4.69	0.34
Malaysia	20.07	0.48	29.09	1.25	42.06	3.07
Pakistan	93.95	2.26	23.34	1.01	18.29	1.33
MIDDLE EAST						
Bahrain	59.97	1.45	85.31	3.67	0.18	0.01
Saud Arabia	405.42	9.77	59.84	2.58	12.27	0.89
United Arab Emirates	556.76	13.42	122.87	5.29	80.42	5.86

Source: International Monetary Fund: Direction of Trade Statistics, December 2004

1) For direction of EAC trade analysis (tables 1 and 16), this paper uses IMF statistics for consistency and completeness sake. For all other calculations of this paper, national statistics are used, since only they provide the commodity breakdown (HS 6-digit) information on EAC imports. For comparison with table 1, below origin of EAC imports according to Partner States' national statistics and commodity breakdown:

¹⁵ Or, alternatively, leave EAC and maintain its membership in the envisaged SADC CU.

¹⁶ SADC has adopted product-specific rules of origin developed from those agreed between South Africa and the EU under the Trade and Development Cooperation Agreement (TDCA), which entered into force in January 2000. SADC has no approved structure for a future CET.

Millions of US \$

Imports of / originating in	Kenya	% of total	Tanzania	% of total	Uganda	%
EAC	28.6	0.8	82.8	4.6	368.1	26.8
Kenya	-		80.2		357.3	26.0
Tanzania	18.2		-		10.8	0.8
Uganda	10.3		2.6		-	
non-EAC	3,446.4	99.2	1,715.3	95.4	1,007.0	73.2
RSA	304.3	8.8	277.1	15.4	99.0	7.2
COMESA*	125.4	3.6			32.3	2.3
COMESA FTA	94.9	2.7				
Egypt	59.3				6.4	0.5
World total	3,475.0	100	1,798.1	100	1,375.1	100

*excluding Uganda viz. Kenya, respectively

C. EAC Partner States' Trade and Tariff Profiles and their Implication for the EAC CU Dispensation

EAC CU Protocol tariff impacts depend on the EAC Partner States' trade and tariff profile at present, compared to the situation which will prevail once the EAC CU has been fully implemented. Therefore, in this section, the paper analyses the three EAC Partner States' 2003 import profiles and endeavours to compare the countries' 2003 tariff profile with tariffs prevailing once the EAC CU is fully operational (2010). The comparison between the EAC Partner States' present and future tariff profiles, against these countries' 2003 import flows, can shed light on comparative static and some dynamic effects emanating from EAC CU Protocol implementation¹⁷.

C.1 Significance of intra-EAC imports

EAC Partner States' imports by country of origin are shown in table 1. It reflects the modest level of intra-EAC trade: only 7.9% of EAC Partner States' total imports consist of imports from within the EAC region. This figure, however, hides huge discrepancies among individual Partner States' intra-EAC trade in absolute and relative terms:

- Kenya is the least dependent on imports from the other two EAC Partner States: it sources merely 3.2% of its world imports from within EAC, of which about two thirds from Uganda and one third from Tanzania.

¹⁷ In 2003, before the CU negotiations had been concluded, a World Bank team carried out a first assessment of the EAC CU trade impacts: Lucio Castro, Christiane Kraus, Manuel de la Rocha, Regional Trade Integration in East Africa: Trade and Revenue Impacts of the Planned East African Community Customs Union, World Bank Africa Region Working Paper Series No. 72, August 2004.

- Tanzania holds an intermediate position sourcing 5.3% of its world imports from within EAC, of which 95% from Kenya.
- Uganda sources a significant 26.8% share of its world imports from within EAC, 97% of which are from Kenya; in fact, Uganda's imports from Kenya account for 57% of total intra-EAC trade and all other intra-EAC imports taken together are smaller than Uganda's alone¹⁸.

Table 2 Significance of intra-EAC Imports – 2003

Total intra-EAC imports (trade) 2003 (USD millions)	623.4
Kenya's share in total intra-EAC imports (%)	21.4
Tanzania's share in total intra-EAC imports (%)	19.5
Uganda's share in total intra-EAC imports (%)	59.1
Share of intra-EAC imports in total imports (%)	7.9

Source: calculated from table 1

Table 1 also reflects EAC Partner States' trade with non-EAC countries and regions. South Africa's significance in that context needs to be highlighted. Kenya's 2003 imports originating in South Africa accounted for 9.0% of its total non-EAC imports and exceeded its intra-EAC imports almost threefold.

Tanzania's imports originating in RSA accounted for 10% of its non-EAC imports and were almost double its intra-EAC imports. Tanzania is a member of the SADC Trade Protocol, but implements significant tariff liberalisation in respect of imports originating in South Africa only in future years (back-loading its tariff liberalisation in the context of asymmetrical tariff liberalisation). Thus, the relatively large share of Tanzania's 2003 imports from South Africa cannot be interpreted as a result of preferential tariff preferences vis-à-vis South Africa, but as reflecting RSA's strategic role as a supplier to Tanzania and, indeed, to sub-Saharan Africa as a whole. Nevertheless, Tanzania must in future open up its market also to imports from RSA and SACU. The sheer significance of Tanzania's imports from South Africa will require careful implementation of EAC's rules of origin, particularly towards the end of the EAC CU transition period to avoid re-exportation, primarily to Kenya, of Tanzania's imports affected under preferential SADC tariffs. It also underlines the importance for EAC to negotiate, as agreed, a FTA agreement with SADC (and COMESA) as soon as possible.

Uganda is the only EAC Partner State, whose intra-EAC imports, overwhelmingly from Kenya, exceed its imports from South Africa (cf. however, footnote 18).

¹⁸ Uganda's genuine intra-EAC trade may be significantly overestimated by official statistics, since Kenya's re-exports of petroleum products to Uganda, and Uganda's coffee exports to third countries, via Kenya for her coffee auctions seem to be recorded as intra-EAC trade.

Kenya and Uganda are much less dependent on imports originating in their fellow COMESA partners, than from South Africa: in both cases, COMESA imports were about one third of imports originating in RSA. In spite of Kenyan and Ugandan tariff preferences, imports originating in COMESA were insignificant, as evidenced in table 1. This stands in stark contrast to the important role which both Kenya and Uganda play as exporters to their neighbouring COMESA countries, discussed under section C.9 below.

Tanzania's imports originating in Zambia are worth highlighting – they exceeded those from Kenya by 25% (table 1¹⁹).

C.2 EAC Partner States' trade and tariff profiles

C.2.1 Kenya

Taking into account Kenya's preferential tariff discount of 90% on intra-EAC imports, statutory tariffs on Kenya's most important imports, shown in table 3, were much lower than its MFN tariffs: the average 2003 tariff was 3.05%; the 2003 trade-weighted average intra-EAC tariff for those most important imports was 2.6%.

Table 3 Kenya's most important 2003 intra-EAC imports and respective tariffs

HS code / product	Import US \$ millions	Tariff 2003 (%)		Tariff 2010 (%)	
		EAC ¹	MFN	EAC	CET
100590 maize	4.1	2.5	25	0	50
240110 tobacco	1.3	2.0	20	0	25
870210 transport vehicles >10 passengers	0.4	3.5	35	0	13 ²
870422 vehicles	0.3	3.5 / 0.5	35 / 5	0	13 ²
100630 rice	0.2	3.5	35	0	75
630900 worn clothing & articles	0.2	3.5	35	0	50
870323 vehicles	0.2	3.5	35	0	13 ²
870421 vehicles	0.2	3.5	35	0	13 ²
870322 vehicles	0.1	3.5	35	0	13 ²

¹ Kenya's tariff preference on intra-EAC imports is equivalent to 90% of the MFN tariff

² average tariff for various HS tariff lines, where tariffs for unassembled or disassembled product is 0%, for finished products 25%

Source: EAC publication on CET; EAC Partner States' information

As from 1 January 2005, Kenya eliminated tariffs on all intra-EAC imports, including those listed in table 3, so that the trade-weighted tariff on these most important 2003 imports was reduced to zero, by 2.6% on average. Thus, the tariff impact of the EAC CU on Kenya's intra-EAC imports was relatively small due, on the one hand, to the

¹⁹ EAC national statistics, contrary to IMF's DOT, record Tanzania's imports from Zambia much lower.

very low pre-CU tariffs, and, on the other, to the relatively low level of intra-EAC imports. As a result, trade creation benefiting Kenya's fellow EAC partners, Tanzania and Uganda, must be expected to be marginal, not only due to these countries' relatively modest supply capacity and competitiveness, but also due to the small Kenyan tariff reduction on intra-EAC trade resulting from the entering into force of the EAC Customs Union Protocol. Another important hurdle for increased EAC Partner States' exports to Kenya are non-tariff barriers, which will be analysed more closely in section D below.

Table 3 also shows the EAC CET level on the listed imports. These CET tariffs lie either in the highest EAC CET range, 25%, and even higher in the case of products included in the EAC sensitive list, or show a relatively high average (it is unclear to which HS 8-digit tariff line the HS 6-digit imports actually relate). In any case, CET tariffs generally afford a comfortable protection for Kenyan national production. Except in the case of most vehicles, such protection may be economically justified since it boosts production of commodities for which Kenyan companies may have a comparative advantage, which they cannot yet fully reap due to their infant industry status.

It is interesting to note that the most important Kenyan imports originating in third countries apparently represent necessary inputs for which no significant production capacities exist in Kenya, so that pre-CU tariff protection was set at 0 or minimal levels. As a result, tariffs on such imports either continue to remain at 0 or have been lowered further from already low levels in the context of the EAC CET. Thus, the argument for keeping production costs and consumer prices low seems to have prevailed in the context of EAC Partner States' negotiations on tariffs for the respective HS product lines over the alternative option to support the generation of tariff revenues.

Table 4 Kenya's most important 2003 third country imports and respective tariffs

HS code / product	Import (US Millions)	Tariff 2003 (%)	2010 (%)
271000 petroleum oils	465.4	0	0
270900 petroleum oil	316.6	0	0
880240 aeroplanes	169.0	0	0
151110 crude oil	124.6	2	0
100190 wheat, meslin	77.9	35	23 ¹
720827 flat rolled iron products	69.9	5	0
300490 medicaments	62.1	15 / 0	10
870323 vehicles	40.7	19 ¹	17 ¹
310520 fertilisers	29.5	0	0
310530 fertilisers	28.7	0	0

¹ average tariff for various 8-digit HS tariff lines

Table 5 contains average tariffs in 2003 and their 2010 level when the CU Protocol is fully implemented²⁰. It shows three different measurements of average tariffs: arithmetic averages, capturing just the different tariff levels, irrespective of the volume of trade affected at such tariffs; arithmetic average collected tariffs, capturing exemptions of the statutory tariffs; and trade-weighted tariff averages, weighting the tariffs with the respective import value shares.

Table 5 Average tariffs on Kenya's imports - 2003 and 2010 (%)

	2003	2010
a) arithmetic average statutory tariff		
on intra-EAC imports	1.9	0.0
on third country imports	19.0	11.2
b) arithmetic average paid tariff		
on intra-EAC imports	1.6	0.0.
on third country imports	13.3	n.a
c) trade-weighted average tariff		
on intra-EAC imports	1.93	0.0
on third country imports	17.55	5.88
on total imports	17.46	5.87

Sources: for Kenya: Treasury Department and Ministry of Finance; for Tanzania: Tanzania Revenue Authority (TRA); for Uganda: Uganda Revenue Authority. Calculations by Lucio Castro

Comparison between the average tariffs yields the following conclusions:

- exemptions of tariffs played an insignificant role in Kenya for its intra-EAC 2003 imports, but a much more important role for its imports originating in third countries (5.3 percentage point difference between b and a for 2003). This can, in part, be explained by Kenya's preferential tariffs on intra-COMESA imports;
- the reduction in average tariffs resulting from the CU is insignificant for intra-EAC imports (a and c for 2010 compared to 2003), but was very substantial for third country imports (for the trade-weighted [c], the decline was even more pronounced than for the arithmetic average tariff [a]). The total trade trade-weighted tariff shows the significant tariff liberalisation which results from EAC CU: tariffs decline by no less than 11.6 percentage points, or 66%²¹;

²⁰ However, it should be recalled that for Kenya both intra-EAC tariffs as well as EAC CET were fully adjusted to their CU levels in January 2005.

²¹ It must be stressed that the calculation of trade-weighted average tariff for 2010 is based on the assumption that the commodity import breakdown in 2010 would be the same as in 2003 – an unrealistic assumption given the tariff / price changes and resulting demand shifts. However, only with this assumption can the change in the trade-weighted average tariff be illustrated after the completion of the EAC CU.

- the fact that the 2010 trade-weighted total Kenyan tariff is very similar to the trade weighted third country tariff average reflects on the one hand, the insignificant level of intra-EAC tariffs and the small share of her intra-EAC imports, and on the other hand that the overwhelming relevance of the EAC CU for Kenya lies in the significant reduction of CET as compared to its average MFN tariff in 2003, captured in the dramatic decline in the third-country trade-weighted average tariff between 2003 and 2010.

C.2.2 Tanzania

Table 6 Tanzania's most important 2003 intra-EAC imports and respective tariffs

HS code / product	Import US Millions	Tariff 2003 (%)		CET 2010 (%)
		MFN	EAC	
300490 medicaments	3.9	10	2	10
300420 medicaments	1.6	10	2	10
481910 cartons, boxes	1.5	15	3	25
300439 medicaments	1.3	10	2	10
100510 seeds	1.1	13 ¹	3	25
843149 machinery parts	0.9	10	2	10
380810 insecticides	0.8	0	0	10
730890 iron & steel structures	0.6	0	0	25
720918 flat rolled iron / steel prod	0.5	10 ²	2	10
842920 graders & levellers	0.4	0	0	0

¹ average tariff of various 8-digit HS codes ² surcharge 10%

Like in the case of Kenya, Tanzania's most important intra-EAC imports were subjected to low 2003 tariffs (table 6 above). The average trade-weighted tariff on the 10 most important intra-EAC imports was 1.9%. Thus, the impact of the elimination of these tariffs, as a result of the EAC Customs Union, will be small.

Table 6 allows a comparison between the EAC CET on Tanzania's most important intra-EAC imports and her national 2003 tariffs on such imports. It can be noted that for cartons, insecticides and iron & steel structures, the EAC CET is considerably higher than Tanzania's national 2003 MFN tariff. This rise in tariffs will create incentives for EAC import substitution, probably in particular for Kenyan producers to export such products to Tanzania. At the same time, the CET will involve an increase in import prices for Tanzanian consumers and EAC producers using such imports as inputs.

Table 7 Tanzania's most important 2003 third country imports and respective tariffs

HS code / product	Import US Millions	Tariff 2003 (%)		CET 2010 (%)
		MFN	EAC	
100190 wheat & meslin	75.7	5 ¹	1 ¹	35
151190 palm oil	47.9	13 ¹	3 ¹	25
870421 motor vehicles for transport	44.0	5 ¹	1 ¹	25 *
870323 motor vehicles for persons	37.3	8 ¹	2 ¹	25 *
630900 worn clothing & articles	29.8	25	5	50
151110 palm oil	25.6	10	2	0
100640 broken rice	24.8	25	5	25
880220 aeroplanes and other	24.1	0	0	0
870333 motor vehicles for persons	21.1	8 ¹	2 ¹	25 *
870210 motor vehicles for more persons	20.1	7 ¹	1 ¹	25 *

* assembled ¹ average tariff of various 8-digit HS codes

For Tanzania's most important imports originating in third countries (table 7), the impact of the EAC CET is ambiguous. The analysis is complicated by the fact that HS 6-digit tariff averages for 2003 and 2010 have to be compared, which hide substantial divergences between the HS 8-digit tariffs – import statistics are available only on a 6-digit level. For some tariff lines (worn cloth; palm oil), CET is substantially higher than the 2003 national MFN tariffs, resulting in higher protection of intra-EAC production, higher consumer prices and trade diversion²². Where higher EAC CET apply for imported inputs (palm oil, wheat), which are processed by Tanzanian firms, the higher tariffs imply reduced or even negative effective protection of those firms' value added. For some of Tanzania's most important third country imports, the EAC CET is lower than the 2003 MFN tariff, while for a third category it is unclear to which 8-digit HS-codes Tanzania's imports refer and how the respective tariffs changed. On the whole, the EAC CET seems to have had no drastic tariff effect – in clear contrast to the results for Kenya.

With respect to average tariffs, an additional factor comes into play for Tanzania, i.e. the discriminatory use of suspended duties (table 8, b) which enhance protection against imports over the nominal tariff. As can be seen, the 2003 tariff on imports originating in third countries, *including* suspended duties, was 0.4 percentage points, or 3%, higher than the average tariff alone (b and a, third country average compared). As part of the creation of the EAC CU, suspended duties are eliminated.

The average collected 2003 intra-EAC tariff was 0.7 percentage points or 18% higher than the simple average tariff. A part of Tanzania's imports from Kenya did not qualify for preferential treatment since they did not meet the rules of origin criteria, as

²² *Trade diversion*: Trade between members of a preferential trading arrangement replacing what were imports from a country outside in the PTA - associated with welfare reduction for the importing country since it increases the cost of the imported good. Viner concept (1950).

reported by Tanzania Revenue Authority officials; another factor was that the authorities did not grant intra-EAC tariff preferences systematically. Both factors caused collected average tariffs to be higher than statutory tariffs (c and a intra-EAC tariffs compared).

In contrast, collected average 2003 tariffs on third country imports were one third lower than simple average tariffs. Preferential tariffs on imports originating in SADC are unlikely to explain this in view of Tanzania's back-loading of tariff liberalisation under the SADC trade dispensation²³. Therefore, the reason most likely lies in ineffective tariff collection.

Table 8 Average tariffs on Tanzania's imports - 2003 and 2010 (%)

	2003	2010
a) arithmetic average statutory tariff		
on intra-EAC imports	3.3	0.0
on third country imports	12.6	11.2
b) arithmetic average tariff incl. suspended duties		
on intra-EAC imports	3.4	0.0
on third country imports	13.0	11.2
c) arithmetic average paid tariff		
on intra-EAC imports	4.0	0.0
on third country imports	8.4	n.a.
d) trade-weighted average tariff		
on intra-EAC imports	3.4	0.0
on third country imports	8.5	5.9
on total imports	8.2	5.6
e) trade-weighted av. tariff incl. suspended duties		
on intra-EAC imports	3.7	0.0
on third country imports	9.1	5.9
on total imports	8.8	5.6

The impact of the EAC CU on Tanzania's average intra-EAC tariffs is larger than in the case of Kenya, but still modest - 3.3, 3.7 and 4 percentage points respectively, on the basis of the arithmetical, the trade-weighted, and the collected average tariff. The elimination of intra-EAC tariffs can be expected to boost intra-EAC trade to some extent and will certainly have a more noticeable impact on imports originating in

²³ It is important to note that Tanzania's average third country tariff in the years to come will be reduced due to its obligation under the SADC Trade Protocol to liberalise tariffs on SADC imports, to be concluded by 2008; based on Tanzania's 2003 share of imports originating in South Africa alone, this will affect some 10% of its total imports. This will bring about additional tariff liberalisation for Tanzania's tariffs, on top of the tariff reduction emanating from the EAC CET and the elimination of suspended duties.

Kenya, than on imports from Uganda, due to Kenya's relative more developed industrial sector.

The introduction of CET will bring about a reduction of tariffs on third country imports, compared to the 2003 average tariff. The effect is small if measured by the arithmetic average tariff, but more noticeable when measured by the trade-weighted average tariff, in which case it amounts to 3.2 percentage points or 35%. It should be recalled that the same indicator dropped by 66% in the case of Kenya, highlighting that the reduction in respect of Kenya's MFN tariff as a result of EAC CET was much more pronounced than for Tanzania, signalling that Tanzania's 2003 MFN tariff was clearly lower than Kenya's.

It is worth noting that, again in contrast to the EAC CU impact in Kenya, for Tanzania tariff reduction on intra-EAC imports exceeds tariff reduction brought about by CET (a, b, d and e compared for 2003 and 2010).

The relatively small difference between the trade-weighted total and third country average tariff in both 2003 and 2010 signals the relatively modest share of Tanzania's intra-EAC imports.

The decline in Tanzania's total trade-weighted average tariff (table 8, d and e) visualises the expected combined effect of intra-EAC tariff elimination and the reduction of her 2003 third-country MFN tariffs brought about by the EAC CET. It reveals that Tanzania's total tariff average will be reduced by 2.6 percentage points, or 32% in 2010. If the elimination of suspended duties is also accounted for, the reduction is even larger: 3.2 percentage points or 36.4%. Thus, the creation of the EAC CU implies a significant tariff liberalisation for Tanzania, and even more so, if it will honour its obligations of additional tariff liberalisation emanating from its participation in the SADC Trade Protocol²⁴.

C.2.3 Uganda

As table 9 shows, Uganda's 2003 preferential COMESA tariffs for its most important intra-EAC imports were low and did not exceed 6%. The extent of intra-EAC tariff liberalisation as a result of the implementation of the EAC CU is, therefore, small. Nevertheless, for all but two of its important intra-EAC imports, there will be some small decline in tariffs, which is more pronounced if one takes into consideration that because of the EAC CU, its discriminatory excise taxes, applied in 2003, will also be scrapped.

²⁴ The possibility also exists that Tanzania will take a decision on its double membership in two different African trade liberalisation schemes, terminating either its participation in the SADC trade dispensation, or in that of EAC (cf. section B.2.3 above). Both the move towards fully fledged EAC and SADC Customs Unions as well as the EPA negotiations of the ESA and SADC groupings are increasing the pressure for Tanzania to take such a decision.

Table 9 Uganda's most important 2003 intra-EAC imports and respective tariffs

HS code / product	Import US Millions	Tariff 2003 %		CET 2010 %
		MFN	EAC	
271000 petroleum	180.9	0	0	0
252310 cement	18.4	7 ¹	4	55
120890 oil seed flour and meals	8.0	7	4	10
300490 medicaments	7.0	0	0	10
250100 salt	6.6	7		25
721049 iron& non-alloy steel prod	4.4	7	4	25
720918 iron& non-alloy steel prod	3.3	7	4	10
480252 other paper	2.7	7	4	10
630510 sacks & bags of jute	2.7	15	6	25
640220 footwear	2.4			25
630140 blankets	2.1	15	6	25
701090 bottles & flasks	2.1	7	4	25

¹ plus 10 % excise

At the same time, the EAC CET for Uganda's most important intra-EAC imports is in one case only not higher than its 2003 MFN tariff – the tariff for imported petroleum remained unchanged at 0%. For all its remaining listed imports, the EAC CET increased. In some cases, the increase in tariffs is quite dramatic. Cement is included in EAC's sensitive list and, therefore, attracts a tariff of 55% when imported from third countries. As a result of this combined impact of the CU, Uganda's intra-EAC imports will become more expensive and will have to be sourced much more than in the past within the EAC, substituting imports which previously were imported from third countries. The latter impact may again be at the cost of consumers and producers using such imports as inputs to be processed locally and will result in trade diversion.

Regarding Uganda's most important imports originating in third countries (table 10), the impact which can be expected as a result of the creation of the EAC CU is very similar to that described in the previous paragraph on Uganda's most important intra-EAC imports. With a few exceptions, the CETs are significantly higher than Uganda's 2003 MFN tariffs. Consumers and producers depending on these imports will have to source them more within the EAC. If they continue sourcing these imports from outside EAC, or if they can find suitable substitutes within EAC, such imports will become more expensive.

Table 10 Uganda's most important 2003 third country imports and respective tariffs

HS code / product	Import US Millions	Tariff 2003 (%)		CET 2010 (%)
		MFN	EAC	
100190 wheat & meslin	52.2	0	0	23 ¹
151190 palm oil	30.6	15	6	19 ¹
300490 medicaments	26.5	0	0	10
870421 motor vehicles	24.9	7	4	0
630900 worn cloth	23.2	15	6	50
870323 motor vehicles for persons	19.0	15	6	13 ¹
852520 transmission apparatus for for radio telephony	17.0	0	0	0
721049 flat rolled iron / steel prod	15.7	7	4	25
850680 batteries	13.7	15	6	35
490199 printed books& brochures	13.3	0	0	0
720839 flat rolled iron / steel prod	13.2	7	4	0
300220 vaccines	12.2	0	0	0

¹ average tariff of various 8-digit HS codes

Table 11 shows the overall effect of tariff changes as a result of EAC CU, captured in the change of average tariffs between 2003 and 2010.

In 2003 Uganda charged excise taxes of 10% discriminating against imports. Thus, protection of local production from imports including excise taxes was higher than reflected in the statutory tariffs (table 11, b with a compared) - in particular with respect to intra-EAC imports, most of which originated in Kenya.

Table 11 Average tariffs on Uganda's imports - 2003 and 2010 (%)

	2003	2010
a) arithmetic average statutory tariff		
on intra-EAC imports	3.2	0.0
on third country imports	7.8	11.2
b) av. nominal protection incl. excises		
on intra-EAC imports	4.3	0.0
on third country imports	8.2	11.2
c) arithmetic average paid tariff		
on total imports	3.2	0.0
on third country imports	3.8	n.a.
d) trade-weighted average tariff		
on intra-EAC imports	3.6	0.0
on third country imports	6.3	9.2
On total imports	5.9	6.7

Discriminatory excise taxes were phased out in the context of the creation of the EAC CU. Average collected 2003 tariffs (c) were identical to the simple average tariffs for intra-EAC imports, but just about half the simple average tariffs for third country imports, indicating extensive exemptions and / or ineffective tariff collection.

In contrast to what was observed for Kenya and Tanzania, Uganda's average tariffs on third country imports increased significantly as a result of the introduction of the EAC CET: for the simple average tariff, the rise amounts to 44%, for the trade-weighted average to 46%. The decline in Uganda's intra-EAC tariffs is strongly overcompensated for by the rise in the tariff on third country imports. This is because Uganda's 2003 tariffs on third country imports were, on average, considerably lower than those of Kenya and Tanzania to begin with (on the basis of the trade-weighted average tariff, that for Uganda was 6.3%, compared to 8.5% for Tanzania and 17.55% for Kenya). In the context of the negotiated compromise for the EAC CET, Uganda had to agree to a CET which was 46% higher than her 2003 MFN tariffs. Thus, the EAC CET reflects the painful compromise between Partner States with drastically different MFN tariffs, strongly divergent industrial development and fundamentally different transport situations at the outset (landlockedness versus own sea ports), which needs to be struck to enable the creation of a common customs territory. As a result, Uganda's cost of living as well as of production is likely to increase considerably as a consequence of the EAC CU – to the extent that such costs are determined by prices of imported consumer goods and intermediate inputs. In a way, the EAC CET compromise compounds Uganda's disadvantage as a landlocked country, for which the costs of imported products is higher anyway due to the relatively higher transport costs.

As a consequence of the EAC CU, Uganda's total trade-weighted average tariff rises by 0.8 percentage points, or 14%, to 6.7 percentage points (compared to its 2003 tariffs), while that of Tanzania falls by 32% to 5.6 percentage points, and Kenya's declines even more drastically by 66% to 5.9 percentage points. The difference in the three Partner States' trade-weighted average 2010 tariffs reflect, in essence, the larger weight of manufactured products in their respective third country imports shopping basket.

C.3 EAC

Table 12 shows the effect of the EAC CU on the three EAC Partner States' average tariffs taken together. As was to be expected, the impact of the EAC CU in terms of reducing Kenya's and Tanzania's average tariffs both on intra-EAC and third country imports more than outweighs the impact of the rise in Uganda's tariffs. Taken together, the net effect of the EAC CU on the three EAC Partner States' tariffs is a 40% decline in the average trade-weighted tariff on total imports, mainly due to the decline in the EAC CET as compared to the three countries' trade-weighted 2003 MFN tariffs and the heavy weight of third country imports for all three EAC Partner

Table 12 Average EAC tariffs on imports - 2003 and 2010

	2003	2010
a) arithmetic average statutory tariff		
On intra-EAC imports	5.8	0.0
On third country imports	12.4	11.2
b) trade-weighted average tariff		
On intra-EAC imports	3.4	0.0
On third country imports	10.2	6.5
On total imports	10.0	6.0

States. Compared to the CET impact, the effect of the elimination of tariffs on intra-EAC trade is relatively small.

In the context of the CU Protocol, EAC Partner States agreed on an asymmetrical intra-EAC tariff liberalisation, providing Tanzania and Uganda with more time to adjust to the new tariff regime, than Kenya. However, in view of the result of the present analysis (much more significant impact of the EAC CET on Partner States' economies than of intra-EAC tariff elimination), the question arises whether an asymmetrical dispensation with respect to the EAC CET could have assisted Tanzania's and Uganda's economy more to adjust to the EAC Customs Union, than more time with respect to intra-EAC tariff liberalisation. A gradual phasing-in of CET could have benefited affected companies more to absorb the CU adjustment shock, than providing time for adjustment to intra-EAC tariff elimination. The negotiations regarding Uganda's request for temporary CET exemptions²⁵ for selected inputs sourced in third countries seem to confirm this supposition.

The creation of the EAC CU brings about significant tariff liberalisation. This will enhance competition in EAC as a whole and tends to reduce consumer prices and production costs in EAC²⁶. Still, the CET compromise reached and implemented at present involves significant economic costs for individual EAC Partners, particularly in terms of higher consumer and production prices in Uganda – a sacrifice to secure continued high protection of Kenya's relatively more developed industrial sector, which, in turn, provokes significant trade diversion. The CET will act as a medium-term boost to industrial production, mainly in Kenya, but also in EAC as a whole.

Had Uganda's level of 2003 MFN tariffs been taken more as a benchmark for the CET, the EAC CU would have achieved more trade liberalisation. This goal could still be achieved, if EAC were to decide, at the occasion of the EAC CU review, to reduce

²⁵ Cf. section C.7.1 below

²⁶ The reduction in EAC tariffs is likely to be passed on to the EAC consumers only to a limited extent since EAC suppliers possess only little bargaining power on world markets. The relationship between EAC's import demand elasticities and EAC's suppliers' export supply elasticities implies that it will rather translate into increased traders' profits.

the 25% CET band to 20%, envisaged as an option by EAC Partner States²⁷. The adoption of 20% as the highest CET band would reduce markedly the extent of trade diversion as a result of EAC CU and would also be helpful in terms of the long-term goal of EAC regional integration, i.e. the effective integration of the region into the global economy.

C.4 Enlarged EAC Membership

Rwanda may soon become a member of EAC: details on its EAC membership and the date of membership are presently under negotiation and expected to be decided upon by November 2005.

In 2002 Rwanda imported goods worth USD 32.2 million from Kenya. Thus, intra-EAC imports can be expected to increase by some 7%, if Rwanda were to join EAC Customs Union dispensation at the time of its EAC accession. In this context, it is relevant to note that Rwanda is a member of the COMESA FTA and has, therefore, substantially liberalised its trade with Kenya. Burundi has also applied for EAC membership. Negotiations on accession have not yet been initiated. Burundi trade with EAC is much smaller than that of Rwanda.

C.5 Significance of Trade in EAC's Sensitive List Products

This section analyses the significance of EAC's sensitive list, both in terms of the volume of Partner States' imports for such products in 2003, and in terms of the level of EAC CET tariffs agreed upon, in comparison to Partner States' 2003 national MFN tariffs. EAC decided to afford sensitive products protection of varying extent in excess of the highest normal EAC CET of 25%. Tables 13 and 14 reflect the CET tariffs and pre-CU national tariffs for EAC's sensitive products.

An assessment of tables 13 and 14 leads to the following conclusions:

- Level of sensitive product CETs relative to highest regular CET band (25 %): for sugar and rice, the EAC CETs lie four and three times respectively higher than the highest regular EAC CET tariff of 25%. For other products, such as milk, wheat and meslin, cement, maize, maize flour, khanga fabrics, bed linen and worn cloth, CETs are double or more than the highest regular CET.
- Level of sensitive product CETs compared with national 2003 tariffs plus other protective charges: among all products classified as sensitive, EAC's negotiators have, in three cases (wheat and meslin, matches, and batteries), adopted the respective highest national tariff of 2003, i.e. that of Kenya, as the respective CET rates. However, if Tanzania's product-specific suspended duties are taken into

²⁷ Cf. section B.2.1 above

account and added to the respective 2003 tariffs, Tanzania's 2003 protection for batteries and matches was higher than that of Kenya and also the highest EAC CET band.

For all other sensitive products, CETs were set significantly higher than the highest national tariff, in most cases Kenya's. But when Tanzania's suspended duties are also taken into account and added to its tariffs, in a number of cases Tanzania's 2003 tariff plus surcharge protection exceeded Kenya's 2003 tariffs. Nevertheless Tanzania's protection was still normally lower than the EAC CETs.

Thus, one can conclude that overall CET protection of EAC sensitive products exceeds previous national protection afforded by 2003 MFN tariffs plus other charges, particularly so if compared to Uganda's protection level. As a result, the Customs Union must be expected to trigger substantial increases in sensitive product prices for end consumers and producers using the respective commodities as inputs, particularly in Uganda.

Overall, Kenya's 2003 tariff protection seems to have been adopted as the minimum for EAC's CET on sensitive products protection.

- Level of sensitive product CETs compared with preferential intra-EAC 2003 tariffs and other protective charges: The combination of increased CET protection (compared to the previous national MFN protection) and the elimination of intra-EAC tariffs and other protective charges for sensitive products can be expected to bring about significant trade diversion effects. This raises the question to what extent sensitive products can be produced competitively within the EAC region, thereby containing the welfare loss for consumers.

- Social policy implications of CET on sensitive products: the substantial tariff increase for sensitive products playing a particular role for consumers and small-scale producers of poor strata of the EAC population implies that the Customs Union may have negative repercussions on poverty in EAC.

The increase in protection for products such as wheat and maize flour, cigarettes, matches, khanga, rice, milk, sacks and bags, result in price increases for end consumers, hitting poor people hardest. On the other hand, such additional protection may provide incentives for some infant industries for which prospects exist for EAC producers to become competitive over the medium to long term. In some cases, such protection may even be warranted to compensate for subsidies paid in the developed countries' markets (e.g. maize flour).

Table 13 EAC common external tariff (CET) on sensitive products

HS heading / Code Nr.	number of 8-digit tariff lines affected	Product	CET
04.01 / 02	12	milk, cream	60
1001.90.20+.90	2	wheat, meslin	35
1005.90.00	1	maize	50
10.06	4	rice	75*
1101.00.00	1	wheat + meslin flour	60
1102.30.00	1	maize flour	50
1701.11.90;.12.90;.91.00;.98.10; .99.90	5	Sugar	100*
1701.11.10+.12.10	2	jaggery	35
2402.20.90+.90;2403.10.00	3	cigars, cigarettes	35
2523.29.00	1	cement	55
3605.00.00	1	matches	35
5208.51.10+.52.10;5209.51.10;5210.51.10; 5211.51.10;5212.15.10+25.10	8	khanga fabrics	50
5514.41.10; 6211.42.10+.43.10 + .49.10	3	khanga	50
6302.21.00 +.31.00 +.51.00 +.91.00	4	bed linen	50
6305.10.00	1	sacks, bags	45**
6309.00.00	1	worn cloth	50***
8309.10.00	1	crown corks	40
8506.10.00 +.30.00 +.40.00 +.50.00 +.60.00 +.80.00	6	batteries	35

* or US \$ 200/MT, whichever is higher; ** or US \$ 0.45 per bag, whichever is higher; *** or US \$ 0.75 per kg, whichever is higher

For worn clothing, it is difficult to find an economic policy justification for the increased CET (43% increase over Kenya's 2003 MFN tariff, 100% increase over Tanzania's MFN tariff and 333% increase over Uganda's MFN tariff), particularly in a post-Multi-Fibre-Agreement (MFA) world in which competitive production of simple clothing in the EAC Region is hard to envisage. High CET for indispensable inputs (wheat flour, bags and sacks) for small-scale enterprises, like bakeries and peasants, imply the risk of cost increases and negative 'effective' value added protection which could undermine the competitiveness of producers who merit support for social reasons.

- *Significance of trade in sensitive products*: imports of goods included in EAC's sensitive products list, both from within the EAC and originating in third countries, accounted for only a modest share of the EAC Partner States' total imports in 2003, as can be seen from table 15.

Table 14 EAC CET on sensitive products and respective national tariffs in 2003

HS heading / code Nr.	EAC CET	(national) tariffs 2003 %					
		Kenya		Tanzania		Uganda	
		MFN	EAC	MFN	EAC	MFN	EAC
Milk, cream	60	25	2.5	26 ^{1,7}	5 ^{2,7}	15	6
wheat, meslin	35	35	3.5	10	2	0	0
Maize	50	25	2.5	25	5	7	4
Rice	75	35	3.5	15 ⁷	3 ⁷	15	6
wheat + meslin flour	60	35	3.5	25	5	15	6
maize flour	50	15	1.5	25	5	15	6
Sugar	100	100	10	25 ²	5 ²	15	6
Jaggery	35	15	1.5	25 ²	5 ²	15	6
cigars, cigarettes	35	30	3	25	5	15	6
cement	55	35	3.5	25 ³	25	7	4
Matches	35	35	3.5	25 ¹	5	15	6
khanga fabrics	50	30	3	25 ⁴	5 ²	15	6
Khanga	50	30	3	25 ⁴	5 ²	15/6	7/4
bed linen	50	25	2.5	25	5	15	6
sacks, bags	45	25	2.5	15 ³	3	15	6
worn cloth	50	35	3.5	25	5	15	6
crown corks	40	25	2.5	25	5 ²	15	6
Batteries	35	35	3.5	25 ⁶	5 ²	15	6

¹ surcharge 25 % ² surcharge 20% ³ surcharge 50% ⁴ surcharge 40%

⁵ surcharge on intra-EAC imports 20% ⁶ surcharge 25%, for intra-EAC imports 20%;

⁷ average tariff for several 8-digit tariff lines

Only for Kenya, products included in the EAC sensitive list accounted for more significant shares of its total intra-EAC imports (though it needs to be stressed that the absolute value of such imports were relatively low – cf. table 14 above). This suggests that for most products included in the EAC sensitive list, the scope for intra-EAC trade and production was and probably will remain low. Possible reasons for this are:

- relatively high transport costs;
- high degree of subsistence agriculture for own consumption;
- limited production capacities within the EAC region due to supply constraints;
- strong competition from Asian producers.

Table 15 Significance of EAC sensitive products imports - share of most important sensitive products imports in total intra EAC- and third country imports (%) - 2003

Sensitive imports share in	Intra-EAC imports	third country imports
Kenya		
Maize (HS 10.590)	14.3	
Rice (HS 100630)	0.7	
Worn clothing (HS 6309)	0.7	
Wheat, meslin (HS 100190)		2.2
Sugar (HS 1701)		1.1
Rice (HS 100630)		1.0
Tanzania		
Wheat, meslin (HS 100190)		3.9
Worn clothing (HS 6309)		1.7
Batteries (HS 850610)		1.1
Uganda		
Wheat, meslin (HS 100190)		3.8
Worn clothing (HS 6309)		1.7
Maize (HS 10.590)		0.9
Rice (HS 100630)		0.7

As a consequence, the elimination of tariff barriers and other charges on intra-EAC trade may trigger trade creation²⁸, which, however, must be assumed to be modest given the low level of pre-2005 tariffs on intra-EAC trade in products included in the EAC sensitive list.

Regarding third country imports of sensitive products, the considerable rise in most respective CET tariffs, relative to previous national MFN tariffs, in combination with the elimination of tariff barriers on intra-EAC trade, and the implicit rise in relative protection levels against third country imports of sensitive products, must be expected to give rise to trade diversion. It seems questionable if regional producers, in response to 0 intra-EAC tariffs, will be able to increase production or offer substitutes in comparable quantity, quality and price for third country imports sourced abroad during pre-CU times. Negative effects on consumers and producers, particularly those of low income strata depending heavily on the respective basic products included in the EAC sensitive list for their livelihood, seem unavoidable. It represents an aggravating factor that these regressive effects will be felt most in the relatively poorer EAC Partner States, above all in Uganda and, to a lesser extent, in

²⁸ **Trade creation:** An increase in trade between members of a preferential trading arrangement replacing, as a result of the PTA, what before was production in the importing country - associated with welfare gains for the importing country since it reduces the cost of the imported good(s). Viner concept.

Tanzania, in view of these Partner States' low 2003 national MFN tariffs on products included in the EAC sensitive list.

On the other hand, the resulting negative effects refer to a relatively small share and level of pre-CU sensitive product imports from third countries into EAC (see table 15 above).

C.6 Dynamic effects of the EAC Customs Union

Dynamic effects of the EAC CU as a result of tariff liberalisation are expected to emanate from enhanced EAC competitiveness due to stiffer competition (reduced average tariffs), economies of scale thanks to the increased effective regional market, trade creation, and, above all, increased foreign direct investment triggered by EAC CU. Such effects are difficult to forecast, particularly at an early stage of implementation of the new EAC trade dispensation. In some cases of the analysis, likely dynamic effects were alluded to. It is clear, however, that positive dynamic effects are seriously jeopardised by EAC Partner States' governments' interference in economic adjustment processes when they grant exemptions and / or tariff corrections from the new EAC trade dispensation and trigger apprehension that such interferences will be repeated in the future. Positive dynamic effects depend on private sector investment responses to the new opportunities created by the EAC CU dispensation. These are undermined by lack of transparency about the 'rules of the game' regarding tariffs prevailing in the CU.

C.7. Post 1/1/2005 Tariff Adjustments and Exemptions

C.7.1 Uganda's request for temporary CET exceptions

Uganda requested a temporary (5 year) exception from CET for 135 industrial inputs imported from third countries to enable producers using such inputs to continue importing them at the Ugandan 0% MFN of 2004, rather than at the 10% EAC CET. The exceptions would ensure that such third country imports are not immediately substituted by possibly more expensive and / or lower quality regionally, primarily Kenya produced, inputs (trade diversion). By August 2005, Partner States had not agreed on a common position to Uganda's request. It needs to be noted that the same inputs are imported by Kenyan and Tanzanian producers at CET tariffs; CET exceptions for Uganda would create competitive distortions within EAC. Uganda's exports to Kenya and Tanzania containing such imported inputs, if temporarily CET exempted, could not be accorded the intra-EAC zero tariff.

C.7.2 CET Adjustments

A significant number of corrective CET changes applicable to sensitive and other products were approved by EAC Partner States' Trade Ministers, following complaints by affected consumers, producers processing imported inputs from

outside EAC and third country WTO member states exporting to the EAC and affected by the new EAC CET.

In June 2005, previously approved EAC CETs were revised as follows:

- for pharmaceutical products, sanitary towels and tampons – reduced from 10% to 0;
- packing materials for manufacture of medicaments were exempted under the remission scheme;
- for certain inputs for coffee and tea producers were reduced to 10%;
- for liquefied petroleum, coal, aluminium wire, safety belts, palm stearin - reduced to 0;
- for second-hand clothes - lowered from 50% to 45%;
- temporary (24 months) import tariff exemptions for rice, wheat grain and barley were granted to Armed Forces Canteen Organisations;
- Tanzania was granted (as a one time exception) tariff free barley imports to sustain beer production;
- Kenya's rice imports from Pakistan were CET exempt, following that country's threat to retaliate with tariffs on tea imports from Kenya;
- inputs for manufacture of agricultural machinery and matches were exempt from CET;
- paper for textbooks and other school materials was granted tariff remissions to protect production in Partner States;
- solar equipment and accessories were exempted from duties and taxes; inputs for horticulture and agriculture were duty exempt;
- specified hotel equipment was duty exempt;
- refrigerated trucks, diapers for medical use, speed governors and computer software were duty exempt.

Some of these corrections address social concerns with respect to the originally approved CET highlighted above. Other corrections can be considered as normal corrections, which proved necessary after unforeseen results of the drastic EAC tariff regime changes implemented in January 2005.

At the same time, the number of changes introduced in response to complaints from affected stakeholders raises doubt about EAC Partner States' resolve to implement and maintain a stable, foreseeable and reliable tariff regime in the EAC CU, which represents an indispensable requirement for new investment in the enlarged EAC customs territory. Ad hoc changes by governments fuel private sector and foreign investor uncertainty about consecutive further changes, triggering a wait-and-see attitude.

A reliable planning basis and stable enabling environment is an indispensable requirement for EAC to reap the expected benefits of integration for the regional economy. Revisions of negotiated tariffs involve changes in important decision

making parameters for the private sector, but when tariffs prove untenable, governments have to adjust them – provided this does not undermine the principle of the EAC integrated uniform customs territory. However, when exemptions are granted for individual countries or even specific sectors of a Partner States' economy, the constitutive basis for the customs union is at risk. This does not only involve discrimination between stakeholders of the same customs territory, but, in addition, creates serious hurdles for monitoring and implementation of the new EAC customs regulations. Such complications are a matter of serious concern at a time when Partner States' customs authorities' capacities are already overstretched by the necessary adjustments from the previous national to the new EAC customs laws and procedures.

Changes in a country's or region's tariff regime unavoidably create problems for some and new opportunities for others. When governments attempt to safeguard private sector stakeholders from necessary adjustments, responding to respective pressures from those negatively affected by the tariff changes, they adjust the new CU tariff dispensation to pre-CU existing economic structures, rather than ensure adjustment of the Partner States' economies to the new EAC CU dispensation. In doing so, they jeopardise the very benefits of the regional trade liberalisation process which can be reaped only as a result of intra-regional resource reallocations and, thus, unavoidably painful adjustment processes on the part of private businesses rendered unprofitable.

C.8 Customs Revenues Impact

The elimination of tariffs as a result of regional trade liberalisation is a serious matter of concern to Partner States' governments due to the emanating customs revenue losses. For the EAC Customs Union, the customs revenue loss due to the EAC CU was estimated by a World Bank team, using a partial equilibrium model²⁹. The study estimates that, between 2005 and 2009, the loss of revenues from tariffs and domestic taxes will amount to 16% for Kenya, 4.2% for Tanzania, 2.9% for Uganda and 11% for EAC as a whole³⁰. Since customs revenues account for about 10% of total tax revenues in the three EAC Partner States, the revenue loss due to the Customs Union is estimated to amount to about 1% of EAC governments' tax revenues.

As from 2010, when the transition period to the EAC CU is over and intra-EAC trade completely liberalised, revenue losses for Kenya will be the same as during the period 2005 – 2009, since Kenya eliminated its tariffs on imports from the two EAC Partners Tanzania and Uganda immediately in 2005. For Tanzania and Uganda, however, EAC CU revenue losses will increase after 2009, due to the elimination of

²⁹Castro, Kraus, de la Rocha, World Bank Africa Region Working Paper Series No. 72, August 2004.

³⁰ *ibid*, p.2.

tariffs on imports from Kenya and the substitution of third country imports by duty free intra-EAC imports. According to the estimates, Tanzania's tariff revenue loss as from 2010, compared to the situation in 2004, will increase to 6.3% of total customs revenues (up from 4.2% in the 2005 – 2009 period), and for Uganda to 8.6% (up from 2.9% in the period up to 2009).³¹

Thus, according to these estimates, Kenya will be the EAC country most affected by revenue losses, although its share of intra-EAC imports is the smallest among the three EAC Partner States. The results underline the fact that EAC countries' revenue losses are overwhelmingly due to the introduction of the CET. Therefore, in the case of the EAC CU, the revenue loss is not to be attributed mainly to intra-regional tariff liberalisation, but to tariff liberalisation for third country imports.

C.9 EAC Partner States' Exports

Regional integration is deemed to strengthen the competitiveness of the involved Partner States' economies as a result of trade liberalisation, ensuing reallocation of resources to production processes in accordance with the countries' comparative / competitive advantages and economies of scale resulting from serving a larger, integrated market. To what extent can the creation of the EAC CU be expected to trigger such benefits for EAC?

The first important observation refers to intra-EAC exports which account for 14.1% of total EAC exports (table 16); this compares to a share of just 7.9% intra-EAC imports in total EAC imports (table 1). The huge discrepancy is explained primarily by EAC's trade balance deficit³²: total imports exceed EAC exports by 93%. As a result, EAC trade integration is significantly larger than the share of intra-EAC imports alone suggests: intra-EAC exports and imports together account for 10% of total EAC's exports and imports. This share can be expected to increase significantly as a result of the EAC CU, albeit mainly due to trade diversion on account of the relatively high average CET.

The second observation concerns the impressive level of EAC exports to its neighbour states from COMESA. EAC's 2003 exports to DR Congo, Rwanda and Zambia alone add up to USD 236 million, almost 6% of EAC's world exports. Although enhanced intra-EAC trade, as a result of the EAC CU, must be assumed to result mainly from trade diversion, it can nevertheless be expected that the resulting strengthening of EAC's industrial base will enhance its competitiveness in the sub-region, particularly in neighbouring COMESA countries with their huge demand for imports from production centres from which transport costs are lower.

³¹ *ibid*, p. 27.

³² EAC total imports USD 7.84 billion; EAC total exports USD 4.07 billion; source: table 1 and 16

Table 16 EAC Partner States' Exports 2003, by Country of Destination

EAC Partners' trade with	Kenya's Exports		Tanzania's Exports		Uganda's Exports	
	USD Millions	%	USD Millions	%	USD Millions	%
TOTAL	2,581.5	100	962.0	100	531.9	100
EAC	434.39	16.83	54.54	5.67	84.26	15.84
Kenya			44.73	4.65	78.43	14.75
Tanzania	109.55	4.24			5.83	1.10
Uganda	324.84	12.58	9.81	1.02		
COMESA						
Congo D.R.C	54.13	2.10	20.04	2.08	12.89	2.42
Egypt	118.78	4.60	2.11	0.22	2.67	0.50
Ethiopia	44.72	1.73	0.47	0.05	0.16	0.03
Rwanda	80.42	3.12	4.90	0.51	20.80	3.91
Zambia	21.17	0.82	21.39	2.22	0.25	0.05
OTHER AFRICAN COUNTRIES						
Somalia	54.94	2.13	0.43	0.04	0.13	0.02
South Africa	10.46	0.41	20.92	2.17	29.63	5.57
INDUSTRIAL COUNTRIES						
Japan	22.38	0.87	89.80	9.33	10.01	1.88
United States	242.09	9.38	23.73	2.47	12.69	2.39
Switzerland	13.06	0.51	3.66	0.38	73.00	13.72
EU	840.17	32.55	301.78	31.37	146.25	27.50
Belgium	28.83	1.12	37.45	3.89	12.90	2.43
France	68.34	2.65	6.05	0.63	5.13	0.96
Germany	84.06	3.26	50.06	5.20	12.02	2.26
Netherlands	219.46	8.50	77.98	8.11	48.96	9.20
United Kingdom	322.10	12.48	50.45	5.24	33.88	6.37
ASIA						
India	36.18	1.40	95.25	9.90	1.13	0.21
Pakistan	129.95	5.03	8.79	0.91	0.22	0.04

Source: International Monetary Fund: Direction of Trade Statistics, December 2004

Rwanda's expected EAC accession later in 2005 will only intensify this tendency. Thus, EAC's exports to neighbouring COMESA countries can be assumed to benefit from the EAC CU, with Kenya and Uganda as the major beneficiaries.

With respect to industrialised countries as a destination for EAC's exports, table 16 highlights the importance of the EU market, which absorbed 33% of EAC's 2003 exports.

D. EAC Customs Union Impacts and Non-Tariff Barriers

D.1 Elimination of non-tariff barriers (NTBs) [Art. 13 CU Protocol]

Partner States committed themselves to eliminate 'with immediate effect' all existing NTBs on intra-EAC trade and to refrain from introducing new NTBs.

To the extent that NTBs result from deliberate policies and procedures, they can and should be eliminated in order to liberalise intra-EAC trade. However, some types of NTBs cannot be eliminated by policy and procedure corrections in the short to medium term, such as high transport and communication costs due to deficient road infrastructure and telecommunications networks, lack of information on trade opportunities, etc. The elimination of structural NTBs cannot be ordered 'with immediate effect' and will need time, significant investment, information campaigns and monitoring to be addressed gradually.

EAC Partner States have focused their negotiations on the elimination of the following policy and procedures-tied NTBs, among others:

- multiple charges and levies at intra-EAC border crossing points;
- cumbersome customs administration procedures at intra-EAC border posts;
- restrictive licence practices by Kenya Dairy Board for Kenya's milk imports from the other Partner States;
- Kenya's restrictions on cereals imports from Uganda;
- Uganda's restriction on beef and beef products imports from Kenya;
- Tanzania's extra charges on pharmaceutical imports from Kenya;
- Tanzania's complaint about unfair trade practices due to failure to secure distribution agents;
- Tanzania's USD 5 road user charge levied on foreign vehicles entering the country, including from EAC Partner States;
- Tanzania's USD 50 visa charges for business people from EAC Partner States;
- lacking harmonisation of Partner States' tax regimes to complement harmonised tariffs;
- new NTB's implemented to compensate for the elimination of tariffs under the CU.

Though EAC Partner States' government officials discussed solutions to the listed NTBs in numerous EAC meetings over years, little, if any, progress could be achieved due to reluctance by all parties involved to cede to complaints from the other side. At the same time, new NTBs were introduced to compensate tariff liberalisation effects.

EAC is making noticeable progress in the harmonisation of product standards between the three Partner States and bringing regional standards in line with international standards, thereby addressing TBT and SPS related NTBs.

Likewise, EAC regional business organisations have focused their attention to NTBs in EAC. The East African Business Council (EABC), in 2005, carried out a study identifying the most important NTBs complicating cross-border transactions in EAC³³. According to this survey, the following NTBs were seen by all three Partner States' business communities as primary hurdles for intra-EAC trade (enumeration in descending order):

- duty and tax administration problems;
- corruption;
- customs procedures;
- licensing procedures;
- police checks, roadblocks;
- immigration procedures;
- transit difficulties.

EABC plans to lobby EAC governments to address the identified priority NTBs and implement a monitoring mechanism to record progress.

UNCTAD is preparing an EAC Investment Guide, after having already published respective national guides for EAC Partner States. In order not to be limited to recommendations only, the national investment guides were complemented by a 'blue book' for each Partner State listing national priority actions to be carried out in order to improve the investment climate in EAC. These blue books include policy and procedures-linked NTBs limiting cross-border intra-EAC trade, since hurdles to investment and trade are closely interlinked. They include

- lack of EAC-wide business visas;
- slow awarding of work permits for residents from other EAC Partner States;
- late payment of VAT refunds;
- absence of double taxation treaties among EAC Partner States.

These various initiatives highlight the large number of deliberate policy-linked NTBs hindering trade in the region. At the same time, the significance of structural NTBs, particularly transport costs, as a factor hampering EAC trade is widely accepted.

However, the initiatives referred to above do not shed light on the relative significance of the policy or procedures-related and structural NTBs to tariffs barriers and their respective negative impact on trade. On this aspect, a NAFCOC survey carried out among SMEs trading in Eastern and Southern Africa provides important insight. According to that survey, tariffs play a much less important role as a barrier to

³³ East African Business Council, Business Climate Index Survey for East Africa 2005; the survey, covering 584 companies and 62 government agencies of Kenya, Tanzania and Uganda; and analysis was carried out by Daima Associates Dar es Salaam.

trans-border trade in Sub-Saharan Africa, than all the following NTBs, in descending order of importance (cf. graph below),

1. poor business ethics and culture;
2. transport and communications;
3. poor business framework (referring to government policies and procedures),
4. poor customs procedures and red tape;
5. finding local partners (information gaps); and
6. language and cultural barriers.

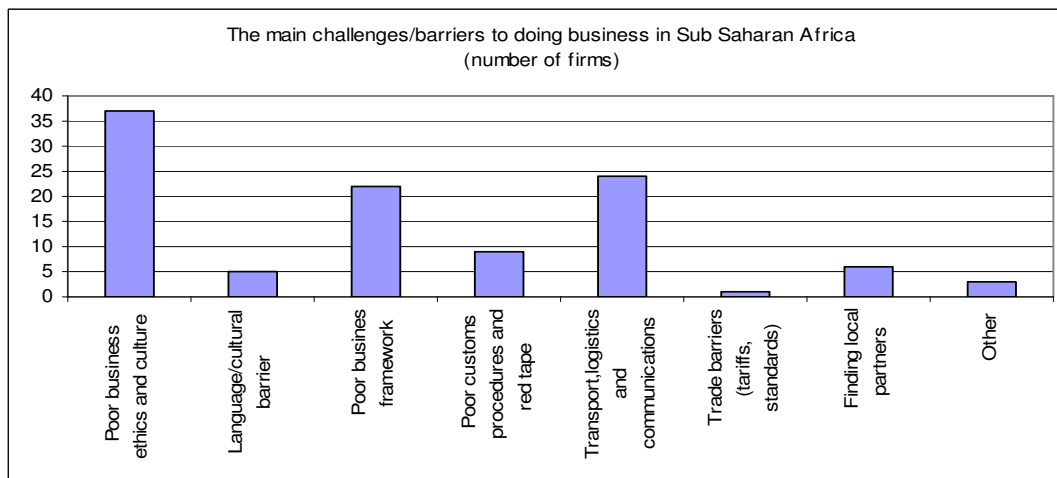


Figure based on a NAFCOC/JCCI (Johannesburg) survey among 79 SME firms with 30 or fewer employees, operating in Eastern- and Southern Africa. Taken from N. Charalambides' paper on 'SADC/EAC/COMESA and EPA Negotiations: Trade Policy Options to Overcome the Problem of Multiple Membership', contracted by GTZ.

Charalambides therefore concludes: 'currently, the private sector view trade agreements as existing on paper only. ... The priorities for the private sector relate more to customs procedures and red tape, bans and non-tariff duties, transport infrastructure and the business environment, many of which can be addressed by measures that do not require the establishment of a customs union.'³⁴

It can safely be assumed that the NAFCOC survey results carried out among South African businessmen certainly apply likewise to trade in East Africa, where transport, communications as well as government policy and procedures linked barriers represent particularly high cost for the private sector. This puts the significance of EAC CU tariff impacts into a new perspective. Government policy and procedures-related NTBs not only represent a relatively higher cost factor, but, in particular, a much higher risk factor for businesses, compared to tariffs, since the latter are

³⁴ Charalambides, N. Paper on 'SADC/EAC/COMESA and EPA Negotiations: Trade Policy Options to Overcome the Problem of Multiple Membership', p. 20, contracted by GTZ.

transparently gazetted in Government publications accessible to private citizens and business people.

It would, therefore, appear that the conventional approach of associating trade liberalisation / expansion to tariff elimination represents a misconception for EAC. EAC trade liberalisation and associated welfare and employment gains are primarily a matter of elimination of policy and procedures linked as well as structural NTBs.

Tariff liberalisation under the EAC trade dispensation certainly has its role to play in enhancing trade within East Africa and with third countries. But a serious initiative to address government policy and procedures-linked barriers to trade could have a much more significant positive impact on trade and, thereby, poverty reduction and employment creation in the region. Such an initiative would have to go hand in hand with significant investment to address structural supply constraints, particularly in transport infrastructure. In view of the much greater importance of addressing NTBs to enhance EAC trade and tap its benefits, the efforts, time and money invested in negotiating the EAC CU tariff dispensation may not yield the expected returns, unless complemented by decisive reduction of existing NTBs.

D.2 Rules of origin (Article 14 and Annex III CU Protocol)

The rules of origin adopted by EAC are similar to those of COMESA. They are relevant for the 5-year transition period to the full CU, during which EAC Partner States extend different tariff preferences to fellow COMESA and SADC countries and Uganda may be accorded temporary EAC CET exemptions on imports of industrial inputs from third countries.

Rule 4, EAC CU Protocol Annex III accords preferential treatment to products

- wholly produced within the common EAC customs territory (i.e. allowing for cumulation); or
- for which the cif value of inputs imported from outside the EAC customs territory does not exceed 60% of the costs of the materials used in the production of the respective goods; or
- for which the value added within the EAC customs territory exceeds 35% of the ex-factory cost of the goods; or
- for which intra-EAC processing results in a change in tariff heading.

After 2009, when the transition to the EAC CU has ended and intra-EAC trade is tariff-free, RoO, in principle, become superfluous. However, a problem arises from EAC's decision to continue tariff collection of CET revenues at the port of destination,

rather than at the place where they enter the common EAC customs territory. This provision, if upheld, will require continued rules of origin checks³⁵ in combination with intra-EAC border controls of trade, preventing maximum simplification of customs procedures within the EAC CU and representing an unnecessary NTB. This would imply foregoing some of the most significant efficiency and welfare gains to be reached by the EAC Customs Union.

A solution of this problem requires EAC Partner States to agree on tariff collection at the port of entry into the EAC of third country imports and an agreement on a tariff revenue sharing formula among EAC Partner States.

D.3 Anti-dumping measures (Art. 16 and Annex IV); subsidies (Art. 17); countervailing measures (Art. 18) and safeguard measures (Art. 19)

The CU Protocol provides significant scope for EAC Partner States to take recourse to compensating measures against dumping, presumed effects of subsidies and countervailing and safeguard action in order to protect industries threatened by a surge in imports. It remains to be seen how and to what extent EAC Partner States make use of such defensive measures and how the EAC Council of Ministers, the EAC Committee on Trade Remedies (Art. 24 CU Protocol) and the EAC Competition Authority react once such protective measures are introduced and brought to their attention.

D.4 WTO notification under the 'Enabling Clause'

The EAC CU Protocol will be notified to WTO under the 'Enabling Clause', a less stringent way of notification of a regional preferential trade agreement to WTO as an exception from the MFN (most favoured nation) principle, than WTO notification under article 24. Enabling clause notification provides for more flexibility and room for exceptions and is, thus, primarily designed for notification of regional trade agreements among developing countries. Such notification limits the scope for complaints from other WTO members against the EAC Customs Union agreement and, as a consequence, creates more scope for EAC Partner States to introduce protective measures. Thus, ipso facto, such notification entails less reliability, transparency, stability and guarantees for investors in, and imports into the respective preferential regional trade bloc.

E. Summary and Conclusions

This paper analysed important provisions of the EAC CU Protocol and assessed their impacts on the EAC Partner States' economies, taking into account their trade and

³⁵ Cf. Castro, et.al, World Bank Africa Working Paper 72, p. 9

tariff profiles. The major conclusions emerging from the analysis can be summarised as follows:

EAC CU's tariff impacts

- Intra-EAC tariff liberalisation in the context of the EAC CU is small in absolute terms and of minor significance, compared to tariff liberalisation emanating from the CET of the EAC CU. As a consequence, the classical welfare, employment and competitiveness enhancing effects of regional trade liberalisation will be small in the case of EAC.
- The CET triggers a very pronounced reduction in Kenya's average tariffs, a marked reduction in Tanzania's tariffs and a modest increase in Uganda's tariffs. For the EAC as a whole, the CU brings about a clear reduction of average tariffs, and therefore an unambiguous liberalisation of overall trade.
- The dominating CET impact on EAC as a whole as well as on individual Partner States raises the question whether a gradual phasing-in of the CET would have been more significant for EAC entrepreneurs and the smooth implementation of the EAC Customs Union Protocol, than the asymmetrical liberalisation of intra-EAC tariffs.
- The EAC CET presents itself as a compromise between Kenya's interest in a substantial average tariff on third country imports into the EAC to protect its industrial sector, which is more developed than that of its fellow EAC partners, and Uganda's interest, as a landlocked country, to keep average tariffs on third country imports low. Uganda consumers and producers using third country imports will have to face a rise in consumer and input prices as a result of the EAC CU.
- The EAC tariff liberalisation is accompanied by a simplification of the Partner States' customs regime due to a simplified and common tariff regime for the three EAC Partner States, an elimination of discriminatory suspended duties in Tanzania and of excises discriminating against imports in Uganda.
- The EAC CU will bring about a substitution of third country imports by increased intra-EAC imports, primarily involving trade diversion. This will mainly increase the demand for processed Kenyan production. It remains to be seen to what extent supply constraints make it difficult for Kenya to respond to this demand increase.
- CET tariffs on products included in EAC's sensitive list were set at significantly higher levels than the respective 2003 national MFN tariffs on such products. However, third country imports of sensitive products play a minor role only.

Corrective adjustments of CETs on sensitive products adopted in June 2005 have addressed some of the social policy concerns.

- Customs revenue losses emanate primarily from the EAC CET and much less from intra-EAC tariff liberalisation. They affect Kenya's tariff revenue hardest, much less Tanzania's and least Uganda's. Overall, customs revenue losses as a result of the EAC CU are modest only.
- Dynamic effects of EAC tariff liberalisation due to stiffer competition, economies of scale, trade creation and increased foreign direct investment result from private sector investment responses to the new opportunities created by the EAC CU dispensation. EAC Partner States' governments' interference in economic adjustment processes jeopardise possible dynamic effects triggering apprehension that such interferences will be repeated in the future.
- Risks for potential dynamic benefits of the EAC CU are compounded by ample scope for anti-dumping, safeguard and countervailing measures of protection against imports provided for by the EAC CU Protocol. Its notification to WTO under the Enabling Clause may further undermine its credibility.
- For the EAC CU to present itself as a credible fast-track trade integration option of COMESA, Tanzania will have to re-join COMESA and suspend its participation in the SADC trade integration dispensation, or else suspend its participation in the EAC CU.

Non-tariff Aspects of the EAC Customs Union

- Substantial EAC 2003 exports to neighbouring COMESA countries suggest that the EAC CU can support the EAC Partner States' role as an important sub-regional hub for exports in respect of these countries' huge absorptive capacity for imports at competitive transport costs supplied by EAC entrepreneurs with intimate market information. Rwanda's expected EAC accession later in 2005 can further support this trend.
- For EAC, the conventional approach of associating trade liberalisation to intra-EAC tariff liberalisation represents a misconception. EAC trade liberalisation and associated welfare and employment gains depend primarily on the elimination of policy and procedures linked as well as structural NTBs. Partner States should therefore invest more time, effort and attention to addressing both policy and procedures-linked as well as structural NTBs. In East Africa, returns in terms of welfare gains, growth, employment generation and poverty reduction are much more likely to be achieved by addressing NTBs, than through tariff reduction.

- EAC CU benefits will not be evenly distributed among EAC Partner States. Partner States with a more developed industrial sector are likely to benefit most. To ensure the long-term stability of the Community and avoid the repetition of the 'old' EAC, the 'new' EAC should adopt deliberate policies to enhance investment in the Partner States expected to benefit less from the EAC CU. Such investment should primarily address these countries' supply constraints and infrastructure bottlenecks and could be funded by an asymmetrical distribution of EAC tariff revenues as well as an infrastructure, or regional, or solidarity fund (whatever its denomination) to be supported by Cooperating Partners³⁶.
- EAC Partner States are encouraged to adopt a policy framework to ensure free movement of persons and free settlement of enterprises within the EAC region to support and ease the resource allocation adjustment processes emanating from the implementation of the EAC Customs Union dispensation.

³⁶ Such funds have played a major role for political stability and economic development in the relatively poorer Partner States in the EU. EAC has, in principle, approved the establishment of such a fund but has not operationalised it.



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