CUTS-ARC
Policy Briefs

CUTS International
AFRICA RESOURCE CENTRE
LUSAKA

No.1/2005

Kenya and the EU
Can Kenya say No to EPAs?

For Kenya, the main objective of international trade agreements with the European Union (EU) is to promote sustainable forms of development, which assist in reducing poverty by bringing structural transformation in the economy, while enhancing growth and employment generation. There is a need to ensure a strong developmental dimension, to take into account the development gap between Kenya and the EU, which implies, linking achievement of development thresholds with liberalisation.

Kenya and the EU started negotiations for a new economic partnership in Lusaka, in October 2005. This pact will replace the Cotonou agreement of 2000 between the EU and 79 African, Caribbean and Pacific (ACP) countries, which allowed the ACP countries duty free access to the EU market.

Background

Kenya, along with other ACP countries, signed the Cotonou Partnership Agreement (CPA) in Benin, on June 23, 2000. The agreement provided for the establishment of a new World Trade Organisation (WTO) compatible trading arrangement, to replace the Lomè Convention made between the EU and ACP countries. The establishment of this new arrangement was made through the negotiation of Economic Partnership Agreements (EPAs) between ACP countries and the EU, which was formally opened in Brussels, on September 27, 2002. The new trading arrangement is expected to enter into force on January 01, 2008.

One of the key targets of EPAs is to improve the business environment for African entrepreneurs by promoting regional integration and tackling supply-side constraints. Under the EPAs, there is a need to define or consolidate a common customs tariff to protect the emerging regional markets, so that Kenya could have an advantage regionally. For Kenyan exports to the EU, free access for textiles & clothing (T&C), which already exists today, will be consolidated within an EPA.

In order to reap the benefits from EPAs, Kenya and other ACP states need to implement a series of structural reforms that would make national economies more competitive through:

- enhancing productive capacities in the main sectors;
- enhancing supply and trading capacity for ACP through regional integration;
- increasing competitiveness of a large part of the export sector;
- attracting greater volumes of investment and technology in the key sectors of the economy;
- diversifying export markets and products;
- developing hard and soft infrastructure;
- enhancing capacity in human resources; and
- building the requisite institutions and confidence in the multilateral trading system (MTS).

Kenya-EU Trade

The EU is Kenya's main trading partner outside of Africa accounting for 31 percent of imports and 35 percent of exports. Kenya's star performer, in terms of exports to the EU, has been the horticulture sector with an 80 percent share. The value of horticulture exports increased by no less than 69 percent from 1999 to 2002. Also, European tourism in Kenya is an important source of revenue for the country. Kenya is a leading player in the EU-ACP discussions on trade in the framework of the Cotonou Agreement and has been a central player on the revitalisation of East African Community (EAC) comprising Kenya, Uganda and Tanzania.

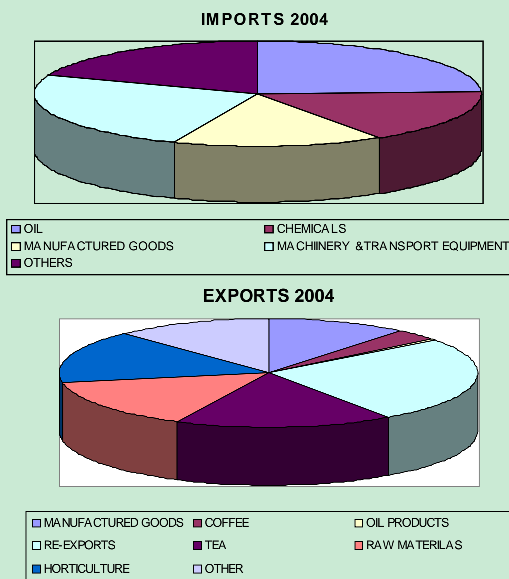
Kenya exports most of her agricultural products to the EU, whereas, a major part of her manufactured goods are exported to the EAC and the Common Market for Eastern and Southern Africa (COMESA). However, its biggest percentage of imports is machinery and industrial goods, which leaves the country with a current account deficit. In 2004, the current account deficit was US$546mn, mainly due to an increase in the merchandise imports.

Table 1: Kenya's Exports to the EU in 2003

Product	Percentage
Plants, flowers	30
Vegetables	16.6
Prepared Vegetables and fruits	9.9
Tea	14.5
Coffee	8.2
Other	19.9

Source: Comext

The charts below illustrate the composition of Kenya's imports and exports for the year 2004.



Source: Central Bank of Kenya, 2004

Of the various destinations of these exports from Kenya, the EU market is of primary significance. With its population of nearly half a billion citizens, the EU constitutes the largest single market in the world accounting for a fifth of global trade. Currently, the EU and Kenya are trading under the ACP-EU partnership agreement signed in Cotonou. This is essentially an agreement to maintain *status quo* (Lomè IV agreement) temporarily while negotiating future trade arrangements.

The EU market is particularly important for Kenya being its second largest market for exports after COMESA. As the Table-2 below illustrates, Europe and Africa together accounted for over 70 percent of Kenya's total exports between 1999 and 2004.

Over the years, Kenya has become the leading supplier of fresh cut flowers to the EU, ahead of Israel and Columbia. Over 60 percent of cut flowers in 2003 were sold to Holland, Europe's flower industry hub. It is the fastest growing sector in the economy, recording 44.7 percent growth in 2004. It is estimated that about 3 million people derive their livelihood from the flower industry.

Supply Side Constraints

There are various supply-side constraints that are serious obstacles to competitive production and marketing. Infrastructure is an example. It is estimated that 90 percent of the road network in the country is dilapidated and in dire need of rehabilitation against a whooping cost of US$1.8bn. The annual costs of maintaining the rehabilitated network is estimated at US$0.2bn. The railway network is similarly in a highly dilapidated condition and requires in excess of US$0.6bn to upgrade and rehabilitate. The provision of quality power service is also a great challenge, requiring about US$0.3bn. These requirements alone exceed the government's gross receipts for most years.

These are some of the constraints contributing to the high cost of doing business that hinder quick supply responses. As of April 2004, for example, Kenya was at a risk of loosing its sugar quota to EU. The ACP London sugar group had raised concerns about the country's progress in delivering the sugar to Portugal. A tonne of sugar in EU market sells at US$450 compared to prices in the regional markets between US$330-360 (in Burundi, Democratic Republic of Congo, and some of the COMESA countries).

The Commodity Dependence

The other fundamental problem is the dependence on primary products with producers operating at the lower end of the value chain. The country's reliance on traditional exports such as coffee and tea makes it very vulnerable to the vagaries of both the market and the weather. The prices of these commodities are also volatile and have been declining. Besides, there are huge disparities between prices paid by final consumers and those received by producers. In coffee, for example, recent estimates show the value of retail sales as US$70bn while producers receive only US$5.5bn. Resolving this commodity crisis is critical in ensuring better gains from trade for all poor countries, including Kenya. There is an urgent need for investments to promote growth and comparative advantage in higher value-added sectors and for diversification of products and processes.

Market Access

Compounding these internal constraints are additional barriers that the EU places in the form of tariffs and non-tariff barriers (NTBs), including farm support systems. Perhaps the most stringent barrier is the European Retailers Protocol on Good Agricultural Practices. (EUREP-GAP), which makes it mandatory that from January 2005, all food products exported to the EU be traced to the exact source through the production, processing and distribution chain. In effect, the rules require that farmers record all steps in the production process, reduce use of chemicals and observe strict hygiene standards. This translates into increased costs of production and produce-handling, investment in facilities, training and record keeping with no immediate gains.

Though large producers are better able to meet these requirements, small and medium size businesses find them

Table 2: Percentage of Kenya's Exports Destination (1999-2004)

Destination	1999	2000	2001	2002	2003	2004
Africa	46.8	46	49.3	49.1	46.2	47.5
Europe	32.4	31.1	28.8	29.2	30.9	27.9
Asia	16.9	15.5	17.2	15.3	15.2	15.8
America	2.7	2.7	2.9	2.4	2.1	2.8
Australia &Oceanic	0.5	0.5	0.6	0.3	0.4	0.3
Others	0.7	3.2	1.4	3.6	3.6	5.8
Total (in US dollar)	1.6bn	1.8bn	2.05bn	2.3bn	2.5bn	2.9bn

Source: Export Processing Zones Authority (EPZA), Kenya

challenging. In Kenya, there are about 500,000 small-scale farmers who account for 60 percent of horticultural exports. In the case of avocadoes, small holders produce 95 percent of the export crop. As of May 2004, less than 5 percent of them were EUREP-GAP certified.

The Head of European Commission (EC) delegation has attempted to allay fears by pointing out that the rules do not have an extra-territorial effect outside the EU. Reports from exporters, however, indicate the EU retailers expect them to meet the guidelines.

The CPA and the EPA

The framework for defining the future trade relationships between Kenya (and ACP in general) is spelt out in the CPA, and will be thrashed out in the EPA currently being negotiated. What might appear to be a relatively straightforward matter regarding the rules of the game to ensure the achievement of CPA objective, 'to reduce and eventually eradicate poverty while contributing to sustainable development', has become the subject of a major controversy.

To achieve the objectives set out in the CPA, the ACP countries and the EU have agreed to enter into EPAs broadly building on existing regional integration arrangements. Kenya's negotiation with the EU is being conducted through the Eastern and Southern Africa (ESA) geographic configuration – a configuration that may well compound the negotiating process.

ESA is a group, widely perceived as artificial and likely to undermine existing regional integration schemes of 16 countries that did not exist prior to the EPA negotiations. Its membership does not conform to any of the existing regional organisations. It includes members from the EAC (customs union): Kenya, Uganda and Tanzania; COMESA: Burundi, Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Rwanda, Seychelles, Sudan, and Uganda; as well as members of COMESA which are also members of the Southern Africa Development Community (SADC): the Democratic Republic of Congo, Malawi, Mauritius, Zambia, and Zimbabwe. This problem of overlap and multiple memberships has been difficult to resolve.

The problem is exacerbating further because of the 16 countries, and except for Kenya, the rest are either classified as least developed countries (LDCs) or small island states that will remain eligible for non-reciprocal preferential market access under the Everything but Arms (EBA) initiative. Zimbabwe seems to be locked out due to the continuing stalemate with the EU over political issues. Kenya, with a more diversified economy and a lot at stake, would appear to be disadvantaged.

Why EPA'S?

The case for EPA's is based on several considerations. Chief among them is exposure to competition that will force regional industries to be more competitive by reducing costs of production and improving quality. Consumers are likely to benefit from decreased costs of finished products while producers would benefit from cheaper intermediate goods. In the long run, the economy reallocates resources into areas where comparative advantage exists, leading to greater efficiency, higher levels of growth, employment and welfare.

EPA's also enable countries to protect their access into the EU markets and may give rise to increased government revenue, as consumers demand more imports at a lower price. The case is also made for their dynamic effects – e.g. their legal framework will make policy reversals difficult thus providing a stable environment more attractive to investors.

Unclear Benefits

The ESA group launched negotiations with EC on February 07, 2004 for which they spelt out three phases:

- phase I: setting of priorities and negotiating procedures (March-August 2004);
- phase II: substantive negotiations (September 2004 - December 2005); and
- phase III: continuation and finalisation of negotiations (January 2006-December 2007).

In Kenya, preparation for EPA trade negotiations is at an advanced stage. Through the EU funded trade negotiations support programme, the Ministry of Trade and Industry formed a negotiation committee comprising ministries, public institutions, private sector and civil society groups. All of them came together to be known as the Kenya-Post Lomè Trade Negotiation Programme (KEPLOTRADE) with the central objective of developing negotiation skills and capacity to support the ESA negotiations with the EU. The main function of the team is to prepare, monitor and advise the government on all aspects pertaining to the forthcoming negotiations of the EPAs. So far, KEPLOTRADE has done research, training of negotiators, stakeholders' consultations and information dissemination through newsletters and web sites in preparation for the negotiations.

Though impact assessments of the effects (including micro and socio-economic effects) of the EPAs on Kenya are not complete, anecdotal evidence suggests that its welfare effects are not clear. Trade diversion effects are likely to reduce the small welfare effects from exports. Regional integration experts also anticipate increased regional tensions arising from EPAs. Impacts of EPA's on Kenya's position in the ESA countries would not improve market access for Uganda and Tanzania owing to their LDC status. Kenya, would face severe competition from the EU for its manufactured products, and most probably lose market share, in its most important market – East Africa and COMESA. Civil society organisations have raised other important issues regarding EPA negotiations, for example, potential displacement of import competing goods in the local and regional markets when the EU gets tariff free access in the region (Ministry of Trade and Industry, Kenya).

Can't Say No to Unequal Partnership

The power imbalance between poor countries and the mighty EU, further buttressed by the ACP countries dependence on EU aid is a fact that cannot be ignored. In the case of Kenya, the expected donor support in the budget for the 2004-05 is around US$633mn (approximately 11.5 percent of the budget). The EC is the second largest donor, particularly in agriculture and rural development, transport health and education. For example, a consortium of donors under the umbrella of the EU has pledged US$829mn for roads projects and also pledged US$2mn in

support of the health sector reform programmes. The EU funds the EPA negotiations themselves. It is difficult under these circumstances to see how the country can say no to EPAs.

Table 3: Kenya Import Taxes (US$mn)					
	1998-99	1999-00	2000-01	2001-/02	2002-03
Vat on imports	241	247	320	327	355
Import duties	379 *620*	381 *628*	384 *704*	288 *615*	265 *620*
Total government gross receipts	2404	2461	2563	2505	2974
Percentage of import taxes to gross receipts	25.8	25.5	27.5	24.6	20.9

Revenue Loss

One of the most serious concerns raised by Kenya has been the impact of the EPAs on government revenues. As the Table-3 illustrates trade taxes make up a significant part of government revenue.

Loss of such revenue would be difficult to offset in the short-term through alternative sources. There is some evidence that these fears may be unfounded. COMESA's experience suggest insignificant revenue loss arising from tariff removal – a study to estimate the probable losses of revenue from removing tariffs on intra-COMESA trade concluded that they would range between 0.1 to 1.6 percent of total revenue.

Reciprocity and Transition

Perhaps the most controversial issue in the proposed trade regime is the withdrawal of previous preferential access to the EU on a non-reciprocal basis. The danger is in opening markets in ACP countries before local producers are in a position to compete with their far larger EU counterparts. At best, this will only entrench primary commodity production exports in ACP countries. It may lead to de-industrialisation and only generate extra profit margins for European exporters instead of lower prices for importers in poor countries.

Concern has also been raised about the ten-year transition period. It has been pointed out that this time frame is too short for a country such as Kenya to implement the kind of structural change in the economy, which would allow competitive production of high value products such as manufacturing.

WTO Compatibility

The fact that the new regime shall be WTO-compliant poses a challenge to the poor countries. Given this, there are proposals to negotiate issues such as investment, government procurement, competition that go beyond what Kenya is negotiating at the multilateral level and makes it difficult for Kenya to coordinate and sequence both multilateral and bilateral agreements to her advantage.

Strategy of Kenya

The trade regime that will emerge out of the ACP-EU economic partnership agreements is expected to be superior to the current Kenya ACP-EU trade regime. Kenya wishes to negotiate for, among others, the following:

- removal of tariff escalation for processed products;
- removal of restriction for certain agricultural products;
- level playing ground in the EU market occasioned by subsidies to the agricultural sector;
- linkages to the country's industrial development and regional integration; and
- agreement on regulations on Sanitary and Phyto-sanitary (SPS) and product standards, which were not covered under the Cotonou agreement and yet turned out to be critical impediments to market access.

In addition, the EPA provides the following opportunities, which Kenya must pursue through negotiations:

- greater market access in the regional market, following support for regional integration through EPA related interventions;
- increased foreign and local investment through development component of EPAs;
- removal of supply side constraint through development component of EPAs, which, for instance, includes infrastructure fund;
- development of Kenya's fishing industry-marine and inland, through fisheries component for EPAs; and
- access to EU service sector through tradable services such as professional services, tourism, etc.

Conclusion

The EPA is not just about trade. It is about partnership for development. Kenya is leading the way with its customs union with the EAC and the fact that it already trades more within the COMESA region. Other crucial issues must, of course, also be addressed such as improving security, infrastructure and addressing governance issues. But, it is certain that Kenya's economic development stands to do very well from deepening the regional economic integration process with the EPA agreement.

EU is by far the most open market for, and largest recipient of, Kenya's exports. Kenya is committed within the EPAs to eliminating the few barriers that remain on Kenyan exports to the EU. In the WTO context, the challenge is to ensure favourable net outcomes of the EPAs negotiations if Kenya decides, after thorough consultation, that this is the best option to pursue. On development issues and addressing supply side constraints in particular, the country must ensure a good deal. Kenya understands what is at stake and should base this fact to improve the welfare of her people.

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