

# **IMPLICATIONS OF THE TRIPARTITE FREE TRADE AREA AGREEMENT ON KENYA**

**BY**

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## **DECLARATION**

I hereby declare that this is my original work and that to the best of my knowledge, it has not been presented for examination in any other University.

Signature.....

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This Research Paper has been submitted with my approval as the University Supervisor.

Signature.....

Date.....

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## **DEDICATION**

I dedicate this paper to all who supported me in making this work a reality. May the Almighty God, who sees in secret, but rewards openly richly bless you.

## **ACKNOWLEDGEMENT**

I honour God Most High, through whose power, wisdom and knowledge I managed to undertake this research. I sincerely appreciate my wife Esther, my daughter Patience and my sons Victor and Ngumbau for their sacrifice and moral support that enabled me to complete this task. Third, I thank my supervisor Prof. Seth Omondi Gor and the entire School of Economics fraternity for the mentorship and support extended to me as I undertook this study. I also take this opportunity to sincerely thank my colleagues from the State Department for Planning for their encouragement and support and the World Trade Organization, World Bank and the United Nations Conference on Trade and Development for availing the required data as well as the data analysis tool. I equally acknowledge my classmates who not only encouraged but also challenged me to conclude this work and all my other friends who contributed in one way or another. May the Lord increase and reward you.

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## **LIST OF ACRONYMS/ABBREVIATIONS**

ACP	Africa Caribbean Pacific
AfCFTA	Africa Continental Free Trade Area
ALLPI	Africa Leather and Leather Products Institute
ASEAN + 3	Association of South East Asian Nations and its three partners including China, South Korea and Japan
ATI	African Trade Insurance Agency
CASSOA	Civil Safety and Security Oversight Agency
CCH	COMESA Clearing House
CCIA	Comesa Common Investment Area
CGE	Computable General Equilibrium
COMESA	Common Market for Eastern and Southern Africa
COMTRADE	Common Format for Transient Data Exchange
CTH	Change in Tariff Heading
CTs	Consolidated Tariff Schedules
EAC	East African Community
EACA	East African Community Competition Authority
EADB	East African Development Bank
ECOWAS	Economic Community of West African States
EPA	Economic Partnership Agreement
EU	European Union
EVFTA	European Union – Vietnam Free Trade Agreement
FTA	Free Trade Area
GATT	General Agreement on Trade and Tariffs
GDP	Gross Domestic Product
GTAP	Global Trade Analysis Project
LVBC	Lake Victoria Basin Commission
MFN	Most Favoured Nation
OSBPs	One Stop Border Posts
PTA	Preferential Trade Area

RECs	Regional Economic Communities
RI	Regional Integration
RIA	Regional Investment Agency
ROW	Rest of the World
SACU	South African Customs Union
SADC	Southern Africa Development Community
SMART	Software for Market Analysis and Restrictions on Trade
STR	Simplified Trade Regime
TDB	Trade and Development Bank
TFTA	Tripartite Free Trade Area
TPP	Trans - Pacific Partnership
TRAINS	Trade Analysis and Information System
UNCTAD	United Nations Conference on Trade and Development
WITS	World Integrated Trade Solutions
ZEP-RE	PTA Reinsurance Company

## **ABSTRACT**

This study explored the implications of the Tripartite Free Trade Area (TFTA) Agreement on Kenya's products using the Software for Market Analysis and Restrictions on Trade (SMART) Model. It undertook simulations to examine the trade creation, diversion, revenue and welfare effects of the TFTA. The study findings revealed that the TFTA will create approximately USD 1.53 billion worth of trade, with DR Congo as the largest beneficiary. Under the TFTA arrangement, Kenya's trade creation is estimated at USD 51.81 million representing 3.38% of the total trade created. Trade diversion effect is estimated at USD 706.14 million with DR Congo having the largest share at USD 185.78 million. Trade diversion effect for Kenya is estimated to be USD 77.23 million representing 10.94% of the total trade diversion. The simulation results further show that USD 754.21 million would be lost in tariff revenue with DR Congo recording the largest loss of USD 337.09 million. Kenya's revenue loss is approximately USD 59.88 million. TFTA will generate an overall welfare gain of USD 163.19 million with DR Congo enjoying 40.38% of the total welfare while Kenya's share is USD 7.59 million representing 3.65% of the total net welfare gain. The study recommends greater specialization in the identified trade creating products for Kenya to cushion less efficient domestic producers from being replaced by cheap imports from more efficient TFTA members. To avert the effect of tariff revenue loss, broadening of the tax base especially targeting Value Added Tax (VAT) as a complementary source of revenue to trade taxation is recommended. Kenya should also increase its regional integration engagements to minimize the effects of further losses in tariff revenue.

# **CHAPTER ONE**

## **1.0 INTRODUCTION**

Regional integration (RI) continues to be one of the key strategies that countries employ to develop and accelerate attainment of sustainable development. It contributes to industrial development and economic growth by nurturing intra – regional trade, cross border investment and infrastructure development. This study explored the implications of the Tripartite Free Trade Area (TFTA) Agreement between the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC) and the Southern Africa Development Community (SADC), on Kenya, a region that spans across an area of 17.5 million square kilometers.

### **1.1 Background to the Study**

#### **1.1.1 Why Countries join FTAs**

Baldwin (1993) postulates that there is a domino effect which makes countries want to form regional economic blocks. This is explained by the fear of exclusion from the expected gains of trade liberalization such as the risk of losing profits and market share by non-Member States. The slow pace of negotiations at the World Trade Organization (WTO) has also been a key motivation for countries to form or join FTAs. However, FTAs should complement rather than substitute the multilateral trading system. Most of the African Countries including Kenya, join FTAs to increase their market access prospects as well as to increase their bargaining power at the international arena. African countries, especially the TFTA Member States are also integrating to accelerate economic transformation through prioritization of infrastructure and industrial development as key pillars of integration.

Following the near collapse of multilateralism especially the WTO Doha Round of negotiations, it can be argued that FTAs present the best option for promoting integration among countries globally. Hoang et al (2005), Matsushita (2010) and VCCI et al. (2012) argue that current FTAs not only cover trade liberalization but also comprise other more complex matters including government procurement, Foreign Direct Investments, Intellectual Property regimes, labour and environmental matters. Nevertheless, developing countries largely join FTAs to benefit from trade

liberalization. Consequently, governments and private sectors in developing countries pay keen attention to the trade impacts of a Free Trade Agreement.

Kenya subscribes to and actively participates in the programmes/projects of different Regional Economic Communities (RECs) and is also a member of the African Union, African Caribbean and Pacific Group of States (ACP) and the World Trade Organization. The RECs to which Kenya is a party include East African Community (EAC), the Inter-Governmental Authority on Development (IGAD), Common Market for Eastern and Southern Africa (COMESA), the Tripartite Free Trade Area (TFTA), the Africa Continental Free Trade Area (AfCFTA) and the Community of Sahel-Saharan States (CENSAD). The objective of the country's involvement in these RECs is to position itself as a regional leader and player in all spheres of goods and services trade, investment, peace and security among others.

## **1.2 Status of Integration in the Tripartite FTA RECs**

The three RECS forming the TFTA have regional integration goals that are almost alike. However, their pace of integration particularly in trade development and cooperation differs in various aspects.

### **1.2.1 Common Market for Eastern and Southern Africa**

COMESA was established in 1994 in line with the Lagos Plan of Action. The REC's substantial progress in trade liberalization culminated into the launch of a FTA in the year 2000 which improved trade among members. In a bid to deepen its integration, COMESA has established a Common External Tariff (CET) and envisions a Customs Union and ultimately a Monetary Union with a view to improving the region's international competitiveness and its people's living standards.

Currently, it is one of Africa's largest RECs comprising of 21 Member States namely: Seychelles, Kenya, Rwanda, Egypt, Djibouti, Ethiopia, Madagascar, Mauritius, Comoros, Burundi, DR Congo, Eritrea, Libya, Sudan, Zambia, Uganda, Malawi, Tunisia, Eswatini Somalia and Zimbabwe.

COMESA boasts an area of over 12 million KM<sup>2</sup> and enjoys a market size of about 588 million people, international trade in goods worth approximately USD 266 billion and a joint GDP of USD 768 billion. COMESA imports and exports to Africa were USD 21.7 million and USD 16.3 million respectively with imports and exports from the Rest of the World amounting to USD 164.9 million and USD 101.9 million respectively in 2018. Over the same period, COMESA imported goods worth USD 3.1 million from EAC with exports to the region standing at USD 2.6 million and imports from SADC amounting to USD 2.7 million with exports at USD 8.8 million. (<https://www.trademap.org/Index.aspx>).

Table 1.1 presents Kenya's trade with the COMESA region for the period 2008 to 2018. It shows that Kenya maintained a positive trade balance with COMESA from 2008 to 2018. The Balance of Trade recorded mixed performance between 2008 and 2015 with some years showing positive growth while others showed a slight decline. However, between 2016 and 2018 the trade balance though positive, declined sharply owing to increased imports from the COMESA region as compared to Kenya's exports.

**Table 1.1: Kenya's Trade with COMESA Countries, 2008-2018**

<b>Year</b>	<b>Export Value (USD Millions)</b>	<b>Import Value (USD Million)</b>	<b>Balance of Trade (USD Million)</b>
<b>2008</b>	1,115	283	832
<b>2009</b>	1,129	249	880
<b>2010</b>	1,360	410	950
<b>2011</b>	1,815	553	1,262
<b>2012</b>	1,757	616	1,141
<b>2013</b>	1,637	583	1,054
<b>2014</b>	1,703	604	1,099
<b>2015</b>	1,791	671	1,120
<b>2016</b>	1,702	696	1,006
<b>2017</b>	1,664	1,153	511
<b>2018</b>	1,600	1,155	445
<b>AVERAGE</b>	<b>1,570</b>	<b>633.9</b>	<b>936.4</b>

*Source: own computation based on Centre for Business Information in Kenya (CBIK) data 2018*

The main export products are: tea and mate, petroleum oils and oils obtained from bituminous minerals; flat-rolled products of iron or non-alloy steel, edible products and preparations; crude, refined or fractionated vegetable fats; medicaments; tobacco manufacture; soap, cleansing and polishing preparations; articles of plastics; paper and paperboard, cut to size or shape, and articles

of paper or paperboard; sugar confectionery; alcoholic beverages; other crude minerals; fertilizers; footwear; lime, cement and fabricated construction materials (except glass and clay materials; and printed matter among others as highlighted in Appendix 1.5.

Kenya's main import products from COMESA as depicted in Appendix 1.6 include: sugars, molasses and honey; unmilled maize excluding sweet corn; milk, cream, and milk products other than butter or cheese; fresh, chilled, frozen or simply preserved vegetables; roots, tubers and other edible vegetable products; essential oils, perfume and flavour materials; feeding stuff for animals (not including unmilled cereals); tobacco, unmanufactured; tobacco refuse; soap, cleansing and polishing preparations; paper and paperboard; lime, cement and fabricated construction materials (except glass and clay materials); particle board, plywood, veneers and other worked wood; television receivers (including video monitors and video projectors; cereals, unmilled (other than wheat, rice, barley and maize); edible products and preparations; and film, plates, foil, sheets and strip of plastics.

Appendix 1.7 provides the details of intra COMESA trade for the period 2008 – 2018.

## **COMESA Institutions and Programmes**

### ***COMESA Institutions***

COMESA has several institutions some of which have their headquarters in Nairobi Kenya. The following are some of the institutions:

*African Trade Insurance Agency (ATI):* ATI was conceived in the year 2000. It's founding member countries were Kenya, Malawi, Burundi, Rwanda, Uganda, Zambia and Tanzania but both corporate and country participation has grown to nine (9) and 14 respectively. The Agency is open for membership by all African Union Members and its main objective is to provide political risk cover to investors, lenders and companies interested in operating within the African market. It is supported by the World Bank through provision of concessional loans to member countries.

*The COMESA Clearing House:* The COMESA Clearing House (CCH) is based in Zimbabwe but is currently hosted by the Central Bank of Mauritius. It enables Member States to utilize local currencies in settling intra – COMESA goods and services transactions. The Clearing House was mostly used in the 1980s and early 1990s when most Member States imposed strict exchange

controls but was later reorganized to facilitate real time gross settlement payments within a new set up of trade liberalization. Consequently, it established the Regional Payment and Settlement System (REPSS) that allows countries to easily transfer funds within the region, hence stimulating economic growth through increased intra-COMESA.

*The COMESA Competition Commission:* The COMESA Competition Commission is a regional body corporate established under Article 6 of the COMESA Competition Regulations in January 2013 and based in Lilongwe Malawi. The Commission is charged with enhancing consumer welfare and promoting competition within the COMESA region among other things. It prohibits, monitors and investigates anti-competitive business practices, controls mergers and acquisitions and mediates anti-competitive disputes between Member States. This Competition Commission was the first of its kind in Africa and the second in the world after the European Competition Authority.

*The Africa Leather and Leather Products Institute (ALLPI):* The COMESA Leather and Leather Products Institute (LLPI) was established in 1990 and has its headquarters in Ethiopia. In 2017 LLPI rebranded to the Africa Leather and Leather Products Institute (ALLPI) with a view to enhancing its support for a strong African leather value chain in a cost-effective and coherent way. The ALLPI has pioneered various programmes and projects in the leather and leather products' trade and investment as well as in human resource and institutional development. It supports entrepreneurs within the sector in preparing feasibility studies and helps Member States to develop their leather sectors through designing and executing various programmes.

*The COMESA Monetary Institute:* The COMESA Monetary Institute, headquartered in Nairobi, was created in 2011 to undertake technical work necessary for enhancing the REC's Monetary Cooperation Programme. The Institute has since its inception undertaken various research and capacity building activities aimed at improving financial stability and macroeconomic management in the region. It lays emphasis on the sustainability and viability of COMESA's integration agenda with key focus on implementing the Multilateral Fiscal Surveillance Framework. Another intervention of the Institute is Financial System Development and Stability Plan aimed at achieving financial integration in the region, hence facilitating and accelerating integration in trade and services.

*COMESA Regional Investment Agency (RIA):* The COMESA RIA was launched in 2006 following a declaration of the region as a Common Investment Area by the Heads of State and Government in 1998. It is based in Cairo, Egypt and is tasked with ensuring implementation of the COMESA Common Investment Area (CCIA) and improving national investments as well as making COMESA a major destination for investors (both regional and international). This is achieved through undertaking of advocacy, facilitation and investment promotion activities. The CCIA is critical because it can attract more investments as compared to national markets due to a larger market size and a bigger purchasing power.

*PTA Reinsurance Company (ZEP-RE)*

ZEP-RE was established on 21<sup>st</sup> November 1990 by the COMESA Heads of State and Government. It was officially launched in 1992 and became operational in January 1993 with its head office in Nairobi Kenya. The company is charged with enhancing trade promotion and ensuring a well-developed and integrated insurance and reinsurance sector in the region. In addition to its operations in various COMESA Member States, ZEP-RE also provides services to Algeria, Morocco, Nigeria, Ghana, Togo, Mozambique, Senegal and Tanzania. The company is headquartered in Nairobi, Kenya.

*COMESA Trade and Development Bank*

The Trade and Development Bank for Eastern and Southern Africa (PTA Bank) is a successor of the former PTA Bank with Headquarters in Bujumbura, Burundi. It was established in 1985 as an independent specialized institution in line with the provisions of the COMESA treaty. The PTA Bank provides technical and financial assistance and promotes socio-economic development among COMESA member states. It achieves its objectives by supplementing the efforts of Member States' national development agencies and in collaboration with other institutions (both national and international) that promote socio-economic development. The PTA Bank draws shareholding from: Member States of COMESA, EAC and SADC, COMESA ZEP-RE, the African Development Bank, Africa – Re, Mauritius and Seychelles National Pension Funds and China and Belarusian Paritetbank among other shareholders.

## **COMESA Court of Justice**

The COMESA Court of Justice was established in 1994 under Article seven of the COMESA Treaty as the Judicial Arm of the REC and is domiciled in Khartoum, Sudan. The Court operates as an independent organ of the Common Market and comprises of two Divisions, the Appellate Division which is headed by the President and the First Instance Division, which is headed by the Principal Judge. The day-to-day operations of the Court are undertaken by the Registrar of the Court assisted by other Registry and Administrative Staff, under the supervision of the Judge President. It has seven (7) judges with the objective of enforcing rules to ensure that the REC is a rules based multilateral organization.

## ***COMESA Programmes***

COMESA has implemented various programmes including cross border trade and transit facilitation programmes such as One Stop Border Posts, resolution of Non - Tariff Barriers to Trade (NTBs) and simplification of customs documentation among others as highlighted below.

*COMESA Simplified Trade Region (STR):* STR was launched in 2010 and recognizes the significance of border trade as a substantial part of trade within COMESA. It is aimed at formalizing informal cross border trade through mechanisms and instruments customized to the needs of small-scale traders to enable them to access the neighbouring markets. The STR serves traders exporting or importing goods with a value of up to USD 2,000 whose eligibility is agreed by the two countries. It accelerates the speed of crossing a border and reduces the cost for small traders who utilize simplified customs processes and certificates of origin.

*One Stop Border Posts (OSBPs)* such as Chirundu between Zambia and Zimbabwe, Malaba between Kenya and Uganda. The OSBPs facilitate trade through reduction in the time taken to process goods across the borders. They consequently enhance the region's competitiveness by reducing the number of cross-border transactions.

*Regional Customs Transit Guarantee Scheme (RCTG-CARNET):* The COMESA Customs Transit Guarantee Scheme is meant to ease transit of goods under customs seals in the COMESA area. It ensures that if goods on transit are diverted for sale in the country of transit, governments can recover taxes and duties from the guarantors.

*The COMESA Yellow Card:* this is a regional third-party motor vehicle insurance scheme which offers legal liability cover. It also covers visiting motorists against medical claims should they cause road accidents and is valid in all participating COMESA member states.

*Cape Town to Cairo Electricity Interconnector:* The Common Market for Eastern and Southern Africa is implementing an electricity interconnector linking the South African Power Pool and the East African Power Pool. The Zambia – Tanzania – Kenya electricity interconnector entails construction of a high voltage power line (about 2300 Km) from Zambia to Kenya through Tanzania, to link power systems of the three countries with an objective of promoting trade in electricity and improving power supply security through creation of a regional energy market.

These institutions and programmes yield a host of benefits to Member States especially in countries where the institutions are headquartered. The benefits accrued include employment creation, entrenching of the country as a diplomatic hub, trade facilitation for exports and improvement of competitiveness.

Despite the milestones, COMESA is faced with various challenges including poor infrastructure networks, macroeconomic instability, human capacity constraints and overreliance on donor support to run its programmes. (African Union Commission, 2019).

### **1.2.2 East African Community**

EAC is one of the fastest growing regional integration groupings in the African continent and has increasingly gained significance within the global trading system. It was first established in 1917 through a Customs Union between Kenya and Uganda which Tanganyika joined in 1927. This was followed by the establishment of East African High Commission (EAHC) which lasted between 1948 and 1961. EAHC was succeeded by the East African Common Services Organization (EACSO) from 1961 to 1967. In 1967, Uganda, Kenya and Tanzania established the East African Community with the aim of strengthening ties between the Member States through a Common Market, a Common External Tariff, and various public services to achieve balanced growth in the region.

However, the EAC collapsed in 1977 following disagreements among its members but was re-established in 1999 through the signing of a new treaty and graduated to a Customs Union (CU)

in 2005. The republics of Rwanda and Burundi became members in 2007 while South Sudan joined in 2016 bringing the membership to six. The DR Congo has applied to join the bloc. EAC has an area of 2.5 million Km<sup>2</sup>, a combined market of 172 million people and a joint GDP of USD 172.7 billion (2017). (<https://www.eac.int/overview-of-eac>).

EAC established a Common Market (CM) in 2010 and is in the process of operationalizing its Monetary Union which was adopted in 2013. However, the RECs goal is to ultimately become a Political Federation. These milestones make EAC Africa's most advanced REC going by integration level.

### **EAC Institutions**

The East African Community has various institutions which help with its operations. Some of the institutions are:

*East African Community Competition Authority (EACA):* EACA is an EAC institution responsible for promotion and protection of fair trade and ensuring welfare of consumers in the EAC region. According to the EAC Completion Act, 2006, EACA role is to prohibit anticompetitive practices through protecting the freedom of all market players to compete. It protects and guarantees market participants equal opportunity and ensures a level playing field. In addition, EACA helps consumers to access better quality products and services at competitive prices while providing various incentives to producers.

*Lake Victoria Basin Commission (LVBC):* The Lake Victoria Basin Commission is a specialized institution of EAC, mandated with coordination of sustainable development and management of the Lake Victoria Basin in the EAC Partner States. It is based in Kisumu City, Kenya within the lake Victoria Basin which is designated as an area of high economic interest and a regional growth zone requiring joint development.

*Civil Safety and Security Oversight Agency:* The EAC Civil Safety and Security Oversight Agency (CASSOA) is charged with ensuring safe, efficient and profitable air transport in the region. It is also responsible for ensuring common and harmonized civil aviation policies, rules and regulations.

*East African Development Bank (EADB)*: The East African Development Bank offers structured financial services and products to different sectors in the EAC region. These include education, health, infrastructure development, tourism and hospitality, agriculture and energy and utilities.

### **Trade between Kenya and EAC**

Since 2008 to date, Kenya has maintained a positive trade balance with the EAC as shown in Table 2.1 and Appendix 1.8. The trade balance grew between 2008 and 2011 but started to decline from 2012 to date. The imports from other EAC countries have been growing substantially, reducing Kenya's dominance in the region. Kenya therefore needs to diversify its export products and push for resolution of various NTBs that have remained a key obstacle to its trade with the other partner states.

**Table 2.1: Kenya's Trade with EAC Countries, 2008-2018**

<b>Year</b>	<b>Export Value (USD Millions)</b>	<b>Import Value (USD Million)</b>	<b>Balance of Trade (USD Million)</b>
<b>2008</b>	842	126.03	716
<b>2009</b>	904	125.32	778.7
<b>2010</b>	1014	202.75	811.3
<b>2011</b>	1371	268.92	1102.1
<b>2012</b>	1349	308.32	1040.7
<b>2013</b>	1250	288.59	961.4
<b>2014</b>	1258	366.44	891.6
<b>2015</b>	1164	402.12	865.9
<b>2016</b>	1217	329.42	887.6
<b>2017</b>	1148	609.42	538.6
<b>2018</b>	1162	627.14	563.6
<b>Average</b>	<b>1152.6</b>	<b>332.2</b>	<b>832.5</b>

*Source: Own computation based on Centre for Business Information in Kenya (CBIK) Data, 2018*

*Main export products to EAC*: Kenya's main exports to EAC comprise: Medicaments, Soap, cleansing and polishing preparations, Articles of plastics, Sugar confectionery, Manufactures of base metal, Palm oil and its fractions, Lubricating petroleum oils and oils obtained from bituminous minerals, Cartons, boxes, cases, bags and other packing containers, Electrical machinery and apparatus, Edible products and preparations, Petroleum oils and oils obtained from bituminous minerals (other than crude); preparations containing by weight 70% or more of petroleum oils or of oils obtained from bituminous materials, Other crude minerals, Civil engineering and contractors' plant and equipment, Bars and rods of iron or steel, Footwear, Registers, account books, note books, order books, receipt books, Organic surface-active agents,,

Other tubes, pipes and hollow profiles , Paints and varnishes, Beer made from malt, Organic surface-active agents

*Main import products:* The main imports from the EAC region are: Paper and paperboard, Feeding stuff for animals (not including unmilled cereals), Vegetables, fresh, chilled, frozen or simply preserved (including dried leguminous vegetables); roots, tubers and other edible vegetable products fresh or dried, Made-up articles, wholly or chiefly of textile materials, Fertilizers, Aircraft and associated equipment; spacecraft, Clay construction materials and refractory construction materials, Maize not including sweet (corn), unmilled, Meals and flours of wheat and flour of meslin, Paints and varnishes, Beer made from malt, Organic surface-active agents, Motor vehicles for the transport of persons, Coal, whether or not pulverized, but not agglomerated, Tea, Hides and skins, Other tubes, pipes and hollow profiles; Articles for conveyance or packing of goods, Coffee, not roasted, Sheep skins and lamb skins without wool on, raw Milk, Lamps and lighting fittings, Bread, pastry, cakes, biscuits and other bakers' wares, Leguminous vegetables, Sugars, beet or cane, raw, in solid form, Food wastes and prepared animal feeds, Densified wood and reconstituted wood, Milk and cream, concentrated or sweetened, Bran, sharps and other residues; Beer made from malt, Worn clothing and other worn textile articles, Sound recording and other sound reproducing apparatus.

In 2018, EAC imports and exports to Africa were valued at USD 5.0 billion and USD 4.5 respectively, while its imports and exports values with the Rest of the World were USD 32.5 billion and USD 12.4 billion respectively. In the same year, EAC imports from COMESA were USD 2.6 billion with exports totaling USD 2.8 billion while imports from SADC amounted to USD 2.7 billion with exports standing at USD 1.74 billion. (<https://www.trademap.org/Index.asp>)

The EAC remains Kenya's major export market and a key source of industrial raw materials and food products. The region experiences challenges such as financial constraints, inadequate human capacity and partial implementation of the CU and the CM.

### **1.2.3 Southern African Development Community (SADC)**

SADC was established in 1992 to spur integration among the member states. In 2008, the REC became a FTA and has since seen intra-regional trade grow to about 22%. The Members of SADC

are Tanzania, Seychelles, Angola, Botswana, Namibia, Madagascar, Mauritius, Comoros, Burundi, DR Congo, Lesotho, Eswatini, Zambia, Mozambique, Malawi, South-Africa and Zimbabwe.

Despite becoming a FTA, SADC has not followed the usual sequential steps to regional integration but has rather pursued a development led approach to integration. Thus, the REC focuses on facilitation of free movement of people, goods, and capital; human development, convergence of macroeconomic indicators and financial integration; industrialization and infrastructure development; climate change and environment as well as peace and security. (Africa Union Commission 2019).

SADC covers an area of 9.6 million square kilometers with a market of 373 million people and a joint GDP of USD 678 billion (2017). The SADC imports and exports to Africa amounted to USD 38.3 billion and USD 39.8 billion respectively, while trade with the Rest of the World stood at USD 165.3 billion worth of imports and USD 187.2 billion worth of exports. Over the same period, SADC imported goods worth USD 7.0 billion from COMESA and exported goods valued at USD 14.6 billion to the region while imports from EAC were USD 1.1 billion with exports at USD 2.4 billion. (<https://www.trademap.org/Index.aspx>, <https://www.worldometers.info/world-population/>).

According to Table 3.1, Kenya recorded a trade deficit with the SADC region over the period 2008-2018. However, the trade deficit was largely as a result of the low Kenyan exports to South Africa vis a vis imports, but the market has great potential for growth of Kenyan exports. Appendix 1.9 shows the details of trade between Kenya and some SADC countries over the period 2008-2018. The SADC region comprises a substantial market for Kenyan products and is also a good destination for Kenyans to invest in.

**Table 3.1: Trade between Kenya and SADC, 2008 - 2018**

Year	Export Value (USD Millions)	Import Value (USD Million)	Balance of Trade (USD Million)
2008	143.0	545.9	-402.9
2009	130.9	781.2	-650.3
2010	129.6	683.2	-553.6
2011	174.9	908.4	-733.5
2012	171.7	715.5	-543.8
2013	166.9	828.4	-661.5
2014	202.1	754.1	-552
2015	164.1	742.6	-578.5
2016	156.6	644.8	-488.2
2017	128.2	874.4	-746.2
2018	156.2	866.9	-710.7
<b>Average</b>	157.7	758.7	-601.9

*Source: Own computation based on Centre for Business Information in Kenya (CBIK) Data, 2018*

*Kenya's main exports to SADC:* The main exports to SADC are: Continuous-action elevators and conveyors for goods or materials, gold, cut flowers and foliage, machine-tools for working metal, sintered metal carbides or cermets, carbonates; peroxocarbonates (percarbonates); commercial ammonium carbonate, construction and mining machinery, Articles of plastics for conveyance or packing of goods; stoppers, lids, caps and other closures of plastics, fresh vegetables, industrial or laboratory furnaces and ovens, and their parts, medicaments, manufactured goods, medicaments containing hormones, calculating machines; accounting machines, postage-franking machines, ticket-issuing machines and similar machines, Tea and roasted Coffee, textile materials, Lubricating petroleum oils and oils , Soap, Margarine, Juice of any single fruit, Non-alcoholic beverages.

*Kenya's main imports from SADC:* the imports from SADC are Flat rolled products of iron or non-alloy steel, coal whether or not pulverized, Semi-finished products of iron or non-alloy steel, Motor vehicles for the transport of persons, polymers of propylene or of other olefins, motor vehicles for the transport of goods, bars and rods hot rolled in irregularly wound coils of iron or steel, wine of fresh grapes, grape must in fermentation, Flat rolled products of iron or non-alloy steel, Sugars, beet or cane, leguminous vegetables, oranges, jewellery of gold, silver or platinum, densified wood and reconstituted wood, tea and hides and skins among others.

Like the other African RECs, SADC is faced with challenges to integration including multiple and overlapping membership, difficulties to cede sovereignty, and limited involvement of the public.

#### **1.2.4 Kenya's Comparative Advantage in the TFTA Region**

The EAC constitutes a key market for Kenya accounting for 21% of total exports in 2017 while exports to COMESA accounted for 14% of total exports constituting 72.5 percent of exports to Africa. According to Trade Map data (UNCTAD 2018), Kenya has a positive trade balance with the TFTA region pointing to the importance of the region to the country's share of international trade.

Kenya's market share in the TFTA region is low, although Kenya has a positive balance of trade. This presents an opportunity for galvanizing the market through export diversification, enhanced value addition and creation of a favorable business environment. This coupled with heavy investment in enabling infrastructure and elimination of Non-Tariff Barriers will enable the country to fully exploit the increasing regional market access. (Kenya Economic Survey, 2017).

Kenya has a comparative advantage in the following export products: tea, horticulture (cut-flowers, vegetables, and fruits), articles of apparels and clothing accessories, coffee, tobacco, pharmaceuticals, iron and steel products, articles of plastics and essential oils which account for over 70 percent of total exports. However, Kenya has a narrow export base comprising mainly of agricultural and low value products hence necessitating expansion and diversification of the export product base. The exports are only concentrated in a few countries hence the need to diversify the markets especially taking advantage of the regional/TFTA market due to proximity.

### **1.3 COMESA-EAC-SADC Tripartite Free Trade Area**

In 2005, COMESA, EAC and SADC Member / Partner States embarked on ambitious negotiations towards establishing a grand Tripartite Free Trade Area. The TFTA was mooted in 2008 during a Summit of the Presidents of the 26 initial Member States held in Kampala, Uganda. The TFTA negotiations were officially launched in June 2011 in Johannesburg and the operational phase launched during the Third Summit of the Tripartite Heads of State held in June 2015 at Sharm El Sheikh, Egypt.

The purpose was to strengthen, widen and deepen regional integration among the three RECs and help to solve the challenge of overlapping membership to RECs through harmonization of trade, customs, industrial and infrastructure development policies and programmes across the three RECs. The TFTA builds on the existing trading arrangements in COMESA, EAC and SADC, but unlike many existing RECs in Africa, it adopts a developmental approach to integration that is anchored on three (3) pillars namely: Market Integration, Industrial development and Infrastructure Development. (African Union Commission, 2019). It envisages a FTA among 29 countries in the tripartite region spanning across an area of 17.5 Million Km<sup>2</sup> with a total population of about 791 million people and a combined Gross Domestic Product (GDP) of about USD 1.6 trillion. This represents 58% of Africa's land mass, 57% of its GDP and 60% of its population. The TFTA region therefore constitutes a huge market and has the potential to yield enormous economic implications to the Member States.

(<https://www.worldometers.info/world-population/>, World Bank, 2017).

The 29 countries that constitute the TFTA are: Seychelles, Kenya, Tanzania, Rwanda, Angola, Egypt, Djibouti, Ethiopia, Botswana, Namibia, Madagascar, Mauritius, Comoros, Burundi, DR Congo, Eritrea, Libya, Lesotho, Eswatini, Sudan, Zambia, Uganda, Mozambique, Malawi, Tunisia, Somalia, South-Africa, South Sudan and Zimbabwe.

### **1.3.1 Status of TFTA Negotiations**

The TFTA is being negotiated in two phases with the first one tackling liberalization of trade in goods while the second phase deals with gradual liberalization of trade in services, competition policy, cross border investment and intellectual property rights. The TFTA Agreement comprises of Forty-Five (45) articles and ten (10) Annexes. Tariff liberalization, rules of origin, elimination of barriers to trade, resolution of disputes and trade remedies are key among the contents of the Agreement. The agreement also bears provisions on customs cooperation, trade facilitation, elimination of quantitative restrictions, balance of payments and protection of infant industries among others. While most of the Phase I issues have been concluded, there are still some outstanding issues namely: Product Specific rules of origin for automotive sector and some textile products, and Tariff Offer Negotiations between SACU and Egypt. Phase II negotiations are

ongoing for Trade in Services and Competition Policy. EAC, to which Kenya belongs, is negotiating the TFTA as a bloc while in the other two RECs, countries often negotiate individually.

## **1.4 Pillars of the Tripartite Free Trade Area**

### **(i) Market Integration Pillar**

The Market Integration pillar consists of 10 technical Annexes which provide for instruments that will be used by Tripartite Member/Partner States in the implementation of the Agreement. Annex I covers elimination of import duties while Annex II (on Trade Remedies) provides for trade defense measures (Safeguard, anti-dumping and Countervailing measures) to deal with cases of dumping, transshipment and subsidization, and safeguard the domestic industries in case of influx of imported products as a result of liberalization. The annex allows Member States to institute measures, including import duties to protect their domestic markets/industries if one of the above trade malpractices are confirmed to be taking place. It is one of the most effective tools to deal with unforeseen negative impacts of liberalization. Annex III is on Non-Tariff Barriers (NTBs). It provides for a mechanism for the identification, categorization, and elimination of NTBs within the tripartite region. The mechanism includes institutional structures for the elimination of NTBs; general categorization of NTBs in COMESA, EAC and SADC; reporting and monitoring tools; and facilitation of solutions to identified NTBs.

Annex IV on Rules of Origin contains provisions necessary to establish whether goods produced in the Member States of the TFTA region qualify to benefit from preferential treatment. Annex V contains provisions that promote cooperation in customs administration aimed at improving, control of trade flows and enforcement of applicable laws and regulations within the Tripartite Member/Partner States, such as establishing common measures in the formulation of their customs laws and procedures, mutual administrative assistance, technical assistance, and harmonization of customs procedures.

Annex VI is on Trade Facilitation. Its objective is to promote co-operation among Tripartite Member/Partner States in simplifying and harmonizing trade documentation and ensuring transparent dissemination of trade information for purposes of facilitating intra-Tripartite trade. Annex VII is on Transit Trade and Transit Facilitation with an objective of simplifying and guiding in the facilitation of goods in transit. Annex VIII on Technical Barriers to Trade seeks to facilitate

trade through cooperation in the areas of technical regulations, standards, metrology, conformity assessment and accreditation, including cooperation in the elimination of unnecessary and unjustifiable technical barriers to trade.

Annex IX on Sanitary and Phytosanitary (SPS) applies to all Sanitary and Phytosanitary (SPS) measures that directly or indirectly affect trade among Tripartite Member/Partner States. It's meant to enable Tripartite Member/Partner States to: facilitate trade in animals and animal products, and plants and plant products whilst safeguarding human, animal and plant life or health; enhancing cooperation in the elimination of unjustifiable SPS measures including harmonization and establishment of equivalence of SPS measures; establishing mechanisms and structures to enhance transparency in the development and implementation of SPS measures; and establishing and implementing a capacity building programme to support implementation of provisions of the Annex. Annex XI provides a mechanism for settlement of all disputes that may arise during implementation of the TFTA agreement, including matters of interpretation. The annex provides options and steps in dispute settlement, ranging from consultation, mediation, and reconciliation to establishment of a Dispute Panel.

### ***Tariff Liberalization***

The TFTA envisages 100 per cent liberalization of tariff lines while bearing in mind the usual general, specific and security exceptions. To achieve the above, the TFTA will consolidate tariff regimes of SACU and EAC subject to reciprocity. Besides the EAC Member States, ten COMESA countries taking part in COMESA Free Trade Area are basing their participation in the TFTA on COMESA principle of liberalizing 100% tariff lines subject to reciprocity. Whereas 90 percent elimination of tariffs will be undertaken immediately after entry into force of the Agreement, liberalization of the remaining 10 percent will be negotiated within 5-8 years.

Countries are at different levels of Tariff Offers negotiations. So far, market access negotiations between Botswana, Eswatini, Lesotho, Namibia and South Africa who are members of the Southern Africa Customs Union (SACU), and EAC, which consists of Burundi, Kenya, Rwanda, South Sudan, Tanzania, and Uganda have been concluded and the two RECs granted approval by the other TFTA Member States to start trading. This brings realization of TFTA benefits closer to reality and creates an opportunity for TFTA to have a coherent approach to AfCFTA negotiations.

The Republic of Tanzania and Egypt have also concluded their tariff negotiations. SACU and Egypt are however, actively engaged in the final stages of their tariff offer negotiations. The EAC has offered to liberalize 65.9% immediately the TFTA enters into force while SACU has offered to liberalize 66.6%. The rest will be phased down within a period of 5 years, 8 years and some under sensitive for negotiations at a later stage.

However, both sides have requested for immediate liberalization of products of export interest to each other's market. SACU has for instance demanded EAC to offer for immediate liberalization motor vehicles, meat products, refrigerators, wines and spirits, plastic tubes, textiles among others. Whereas SACU has accepted EAC's request to offer immediate liberalization for tea, coffee, fruits and fruits juices, it has not accepted some products of export interest to EAC. Overall EAC has offered effectively more tariff lines for immediate liberalizations than SACU (28% for EAC and 10% for SACU).

### ***Products Specific Rules of Origin***

Regarding product Specific Rules of Origin, 5030 tariff lines out of 5387 products of interest to Kenya have been concluded translating to about 93.37%. These include agricultural products, chemicals, base metals, and construction materials. However, consensus has not been reached on products such as electrical and electronic machinery, textiles, motor vehicles and cooking/edible oil where member states have very strong defensive and/or offensive positions.

### ***Sanitary and Phytosanitary Measures (SPS)***

The Annexes on SPS and Technical Barriers to Trade (TBT) have provisions to enable a business friendly SPS/TBT regulatory environment and a functional Free Trade Area. This is because SPS and TBT are a major constraint to trade especially among small cross border traders who are not able to meet the SPS requirements. As a result, Risk-based approaches have been developed within the Tripartite and integrated into border procedures and processes by Member/Partner States. This will help to profile small traders and enable them to cross borders without having to meet the SPS/TBT requirements as long as they are labelled risk free.

### ***Non-Tariff Barriers***

Under Annex III of its Agreement, the TFTA provides for the establishment of a mechanism for identifying, categorizing and eliminating NTBs within the tripartite region. The mechanism includes the following: institutional structures for eliminating NTBs, general categorization of NTBs in the three RECs, reporting and monitoring tools and facilitating solutions to the identified NTBs. Currently, Member States are using an online and SMS Tripartite NTB reporting mechanism which was established with the assistance of the African Development Bank. It is however imperative upon Member States to establish national institutions to address NTBs, while continuing to strengthen the online and SMS reporting system.

The web based NTBs Reporting, Monitoring and Eliminating Mechanism enables stakeholders to report and monitor the resolution of barriers encountered as they conduct their business in the COMESA, EAC and SADC regions. It enhances transparency and easy follow-up of reported and identified NTBs and NTMs. It is accessible to economic operators, government functionaries, academic researchers and other interested parties. The SMS NTB reporting tool enables traders to report problems they face, the location, company involved and the contact details. The aggrieved party uses an SMS to relay the problem and have it registered. The complaint is stored in the system then the administrator is notified to assign Focal Points and RECs to solve the problem then notify the complainant that his issue is being resolved. Once the issue is resolved, the complainant receives notification from the administrator. Based on the NTBs Reporting, Monitoring and Eliminating Mechanism website (October 2019), 680 complaints have been registered and 625 complaints resolved while 55 complaints are unresolved.

### ***Private Sector Platform***

The TFTA hosts a private sector platform that brings together SADC Chamber of Commerce, East African Business Council and COMESA Business Council. The platform was instrumental in negotiating the Tripartite Agreement on Movement of Business Persons. The platform also runs a Local Sourcing Partnership programme which trains, certifies SMEs on food safety standards and links them up to major buyers in the region. So far, more than 280 SMEs have been trained and certified.

### ***Signing and Ratification of the TFTA Agreement***

Since its launch in June 2015, some 22 countries have signed the TFTA Agreement but only six (6) namely; Kenya, Uganda, Egypt, Rwanda, South Africa and Burundi have ratified the Agreement. Nine other countries including Comoros, Sudan, Zambia, Zimbabwe, Malawi, Namibia, Botswana, Eswatini and Tanzania are at various stages of ratifying the Agreement. The Agreement will enter into force once the 14<sup>th</sup> instrument of ratification is deposited.

#### **(ii) Industrial Development Pillar**

The Framework for Cooperation and the Work Programme/Road Map for the Industrial Development Pillar was endorsed by the Tripartite Ministerial Council in October 2016 and implementation of some of the various phases commenced. According to the framework, the objective of industrial cooperation is to attain economic transformation for sustainable and inclusive development in Tripartite Member/Partner States through: enhancing productive capacity and addressing supply side constraints; promoting value addition and diversification of the industrial base; increasing intra and extra-regional trade; contributing to job creation and poverty reduction; strengthening of R&D, technology and innovation capabilities to support structural transformation of the industrial sector; enhancing the capacity for industrial policy formulation, implementation and monitoring and evaluation; and fostering the development of regional value chains.

Industrial cooperation covers the following broad areas: industrial policy coordination, policy advocacy and best practice sharing; development of regional and cross border industrial value chains and linkages; Micro Small and Medium Enterprises (MSMEs) development; capacity Building and Industrial Skills Development; Standards, Quality Assurance, Accreditation and Metrology systems and infrastructure; Science, Research & Development to stimulate technology transfer, and commercialization of innovations; Industrial Statistics and Information Dissemination Systems; Intellectual Property Rights (IPR) and Indigenous Knowledge Systems (IKS); sustainable utilisation of resources including Blue economy; industrial Collaboration and Partnerships; and resource mobilization and Financing for Industrial Development.

The following are the principles that guide cooperation in industrial development within the tripartite region:

- i. Policy coherence and consistency between industrial development programme, market access and infrastructure pillars;
- ii. Complementarities and synergies with on-going national and regional industrial development initiatives;
- iii. Optimization of comparative and competitive advantages in resources and productive capacities within the Tripartite Member/Partner States;
- iv. Cooperation in the mobilization of resources, investment and capacity development;
- v. Mutual benefit with regard to cooperation in industrial development; and
- vi. Environmental consideration.

The Framework for Cooperation and the Work Programme/Road Map identified actions and priorities necessary to increase productivity and competitiveness in the value chains of the tripartite region, and subsequently enhance the business environment for the chosen priority sectors in chemicals, agro processing and minerals. The following activities are on-going: establishment of infrastructure for industrial statistics software development; and industrial capacity development and support for regional value chains. The tripartite region envisions establishment of a Tripartite Industrial Coordination Development Unit (TIDCU) to facilitate implementation of the industrial work programme.

### **(iii) Infrastructure Development Pillar**

The Tripartite Free Trade Area places infrastructure development at the core of its integration. Infrastructure is a prerequisite and a catalyst for trade, industrial development, regional integration and economic development. The objective is to develop cost-effective, seamless, efficient and integrated cross-border infrastructure services and networks to boost poverty reduction, sustainable development and regional integration. This will be achieved through the development of a single integrated regional road transport market characterized by harmonized policies, laws, regulations, standards and systems towards facilitating provision of competitive and efficient international transport and logistics services.

The First Tripartite Sectoral Ministerial Committee Meeting on Infrastructure (TSMCI) took place on 26 October 2017 in Dar es Salaam Tanzania. The Committee launched the Tripartite Transit Transport Facilitation Programme with a budget of Euro 18 Million and which is under implementation. Some of the milestones under this pillar are as highlighted below:

Under Roads Transport the TFTA region is implementing the Tripartite Transport and Transit Facilitation programme. This entails harmonization of tripartite standards and assistance to countries to domesticate the standards towards improving efficiency of transport corridors. Other projects being undertaken include physical development of major transit corridors, mainly the North - South corridor, Central corridor, Northern Corridor and Djibouti Corridor. The Civil Aviation sector has prioritized Air Transport Liberalization and in particular the full application of the Yamoussoukro Decision and operationalization of a single African Air Transport Market. The three RECs are collaborating in the establishment of a Seamless Upper Airspace across the tripartite region through investment in integrated Communications, Navigational, and Surveillance/Air Traffic Management systems.

On Railways Transport, a comprehensive Tripartite Railway Strategy has been developed to address challenges of low rail freight volumes; poor service delivery; inadequate infrastructure and equipment; poor safety; inefficient operations; weak coordination; and serious funding shortfalls. There are also efforts to provide solutions in the domain of maritime safety and security, strengthening the Port State Control and Flag State Implementation functions as well as development of regional maritime databases to facilitate information exchanges on port safety and security through funding from the EU.

The Tripartite region has prioritized creation of a Navigational Line between Lake Victoria and the Mediterranean Sea (VICMED) anchored on the navigational route along the Nile River from Lake Victoria. The corridor development involves 8 COMESA Member States including DR Congo, Burundi, Rwanda, Ethiopia, Egypt, Sudan, Uganda and Kenya plus Tanzania and South Sudan.

Within the Energy Sector, the TFTA region envisions enhancement of regional competitiveness through regional integration, power generation and interconnection projects. Some of the projects under this sector include Zambia – Tanzania - Kenya (ZTK) Power Transmission Interconnection

Project, Zimbabwe – Zambia – Botswana - Namibia (ZIZABONA) inter-connector, Ethiopia - Kenya Power Interconnector Project, Malawi-Zambia Interconnector, Uganda (Olwiyo) –South Sudan (Juba), Ethiopia- South Sudan power interconnector project and the development of guidelines on Renewable Energy Development.

The region also envisions a project on enhancement of ICT Governance and Enabling Environment in the Indian Ocean, East and Southern Africa areas. The project will facilitate the development and improvement of regional connectivity and access to secure and reliable ICT services in a harmonized manner. It will promote the realization of an enabling environment to enable improved regional ICT governance, cost effectiveness and secure regional connectivity and access which will reduce the costs of investment and trade and thereby stimulate growth in the region. Under the continent’s Programme for Infrastructure Development in Africa (PIDA), the COMESA, EAC and SADC Secretariats through support from the NEPAD Agency are working towards bridging the gap in the ICT missing Links and Infrastructure Sharing in the Tripartite Region.

#### **(iv) Movement of Business Persons**

The Tripartite agreement on Movement of Business Persons obliges Member States to grant temporary entry to a business visitor seeking to engage in a business activity that requires the person to seek an employment authorization or advance entry visa in the country of origin. The person should however demonstrate compliance with existing immigration measures applicable to entry by presenting proof of residence in a Tripartite Member State and documentation explaining the purpose of entry. It discourages Tripartite Member States setting prior approval labor certification tests, petitions and procedures as conditions for entry.

The agreement further obliges each Tripartite Member State to grant entry and provide confirmation of such entry to a business person seeking to: (i) undertake substantial trade in goods or services between the Tripartite Member State where the person is a resident and the territory of the Member State into which entry is sought (b) establish, develop, administer or provide advice or key technical services to the operation of an investment to which the business person or the business person's enterprise has committed, or is in the process of committing, a substantial amount of capital, in a capacity that is supervisory, executive or involves essential skills.

The Agreement on Movement of Business Persons has been concluded and adopted by the Tripartite Sectoral Ministerial Committee.

### **1.5 Statement of the Problem**

Kenya is a founding member of several RECs including the EAC, COMESA, IGAD and CENSAD. This membership to multiple FTAs has resulted in complex and overlapping rules of origin for Kenya and its trading partners. It is an inconsistent regulatory framework which makes it difficult for Kenya to comply with the FTAs, increases transaction costs for enterprises and ultimately affects the benefits that the country derives from trade liberalization. Kenya is also faced with the challenge of erosion of preferences within its traditional export markets of Europe and United States. This is because as countries that were not competitive before in these markets negotiate concessions, Kenya's advantage continues to dwindle. This necessitates the sourcing of new markets by the country and especially in regions in which Kenya enjoys proximity.

Joining the TFTA has the potential to address the above challenges and yield enormous benefits to the Kenyan economy. It is against this background that this study is undertaken to highlight the possible effects (welfare, revenue, trade creation and diversion) that implementing the TFTA will have on Kenya's trade, hence informing the country's engagements within the TFTA and the AfCFTA going forward.

### **1.6 Objectives of the Study**

The general objective of the Study was to examine the implications of the Tripartite Free Trade Area Agreement on Kenya's trade. The following were the specific objectives:

- i. To examine the trade creation and diversion effects of the TFTA Agreement on Kenya's products;
- ii. To examine the revenue effects of the TFTA Agreement on Kenya; and
- iii. To examine the welfare effects of the TFTA Agreement on Kenya.

## **1.7 Research Questions**

- i. What are the trade creation and trade diversion effects arising from adoption of the TFTA Agreement by Kenya?
- ii. What is the revenue effect arising from Kenya's tariff liberation under the TFTA Agreement?
- iii. Will the TFTA improve or reduce the welfare of Kenyans?

## **1.8 Significance of the Study**

Preferential trading regimes such as FTAs are characterized by various effects, some positive and others negative. African policy makers have for long prioritized promotion of intra - regional trade. Consequently, regional economic communities have proliferated across the entire continent, often creating overlapping and at times incompatible, preferential trade regimes. The Tripartite Free Trade Area is one among these RECs whose actualization is expected to boost intra-Africa trade.

African policymakers and some analysts consider the Tripartite FTA to have great potential to change trade within the continent and positively impact the population. TFTA is also considered a key foundation in negotiating the Africa Continental Free Trade Area (AfCFTA).

The Tripartite region is a huge market with a rapidly growing middle class and a huge pool of young, vibrant and potentially highly productive labour force. Proper harnessing of this market and workforce is therefore expected to attract substantial foreign and domestic investment. This could in turn trigger economic growth, wealth creation, employment creation and poverty alleviation across the tripartite region.

This study therefore estimated the gains and losses arising from 100% tariff liberation within the TFTA region. It also suggests policy recommendations that are key in shaping Kenya's participation in the remaining aspects of negotiations as well as during the Agreement's implementation. Moreover, the Study offers proposals on the products for which Kenya has a comparative advantage within the TFTA region and measures that should be undertaken to exploit their potential.

## **1.9 Organization of the Study**

The first chapter introduces and provides a background to the study while the second chapter covers literature review. Chapter three discusses the methodology, model specification, model estimation, data requirements and analysis techniques as well as the model assumptions and limitations. Chapter four contains the results and discussions while chapter five gives the summary, conclusions and recommendations.

## **CHAPTER TWO**

### **2.0 LITERATURE REVIEW**

This chapter contains the review of literature. It highlights various theories and related variables that illustrate the nexus between factors that influence trade flows and how trade on the other hand impacts a country's overall growth. The chapter further presents an empirical analysis of the various studies undertaken on the implications of FTAs on Member Countries.

#### **2.1 Theoretical Literature**

This paper is based on Viner's (1950) theory of customs union which is often used to analyze static impacts of a Free Trade Area. Viner came up with a conceptual framework (trade creation and diversion) through which trade effects of a Free Trade Area can be studied.

According to Viner (1950), trade creation and diversion are useful in measuring a FTA's static impacts. In theory, a trade creation effect improves welfare because import prices fall owing to reduced tariffs hence consumers access the goods at a lower cost. (Kato K. et al 2012). On the contrary, trade diversion is welfare reducing for it leads to elimination of tariffs which in turn switches import sources from more efficient and low-cost countries (non TFTA members) to less efficient countries within the TFTA.

Viner's theory was enhanced by the work of Balassa (1960), who explained that economic communities evolve naturally over time with a FTA as the initial stage, followed by a Customs Union. Katsioloudes and Hadjidakis (2007), Hoang et al (2005), Negaris (2009), Nguyen (2011) and Plummer et al (2010) agree with Viner (1950) that trade is created when local products in a Free Trade Area Member State are substituted by lower - cost products from another FTA country due to liberalization of trade. Simply put, citizens shift from consuming higher- cost local products to consuming lower - cost products sourced from other members of the FTA.

Thus, creating a Free Trade Area boosts trade, promotes efficient allocation of resources and enhances specialization in production of goods for which the countries have comparative

advantage. (Azza, 2017). Consequently, a FTA leads to increased consumer surplus and ultimately the welfare of the citizenry of Member States. (Hoang et al 2005, Azza, 2017).

Further, just like Viner (1950), Hoang et al (2005); Katsiolouides and Hadjidakis (2000); Negaris (2009); Plummer et al (2010); and Nguyen (2011), postulate that a FTA can cause diversion of trade owing to its preferential treatment of Member States. According to Sayavong (2015), following reduction or removal of duties, countries can substitute imports from non-members with those from member states because they enjoy preferential tariffs. This leads to trade diversion which worsens allocation of resources globally while shifting production from areas of comparative advantage. A FTA that diverts trade therefore results in both creation and diversion of trade. This can either enhance or worsen welfare of Member States subject to which of the two opposing forces is relatively stronger.

FTAs also cause dynamic effects whose manifestation in the economy takes longer. Such effects however continue to generate benefits for a long time even after a country withdraws its membership to the FTA.

Other benefits associated with FTAs are technology transfer, promotion of specialization, improvement of efficiency, competition and general economic growth. (Plummer G. et al. 2010, Eicher et al. 2000, and Jha et al. 2010). When joining FTAs, member states, especially developing countries, also seek opportunities for reform and harmonization of trade policies (Katsiolouides and Hadjidakis 2007). FTAs are also known to encourage partnerships in other areas like protection of intellectual property rights, sustainable development and employment creation among others.

There are however certain challenges FTAs bring about. For instance, FTAs are only second-best alternative after multilateral liberalization (Huong, 2016). This is owing to the FTAs' nature of discrimination against non-members. Bui (2010) and Huong (2016) postulate that membership to multiple FTAs results in complex and overlapping rules of origin and an inconsistent regulatory framework which makes it difficult for countries to comply with the FTAs and increases transaction costs for enterprises. Moreover, FTAs can reduce the welfare of member states due to trade diversion characteristics.

## 2.2 Empirical Literature

Huong (2016) utilized SMART in analyzing how elimination of tariffs, following Vietnam and European Union (EU) Free Trade Agreement (EVFTA), would affect imports of medicine by Vietnam from EU. The study found that Vietnam's exemption of EU medicines from tariff wouldn't significantly increase EU exports to Vietnam. However, if Vietnam deepens its cooperation with the Trans-Pacific Partnership (TPP) as well as integrate more with the ASEAN plus South Korea, Japan and China, (ASEAN + 3), it would slightly affect its imports from the EU.

Huong (2016) observes that, the EU would continue to export more medicine to the Vietnamese Market than any other country in the world at least in the foreseeable future. Additionally, the study revealed the possibility of uneven distribution in increase of EU exports to Vietnam by country, groups of pharmaceuticals and product. The analysis further revealed that EVFTA trade creation effect would surpass the diversion of trade and hence improve Vietnam's welfare.

Lang (2005) assessed the EU and ECOWAS trade liberalization via WITS/SMART. His study assumed that imports from the EU into ECOWAS would be fully liberalized. Lang (2005) specifically considered creation and diversion of trade, as well as revenue effects. This study also singled out products that may be most affected while also analyzing the impact to individual Member States.

According to Lang (2005), total imports by ECOWAS from EU would grow by USD 1.80 billion and the greatest gainers would be United Kingdom and France. The removal of tariffs on all goods emanating from the EU would also lead to welfare gains by the consumers through net trade creation. Lang (2005) also found that trade worth over USD 3.65 billion would be diverted to EU producers with less efficiency while ECOWAS producers would suffer from the trade diversion. Lang (2005) also found that the EPA would reduce tariff revenues with countries like Ghana and Guinea-Bissau suffering severe revenue shortfalls of up to 19 per cent.

A study by Willenbockel (2013) using an ex-ante computable general equilibrium (CGE) model assesses the TFTA Agreement between the Member States of COMESA, EAC and SADC. His analysis is based on eight different trade integration scenarios with distinct levels of ambition. All

the eight simulation scenarios that Willlenbockel (2013) considered indicated that the TFTA will have positive income gains. According to the study, creation of the TFTA among all the 26 Member States while fully eliminating all tariffs would cause a 578 million US dollar worth of welfare gains annually.

Willlenbockel (2013) further suggests that under full intra – TFTA tariff liberation, the republic of South Africa would experience the largest real income with other SACU members projected to record the largest gains relative to baseline absorption.

According to Willlenbockel 2013, Kenya will enjoy a small aggregate net welfare gain under scenario 2 and a more significant gain under scenario 8. The volume of both intra-TFTA imports and intra-TFTA exports rises significantly. Under sectoral analysis, the greatest impact of the TFTA is projected for sugar products with output dropping by more than 25% in response to elimination of the high level of protection from competing TFTA imports.

A second study by Willlenbockel (2014) provided an ex ante Computable General Equilibrium assessment of the TFTA Agreement. The simulation analysis considered eight distinct trade integration scenarios at different levels of ambition and found that all the liberalization scenarios would positively impact net real income. Willlenbockel (2014) found that establishment of the TFTA with 100% tariff liberalization would lead to an annual welfare gain of USD 578 million or about 0.1% of the total TFTA Region.

Makochekanwa (2014) analyzed the potential impacts of the TFTA on the 26 Member States. His analysis was categorized into: (i) welfare implications, and (ii) food security. This study examined the welfare implications of the TFTA through the SMART model. According to the study about USD 2 billion of trade will be created with DR Congo and Angola benefiting the most.

The study also found that trade diversion worth about USD 4.54 billion would arise leading to USD 1.5 billion net trade effect across the tripartite membership. According to the study, implementation of the TFTA will occasion a revenue loss of around USD 1 billion due to elimination of import duties. Makochekanwa (2014) also found that DRC, Angola and Kenya will experience the highest welfare gains.

Mold and Mukwaya (2017) used the Global Trade Analysis Project (GTAP) CGE model and the latest GTAP 9 database to evaluate the effect of the TFTA on consumption, industrial production and trade, across the 26 TFTA Member States. Their analysis found out that intra-regional trade will increase significantly by 29 per cent owing to tariff elimination between member states. The study also found that the TFTA integration would mostly benefit the manufacturing sector.

Mold and Mukwaya (2017) also revealed a USD 2.4 billion aggregate welfare gain for TFTA members. According to the study, South African consumers would be the main beneficiaries accounting for 72.5 per cent of the welfare gains. Other major beneficiaries are Angola, DRC, Tanzania and Egypt. The study allayed concerns by various proponents that industrial production of the TFTA could concentrate in Egypt and South Africa which have the highest productivity levels. The simulation results revealed that such fears were exaggerated and that there is little evidence that industries will be concentrated in larger countries.

Pasara.T and Dunga.H, (2019) employed the SMART model in examining the welfare effects of economic integration among the TFTA Member States. Their results revealed skewed welfare gains and showed that some economic sectors and countries would gain more than others. The study concluded that larger economies were poised to gain more than smaller economies while less liberalized economies would experience greater trade creation than more liberalized ones. The study reveals that trade in manufactured products and consumer goods will be the highest contributors and suggests that less liberalized economies will suffer greater revenue loss compared to liberalized economies. It recommends provision of assistance to negatively impacted economies to minimize the resultant losses.

### **2.3 Overview of Literature**

Literature and studies on the Static impacts of FTAs is founded on Viner's work of 1950. Viner's work was further enhanced in 1960s by Balassa who explained that economic communities evolve naturally over time with a FTA as the initial stage, followed by a Customs Union.

The SMART static model has been useful in analyzing the static impacts of FTAs yielding various results but with a general conclusion that various factors can explain international trade. Given the

model's strength in analyzing the effects of a tariff change at national level, SMART has been utilized in evaluating the impacts of change in trade policy assuming that products are not perfect substitutes.

Different studies have used SMART to simulate tariff liberalization effects within the TFTA market among other issues. These include Makochekanwa (2014) who analyzed how the TFTA would affect the 26 Member States and Mold and Mukwaya (2017) who evaluated the TFTA's effect on consumption, industrial production and trade, across the 26 TFTA Member States.

These studies were based on the 26-initial membership of the TFTA and none was undertaken in Kenya with specific reference to Kenya. In addition, the studies were undertaken at a time when most aspects of the negotiations were still outstanding especially on tariff offers. This study analyses the implications of the TFTA Agreement on Kenya's trade in the wake of 100 per cent tariff liberalization within the TFTA region considering the current membership of 29 countries. The study makes policy recommendations on the country's approach to the TFTA negotiations and its trade within the TFTA region after entry into force of the agreement. It also proposes policy interventions that would protect the country's industries against unfair competition and important products that Kenya should focus on.

# CHAPTER THREE

## 3.0 METHODOLOGY

This chapter specifies the model that was used, provides sources of data and the tools of analysis as well as variables description. The chapter also explains how data was obtained and managed during analysis.

### 3.1 Model

This study used the SMART model which is inbuilt in the World Bank and UNCTAD's World Integrated Trade Solutions (WITS) trade data base. According to Plummer Et al. (2010), the model centers on how a change in trade policy influences importation of goods into a certain market. In SMART, the market's demand side arises from the assumption that products originating in various countries are imperfect substitutes.

By default, the SMART model assumes that each county has an infinite export supply elasticity hence at a given price, countries can supply as much of the good as possible to Member States within a FTA. For a price taker or importing country with small import quantities which cannot distort world prices, this assumption is quite appropriate.

In illustrating this model Panagariya and Jagdish (1999) presume 3 countries A, B and C where counties B and C export a good to country A, but countries A and B are in a FTA arrangement. A reduction in duty for country B's exports to country A lowers the price and price index of country B's commodity leading to increased demand of the commodity in country A. A lower price of country B's products compared to C leads to a shifting of domestic demand in country A from C to B. in a nutshell, belonging to a FTA leads to a surge in imports from a country enjoying preferential trading terms due to reduced prices while other members of the FTA `record increases in exports and exports by non-FTA members fall. SMART can also be used to compute the behavior patterns of revenue and welfare under trade liberalization

### **3.1.1 Data Requirements and Sources**

For the simulation of a FTA, the SMART model requires a variety of data which is available in among others the World Integrated Trade Solutions (WITS) database. In this study, Kenya's import volumes from the rest of the world and the TFTA Member States were sourced from the Common Format for Transient data Exchange (UN COMTRADE) and the Trade Map Database. The import tariff rates - Most Favoured Nation (MFN) rates that Kenya imposes on the Member States came from the World Trade organization and Trade Analysis and Information System Integrated Data Base.

The data required included: (i) value of imports from each TFTA Member State (ii) the tariffs applicable to each Member State (iii) the product's export supply and import demand elasticities and (v) the elasticity of substitution between varieties of the product. It is worth noting that SMART takes a single import demand elasticity for a commodity and not one for each national variety. In addition, the elasticity of export supply for all exporters of the commodity must be the same. The model also anticipates the same elasticity of substitution for any pair of varieties of commodities.

### **3.1.2 Model Assumptions**

The model assumes:

1. Infinite elasticity of export supply because TFTA Members are considered small by international standards;
2. 1.5 import substitution elasticity meaning that although they may be similar, products from different countries cannot substitute each other; and
3. Complete (100%) tariff liberalization and import demand elasticity at Harmonized System 6-digit level.

## **3.2 Empirical Smart Model Specification**

This paper engaged the SMART simulation tool to determine the implications of COMESA-EAC-SADC TFTA on Kenya's trade. The choice of SMART is due to its strength in analyzing a tariff

effect at national level as well as its capacity to evaluate implications of changes in trade policy where commodities being traded cannot perfectly substitute each other. (Makochekanwa, 2014).

Laird and Yeats (1986) are the authors of the SMART model theory. It uses a commodity trade statistic (COMTRADE); tariff, para-tariffs and non-tariff measures (Trade Analysis Information Systems); Integrated Data Base and Consolidated Tariff Schedules (CTs) databases. These databases offer analytical tools to simulate reductions in tariffs. The model deduces the effect of a trade liberalization i.e. tariff reduction for a single market on trade creation and diversion, and the revenue and welfare among other variables. (Makochekanwa, 2014).

In deriving the SMART model, Laird and Yeats (1986) began with simplified import demand, export supply functions and an equilibrating identity. Following this derivation for instance, Kenya's import demand function for commodity  $i$  produced in country  $k$ , where  $k$  is any of the other 28 TFTA Member/partner States is expressed as follows:

$$M_{ijk} = F(Y_j, P_{ij}, P_{ik}) \quad (1)$$

Where:-

$M$  = Imports

$Y$  = National Income

$P$  = Price

$j$  = Importing country in this case Kenya

$i$  = Commodities imported

$k$  = Exporting TFTA member

The counterpart export supply function for commodity  $i$  of the exporting/producer TFTA country is as follows:

$$X_{ijk} = F(P_{ijk}) \quad (2)$$

Where  $X_{ijk}$  denotes good  $i$  exports by country  $k$  to country  $j$ .

The partial equilibrium of the two countries is as expressed in 3 below:

$$M_{ijk} = X_{ijk} \quad (3)$$

Assuming that the domestic price of commodity  $i$  in the importing country  $j$  within the FTA is equivalent to the export price of country  $k$  plus transport and insurance charges, then this price will rise by an amount equivalent to the ad valorem incidence of any tariff or non-tariff distortion applied to the commodity as reflected below:

$$P_{ijk} = P_{ijk} (1+t_{ijk}) \quad (4)$$

The exporting TFTA Partner State  $k$  earns revenue as shown below:

$$R_{ijk} = X_{ikj} \cdot P_{ikj} \quad (5)$$

### 3.2.1 Trade Creation

Trade creation arises when country  $j$  (in this case Kenya) records an increase in demand for product  $i$  from country  $k$  as a result of the price decrease arising from lower or eliminated tariffs/non-tariff distortions.

Total differentiation of (4) - the domestic price equation with respect to foreign price and tariffs gives the trade creation formula as shown in equation (6):

$$dP_{ijk} = P_{ijk} \cdot dt_{ijk} + (1+t_{ijk}) \cdot dP_{ijk} \quad (6)$$

Equation (7) below provides the expression for elasticity of import demand with respect to the domestic price:

$$dM_{ijk} / M_{ijk} = Em \cdot (dP_{ijk} / P_{ijk}) \quad (7)$$

Substituting equation (4) and (6) into (7) gives:

$$\frac{dM_{ijk}}{M_{ijk}} = Em \cdot \left\{ \frac{dt_{ijk}}{(1+t_{ijk})} + \frac{dP_{ijk}}{P_{ijk}} \right\} \quad (8)$$

Where  $Em$  is the import demand elasticity in respect of domestic price.

Export supply elasticity with respect to world price is expressed as follows:

$$dP_{ijk} / P_{ijk} = (dX_{ijk} / X_{ijk}) / Ex \quad (9)$$

From equation (3) it follows that:

$$dM_{ijk} / M_{ijk} = dX_{ijk} / X_{ijk} \quad (10)$$

Substituting Equation 10 into 9 and the result into 8 gives the equation used to estimate Trade creation. From (3), this is equal to the growth of country  $k$ 's exports of commodity  $i$  to country  $j$ .

The Trade Creation formula therefore is:

$$TC_{ijk} = \frac{M_{ijk}.Em.dt_{ijk}}{\left\{(1+t_{ijk}).\left(1.\left(\frac{Em}{Ex}\right)\right)\right\}} \quad (11)$$

With  $TC_{ijk}$  implying trade creation.

The formulation  $TC_{ijk}$  stands for total trade created over  $I$  Commodities affected by tariff reduction while current levels of import demand of commodity  $i$  are represented by  $M_{ijk}$ . It's worth noting that in case of infinite export supply elasticity with respect to international prices, the denominator on the right side of equation (11) becomes unity hence can be dropped.

In this regard, the current level of imports, the elasticity of import demand and the relative change in tariff will determine trade creation as illustrated in (12).

$$TC_{ijk} = M_{ijk}.Em. dt_{ijk} \quad (12)$$

A substantial increase in  $TC_{ijk}$  denotes increase in creation of trade.

### 3.2.2 Trade Diversion

In a FTA, diversion of trade occurs when efficient producers from the rest of the world are displaced by less efficient producers within the FTA. In this study, trade diversion will be

considered to occur when Kenya removes or reduces tariffs for TFTA Member States while retaining tariffs on imports from non-TFTA countries.

Equation (13) estimates the elasticity of substitution which influences Trade Diversion:

$$\sigma_M = \frac{\Delta\left(\frac{\sum_k M_{ijk}}{\sum_K M_{ijK}}\right) / \left(\frac{\sum_k M_{ijk}}{\sum_K M_{ijK}}\right)}{\Delta\left(\frac{\sum_k P_{ijk}}{\sum_K P_{ijK}}\right) / \left(\frac{\sum_k P_{ijk}}{\sum_K P_{ijK}}\right)} \quad (13)$$

Where  $\sigma_M$  stands for elasticity of substitution with respect to relative prices of the same product from different import origins,  $k$  represents one lot of foreign suppliers' imports while imports from another group of foreign suppliers is represented by  $K$ .

Expanding equation (13) through extensive expansion, substitutions and rearrangements gives the trade diversion equation (14) which can be expressed as follows:

$$TD_{ijk} = \frac{M_{ijk}}{\sum_k M_{ijk}} \frac{\sum_k M_{ijk} \sum_K M_{ijK} \frac{\Delta(P_{ijk}/P_{ijK})}{P_{ijk}/P_{ijK}} \sigma_M}{\sum_k M_{ijk} + \sum_K M_{ijK} + \sum_k M_{ijk} \frac{\Delta(P_{ijk}/P_{ijK})}{P_{ijk}/P_{ijK}} \sigma_M} \quad (14)$$

With the trade diversion effects represented by  $TD_{ijk}$ .

Further simplification of expression (14) gives equation (15) which depicts the trade preference and demonstrates the price that shows movement due to tariff changes or the ad valorem incidence for the rest of the world and the trade preference.

$$TD^{RTA} = \frac{M^{TFTA} M^{ROW} \left( \frac{1+t_{TFTA}^1}{1+t_{TFTA}^0} - 1 \right) \sigma_M}{M^{TFTA} + M^{ROW} + M^{TFTA} \left( \frac{1+t_{TFTA}^1}{1+t_{TFTA}^0} - 1 \right) \sigma_M} \quad (15)$$

**Where:**

$TD^{RTA}$  = Diversion of trade on commodity  $i$  exported by country  $j$  into country  $k$ .

$M^{TFTA}$  = Imports of commodity  $i$  from TFTA countries.

$M^{ROW}$  = Exports of commodity  $i$  from the rest of the world to country  $j$ .

$\sigma_M$  = Elasticity of substitution.

$t_{TFTA}^0$  &  $t_{TFTA}^1$  are the initial and end periods' import duties respectively, charged on imports from the preference countries by Kenya and  $t_{TFTA}^1 < t_{TFTA}^0$ . The greater the value for elasticity of substitution, the higher the trade diversion effect.

### 3.2.3 The Revenue Effect

Revenue effect is derived by totally differentiating revenue with respect to volume of imports and the import price following a change in tariff.

Prior to change in tariff, the revenue equation is as follows:

$$dR_{ijk} = P_{ijk}(dX_{ijk}) + (X_{ijk})dP_{ijk} \quad (16)$$

Dividing  $dR_{ijk}$  in equation (16) by  $R_{ijk}$  and the expression on the right-hand side of the same equation by  $X_{ijk}(P_{ijk})$  gives equation (17).

$$\frac{dR_{ijk}}{R_{ijk}} = \left( \frac{P_{ijk}(dX_{ijk}) + X_{ijk}(dP_{ijk})}{P_{ijk}(X_{ijk})} \right) \quad (17)$$

Simplifying equation (17) and substituting the result in equation (10) gives equation (18)

$$\frac{dR_{ijk}}{R_{ijk}} = \frac{dM_{ijk}}{M_{ijk}} + \frac{dP_{ijk}}{P_{ijk}} \quad (18)$$

Equation (18) can alternatively be written as:

$$\frac{dR_{ijk}}{R_{ijk}} = \left( \frac{dt_{ijk}}{1+t_{ijk}} \right) \cdot Em \left( \frac{1+Ex}{Ex-Em} \right) \quad (19)$$

Equation (19) gives the net revenue effect, where:  $R_{ijk}$  is the effect on revenue after change in tariff;  $Em$  = the importing country's elasticity of import demand; while  $t_{ijk}$  is tariff and  $Ex$  is elasticity of export supply.

### 3.2.4 Welfare Effect

The welfare effect is the sum of the surpluses enjoyed by the consumer and producer. It shows net welfare effects of each TFTA country due to liberalization under the TFTA as shown in equation (20):

$$W_{ijk} = 0.5 (\Delta t_{ijk} \cdot \Delta M_{ijk}) \quad (20)$$

With  $M_{ijk}$  representing country  $j$ 's imports of commodity  $i$  from country  $k$ ; and  $t_{ijk}$  tariff.

### 3.3 Variables and Expected Signs

Table 3.2 summarizes the Variables used in the study and their expected signs. The variables include imports in US dollars, import tariffs, Trade Creation Effect, Trade Diversion Effect, Revenue Effects and Welfare Effects.

**Table 3.2: Variables and Expected Signs**

Variable	Description	Probable Sign
Imports	Import values in US dollars	+
Import Tariff	Customs duties on merchandise imports	-
Trade Creation Effect	Increase in demand in the importing country (Kenya) for commodity $i$ from a TFTA country due to a decrease in price following a reduction or elimination of tariff/non-tariff distortions	+
Trade Diversion Effect	Displacement of products originating from a group of overseas exporters for products from another group of overseas suppliers due to changes in the relative prices of imports	+/-
Revenue effects	The total differential of revenue with respect to import price and volume of imports after the tariff change	+ / -
Welfare effect	Sum of consumers' and producers' surplus	+ / -

*Source: Own computation based on the SMART simulations approach*

### 3.4 Data Analysis Technique

This study utilized the harmonized commodity coding system (HSC) data at the six-digit level. Calculation at this level avoids aggregation of tariff rates and allows for individual tariff line

analysis and allows for identification of product categories most affected by elimination or reduction of tariffs.

Trade agreements usually include provisions for reducing tariffs gradually. However, in undertaking simulations for this study, it was assumed that all import tariffs will be completely and immediately eliminated. This assumption allows estimation of static effects under the most ambitious liberalization scenario that can reflect long term and possibly future scenarios.

# CHAPTER FOUR

## 4.0 RESULTS AND DISCUSSIONS

This chapter contains the study findings as per the research objectives and methodology.

### 4.1 Results

#### 4.1.1 Trade Creation

From the simulation results, trade worth about USD 1.53 billion will be created due to the intra-TFTA trade among the member countries. Out of this, DR, Congo would have the largest trade creation effect of 64.28% followed by Angola at 11.59% and Ethiopia with 6.55% of the total trade creation effect. Kenya is estimated to have total trade creation effect of USD 51.80 million representing 3.38% of the total trade creation effect. Out of the USD 51.80 million trade creation effect for Kenya, motor vehicles for goods transport of a total vehicle weight not exceeding 5 tonnes would be the largest trade creating product at 10.99%. This will be trailed by: other cane or beet sugar and chemically pure sucrose in solid form (5.31%); particle board of wood or other ligneous materials (4.38%); Fresh Apples; (3.34%) other angles, shapes and sections of iron or non-alloy steel not further worked than hot rolled, hot drawn or extruded; and other paints and vanishes (including enamels and lacquers), based on synthetic polymers (2.37%) among others as shown in Table 4.2 and appendix 1.1.

#### 4.1.2 Trade Diversion

USD 706.14 million worth of trade is expected to be diverted with DR Congo having the largest trade diversion effect at USD 185.76 million representing 26.31% of the total trade diversion effect. This is followed by Ethiopia, Angola and Kenya at 13.37%, 10.94% and 10.77% respectively. Kenya's involvement in the TFTA is estimated cause a trade diversion effect of USD 77.23 million representing 10.94% of the total trade diversion. The main products that contribute to this trade diversion effect for Kenya include: motor vehicles for transporting goods of a gross vehicle weight not exceeding 5 tonnes (5.72%); other cane or beet sugar and chemically pure sucrose in solid form (3.48%); other cane sugar and chemically pure sucrose in solid form (2.27%) ; motor cars and other motor vehicles principally designed for the transport of persons (other than

those of heading 87.02), including station wagons and racing cars of a cylinder capacity exceeding 2500 cm ( 1.16%); Wine of fresh grapes, including fortified wines; grape must other than that of heading 20.09 in containers holding 2 litres or less (1.06%; motor cars and other motor vehicles for the transport of persons, including station wagons and racing cars of a cylinder capacity exceeding 1500 cm<sup>3</sup> but not more than 3000 cm<sup>3</sup> (0.86%); new pneumatic tyres, of rubber used on motor cars among others as shown in Table 4.2 and appendix 1.2.

#### **4.1.3 Revenue Effect**

The simulation results showed a USD 754.21million loss in tariff revenue with DR Congo having the largest loss in tariff revenue at USD 337.09 million followed by Angola, Ethiopia and Kenya at USD 84.07 million, USD 79.73 million and USD 59.88 million respectively. The results show that Kenya will lose USD 59.88 million in forgone tariff revenue with motor vehicles for transporting goods of a total vehicle weight not exceeding 5 tonnes contributing the largest revenue effect at USD 7.42 million representing 12.41%. Other key contributors to revenue loss are: other cane or beet sugar and chemically pure sucrose in solid form (9.70%); fresh apples (5.86%); other cane sugar and chemically pure sucrose in solid form (4.68%); fresh grapes wine, including wines that are fortified; and grape must excluding that of heading 20.09 (3.54%) among others as shown in Table 4.2 and appendix 1.3.

#### **4.1.4 Welfare Effect**

The overall welfare effect as a result of the TFTA is a gain estimated at USD 163.19 million with DR Congo enjoying the largest net welfare gain at 40.83% of the total welfare gain followed by Angola at 27.17% and Ethiopia at 9.34%. Kenya is estimated to have a positive net welfare gain on USD 7.59 million representing 4.65% of the total net welfare gain. Among the welfare enhancing products for Kenya in the TFTA are: other cane or beet sugar and chemically pure sucrose in solid form (10.32%); motor vehicles for transporting goods of a gross vehicle weight not more than 5 tonnes (6.60%); chemically pure sucrose in solid form and other cane sugar (4.53%); particle board of wood/other ligneous materials (3.40%); Fresh Apples (2.88%) among others as shown in Table 4.2 and appendix 1.4.

## 4.2 Discussions

The trade creation effect which implies additional imports from the TFTA members would mean stiff competition to domestic products which calls for robust measures towards improving the business environment and performance of local industries. From the results as reflected in Table 4.2, Kenya's additional imports from the TFTA members will be USD 51.80 million representing 3.38% of the total additional intra-TFTA imports. This represents the value in domestic production that would be replaced by cheap imports from the other TFTA Member States following 100% tariff liberalization within the region.

**Table 4.1: Tabulated Simulation Results by Partner/Member State**

<b>Export Elasticity of Supply assumed at 99%, Import Elasticity of Substitution assumed at 1.5</b>									
S/No	Country	Trade Creation Effect ('000 US\$)	% share of the TC	Trade Diversion Effect ('000 US\$)	% share of the TD	Revenue Effect ('000 US\$)	% share of the RE	Welfare Effect ('000 US\$)	% share of the WE
1.	Angola	177,856.93	11.59	76,079.71	10.77	-84,078.43	11.15	44,338.10	27.17
2.	Botswana	1.82	0.00	5.97	0.00	-3.81	0.00	0.65	0.00
3.	Burundi	1,329.77	0.09	309.24	0.04	-2,240.95	0.30	374.28	0.23
4.	Comoros	303.09	0.02	234.12	0.03	-263.12	0.03	27.04	0.02
5.	Djibouti	13,836.07	0.90	8,088.52	1.15	-7,578.26	1.00	2,127.87	1.30
6.	DR Congo	986,230.03	64.28	185,759.75	26.31	-337,094.46	44.69	65,902.58	40.38
7.	Egypt	18,860.42	1.23	21,645.63	3.07	-10,890.92	1.44	1,762.30	1.08
8.	Eritrea	1,640.26	0.11	949.02	0.13	-762.77	0.10	95.47	0.06
9.	Ethiopia	100,476.10	6.55	94,402.29	13.37	-79,727.70	10.57	15,239.54	9.34
10.	Kenya	51,812.27	3.38	77,236.23	10.94	-59,880.07	7.94	7,587.73	4.65
11.	Lesotho	84.50	0.01	118.64	0.02	-42.97	0.01	1.25	0.00
12.	Libya	0.00	-	0.00	-	-0.00	-	0.00	-
13.	Madagascar	29,112.15	1.90	22,525.49	3.19	-17,448.96	2.31	1,707.90	1.05
14.	Malawi	141.56	0.01	341.28	0.05	-142.80	0.02	6.65	0.00
15.	Mauritius	457.65	0.03	642.10	0.09	-591.93	0.08	46.59	0.03
16.	Mozambique	3,239.71	0.21	3,983.77	0.56	-3,095.32	0.41	205.72	0.13
17.	Namibia	275.98	0.02	784.43	0.11	-344.23	0.05	9.23	0.01
18.	Rwanda	18,588.12	1.21	7,088.73	1.00	-12,361.68	1.64	2,573.76	1.58
19.	Seychelles	47.62	0.00	100.03	0.01	-58.41	0.01	7.26	0.00
20.	Somalia	-	-	-	-	-	-	-	-
21.	South Africa	43,018.52	2.80	43,616.30	6.18	-21,075.76	2.79	5,338.76	3.27

22.	South Sudan	-		-	-	-	-	-	-
23.	Sudan	-		-	-	-	-	-	-
24.	Swaziland	36.83	0.00	74.53	0.01	-44.40	0.01	3.05	0.00
25.	Tanzania	9,204.70	0.60	18,069.60	2.56	-15,677.93	2.08	2,995.59	1.84
26.	Tunisia	31,471.02	2.05	54,801.20	7.76	-41,053.56	5.44	5,880.29	3.60
27.	Uganda	34,609.45	2.26	71,572.77	10.14	-47,821.91	6.34	5,452.17	3.34
28.	Zambia	12.86	0.00	35.43	0.01	-14.18	0.00	0.89	0.00
29.	Zimbabwe	11,519.24	0.75	17,683.82	2.50	-11,919.45	1.58	1,507.96	0.92
	<b>Total</b>	<b>1,534,166.7</b>	<b>100.0</b>	<b>706,148.6</b>	<b>100.0</b>	<b>-754,213.9</b>	<b>100.00</b>	<b>163,192.6</b>	<b>100.0</b>

*Source: Own computation based on the SMART simulations approach*

Trade diversion in SMART only re-allocates shares of market amongst exporters based on the new relative price without affecting the overall imported quantity. This is because the surge in imported goods from countries in the bloc is compensated by an exact decline in goods imported from the rest of the world. From the results in Table 4.2, and based on Kenya's trade within the TFTA, trade worth USD 77.23 million would be reallocated to less efficient and cost ineffective producers (TFTA Member States) from more efficient and cost-effective producers (Rest of the world) due to tariff reduction.

The results as per Table 4.2 show a modest loss in tariff revenue by Kenya at USD 59.88 million as gain in tariff revenue from additional imports cannot offset lost revenue due to removal of duties. However, the gains from consumption and trade creation outweigh any loss in revenue and producer surplus giving Kenya a net positive welfare effect of USD 7.59 million. Therefore, Kenya will improve welfare of its citizens and that of the economy through access to a wider market for exports; cost reduction resulting from intensified competition; and diversified consumer choices from increased imports.

# CHAPTER FIVE

## 5.0 SUMMARY, CONCLUSION AND POLICY RECOMMENDATIONS

This chapter provides the summary, conclusions of the study, policy recommendations and limitations of the study as well as areas for further research.

### 5.1 Summary

This study explored the implications of the TFTA agreement on Kenya using the SMART simulation tool. The objectives were to examine the trade creation, diversion, revenue and welfare effects of the TFTA Agreement on Kenya.

The study used the COMTRADE tariff, para-tariffs and non-tariff measures dataset; Integrated Data Base and Consolidated Tariff Schedules (CTs) databases to analyze reductions in tariff. The model estimated the impact of a change in trade policy i.e. tariff liberalization for a market on trade creation and diversion; revenue and welfare effects among other variables. The data used for the study was based on the six-digit level harmonized commodity coding system.

The study found that, the TFTA will create approximately USD 1.53 billion worth of trade with DR, Congo as the largest beneficiary at 64.28% followed by Angola at 11.59% and Ethiopia at 6.55%. Kenya will experience a total trade creation effect of USD 51.80 million representing 3.38% of the total trade created. Out of the USD 51.80 million trade creation effect for Kenya, motor vehicles for transporting goods of a gross vehicle weight not exceeding 5 tonnes would be the largest trade creating product at 10.99%.

Trade Diversion effect is estimated at USD 706.14 million with DR Congo having the largest share at USD 185.76 million followed by Angola, Kenya and Ethiopia at 13.37%, 10.94% and 10.77% respectively. The main products contributing to Kenya's trade diversion effect include motor vehicles, chemically pure sucrose and other cane or beet sugar (3.48%); and chemically pure sucrose in solid form and other cane sugar (2.27%).

The simulation results further showed that USD 754.21 million would be lost in tariff revenue with DR. Congo recording the largest loss of USD 337.09 million while Angola and Ethiopia would

each lose USD 84.07 million and USD 79.73 million respectively. The results show that Kenya will lose USD 59.88 million in forgone tariff revenue. Motor vehicles will contribute the largest revenue effect at USD 7.42 million representing 12.41% while other cane or beet sugar and chemically pure sucrose in solid form will contribute (9.70%) of the welfare. Fresh apples and chemically pure sucrose in solid form and other cane sugar will contribute (5.86%) and (4.68%) respectively.

The TFTA will generate an overall welfare gain of USD 163.19 million. DR Congo will enjoy 40.83% of the total net welfare gain followed by Angola, Ethiopia, and Kenya at 27.17%, 9.34% and 4.65% respectively. Kenya is estimated to experience a positive net welfare gain of USD 7.59 million representing 4.65% of the total net welfare gain. Among the welfare enhancing products for Kenya in the TFTA are: chemically pure sucrose in solid form and other cane or beet sugar (10.32%); motor vehicles (6.60%); chemically pure sucrose in solid form and other cane sugar (4.53%); particle board of wood/ other ligneous materials (3.40%); and fresh apples (2.88%).

## **5.2 Conclusion**

The SMART model simulation results a priori met the study expectations as highlighted by Viner in his theory on Customs Union and other related theories on international trade. It revealed that the economic integration of COMESA, EAC and SADC Regional Economic Communities into the Tripartite Free Trade Area will yield benefits to all Member States. However, as may be expected, the levels of benefits vary across economies with some gaining more than others. The highest trade creating economies are DR. Congo, Angola, Ethiopia, South Africa and Madagascar while the highest levels of trade diversion are recorded by DR Congo, Ethiopia, Kenya, Angola and South Africa. The highest TFTA welfare gainers are DR Congo, Angola, Ethiopia, Kenya and South Africa. The model also revealed that trade creation was higher for countries such as DR Congo, Angola and Ethiopia whose international trade policies restrict trade as compared to more liberalized economies in EAC and SACU. However, it is worth noting that the study results are static in nature implying that taking dynamic effects into account would have greater effects. The results allay fears by some pundits that more advanced economies will gain more than smaller ones as DR. Congo, Angola and Ethiopia have the highest welfare gains.

### **5.3 Policy Recommendations**

The Tripartite Free Trade Area is a sound policy option for Kenya. Kenya has ratified the TFTA Agreement, signaling readiness and willingness to implement it upon entry into force. This study therefore proposes measures to mitigate the negative effects while maximizing her benefits from the TFTA. In order to cushion less efficient domestic producers from being replaced by cheap imports from more efficient producers in other TFTA Member States due to the trade creation effect, there is need for greater specialization and enhanced production in the identified trade creating products including: motor vehicles for goods transport of a total vehicle weight not exceeding 5 tonnes, other cane or beet sugar and chemically pure sucrose in solid form, particle board of wood or other ligneous materials, Fresh Apples, other angles, shapes and sections of iron or non-alloy steel not further worked, and other paints and vanishes, based on synthetic polymers.

In addition, the Government of Kenya should continue to protect its infant industries from unfair competition and its consumers from loss in welfare by ensuring detailed sector – by sector and product - by product negotiation. The Government should also improve the business environment to make Kenyan producers competitive both locally and within the region. This should involve substantial investment in transport and energy infrastructure, human resource development and technology and innovation both by the public and the private players.

To avert the effect arising from the loss of tariff revenue due to withdrawal of tariffs, the study recommends broadening of the tax base and improving on tax administration for increased revenue collection. Kenya should among other measures target Value Added Tax (VAT) as a complementary source of revenue to trade taxation. Moreover, the Government should improve on collection of company and personal taxes as well as excise duty and consider alternative ways of increasing revenue generation from other local taxes through development of the domestic market as suggested by Simiyu and Osman (2018).

Moreover, Kenya should fully implement its Trade Policy and Export Strategy which prioritize diversification of the economy, and development and promotion of exports. Emphasis should be made on high technology exports in labour intensive sectors such as agriculture, livestock, fisheries, mining, services, ICT and manufacturing. This will enable the country to fully exploit

the opportunities arising from a liberalized regional market and minimize the effects of further losses of tariff revenue.

#### **5.4 Limitations of the Study**

The partial equilibrium SMART model used in this paper produces vital quantitative results on creation of trade, diversion of trade and a FTAs revenue and welfare effects. The model also makes it possible to undertake analysis at a high level of disaggregation of trade data.

The model has some limitations as highlighted below. First, being a partial equilibrium model the results of SMART are restricted to direct effects of change in trade policy only in a single market. Hence, indirect effects of trade policy changes in other markets i.e. inter-industry effects as well as feedback effects are overlooked. These effects spill over to interrelated markets and in return affect the original market. Besides, the model doesn't estimate the effect of an FTA on local production which could be of interest to decision makers. SMART also fails to take into consideration the possibility of new imports from new foreign countries into the domestic market. More research can be undertaken to fill this gap.

#### **5.5 Areas for Further Research**

More research can be undertaken preferably with a Computerized General Equilibrium (CGE) model to capture how trade policy changes in other markets would indirectly affect Kenya given 100% liberalization under the TFTA.

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## APENDICES

### Appendix 1.1: Trade Creation by Product

Product Code HS 6 Digit	Product Description	Trade Creation Effect in 1000 USD	% Share of the TTC
870421	Motor vehicles for the transport of goods of a gross vehicle weight not exceeding 5 tonnes	5,694.75	10.99
170199	Other cane or beet sugar and chemically pure sucrose, in solid form	2,752.04	5.31
441011	Particle board of wood or other ligneous materials, whether or not agglomerated with resins or other organic binding substances.	2,267.64	4.38
080810	Fresh Apples	1,730.64	3.34
721650	Other angles, shapes and sections of iron or non-alloy steel not further worked than hot-rolled, hot-drawn or extruded	1,429.69	2.76
320890	Other Paints and varnishes (including enamels and lacquers) based on synthetic polymers or chemically modified natural polymers, dispersed or dissolved in a non-aqueous medium; solutions as defined in Note 4 to this Chapter.	1,226.35	2.37
730840	Equipment Structures (excluding prefabricated buildings of heading 94.06) and parts of structures (for example, bridges and bridge-sections, lock-gates, towers, lattice masts, roofs, roofing frame-works, doors and windows and their frames and thresholds for doors, for scaffolding, shuttering, propping or pit-propping	1,132.09	2.18
870332	Motor cars and other motor vehicles principally designed for the transport of persons (other than those of heading 87.02), including station wagons and racing cars of a cylinder capacity exceeding 1500 cm <sup>3</sup> but not exceeding 2500 cm <sup>3</sup>	1,112.99	2.15
170114	Other cane sugar and chemically pure sucrose in solid form	889.39	1.72
870333	Motor cars and other motor vehicles principally designed for the transport of persons (other than those of heading 87.02), including station wagons and racing cars of a cylinder capacity exceeding 2500 cm <sup>3</sup>	739.97	1.43

Source: Own computation based on the SMART simulations approach

## Appendix 1.2: Trade Diversion Effect by Product

Product Code HS 6 Digit	Product Description	Trade Diversion Effect in 1000 USD	% Share of TTD
870421	Motor vehicles for the transport of goods of a gross vehicle weight not exceeding 5 tonnes	4,414.23	5.72
170199	Other cane or beet sugar and chemically pure sucrose, in solid form.	2,689.44	3.48
170114	Other cane sugar and chemically pure sucrose in solid form	1,750.53	2.27
870333	Motor cars and other motor vehicles principally designed for the cm <sup>3</sup>	894.07	1.16
220421	Wine of fresh grapes, including fortified wines; grape must other than that of heading 20.09 in containers holding 2 litres or less	816.69	1.06
870323	Motor cars and other motor vehicles principally designed for the transport of persons (other than transport of persons (other than those of heading 87.02), including station wagons and racing cars of a cylinder capacity exceeding 2500 those of heading 87.02), including station wagons and racing cars of a cylinder capacity exceeding 1500 cm <sup>3</sup> but not exceeding 3000 cm <sup>3</sup>	660.67	0.86
401110	New pneumatic tyres, of rubber of a kind used on motor cars (including station wagons and racing cars)	638.97	0.83
730890	Other Structures (excluding prefabricated buildings of heading 94.06) and parts of structures (for example, bridges and bridge-sections, lock-gates, towers, lattice masts, roofs, roofing frameworks, doors and windows and their frames and thresholds for doors,	554.17	0.72
330210	Mixtures of odoriferous substances and mixtures (including alcoholic solutions) with a basis of one or more of these substances, of a kind used as raw materials in industry; other preparations based on odoriferous substances, of a kind used for the manufacturing in the food or drink industries	492.20	0.64
180690	Other chocolate and other food preparations containing cocoa.	463.48	0.60
480256	Uncoated paper and paperboard, of a kind used for writing, printing or other graphic purposes, and non-perforated punch-cards and punch tape paper, in rolls or rectangular (including square) sheets, of any size, other than paper of heading 48.01 or 48.03 weighing 40 g/m <sup>2</sup> or more but not more than 150 g/m <sup>2</sup> , in sheets with one side not exceeding 435 mm and the other side not exceeding 297 mm in the unfolded state	462.21	0.60
760720	Aluminium foil (backed with paper, paperboard, plastics or similar backing materials) of a thickness (excluding any backing) not exceeding 0.2 mm.	408.58	0.53

390690	Other acrylic polymers in primary forms.	398.24	0.52
441114	Fibreboard of wood or other ligneous materials, whether or not bonded with resins or other organic substances of a thickness exceeding 9 mm	390.56	0.51
100510	Maize (corn) Seed	389.71	0.50
870332	Motor cars and other motor vehicles principally designed for the transport of persons (other than those of heading 87.02), including station wagons and racing cars of a cylinder capacity exceeding 1500 cm <sup>3</sup> but not exceeding 2500 cm <sup>3</sup>	381.09	0.49
441011	Particle board of wood or other ligneous materials, whether or not agglomerated with resins or other organic binding substances.	363.71	0.47
330590	Other preparations for use on the hair	352.89	0.46
330499	Other Beauty or make-up preparations and preparations for the care of the skin (other than medicaments), including sunscreen or sun-tan preparations; manicure or pedicure preparations.	349.78	0.45

*Source: Own computation based on the SMART simulations approach*

### Appendix 1.3: Revenue Effect by Product

<b>Product Code Hs 6 Digit</b>	<b>Product Description</b>	<b>Revenue Effect in 1000 USD</b>	<b>% Share of the TRE</b>
870421	Motor vehicles for the transport of goods of a gross vehicle weight not exceeding 5 tonnes	-7,429.91	12.41
170199	Other cane or beet sugar and chemically pure sucrose, in solid form	-5,808.11	9.70
080810	Fresh Apples	-3,508.03	5.86
170114	Other cane sugar and chemically pure sucrose in solid form	-2,800.85	4.68
220421	Wine of fresh grapes, including fortified wines; grape must other than that of heading 20.09 in containers holding 2 litres or less	-2,119.22	3.54
081090	Other fruit, fresh	-969.85	1.62
180631	Filled Chocolate and other food preparations containing cocoa.	-881.12	1.47
870333	Motor cars and other motor vehicles principally designed for the transport of persons (other than those of heading 87.02), including station wagons and racing cars of a cylinder capacity exceeding 2500 cm <sup>3</sup>	-878.63	1.47
441011	Particle board of wood or other ligneous materials, whether or not agglomerated with resins or other organic binding substances	-866.93	1.45
401110	New pneumatic tyres, of rubber of a kind used on motor cars (including station wagons and racing cars)	-857.70	1.43
730890	Particle board of wood or other ligneous materials, whether or not agglomerated with resins or other organic binding substances	-649.77	1.09
390690	Other acrylic polymers in primary forms	-645.91	1.08
320890	Other Paints and varnishes (including enamels and lacquers) based on synthetic polymers or chemically modified natural polymers, dispersed or dissolved in a non-aqueous medium; solutions as defined in Note 4 to this Chapter.	-631.32	1.05
760720	Aluminium foil (backed with paper, paperboard, plastics or similar backing materials) of a thickness (excluding any backing) not exceeding 0.2 mm	-600.05	1.00
870323	Motor cars and other motor vehicles principally designed for the transport of persons (other than those of heading 87.02), including station wagons and racing cars of a cylinder capacity exceeding 1500 cm <sup>3</sup> but not exceeding 3000 cm <sup>3</sup>	-596.22	1.00
100590	Other Maize (corn)	-568.76	0.95

480256	Uncoated paper and paperboard, of a kind used for writing, printing or other graphic purposes, and non-perforated punch-cards and punch tape paper, in rolls or rectangular (including square) sheets, of any size, other than paper of heading 48.01 or 48.03 weighing 40 g/m <sup>2</sup> or more but not more than 150 g/m <sup>2</sup> , in sheets with one side not exceeding 435 mm and the other side not exceeding 297 mm in the unfolded state	-521.50	0.87
180690	Other Chocolate and other food preparations containing cocoa.	-485.82	0.81
330590	Other Preparations for use on the hair.	-484.08	0.81
330210	Mixtures of odoriferous substances and mixtures (including alcoholic solutions) with a basis of one or more of these substances, of a kind used as raw materials in industry; other preparations based on odoriferous substances, of a kind used for the manufacturing in the food or drink industries	-479.13	0.80

*Source: Own computation based on the SMART simulations approach*

#### Appendix 1.4: Welfare Effect by Product

<b>Product Code HS 6 Digit</b>	<b>Product Description</b>	<b>Welfare in 1000 USD</b>	<b>% Share of the TWE</b>
170199	Other cane or beet sugar and chemically pure sucrose, in solid form.	783.18	10.32
870421	Motor vehicles for the transport of goods of a gross vehicle weight not exceeding 5 tonnes	500.61	6.60
170114	Other cane sugar and chemically pure sucrose in solid form	343.72	4.53
441011	Particle board of wood or other ligneous materials, whether or not agglomerated with resins or other organic binding substances.	257.79	3.40
080810	Fresh Apples	218.48	2.88
320890	Other Paints and varnishes (including enamels and lacquers) based on synthetic polymers or chemically modified natural polymers, dispersed or dissolved in a non-aqueous medium; solutions as defined in Note 4 to this Chapter	199.70	2.63
730840	Equipment Structures (excluding prefabricated buildings of heading 94.06) and parts of structures (for example, bridges and bridge-sections, lock-gates, towers, lattice masts, roofs, roofing frame-works, doors and windows and their frames and thresholds for doors, for scaffolding, shuttering, propping or pit-propping	199.68	2.63
870332	Motor cars and other motor vehicles principally designed for the transport of persons (other than those of heading 87.02), including station wagons and racing cars of a cylinder capacity exceeding 1500 cm <sup>3</sup> but not exceeding 2500 cm <sup>3</sup>	124.21	1.64
210390	Other Sauces and preparations therefor; mixed condiments and mixed seasonings; mustard flour and meal and prepared mustard.	109.19	1.44
730890	Other Structures (excluding prefabricated buildings of heading 94.06) and parts of structures (for example, bridges and bridge-sections, lock-gates, towers, lattice masts, roofs, roofing frame-works, doors and windows and their frames and thresholds for doors,	108.42	1.43
620462	Women's or girls' suits, ensembles, jackets, blazers, dresses, skirts, divided skirts, trousers, bib and brace overalls, breeches and shorts (other than swimwear) of cotton	101.07	1.33
721650	Other angles, shapes and sections of iron or non-alloy steel not further worked than hot-rolled, hot-drawn or extruded	97.63	1.29
570320	Carpets and other textile floor coverings, tufted, whether or not made up of nylon or other polyamides	88.14	1.16

721041	Corrugated flat-rolled products of iron or non-alloy steel, of a width of 600 mm or more, clad, plated or coated	86.35	1.14
870333	Motor cars and other motor vehicles principally designed for the transport of persons (other than those of heading 87.02), including station wagons and racing cars of a cylinder capacity exceeding 2500 cm <sup>3</sup>	84.90	1.12
081090	Other fruit, fresh	84.52	1.11
220421	Wine of fresh grapes, including fortified wines; grape must other than that of heading 20.09 in containers holding 2 litres or less	84.114	1.11
170390	Other molasses resulting from the extraction or refining of sugar.	83.01	1.09
480256	Uncoated paper and paperboard, of a kind used for writing, printing or other graphic purposes, and non-perforated punch-cards and punch tape paper, in rolls or rectangular (including square) sheets, of any size, other than paper of heading 48.01 or 48.03 weighing 40 g/m <sup>2</sup> or more but not more than 150 g/m <sup>2</sup> , in sheets with one side not exceeding 435 mm and the other side not exceeding 297 mm in the unfolded state	80.44	1.06
180690	Other chocolate and other food preparations containing cocoa	71.66	0.94

*Source: Own computation based on the SMART simulations approach*

### Appendix 1.5: Kenya's Top 30 Export Products to COMESA in 2018

S/No.	Product	Value in Million USD
1.	Tea and mate	223
2.	Petroleum oils and oils obtained from bituminous minerals (other than crude);	82
3.	Flat-rolled products of iron or non-alloy steel, clad, plated or coated	73
4.	Edible products and preparations	66
5.	Fixed vegetable fats, crude, refined or fractionated, other than 'soft'	66
6.	Medicaments (including veterinary medicaments)	58
7.	Tobacco, manufacture (whether or not containing tobacco substitute)	55
8.	Soap, cleansing and polishing preparations	54
9.	Articles of plastics	53
10.	Paper and paperboard, cut to size or shape, and articles of paper or paperboard	44
11.	Sugar confectionery	44
12.	Alcoholic beverages	37
13.	Other crude minerals	35
14.	Fertilizers (other than those of group 272)	33
15.	Footwear	29
16.	Lime, cement and fabricated construction materials (except glass and clay materials)	27
17.	Printed matter	24
18.	Insecticides, rodenticides, fungicides, herbicides, anti-sprouting products and plant-growth regulators, disinfectants and similar products, put up in forms or packings for retail sale	24
19.	Pigments, paints, varnishes and related materials	21
20.	Cereals, unmilled (other than wheat, rice, barley and maize)	21
21.	Margarine and shortening	21
22.	Road motor vehicles	16
23.	Made-up articles, wholly or chiefly of textile materials	16
24.	Plates, sheets, film, foil and strip, of plastics	14
25.	Iron and steel bars, rods, angles, shapes and sections (including sheet piling)	14
26.	Manufactures of base metal	14
27.	Office and stationery supplies	13
28.	Metallic salts and peroxysalts, of inorganic acids	12
29.	Perfumery, cosmetics or toilet preparations (excluding soaps)	13
30.	Tubes, pipes and hollow profiles, and tube or pipe fittings, of iron or steel	12

### Appendix 1.6: Kenya's Top 30 Import Products to COMESA in 2018

S/No.	Product	Value in Million USD
1.	Sugars, molasses and honey	146
2.	Maize not including sweet (corn), unmilled	102
3.	Milk and cream and milk products other than butter or cheese	97
4.	Vegetables, fresh, chilled, frozen or simply preserved (including dried leguminous vegetables); roots, tubers and other edible vegetable products fresh or dried	83
5.	Essential oils, perfume and flavour materials	77
6.	Feeding stuff for animals (not including unmilled cereals)	72
7.	Tobacco, unmanufactured; tobacco refuse	46
8.	Soap, cleansing and polishing preparations	41
9.	Paper and paperboard	40
10.	Works of art, collectors' pieces and antiques	35
11.	Lime, cement and fabricated construction materials (except glass and clay materials)	30
12.	Veneers, plywood, particle board, and other wood, worked	29
13.	Television receivers (including video monitors and video projectors), whether or not combined, in the same housing, with radio-broadcast receivers or sound or video recording or reproducing	25
14.	Cereals, unmilled (other than wheat, rice, barley and maize)	19
15.	Edible products and preparations	16
16.	Plates, sheets, film, foil and strip, of plastics	15
17.	Tea and mate	15
18.	Flat-rolled products of iron or non-alloy steel, clad, plated or coated	12
19.	Copper	11
20.	Glassware	10
21.	Fruit and nuts (not including oil nuts), fresh or dried	10
22.	Alcohols, phenols, phenol-alcohols, and their halogenated sulphonated, nitrated or nitrosated derivatives	9.3
23.	Pigments, paints, varnishes and related materials	8.9
24.	Oil seeds and oleaginous fruits of a kind used for the extraction of 'soft' fixed vegetable oils (excluding flours and meals)	7.9
25.	Wood, simply worked, and railway sleepers of wood	7.1
26.	Polyacetals, other polyethers and epoxide resins, in primary forms; polycarbonates, alkyd resins and other polyesters, in primary forms	7

27.	Wire of iron or steel	6.4
28.	Miscellaneous manufactured articles	6.4
29.	Fixed vegetable fats and oils, 'soft' crude, refined or fractionated	6.3
30.	Miscellaneous chemical products	5.9

## Appendix 1.7: Intra COMESA Trade, 2008-2018

<b>Intra-COMESA Export Trade by Country, Values in USD million</b>											
<b>Year</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Burundi	24.4	26.9	24.6	37.8	40.8	39.9	75.6	48.0	44.0	43.0	37.4
Comoros	0.2	0.9	2.6	2.9	1.1	1.7	9.1	3.9	7.5	3.4	1.5
Congo DR	511.3	469.8	1,134.3	1,256.0	1,208.8	1,712.1	1,202.8	1,777.9	631.7	706.7	1,114.7
Djibouti	4.9	179.5	12.2	154.3	14.7	5.6	1.9	11.6	50.4	19.5	21.6
Egypt	1,868.0	2,137	2,572.2	1,874.8	2,767.8	2,605.5	2,286.3	1,936.0	1,986.6	2,025.2	2,335.6
Eritrea	18.6	32.1	2.2	10.0	7.3	5.6	4.7	9.6	3.0	5.4	2.2
ESwatini	168.1	144.7	140.3	94.6	44.7	123.8	187.5	177.0	157.2	203.7	206.5
Ethiopia	231.3	246.5	519.5	556.7	281.1	597.1	618.0	173.6	132.7	210.6	213.1
Kenya	1,845.8	1,573	1,823.1	2,250.4	2,103.1	2,097.3	1,831.9	1,641.3	1,693.4	1,640.4	1,602.6
Libya	1,199.6	736.2	590.2	90.3	410.7	470.9	43.1	107.5	118.9	81.9	108.2
Madagascar	13.3	25.2	54.1	50.2	40.9	63.9	66.7	56.2	77.7	109.5	128.6
Malawi	85.5	167.3	215.6	312.9	170.7	143.8	603.8	211.1	156.3	132.5	329.8
Mauritius	166.7	156.9	158.0	189.1	207.2	213.4	219.8	226.1	230.4	251.4	231.1
Rwanda	216.1	109.7	82.7	151.5	306.5	333.2	336.8	331.0	354.5	466.9	488.4
Seychelles	2.2	8.0	2.5	247.2	4.8	3.7	2.2	1.6	12.2	16.7	24.6
Somalia	11.8	4.0	1.1	0.7	0.7	3.6	0.9	3.8	3.9	2.0	12.0
Sudan	145.5	198.9	343.0	432.6	282.6	169.0	268.1	1,415.7	823.9	815.3	705.1
Tunisia	1,097.4	991.3	932.7	1,013.9	1,020.5	1,028.2	836.7	689.2	571.8	515.4	641.6
Uganda	670.5	716.6	716.3	967.8	509.4	551.5	916.5	838.2	812.4	1,042.2	780.7
Zambia	855.2	646.2	690.2	1,146.7	1,586.8	1,842.4	1,169.2	976.3	873.9	921.4	1,202.1
Zimbabwe	223.3	145.4	267.0	150.7	120.9	135.4	113.9	101.4	89.8	86.0	97.9
<b>COMESA</b>	<b>9,360</b>	<b>8,717</b>	<b>10,284</b>	<b>10,991</b>	<b>11,131</b>	<b>12,147</b>	<b>10,795</b>	<b>10,737</b>	<b>8,832</b>	<b>9,299</b>	<b>10,285</b>
<b>Intra-COMESA Import Trade by Country, Values in USD million</b>											
Burundi	75.0	91.0	106.5	157.7	158.0	308.8	102.4	77.4	82.2	92.2	165.7
Comoros	9.2	9.1	13.1	7.5	33.6	24.6	18.1	9.7	10.8	7.5	28.6
Congo DR	718.7	725.2	806.2	1,172.0	1,348.3	2,045.8	1,632.8	2,005.8	317.8	338.6	527.3
Djibouti	52.4	48.7	80.1	116.6	99.6	94.7	91.2	90.9	138.3	114.7	126.0
Egypt	1,241.8	757.4	1,029.4	907.3	1,082.0	719.3	800.0	676.2	757.3	602.3	942.5
Eritrea	24.1	21.1	155.5	94.6	92.3	12.9	91.4	60.1	96.9	137.8	126.0
Eswatini	51.1	0.6	10.7	7.0	5.4	14.4	16.8	21.0	11.4	14.7	20.0
Ethiopia	335.9	231.1	294.8	291.3	237.1	197.6	319.1	297.3	315.8	318.1	394.4
Kenya	411.3	318.4	515.6	656.7	728.3	676.0	663.9	617.0	686.6	1,109.7	1,149.3
Libya	1,890.5	2,006	2,183.7	1,470.7	2,498.6	2,366.4	1,166.6	1,229.1	1,102.9	888.4	1,209.3
Madagascar	70.6	148.3	199.2	176.1	148.2	155.3	175.6	155.1	178.3	222.2	104.8
Malawi	186.9	132.0	232.1	225.6	458.8	236.8	232.8	226.5	280.2	207.5	169.1
Mauritius	145.3	105.1	128.5	156.0	152.1	186.5	163.5	174.1	204.2	264.9	210.2
Rwanda	408.5	435.9	415.4	403.8	437.4	374.5	448.9	395.4	363.7	422.5	438.6
Seychelles	48.5	52.2	47.1	51.4	45.4	51.6	42.2	90.9	56.4	59.5	60.9
Somalia	298.9	385.0	455.8	354.1	321.6	937.0	828.5	802.1	63.1	306.2	325.5
Sudan	888.0	594.9	769.3	665.1	583.5	689.0	537.5	827.5	880.5	763.2	654.5
Tunisia	1,348.8	746.9	475.1	217.9	595.2	689.9	302.8	202.4	232.9	428.6	503.8

Uganda	570.7	579.0	587.0	676.6	733.8	704.6	797.1	699.8	581.7	691.4	791.1
Zambia	780.5	668.7	1,394. 3	1,637. 4	1,872. 5	2,802. 6	2,328. 7	2,003. 6	1,510. 4	1,389. 7	1,780.0
Zimbabwe	97.6	166.0	271.2	462.1	641.1	416.4	340.6	435.8	364.1	308.6	480.0
<b>COMESA</b>	<b>9,654</b>	<b>8,223</b>	<b>10,170</b>	<b>9,908</b>	<b>12,273</b>	<b>13,705</b>	<b>11,100</b>	<b>11,098</b>	<b>8,235</b>	<b>8,689</b>	<b>10,208</b>

Source: COMSTAT database, 2018

**Appendix 1.8: Kenya's Trade with EAC Countries, 2008-2018**

Year	Exports in USD Million	Imports in USD Million	Balance of Trade
<i>Uganda</i>			
2008	424	52	372
2009	462	44	418
2010	521	92	429
2011	759	103	656
2012	674	153	521
2013	654	161	493
2014	609	175	434
2015	686	223	463
2016	622	193	429
2017	618	420	198
2018	619	494	125
<b>Average</b>	<b>604.4</b>	<b>191.8</b>	<b>412.6</b>
<i>Burundi</i>			
2008	35	0.78	34.2
2009	46	0.92	45.1
2010	55	1.45	53.6
2011	59	4.7	54.3
2012	53	3.1	49.9
2013	56	0.53	55.5
2014	78	0.29	77.7
2015	66	2.23	63.8
2016	72	0.68	71.3
2017	74	0.59	73.4
2018	66	0.68	65.3
<b>Average</b>	<b>60</b>	<b>1.45</b>	<b>58.6</b>
<i>Rwanda</i>			
2008	90	0.25	89.8
2009	95	2.40	92.6
2010	105	4.30	100.7
2011	136	4.22	131.8
2012	162	8.22	153.8
2013	135	10.06	124.9
2014	144	7.15	136.9
2015	179	7.89	171.1
2016	175	7.74	167.3
2017	171	16.83	154.2
2018	178	11.86	166.1
<b>Average</b>	<b>142.7</b>	<b>7.35</b>	<b>135.4</b>
<i>Tanzania</i>			
2008	293	73	220

2009	301	78	223
2010	333	105	228
2011	417	157	260
2012	460	144	316
2013	405	117	288
2014	427	184	243
2015	337	169	168
2016	348	128	220
2017	285	172	113
<b>Average</b>	<b>327.8</b>	<b>120.6</b>	<b>207.2</b>

*Source: Centre for Business Information in Kenya (CBIK, 2018)*

### Appendix 1.9: Trade between Kenya and SADC Countries, 2008-2018

Year	Exports in USD million	Imports in USD million	Balance of trade in USD million
<b><i>South Africa</i></b>			
2008	36.5	469.5	-433
2009	35.8	705.6	-669.8
2010	24.4	598.3	-573.6
2011	28.3	706.8	-678.5
2012	26.8	619	-592.2
2013	32.8	707.2	-674.4
2014	59.4	638.9	-579.5
2015	43.4	613.1	-569.7
2016	41.5	498.6	-457.1
2017	27.6	618.8	-591.2
2018	43.9	647.3	-603.4
<b><i>Zambia</i></b>			
2008	55.1	18.7	36.4
2009	48.3	15.7	32.6
2010	46.9	24.6	22.3
2011	61.3	55.7	5.6
2012	66.7	28.8	63.9
2013	62.9	28.9	54
2014	66.7	43.8	22.9
2015	59.1	38.9	20.2
2016	51.7	42.0	9.7
2017	38.7	77.4	-38.7
2018	52.9	68.8	-15.9
<b><i>Zimbabwe</i></b>			
2008	1.8	1.6	0.2
2009	3.6	6.0	-2.4
2010	7.4	5.7	1.7
2011	15.8	16.6	-0.8
2012	17.2	10.6	6.6
2013	18.1	8.2	9.9
2014	16.6	4.9	11.7
2015	12.2	2.2	10
2016	9.1	12.6	-3.5
2017	15.1	29.5	-14.4
2018	11.5	17.7	-6.2
<b><i>Lesotho</i></b>			
2008	0.0	2.5	-2.5
2009	0.2	1.3	-1.1
2010	0.0	0.2	-0.2
2011	0.2	0.4	-0.2
2012	1.1	0.5	0.6
2013	0.3	0.8	-0.5

2014	0.5	0.1	0.4
2015	0.6	0.1	0.5
2016	0.3	0.1	0.2
2017	3.3	0.3	3.0
2018	0.1	0.0	0.1
<b><i>Botswana</i></b>			
2008	0.7	0.1	0.6
2009	0.2	0.1	0.1
2010	0.4	0.2	0.2
2011	1.4	0.2	1.2
2012	0.4	0.9	-0.5
2013	3.6	0.2	3.4
2014	7.3	0.1	7.2
2015	4.4	0.2	4.2
2016	2.3	0.2	2.1
2017	1.0	0.7	0.3
2018	1.3	0.3	1
<b><i>Mozambique</i></b>			
2008	8.7	2.8	5.9
2009	11.3	1.0	10.3
2010	7.7	9.8	-2.1
2011	8.1	15.1	-7
2012	12.5	7.0	5.5
2013	14.1	18.3	-4.2
2014	18.1	7.3	10.8
2015	12.9	14.1	-1.2
2016	23.6	23.6	0
2017	12.2	31.7	-19.5
2018	12.1	32.4	-20.3
<b><i>Malawi</i></b>			
2008	40.2	0.7	39.5
2009	31.5	1.2	30.3
2010	42.7	5.3	37.4
2011	58.2	65.0	-6.8
2012	46.9	7.8	39.1
2013	35.0	10.4	24.6
2014	33.3	3.0	30.3
2015	30.5	2.5	28
2016	27.9	3.8	24.1
2017	29.7	4.0	25.7
2018	32.2	14.1	18.1
<b><i>Eswatini</i></b>			
2008	0.0	50.1	-50.1
2009	0.0	50.4	-50.4
2010	0.1	39.1	-39
2011	1.6	48.6	-47

2012	0.1	40.9	-40.8
2013	0.1	54.4	-54.3
2014	0.2	56.0	-55.8
2015	1.0	71.6	-70.6
2016	0.2	64.0	-63.8
2017	0.6	112.3	-111.7
2018	2.2	86.3	-84.1

*Source: Centre for Business Information in Kenya (CBIK), 2018*