THE EFFECT OF THE EAST AFRICAN COMMUNITY ON CROSS BORDER TRADE AT THE MALABA BORDER

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DECLARATION

This research project is my original work and has not been presented to any other university for a degree award.

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This research project has been a very enlightening and rewarding experience for me in an area that is of great personal interest.

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DEDICATION

This project is dedicated to my parents, particularly my late father, Mr. Lucas G Kuria, for giving me the willpower to undertake this course.

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ABSTRACT

The study set to establish the effect of the East African Community (EAC) Protocol on cross border trade, with specific reference to the Kenya-Ugandan Malaba border.

The main objectives of the study were to determine how the Protocol has affected the volume of cross border trade and to establish whether there was any effect on the volume of illegal trading. The study has explored literature on trade between Kenya and Uganda at the Malaba border and has particularly focused on the effect of bilateral unions on cross border trade.

The target population were traders from the Malaba border. There being no formal data on the number of traders, the study relied on estimates of registered traders from the Kenya Revenue Authority (KRA), which indicated that they were about 3,000. The study used a sample of 100 traders, 50 registered and the other 50 chosen using snowball sampling technique. Questionnaires were used to collect data from the respondents. The questions were both closed and open ended.

Data has been presented using tables and graphs. In addition, frequencies and percentages have been used for ease of interpretation. The results showed that to a larger extent, the EAC Protocol has had a positive impact on the volume of cross border trade. The Protocol has reduced various non-tariff trade barriers which were not necessary. However, in relation to illegal cross border trade, the findings showed that the Protocol has not yet had any significant impact.

CHAPTER ONE: INTRODUCTION

1.1 Background

The formation of trade blocks and integration of economies in the world has increased in the recent past. Institutions and organizations have been developed in order to facilitate trade and other economic matters, combine resources for the achievement of common goals, and strengthen international and intercultural dialogue. Majority of developing countries have embraced economic liberalization policies supported by the IMF, World Bank and the international donor community as a way of revamping their economies. Kenya, Uganda and Tanzania are among the African countries that implemented most of these policies. Amongst the policies undertaken was trade liberalization which dismantled trade controls, the monopoly of the commodity marketing boards, reduced the role of government to impose farm gate prices, abolished export duties and opened the trade sector to competition. The foreign exchange liberalization also allowed the forces of demand and supply to determine the market rates (Arvind, 2000).

Theory of economic integration was founded with the seminal contribution of Viner (1950). He distinguished between two effects, one in which trade between partner countries expands in accordance with international comparative advantage, and the other in which trade between countries expands as a result of the preferential treatment given to imports from within the region as compared to those from the rest of the world. Viner named the former effect "trade creation" where domestic products are substituted by imports of lower-cost goods produced by a country's partner. The latter he called "trade diversion" which stands for the shift in imports from the least-cost exporter to the more expensive product from the nation's partner.

Economic integration has the potential to reverse the marginalization of African economies from the global economy, if external capital becomes available and domestic institutional environment, and capacity allows it to be efficiently and equitably used. In order for any regional related initiatives to succeed, they must be broadly embraced and owned by all constituent groups or stakeholders of individual states such as civil society groups, intellectuals, farmers, the private sector, and trade union groups (Vivek et al., 2005).

1.1.1 Cross Border Trade

Cross-border trade encompasses all merchandise entering or leaving a country from or to another country, with exception of transit goods. It also includes trade in financial services such as dealings in foreign exchange (money changers at the border posts) among other dealings (Obwona and Ayoki, 2005). Naheed (1994) points out that cross-border trade occurs when a firm exports or imports goods or services to consumers in or from the neighboring country. He observes that proximity to one another, for instance in the case of Kenya and Uganda, a common history and cultural assimilation of the communities in the two countries are important precursors to cross border trade.

Mwaniki (2006) singles out informal cross border trade which refers to registered or unregistered business activities undertaken across the borders based mainly on popular economy. He observes that one of the main characteristics of this trade is that it is not mandatory to submit tax returns at the end of each financial year hence not entered in national accounts. Generally cross border trade is conducted by small-scale quasi-professional traders including women, who use various means to move small quantities of goods across national frontiers. Obwona and Ayoki (2005) underscore

this fact by observing that there is a substantial amount of trade between neighbours that goes unrecorded, a lot of it in small scale using several methods of transportation, including bicycles. The bulk of this trade takes place in and around established townships and customs posts along the borders.

Naheed (1994) observes that cross-border trade is an aspect that has gained popularity since the establishment of international boundaries. Countries can trade with other immediate neighboring countries in the same continent or with countries from other continents. This over time, coupled with rapid globalization, has led to emergence of different trading blocks that are governed by different sets of rules. Consequently, a process of regionalization around the world has paralleled the process of globalization in recent years. There has been a spectacular rise of regional and bilateral trade agreements in most parts of the globe. In Asia and Africa there has been a renewed interest in pursuing policies to promote regional integration. At the same time, there has been a growing interest in the developing world and between developed and developing countries to cooperate in the provision of regional cooperation projects in areas such as preserving the environment, building transnational infrastructure networks, and providing for the eradication of cross-border diseases among other areas (Devlin and Estevadeordal, 2002).

1.1.2 The East African Community

The revived East African Community (EAC) is one of a number of regional integration arrangements in Sub Saharan Africa. Although a previous unsuccessful EAC was established in 1919, it ceased to function in the 1970s (UNECA, 2006). The treaty establishing the current EAC was signed on 30 November 1999 and came into force in July 2001 upon its ratification by the Republics of Kenya, Uganda and

Tanzania (Rwanda and Burundi are the new member states that joined the EAC Treaty in July 2007).

The main objective of the current EAC is to promote cooperation in "political, economic and social fields" by encouraging economic development (including trade liberalization, monetary and financial integration, the free movement of persons, capital, goods and services); science and technology (including infrastructure, health and education); as well as political and legal matters. It envisages deepening regional integration by establishing a customs union (CU), common market, a monetary union and, ultimately a political federation among the partner countries (EAC Treaty, 2001).

The launch of the EAC Customs Union in December 2004 marked the introduction of Common External tariffs and Internal Tariffs for Extra regional imports and intra-regional trade, respectively. The EAC Customs Union will create a single market of over 90 million people and a combined GDP of around US$30 billion. The main goals of the East African Community Customs Union are: Liberalizing intra-regional trade in goods on the basis of mutually beneficial trade arrangements among the Partner States; Promoting efficiency in production; Enhancing domestic, cross border trade and foreign investment; and Promoting economic development and diversification as well as industrialization (GoK, 2009).

The Treaty provides for the conclusion of relevant Protocols establishing both the Customs Union under Article 75(1) and the Common Market under Article 76(4) states that within the Common Market, there shall be free movement of labour, goods, services, capital and the rights of establishment and residence. Article 76(1) of the Treaty goes ahead to recognize the principles of free movement as pillars of a Common Market and indeed makes them mandatory. Article 104 of the Treaty then

buttresses these freedoms by outlawing any form of discrimination based on nationality and mutual recognition of professional qualifications (GoK, 2009).

That Protocol was designed to ensure that restrictions on taxation with the potential to hinder free movement of goods in the EAC Customs Union territory are removed so as to allow normal rules of competition to reign. Under the Customs Union Protocol, free movement of goods is being achieved through a combination of factors. These are: removal of internal tariffs and non-tariff barriers, harmonization of domestic taxes and excise duties, ensuring that the Common External Tariff is respected and, making sure that internal tariffs are successfully eliminated by the year 2010 when the Common Market Protocol comes into force (GoK, 2009). This study focuses on the effect of the provisions of the Protocol on cross border trade between Kenya and Uganda at the Malaba border post.

The Malaba border post is one of the busiest and main gateways for both imported and exported goods between Kenya and Uganda. The border post receives heavy traffic flow of trucks, buses, small vehicles and is a key point on the northern corridor. There are well established government institutions that oversee the smooth flow of traffic and trade. The border has river Malaba as a barrier separating the two countries. There is a railway line and road network connecting Uganda and Kenya. The other infrastructure available is the telecommunications, posta and financial institutions. The financial services are provided by Stanbic and Barclays Banks, which are both in Malaba and Tororo towns. There is no forex bureau in Malaba. However, currency conversion is handled through the informal system of money changers who are registered by the local authorities (GoU, 2007)

1.2 Statement of the Problem

Kenya and Uganda are important trading partners, but formal trade links between them have been constrained by a myriad of factors which have spurred the growth of informal (unrecorded) cross-border trade. Interest in cross-border trade has been overwhelming, but knowledge of its magnitude, determinants, and consequences remains inadequate. Further still, the impact of the establishment of the East African Community Customs Union on cross-border trade remains largely unknown.

Multilateral trade agreements have brought down tariff barriers to trade following negotiations under WTO. However, non-tariff barriers (NTBs) have gained prominence as alternative trade policy instruments for domestic industry protection or for regulating trade. In their application, NTBs are increasingly raising market access concerns at both global and regional levels. In March 2004, member states of the EAC signed a Protocol for establishment of the East African Community Customs Union which commits the states to eliminate NTBs. The Protocol for the Establishment of the EAC Customs Union provides the legal structure for NTB elimination in Article 13 (World Bank, 2008). Key among the member states of the EAC are Kenya and Uganda.

Various documented studies have focused on different aspects of the co-operation. For instance, using EAC as a case study, Korir (2007), looked at the factors that make regional integration attractive to international capital in-flows. The study concluded that EAC like other regions and countries is seeking to attract foreign direct investment. Another study carried by Mjema (2002) established that despite formal organization there exist lots of unrecorded trade between Tanzania and Kenya. According to Mjema's study, exports involve mainly the same product

categories, which include food products while, imports largely involve manufactured and petroleum products. There is no study that has been conducted to investigate the effect of the revival of the East African Community on Cross border trade. There only exists scanty knowledge on the effect of EAC on the volumes of trade between Kenya and Uganda and on illegal trade practices. This study aims at filling this knowledge gap.

The study lays focus on the impact of the EAC Customs Union Protocol on trade across the Kenya–Uganda border at the Malaba border point. The EAC common external tariff took effect on 1 January 2005; at the same date, tariffs on intra-EAC trade were partially liberalized and will be fully eliminated by end 2009. The relevance of non-tariff barriers (NTBs) to cross border trade and EAC's strategies to eliminate them are also analyzed. NTBs are considered more critical obstacles to EAC trade, than tariffs. Policies to address them effectively are considered a prerequisite to reap EAC-CU welfare gains. This study seeks to answer the questions: Has there been any significant change in the pattern and volume of trade between Kenya and Uganda arising from EAC-CU as a result of reduced tariff and non tariff barriers to trade? To what extent has EAC affected informal cross border trade and illegal trade practices?

1.3 Objectives of the Study

The objectives of the study was to:

i. Establish the effect of EAC on the volume of formal trade between Kenya and Uganda at the Malaba border.

ii. Determine the effect of EAC on the volume of informal cross border trade at the Malaba border.

1.4 Significance of the Study

The findings are relevant for investors in making decisions regarding investments in the region. If the East Africa Customs Union is attractive in terms of doing its work like dealing with counterfeiting and illegal trade, it may guarantee returns to investment hence attracting investors.

The research findings are also of value to the various industries in the region that will have available information on the functions of the Customs Union. Further, individual companies may apply these findings in formulating strategies on how to optimize gains within the union.

The information is beneficial to scholars in the field of international business management in understanding the importance of regional integration towards economic development. They can also use the information as a reference point for further research on integration.

CHAPTER TWO: LITERATURE REVIEW

2.1 The Concept of Economic Integration

According to Oxford Advanced Learners' Dictionary, integration means to bring together two or more things in such a way that one becomes fully a part of the other. Rugman, Collinson and Hodgetts (2006) view economic integration as the establishment of transnational rules and regulations that enhance economic trade and cooperation among countries. They observe that at one extreme, economic integration would result in one worldwide free trade market in which all nations had a common currency and could export anything they wanted to any nation. At the other extreme would be a total lack of economic integration, in which nations were self-sufficient and did not trade with anyone. According to Salvatore (1987), economic integration refers to the commercial policy of discriminatively reducing or eliminating trade barriers among the member states. He points out that the degree of economic integration ranges from Preferential Trade arrangements to Free Trade Areas, Customs Union, Common Market and Economic Union.

McIntyre (2005) views integration as a process that may lead to a condition in which a group of people has attained within a territory a sense of community and of Institutions and practices strong to assure, for a long time, dependable expectations of peaceful change among its population. Hass (1958) writing on the unity in Europe, defined integration as a process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations, and political activities towards new center, whose institutions demand jurisdiction over the pre-existing national states.

Theory of economic integration can be attributed to the works of Viner (1950). He distinguished between two effects, one in which trade between partner countries expands in accordance with comparative advantage, and the other in which trade between partner countries expands as a preferential treatment given to imports from within the region as compare to those from the rest of the world. Viner named the former effect "trade creation", where domestic products are substituted by imports of lower-cost goods produced by a country's partner. The latter he called "trade diversion", which refers to shift in imports from the least-cost export to the more expensive product from the nation's partner.

As a variation of economic integration, regional integration has been seen as a useful component on the way towards global integration, but not a substitute for it. Such arrangements help to overcome the disadvantages of small economic size, enhance export competitiveness, minimize adjustment costs, and provide an effective framework for financial sector, legal and regulatory reforms, investment promotion, and the implementation of sectoral policies. They can also contribute to increasing the stability and predictability of macroeconomic policy. Further, regional integration can be a powerful instrument of conflict prevention and resolution, and can foster the conditions of peace necessary for successful economic development (Yehoue, 2005).

Though integration in East Africa is envisaged to later lead to political federation, this doesn't happen easily and on a straight line. Yehoue (2005) writing on the European Union identified stages that an integrative process may follow to reach the highest level of integration. The progressive removal and ultimate eradication of economic barriers between states is often a lengthy and winding process, whose rhythm is determined by economic as well as political bargaining and compromise. Yang and

Gupta (2005) observe that political resolution also determines the intensity of economic integration from simple elimination of trade tariffs to the total unification of monetary and fiscal policies and institutions; there are numerous stages of economic integration.

Perhaps the greatest stumbling block to successful economic integration among groups of developing nations is that the benefits are not evenly distributed among members. Instead the benefits are likely to accrue mainly to the most advanced nation in the group. This leads lagging nations to withdraw, causing the attempt at economic integration to fail. Another difficulty is many developing nations are not willing to relinquish part of their newly acquired sovereignty to a super national community body, as required for a successful economic integration (Salvatore, 1987). Rugman, Collinson and Hodgets (2006) agree with Salvatore by observing that the concept of economic integration is attractive but there are many implementation problems. In particular it requires that the participants agree to surrender some of their national sovereignty such as the authority to set tariffs and quotas.

2.2 Levels of Economic Integration

Rugman, Collinson and Hodgets (2006) have identified five levels of economic integration which extent from simple economic trade arrangements to full political integration characterized by a single government. The levels, starting with the simplest, include: Free Trade Area, Customs Union, Common Market, Economic Union, and Political Union.

Free Trade Area is an economic integration arrangement in which barriers to trade such as tariffs among member countries are removed. Under this arrangement, each participant will seek to gain by specializing in the production of those good and

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services for which it has a comparative advantage and importing those for which it has a comparative disadvantage. An example is the North American Free Trade Agreement (NAFTA) which has Canada, U.S and Mexico as members.

A Customs Union is a form of economic integration in which all tariffs between member countries are eliminated and a common trade policy toward non-member countries is established. Under this arrangement, a country outside the union will face same tariff on exports to any member country receiving the goods. Further, under this arrangement, member countries cede some of the control of their economic policies to the groups at large. This is the arrangement that East African Community (EAC) is pursuing.

A Common Market is a form of economic integration characterized by the elimination of trade barriers among member nations, a common external trade policy, and mobility of factors of production among member countries. A Common Market allows reallocation of production resources such as capital, labour, and technology, based on theory of comparative advantage. An example of a Common Market is the European Union (EU). An effort to create a common market in the EAC has received resistance from some member countries.

An Economic Union is a form of economic integration characterized by free movement of goods, services, and factors of production among member countries and full integration of economic policies. It unifies monetary and fiscal policy among member nations, including the same tax rates, and has a common currency (or a permanently fixed exchange rate among currencies). Additionally, most of the national economic policies of the individual countries are ceded to the group at large.

There are no true economic unions in the world, but the creation of a single currency, the euro, certainly move the EU in this direction.

Lastly, a Political Union is one in which there is full economic integration, unification of economic policies, and a single government. This occurs when countries give up their individual national powers to be united and led by one government. One successful example is the Unites States of America, which combined independent states into a political union. The EU is now also on its way to becoming a political union.

2.3 The Concept of Trade

Trade is the voluntary exchange of goods and services and a mechanism that allows trade is called a market. The original form of trade was barter, the direct exchange of goods and services. Modern traders instead generally negotiate through a medium of exchange, mostly money. Trade is as old as mankind, although it has evolved over the years with civilization from the simple exchange of goods and services between families, communities and later countries on small scale (barter trade) to a complex and sophisticated modern day global trade among nations and regional trading blocks, governed under national, regional and international treaties (Oparanya, 2008).

International trade deals with exchange of goods and services across international borders. The history of international trade is as old as the civilization of mankind. Trade began when the first forms of society –the family, church and kingdom started to exchange goods for goods. However, the first recording of trade was done in the year 2,250 BC in Babylon by King Hammurabi. He proposed a series of laws governing trade, personal relationships, discipline and punishments. The second recording of trade was during the reign of King Solomon in about 900 BC. He was

visited by the Queen of Sheba and brought items of trade which included gold and silver among others. Further recording of trade was during the Roman Empire that ruled the Mediterranean's from 500 BC -1200 AD.

The Roman Empire significantly contributed to the development of international trade as we know it today. They were the first to develop trade infrastructure that included shopping centers, shops, and factories including roads. They also developed systems of measurements in terms of length and weight which are essentially critical into the development of international trade. It was also during this time that currency was introduced as a means of exchange. The church then played a key role in establishing a system of laws and discipline in conducting trade. The church was among the strongest institutions in the Mediterranean countries between 200 -1400 AD hence its significance to trade (Oparanya, 2008).

2.4 Theory of International Trade

Theory of international trade provides explanations for the pattern of international trade and the distribution of the gains from trade. Theory convinces most economists of the benefits of liberal trade. But many non-economists oppose liberal trade Opponents include some who may have encountered trade theory but nevertheless fall prey to fallacious reasoning (Anderson, 2006). A number of theories explain why it is beneficial for a country to engage in cross border trade. Etjil (2000) asserts that there are two basic explanations why nations trade: classical and modern theoretical explanations.

2.4.1 Classical Explanations of Trade

Mercantilist Theory

Mercantilism is a theory used to explain trade patterns in England and goes through 1600 -1800s. The dominant actors of trade that time were the merchants who used to travel by sea and export from England to other countries and brought back gold and other precious metals as pearl. Gold was the basis of payment at that time, and a country or government having more gold on its vaults was considered wealthy. The wealth of a nation therefore was considered by mercantilists to be the amount of gold it had in its possession.

Mercantilism economic theory states that a nation's prosperity depends upon its supply of capital and that the total volume of trade is unchangeable i.e. a zero sum game where wealth is not generated. As seen by mercantilism, zero sum game sees the aim of trade as the accumulation of specie and foreign exchange, the maximization of manufacturing exports and the minimization of manufacturing imports. It completely ignores the benefits available through the international division of labour and the effect of globalization on the international economy (Goode, 2003). Sometimes referred to as "hoarding," mercantilism suggest that the government should play an active, protectionist role in the economy by encouraging exports and discouraging imports, especially through the use of tariffs.

Mercantilism was propagated in the 16th and 17th centuries with the growing influence of the early industrial capitalism that was interested in an expansion of the export of trade (Roll, 1992). It advocated that countries should simultaneously encourage exports and discourage imports at all cost (Hill, 2005). The leading features of mercantilists' outlook were the regulation of foreign trade to produce an inflow of gold and silver, promotion of industry by inducing cheap raw material imports,

encouragement of exports, particularly of finished goods, and an emphasis on population, keeping wages low (Roll, 1992).

The main objective of these precepts, which would define international relations for centuries, is that a country needed a positive balance of trade to gain more precious metals. A favourable balance of trade would mean an influx of bullion, while a negative one would mean the bullion supplies would gradually be reduced. Thus, each nation had to export more goods and services than it imported, except for nations that could produce a lot of their own precious metals. Blaug (1985), concurred that the core of mercantilism was the doctrine that a favourable balance of trade is desirable because it is somehow productive of national prosperity.

A key tenet of mercantilism is that exporting raw or unfinished materials disadvantages a nation, as greater wealth results from performing value-added manufacturing work within that nation. Thus England for instance, banned the export of unfinished cloth to the Netherlands (Wikipedia, 2000). Currently, all serious economists reject mercantilism, though some elements are looked upon favorably. The first and foremost is that theory assumed capital to be a fixed factor of production, whereas today it is highly mobile. Furthermore, with today's technology and financial trade policies, companies are likely to base investment decision on where the investment climate is most advantageous, undermining the assumption that led to this theory.

Nowadays, there are some governments that still advocate for the government intervention in international trade and business. Such governments make sure that they export more than they import, allowing a surplus in their balance of payments. Most writers have termed this economic situation as economic nationalism, high

technology mercantilism or neo-mercantilism. Japan is a good example of a country that is practicing high technology mercantilism.

Theory of Absolute Advantage

Adam Smith argued that different countries enjoyed absolute advantage in the production of some goods, which formed the basis of trade between the countries (Ahuja, 2004). Smith existed during the industrial revolution in the 17lh century (Wilson 1991). He was the first academic economist and his work meant a revolution of economic thinking (Roll 1992). He was the first to explain why unrestricted free trade is beneficial to a country.

Free trade In this case to a situation where government does not attempt to influence trade through quotas and subsidies what its citizens can buy from another country, or what they can produce and sell to another country (Hill, 2005). Smith argued that the invisible hand of the market mechanism, rather than government policy, should determine what a country imports and exports His arguments imply that such a laissez-faire stance towards trade is in the best interests of a country (Hill, 2005).

Furthermore, Adam Smith attacked the mercantilists assumption that trade is zero-sum game Smith argued that countries differ in their ability to produce goods efficiently. Adam Smith asserted that a country has an absolute advantage in the production of a product when it is more efficient than any other in producing it. Hence countries should specialize in the production of goods for which they have an absolute advantage then trade these for goods produced by other countries (Hill, 2005).

Theory of Comparative Advantage

In 1817 David Ricardo took Adam Smith's theory one-step further by exploring what might happen when one country has an absolute advantage in the production goods

(Hollander, 1979). According to Ricardo's theory of comparative advantage, it makes sense for a country to specialize in the production of those goods that it produces most efficiently and to buy the goods that it produces less efficiently for other countries, even if this means buying goods from other countries that it could p more efficiently itself (Ricardo, 1967).

Hence, international trade will benefit a country if it specializes in the produce those goods in which it has the greatest comparative advantage over other countries. Ricardo demonstrated that for two nations without input factor mobility, special and trade could result in increased total output and lower costs than if each nation to produce in isolation.

Since Ricardo's exposition, the distinction between absolute and comparative advantage has been taught as one of the field's most brilliant insights. Nations will export what they have an absolute advantage in producing, but also what they comparative cost edge in producing. Blaug, (1986) aptly puts it that Ricardo's exposition became, 'the fountainhead of all nineteenth century free trade doctrine'. In a nutshell, theory of comparative advantage suggests that unrestricted free trade brings about increased world production; that is, that trade is a positive-sum game. It further suggests that opening up a country to free trade stimulates economic growth, which creates dynamic gains from trade (Hill, 2005).

Theory of Natural Advantage

This theory states that some countries are endowed by nature to have minerals, oil or even different climatic conditions for producing certain crops. Countries located in various parts of the planet earth have varied natural advantage emanating from their geographical position. For instance, oil deposits are found in large deposits in the

Middle East and most of the valued minerals are found in Africa. Countries with natural resources can just exploit this and participate in international trade and business (Oparanya, 2008).

Theory of Acquired Advantage

This theory states that some countries can improve their capabilities in participating in international trade by developing some advantages based on their available resources. For example, they can improve their position by training their manpower to a certain level that they become an asset to a country. They can then export skilled labor or attract labor intensive production in their country. For example, Japan, Taiwan and Malaysia have developed their middle level institutions as technical institutions that produce skilled labor for assembly plants and manufacturing industries. Kenya has also produced highly qualified personnel, better than her neighbouring countries.

Heckscher - Ohlin Theory of Factor Endowments (1933)

Ricardo's theory stresses that comparative advantage arises from differences in productivity. Thus, whether Kenya is more efficient than Uganda in the production of coffee depends on how productively it uses its resources. Ricardo stressed labor productivity and argued that differences in labor productivity between nations underlie the notion of comparative advantage. Swedish economists Filip Heckscher in 1919 and Bertil Ohlin in 1933 argued that comparative advantage arises from differences in national factor endowments (Jones and Kenen, 1984).

The Heckscher-Ohlin theory of factor endowment (also known as factor proportions theory) is an attempt to refine the law of comparative advantage by emphasizing differences in factor endowments as the source of comparative advantage (Harrison et al, 2000). Hence differences in factor endowments cause differences in factor prices

and therefore account for differences in comparative costs of producing different commodities (Ahuja, 2004). Differences in factor proportions required for the production of different commodities too constitute an important force underlying differences in comparative costs as between different countries. This leads to differences in market prices of different commodities in different countries.

It follows then that some countries have a comparative cost advantage in the production of a commodity for which the required factors are found in abundance comparative disadvantage in production of a commodity for which the requirements are not available in sufficient quantities. Thus a country would gain from importing goods they have a comparative disadvantage in producing and man and export goods they have a comparative advantage in producing. Furthermore, this is viewed in International trade of goods as an indirect or d means of trading factors or factor services embodied in traded baskets of good goods produced in China, a country with a huge amount of labor, reflect intensity whilst machinery produced in say, Germany reflects capital intensity in usage. Hence, countries will export commodities that make intensive use (factors with which they are well endowed and import goods that make intensively those factors, which are relatively scarce. (Harrison et al, 2000).

2.4.2 Modern Trade Theories

Human Skills Theory

One of the implications of theory is that countries, which invest heavily into human capital, will emerge with relatively abundant human skills providing the country with an important source of comparative advantage as suggested by Heckscher-Ohlin theory. Investment in human capital takes many forms but is mainly in education and training, health and safety, and facilities to supply a continuous flow of highly

educated and trained personnel and skilled labor. It is not just the quantity but also the quality of this type of investment, which gives countries certain comparative advantages.

Thus countries with a relative abundance of human skills, made possible by heavy investment in human capital, will provide incentives and opportunities for firms to innovate new products for export. By tracing the skills development of a particular country it is possible to provide some explanation for its trade patterns (Harrison et al, 2000). This theory clearly confirms the reason why Kenya is more competitive than its partners in the EAC.

Purchasing Power Parity Theory

This theory was brought forward by Gustav Cassel of Sweden. It states that rate of exchange between two countries depends upon the relative purchasing power of their respective currencies. Such will be the rate which equates the two purchasing powers. While the value of the unit of one currency in terms of another currency is determined at any particular time by the market conditions of demand and supply, in the long run, the exchange rate is determined by the relative values of the two currencies as indicated by their purchasing powers (Ahuja, 2004)

The rate of exchange tends to rest at the point that expresses equality between the respective purchasing powers of the two currencies. This point is called purchasing power parity. Under a system of autonomous paper standards the external value of a currency is said to depend ultimately on the domestic purchasing power parities of different currencies in different countries. In actual practice, the parity will be modified by the cost of transporting goods (including duties etc) form one country to another.

However, Purchasing Power Parity Theory has been criticized because the actual rates of exchange between two countries very seldom reflect the relative purchasing powers of the two currencies. This may be due to the fact that governments have either controlled prices or controlled exchange rates or imposed restrictions on import and export of goods. Furthermore, it is very difficult to measure purchasing power of a currency which is usually done with the help of index numbers. But index numbers are not infallible.

Therefore, theory of purchasing power applies to a stationary world, but in reality, the world is not static but dynamic. Conditions relating to money and prices, tariffs etc. constantly go on changing and prevent us from arriving at any stable conditions about the rates of exchange. Secondly, items of balance of payments like insurance and banking transactions and capital movements are very little affected by the changes in general price levels. But these items do influence exchange rates by acting upon the supply of and demand foreign currency, influences which the purchasing power parity theory ignores.

Balance of Payment Theory of Exchange Rate

This theory is explained by determination of exchange through demand and supply, postulates that exchange rate is determined through the demand for and supplies foreign exchange by a country. The demand for foreign currency comes from the residents and firms who need the foreign currency to pay for goods and services they want to import from that foreign country.

It also arises from residents and firms wanting to purchase assets in the foreign count like bonds and equity shares. When there is a fall in the price of foreign currency in

terms of domestic currency, when foreign currency depreciates, fewer domestic currency would be required to get foreign currency.

The foreign currency worth of foreign goods could be purchased with fewer local currencies. This induces residents and firms to import more from the foreign country resulting in increase in quantity demanded of foreign currency by the residents. If the prices of foreign currency appreciate, the opposite is true. The supply of foreign currency comes as remittances from the foreign country, foreigners investing/buying assets like bonds and equity shares from foreign exchange markets, foreigners making loans to the residents.

This theory is more realistic as the price of foreign currency is seen here as a function of many significant variables and not merely purchasing power expressed in general price level. It clearly shows the possibility of correcting balance of disequilibrium through exchange rate adjustments rather than through domestic price deflation as implied by purchasing power parity. Theory highlights the fact that disequilibrium in the balance of payments, if left to the market forces, can be corrected through depreciation or appreciation in exchange rate.

Porter's National Competitive Advantage Theory

A survey of the world's countries trade reveals that some countries are more successful in exporting than others. It also shows that even countries with natural endowments giving them an inherent absolute advantage sometimes fail to exploit their absolute advantage to the full, whilst others, even those with less of an absolute advantage excel (Harrison et al, 2000).

Hence, Porter argues that the existing international trade theories provide only a partial explanation and suggests that countries and firms develop strategies to

maintain and enhance their productivity and competitiveness over time (Porter, 1990). According to Porter, countries possess very few natural resources or factor endowments that are inherent but instead create competitive advantage through sustained effort in investment and capital formation (Harrison et al, 2000).

Porter theorizes that four broad attributes of a nation shape the environment in local competition, and these attributes promote or impede the creation of competitive advantage (Hill, 2005). These attributes are: Factor endowments (a nation's natural resources provide a country with initial competitive advantage such as skilled labour or the infrastructure necessary to compete in a given Industry); Demand conditions (the nature and structure of domestic demand for an industry's product or service); Related and supporting industries (the presence or absence of supporting and related industries that are internationally competitive); and the Firm's strategy, structure and rivalry (the conditions governing how a company is created, organized and managed, and the nature of domestic rivalry. (Harrison et al, 2000 and Hill, 2005).

Porter contended that the degree to which a nation is likely to achieve international success in a certain industry is a function of these four determinants of factor endowments, domestic demand conditions, related and supporting industries, and a firm's strategy, structure and rivalry. These determinants, collectively rather individually, create the conditions which enable countries and firms to compete with the best in the world (Harrison et al, 2000)

2.5 Cross Border Trade

Generally cross border trade is conducted by small scale quasi-professional traders including women, who use various means to move small quantities of goods across national frontiers. Border areas are traditionally considered as disadvantaged and low

opportunity regions. The geographical coordinates of such areas are expected to form a low competitiveness profile for one or more of the following reasons: a peripheral location and an isolated position with respect to the economic and political heartland of their country, resulting in relatively high transportation costs; limitations to physical flows of commodities, truncated markets, and distorted trade relations; a relatively poor infrastructure because of their geographical location on peripheral arteries of transport and communication networks; less developed social and business service provision and large differences in legal, administrative, and social welfare systems as well as in language and cultural traditions, which altogether hamper communication and cooperation with regions across the border (Niebuhr and Stiller 2002; Nijkamp 1998; Petrakos 1996; Petrakos and Economou 2002).

Cross border trade activities, depending on the way they are conducted can be both beneficial and harmful to the economy. In many instances, they help to create employment (formal and informal) especially for the local population close to the border areas. The increased presence of traders and movement of people and goods across borders has certainly created more demand for goods and services hence employment e.g. in hotels, lodges and restaurants, shops, money changing, etc. In a formal or law abiding situation (where official procedures are followed by operators) the economy gains through tax revenue (Obwona and Ayoki, 2005).

However, where informal trade is conducted using illegal or illicit means, cross border trade can be detrimental to the economy. For instance, the trade can have a distorting effect on prices, with attendant consequences on competitiveness, employment and loss of revenues (as goods are sold below normal market prices), thus a source of disincentive to investment. In fact, this underground economy, if

significant in magnitude, can make implementation of monetary and fiscal policies difficult (Obwona and Ayoki, 2005).

The informal cross border trade refers to the unregistered business activities undertaken across borders based mainly on popular economy. One of the main characteristics of this trade is that it is not mandatory to submit tax returns at the end of each financial year hence not entered in national accounts. It is observed that this form of trade has severe consequences for the country's social and economic development as it denies the country of much needed revenue, and retards the growth of private sector and flow of investment through price distortion, among other effects.

2.6 Tariff and Non-Tariff Barriers to Cross Border Trade

2.6.1 Tariffs and Tariff Rate Quotas

Tariffs, which are taxes on imports of commodities into a country or region, are among the oldest forms of government intervention in economic activity. They are implemented for two clear economic purposes. First, they provide revenue for the government. Second, they improve economic returns to firms and suppliers of resources to domestic industry that face competition from foreign imports (Coughlin and Wood, 1999).

Tariffs are widely used to protect domestic producers' incomes from foreign competition. This protection comes at an economic cost to domestic consumers who pay higher prices for import competing goods and to the economy as a whole through the inefficient allocation of resources to the import competing domestic industry. Therefore, since 1948, when average tariffs on manufactured goods exceeded 30 percent in most developed economies, those economies have sought to reduce tariffs

on manufactured goods through several rounds of negotiations under the General Agreement on Tariffs Trade (GATT) (Coughlin and Wood, 1999).

In the past, and even under GATT, tariffs levied on some agricultural commodities by some countries have been very large. When coupled with other barriers to trade they have often constituted formidable barriers to market access from foreign producers. In fact, tariffs that are set high enough can block all trade and act just like import bans (Sumner, Smith and Rosson, 2002).

A tariff-rate quota (TRQ) combines the idea of a tariff with that of a quota. The typical TRQ will set a low tariff for imports of a fixed quantity and a higher tariff for any imports that exceed that initial quantity. In a legal sense and at the WTO, countries are allowed to combine the use of two tariffs in the form of a TRQ, even when they have agreed not to use strict import quotas. In the United States, important TRQ schedules are set for beef, sugar, peanuts, and many dairy products. In each case, the initial tariff rate is quite low, but the over-quota tariff is prohibitive or close to prohibitive for most normal trade (Sumner, Smith and Rosson, 2002).

2.6.2 Non-Tariff Trade Barriers

Countries use many mechanisms to restrict imports. Among the key mechanisms include the following: domestic content requirements, import licenses, import state trading enterprises, technical barriers to trade, and exchange rate management policies (Coughlin and Wood, 1999; Sumner, Smith and Rosson, 2002).

Governments have used domestic content regulations to restrict imports. The intent is usually to stimulate the development of domestic industries. Domestic content regulations typically specify the percentage of a product's total value that must be produced domestically in order for the product to be sold in the domestic market

(Carbaugh) Several developing countries have imposed domestic content requirements to foster agricultural, automobile, and textile production. They are normally used in conjunction with a policy of import substitution in which domestic production replaces imports. Member countries of trade agreements also use domestic content rules to ensure that non-members do not manipulate the agreements to circumvent tariffs (Coughlin and Wood, 1999; Sumner, Smith and Rosson, 2002).

Import licenses have proved to be effective mechanisms for restricting imports. Under an import licensing scheme, importers of a commodity are required to obtain a license for each shipment they bring into the country. Without explicitly utilizing a quota mechanism, a country can simply restrict imports on any basis it chooses through its allocation of import licenses (Coughlin and Wood, 1999; Sumner, Smith and Rosson, 2002).

Import State Trading Enterprises (STEs) are government owned or sanctioned agencies that act as partial or pure single buyer importers of a commodity or set of commodities in world markets. They also often enjoy a partial or pure domestic monopoly over the sale of those commodities. STEs can restrict imports in several ways. First, they can impose a set of implicit import tariffs by purchasing imports at world prices and offering them for sale at much higher domestic prices. The difference between the purchase price and the domestic sales price simply represents a hidden tariff. Import STEs may also implement implicit general and targeted import quotas, or utilize complex and costly implicit import rules that make importing into the market unprofitable (Coughlin and Wood, 1999; Sumner, Smith and Rosson, 2002).

All countries impose technical rules about packaging, product definitions, labeling, etc. In the context of international trade, such rules may also be used as non-tariff trade barriers. Such rules violate WTO provisions that require countries to treat imports and domestic products equivalently and not to advantage products from one source over another, even in indirect ways (Coughlin and Wood, 1999; Sumner, Smith and Rosson, 2002).

Some countries may restrict imports through managing their exchange rates. To some degree, countries can and have used exchange rate policies to discourage imports and encourage exports of all commodities. The exchange rate between two countries' currencies is simply the price at which one currency trades for the other. For example, if one U.S. dollar can be used to purchase 100 Japanese yen (and vice versa), the exchange rate between the U.S. dollar and the Japanese yen is 100 yen per dollar. If the yen depreciates in value relative to the U.S. dollar, then a dollar is able to purchase more yen. A 10 percent depreciation or devaluation of the yen, for example, would mean that the price of one U.S. dollar increased to 110 yen. One effect of currency depreciation is to make all imports more expensive in the country itself. A policy that deliberately lowers the exchange rate of a country's currency will, therefore, inhibit imports of commodities (Coughlin and Wood, 1999; Sumner, Smith and Rosson, 2002).

2.7 Elimination of Non-Tariff Barriers (NTBs) in EAC

To the extent that NTBs result from deliberate policies and procedures, they can and should be eliminated in order to liberalize intra-EAC trade. Partner States committed themselves to eliminate 'with immediate effect' all existing NTBs on intra-EAC trade and to refrain from introducing new NTBs (CU Protocol). However, some types of

NTBs cannot be eliminated by policy and procedure corrections in the short to medium term, such as high transport and communication costs due to deficient road infrastructure and telecommunications networks, lack of information on trade opportunities, etc.

Kenya and Uganda have focused their negotiations on the elimination of the following policy and procedures-tied NTBs, among others: multiple charges and levies at intra-EAC border crossing points; cumbersome customs administration procedures at intra-EAC border posts; restrictive license practices by Kenya Dairy Board for Kenya's milk Imports from the other Partner States; Kenya's restrictions on cereals imports from Uganda; Uganda's restriction on beef and beef products imports from Kenya; lacking harmonization of Partner States' tax regimes to complement harmonized tariffs; new NTB's implemented to compensate for the elimination of tariffs under the Customs Union.

EAC is making noticeable progress in the harmonization of product standards between the Partner States and bringing regional standards in line with international standards. Likewise, EAC regional business organizations have focused their attention to NTBs in EAC. According to the East African Business Council (EABC) (2005), the most important NTBs complicating cross-border transactions in EAC are: duty and tax administration problems; corruption; customs procedures and red tape; licensing procedures; police checks, roadblocks; immigration procedures; and poor transport and communication.

It would, therefore, appear that the conventional approach of associating trade liberalization / expansion to tariff elimination represents a misconception for EAC. EAC trade liberalization and associated welfare and employment gains are primarily a

matter of elimination of policy and procedures linked as well as structural NTBs. Tariff liberalization under the EAC trade dispensation certainly has its role to play in enhancing trade within East Africa and with third countries. But a serious initiative to address government policy and procedures-linked barriers to trade could have a much more significant positive impact on trade and, thereby, poverty reduction and employment creation in the region. Such an initiative would have to go hand in hand with significant investment to address structural supply constraints, particularly in transport infrastructure (Stahl. 2005).

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

The study was carried out through a descriptive survey design. This design enabled the researcher to study a sample of the population in order to make generalizations and draw conclusions about the entire population. The design was also appropriate because of the cross-sectional nature of data to be collected and the nature of the phenomenon under investigation.

3.2 Population of Study

The target group for the purposes of this study were importers and exporters at the Malaba border point. The study focused on traders on the Kenya side of the border. Most of them are unregistered and therefore there could be no authentic source of information on how many they could be. However, sources at KRA offices at Malaba indicated that there were 3,343 registered traders as at 30/06/2009. According to the KRA Simba System, only 1,115 of the registered traders are active. It was expected that total population of traders at the Malaba border was higher given that others are not registered even though they are engaged in active trade.

3.3 Sampling and Sample Size

Given the large number of elements in the population of study, there was need for sampling. The idea was to select some elements of the entire population in order to make generalizations and draw conclusions for the entire population (Cooper et al 2003). The study targeted a total of 100 traders to drawn by way of both stratified and snowball sampling techniques. Stratification was based on registration status of the traders. Therefore, to arrive at 100 traders, 50 traders were randomly selected from

among the registered and active ones while the other 50 were selected through snowballing from among the un-registered traders.

3.4 Data Collection

Both primary and secondary data was used in this research. The primary data was collected using a structured questionnaire. The questionnaire used in the study was divided into three parts. Part I focused on the demographic data of the traders while Part II and III focused on the effects of EAC on the volume of trade between Kenya and Uganda, and the effect of EAC on informal cross border trade respectively. Secondary data was captured through documentary review of the trading records at the Central Bureau of Statistics and the Kenya Revenue Authority on the Malaba Border point.

3.5 Data Analysis

The data collected was largely quantitative and descriptive in nature. Therefore descriptive statistical tools of analysis (frequencies, percentages, and mean scores) was used to analyze these data. Frequencies and percentages were used to measure the Incidence of informal cross border trade and the most frequent illegal trade practices. Mean scores were used to measure the effect of the presence or absence of tariff and non-tariff barriers to the volume of trade between Kenya and Uganda. Analyzed data was presented using tables and charts for ease of interpretation and reporting.

CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

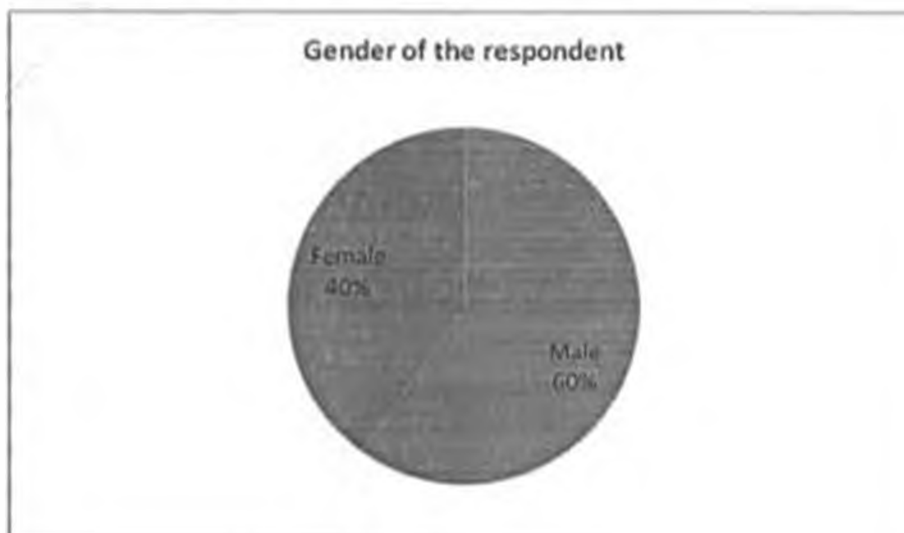
This Chapter presents the data analysis and interpretations from the findings of the field work. The findings have been presented using tables and graphs for easier pictorial interpretation. In addition, frequencies and percentages have been used.

4.2 Respondents Profile

4.2.1 Gender

The findings show that 60% of the respondents were male while 40% of the respondents were female; this was as presented in Fig 1 below.

Figure 1: Gender of the respondents



4.2.2 Duration in Business

12% of the respondents had been in business for below 5 years, 17% had been in business for between 5-10 years; 32% had been in business for between 10-15 years and 39% had traded for over 15 years. Table 1 below shows the findings.

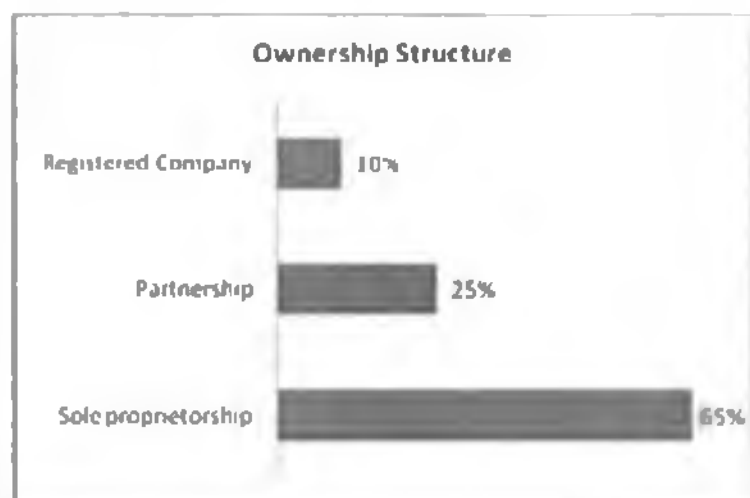
Table 1: Duration in Business

Duration of Business	Frequency	Percentage
Below 5 years	12	12%
5-10 years	17	17%
10-15 years	32	32%
Over 15 years	39	39%
Total	100	100%

4.2.3 Ownership Structure of your Business

10% of the respondents were registered companies. 25% indicated that they were partnerships, while a majority. 65% were sole proprietors. Figure 2 below shows the results.

Figure 2: Ownership Structure



4.2.4 Nature of your Business

The findings revealed that 12% of the respondents were in exporting business. 48% were in importing; 25% were in both exporting and imputing while 15% were agencies. Table 2 below shows the results:

Table 2: Nature of Business

Nature of the Business	Frequency	Percentage
Exporting	12	12%
Importing	48	48%
Exporting and Importing	25	25%
Agency	15	15%
Total	100	100%

4.2.5 Products Traded

The majority of the respondents traded in raw materials category, this was represented by 35%, and this was followed by 24% of the respondents who traded in foodstuffs. 16%, 15% and 10% traded in spare parts, clothes and vehicle spare parts respectively. Table 3 below shows the results.

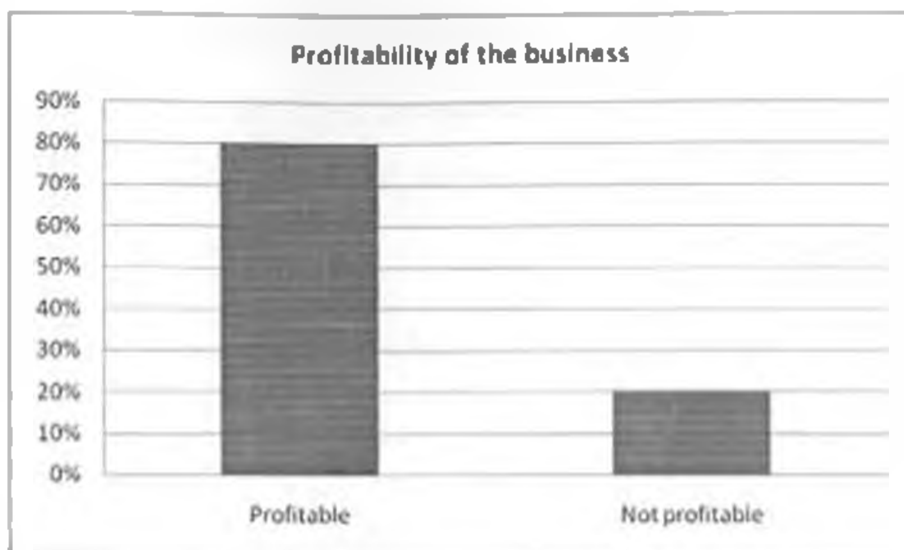
Table 3: Products Traded

Products Traded in	Frequency	Percentage
Foodstuffs	24	24%
Raw materials	35	35%
Clothes	15	15%
Spare Parts	16	16%
Vehicles and other machines	10	10%

4.2.6 Profitability of Businesses

The majority of the respondents consider their businesses to be profitable; this was represented by 80% of the respondents while 20% consider their businesses to be non-profitable. Figure 3 below indicates the findings.

Figure 3: Profitability of businesses



4.3 EAC Protocol and Volume of Trade in Non-Tariff Barriers to Trade

4.3.1 Effect of EAC Protocol on Trade Volume across the Border

A majority of the respondents, represented by 35% considered the EAC Protocol to affect volume of cross border trade to a moderate extent; followed by 28% percent who indicated that the Protocol had affected trade to a less extent. 15% showed that there was no effect at all while 14% and 8% indicated that the Protocol affected cross border trade to a larger and very large extent respectively.

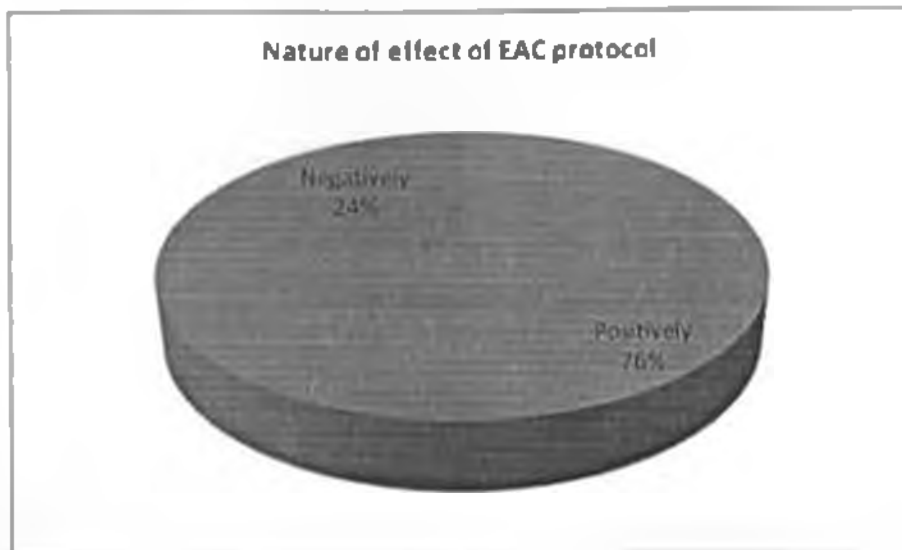
Table 4: Extent of Effect on Trade Volume

Extent of Effect	Percentage
Not at all	15%
To a less extent	28%
To a moderate extent	35%
To a large extent	14%
To a very large extent	8%
Total	100%

4.3.2 Nature of Effect of EAC Protocol

The results show that 76% of the respondents consider the effect of the EAC Protocol to be positive, while 24% of the respondents consider the effect to be negative. Figure 4 below shows the findings.

Figure 4: Nature of effect of EAC Protocol



4.3.3 Extent of elimination of Non-tariff Trade Barriers due to EAC Protocol

According to this survey, the following NTBs were seen by all respondents as primary hurdles for intra-EAC trade; duty and tax administration problems, corruption, customs procedures and red tape, licensing procedures, police checks, roadblocks, Immigration procedures, and poor transport and communication.

The findings show that to a large extent, the following trade barriers have been minimised due to the EAC Protocol; domestic content requirements; import requirements; import state trading enterprises; poor transport and communication and immigration procedures. To a moderate extent technical barriers to trade and lack of information on trading procedures have been eliminated by the EAC Protocol. To a less extent, the Protocol has reduced exchange rate management policies and licensing

procedures. The Protocol has not at all affected the following barriers, such as corruption; duty and tax problems; customs procedures; corruption and police checks and road blocks. Table 5 below summarizes the findings.

Table 5: Non Tariff Trade Barriers

Non Tariff Trade Barriers	Mean	Std Dev
Domestic content requirement	4.1	0.011
Import licenses	4.7	0.013
Import state trading enterprises	4.9	0.0342
Technical barrier to trade	3.2	0.0472
Exchange rate management policies	2.2	0.0772
Poor transport and communication	4.2	0.0728
Immigration procedures	4.5	0.0613
Police checks and road blocks	1.2	0.0623
Duty and tax problems	1.1	0.0136
Customs procedures	1.6	0.03272
Licensing procedures	2.3	0.08328
Lack of information on trading procedures	3.5	0.07271
Corruption	1.2	0.0837

4.4 Effect of EAC Protocol on Informal Cross Border Trade

4.4.1 Statements about Informal Cross Border Trade between Kenya and Uganda

The survey indicated that a substantial proportion of informal cross-border trade in the region concerns *staple food commodities* (e.g., maize, rice and cattle) and *low quality consumer goods* (e.g., clothes, shoes and electronic appliances).

It is mainly conducted by individual traders (a large proportion of which are women) and micro-, small and medium-sized enterprises and often consists of small

consignments. Some of these traders operate entirely outside the formal economy; others are registered domestically yet escape fully or partially trade-related regulations and duties (e.g., they avoid official border posts or pass through such posts yet resort to illegal practices such as under-invoicing, misclassification of goods and misdeclaration of country of origin).

The respondents were indifferent on whether informal cross border trade flows often consist relatively of small consignments of goods and that goods traded informally often reflect many of those recorded in formal regional trade statistics and promoted through government export promotion schemes. The respondents agreed that informal cross-border trade is generally characterized by an important share of female traders and most of the informally traded industrial commodities are re-exports, i.e., imports that are exported without much value addition. Table 6 below summarizes the results of the study.

Table 6: Informal Cross Border Trade

Statement on Informal cross border trade	Mean	Std Dev
Informal cross-border trade between Kenya and Uganda mainly concerns individual dealers and micro-, small-, and medium-sized enterprises (MSMEs)	5.0	0.06121
Informal cross-border flows often consist of relatively small consignments of goods.	3.1	0.0231
A large share of informally traded goods is transported by vehicle, bicycle, push carts or by head/hand.	5.0	0.07161
Some informal traders are not registered at all.	5.0	0.02281
Informal cross-border trade is generally characterized by an important share of female traders.	4.2	0.07271
Most of the informally traded industrial commodities are re-exports, i.e., imports that are exported without much	4.0	0.0823

value addition.		
Almost all types of goods (i.e., agricultural and manufactured) are involved in informal cross-border trade between Kenya and Uganda.	5.0	0.0822
Goods traded informally often reflect many of those recorded in formal regional trade statistics and promoted through government export promotion schemes	3.2	0.0212

4.4.2 Effect of EAC Protocol on Informality of the Cross Border Trade

The findings indicate that according to a majority of the respondents, represented by 39%, indicate that there was no effect at all of the EAC Protocol on informality of the cross border trade. This was followed by 32% of the respondents who showed that there was less effect. 22% indicated that there was moderate effect while 5% and 2% showed that the effect was to a large and very large extent, respectively. The findings are as in Table 7 below.

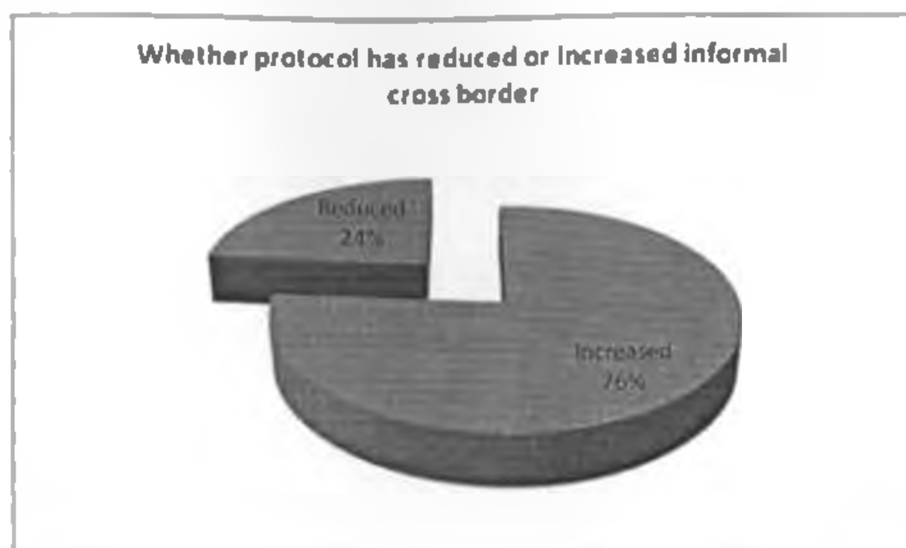
Table 7: Effect of EAC Protocol on Informal Trade

Extent of effect	Percentage
Not at all	39%
To a less extent	32%
To a moderate extent	22%
To a large extent	5%
To a very large extent	2%
Total	100%

4.4.3 Whether the EAC Protocol has reduced or increased cross border trade

76% of the respondents indicated that the EAC Protocol has encouraged cross border trade, while 24% indicated that the Protocol has reduced cross border trade.

Figure 4: Effect of Protocol on Cross Border Trade



4.5 Effect of EAC Protocol on Illegal Cross Border Trade

4.5.1 Illegal Cross Border Trade between Kenya and Uganda

The respondents strongly agree that illegal cross border trade continues, not to circumvent official markets but it is attributed to family links, ignorance and insufficient level of civic awareness, among other factors. The respondents further agree that price disparity for identical products due to differences in tax regimes is one of the major incentives for illegal cross border trade, and that differences in fiscal and trade policies lead to the tremendous and perhaps unprecedented illegal cross border trade between Kenya and Uganda. In addition, smuggling, under-declaration and false declarations are the common illegalities in cross border trade between Kenya and Uganda.

Table 8: Illegal Cross Border Trade

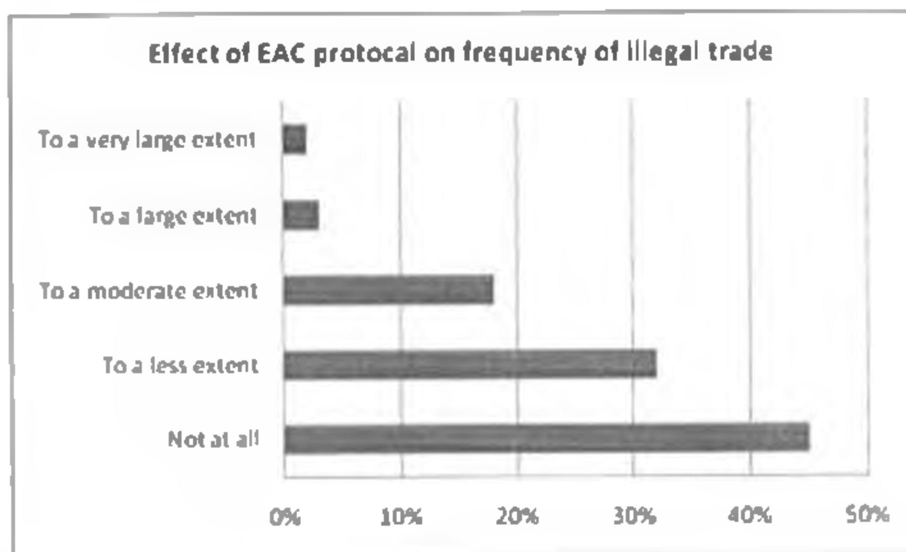
Statements on Illegal Cross Border Trade	Mean	Std Dev
Differences in fiscal and trade policies lead to the tremendous and perhaps unprecedented illegal cross border trade between Kenya and Uganda.	4.8	0.0343

Illegal cross border trade is continued not to circumvent official markets but it is attributed to family links, ignorance and insufficient level of civic awareness, among other factors.	5.0	0.06343
Price disparity for identical products due to differences in tax regimes is one of the major incentives for illegal cross border trade.	5.0	0.06272
Smuggling, under-declaration, and false declarations are the common illegalities in cross border trade between Kenya and Uganda.	4.5	0.07634

4.5.2 Effect of the EAC Protocol on the frequency of illegal trade practices

The findings indicate that 45% of the respondents consider the Protocol to have had no effect on frequency of illegal trade. 32% indicated that the effect is to a lesser extent and 28% showed that the effect is to a moderate extent. Figure 6 below shows the results.

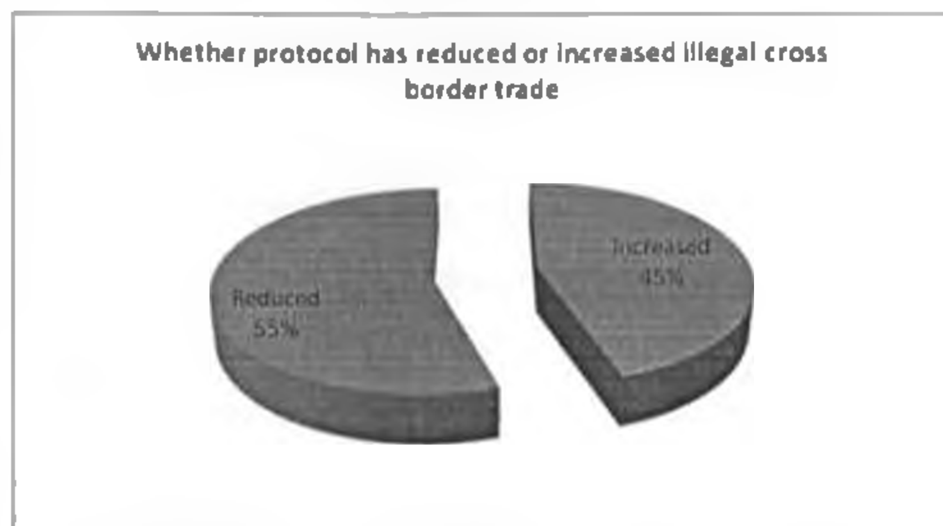
Figure 5: Effect of Protocol on Illegal Trade



4.5.3 Whether the EAC Protocol has reduced or increased on frequency of illegal trade practices

As presented in the figure below, 55% of the respondents indicated that the Protocol has reduced frequency of illegal trade while the other 45% indicated that the Protocol has increased the frequency. Figure 7 below shows the results.

Figure 6: Effect of the Protocol on Illegal Trade



4.5.4 The Success Rate of the Implementation of the EAC Protocol

The findings indicate that a majority of the respondents, 45%, indicated that to some extent, the implementation was somehow successful. 23% of the respondents showed that the implementation was not successful. 18% and 14% indicated that the implementation was successful and very successful respectively. Table 9 below shows the findings.

Table 9: Success Rate of Protocol Implementation

Rating the Success	Frequency	Percentage
Not Successful	23	23%
Somehow successful	45	45%
Successful	18	18%
Very successful	14	14%
Total	100	100%

CHAPTER FIVE: SUMMARY , CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This Chapter presents the summary, conclusions and recommendations from the findings of the study. The conclusions are drawn from the objectives of the study and are informed by the findings and interpretations as presented in Chapter Four.

5.2 Summary

Most of the respondents were male and had been in business for over 15 years. In relation to ownership structure, a majority were sole proprietors and traded in the raw materials category. Most of the respondents consider their businesses to be profitable, this was represented. A majority of the respondents considered the EAC Protocol to affect the volume of cross border trade only to a moderate extent; this was followed by those who indicated that the Protocol had affected trade to a less extent. Generally, the effect of the Protocol was considered to be positive.

Some respondents in the registered company category sector viewed trade agreements as existing on paper only. The priorities for the private sector were found to relate more to customs procedures and red tape, bans and non-tariff duties, transport infrastructure and the business environment, many of which can be addressed by measures that do not require the establishment of a customs union. It would, therefore, appear that the conventional approach of associating trade liberalization / expansion to tariff elimination represents a misconception for EAC.

The respondents strongly agree that informal cross border trade between Kenya and Uganda mainly concerns individual dealers, micro and small and medium sized enterprises; that a large share of informally traded goods is transported by vehicle,

bicycle, push carts or by head or hand; that some informal traders are not registered at all and that almost all types of goods are involved in informal cross border trade between Kenya and Uganda.

The respondents were indifferent on whether informal cross border trade flows often consist relatively of small consignments of goods and that goods traded informally often reflect many of those recorded in formal regional trade statistics and promoted through government export promotion schemes.

The respondents agreed that informal cross-border trade is generally characterized by an important share of female traders and most of the informally traded industrial commodities are re-exports, i.e., imports that are exported without much value addition.

A majority of the respondents, indicated that there was no effect at all of the EAC Protocol on informality of the cross border trade and that the EAC Protocol has increased cross border trade. The respondents strongly agree that illegal cross border trade is continued not to circumvent official markets but it is attributed to family links, ignorance and insufficient level of civic awareness, among other factors.

The respondents further agree that price disparity for identical products due to differences in tax regimes is one of the major incentives for illegal cross border trade. The respondents also agreed that differences in fiscal and trade policies lead to the tremendous and perhaps unprecedented illegal cross border trade between Kenya and Uganda, in addition smuggling, under-declaration, and false declarations are the common illegalities in cross border trade between Kenya and Uganda.

Most of the respondents consider that the Protocol has had no effect on frequency of illegal trade. The findings indicate that a majority of the respondents indicated that to some extent, the implementation was somehow successful.

5.3 Conclusion

Both Kenya and Uganda Governments have made considerable efforts in reducing the incentives to trade informally, by diminishing the costs of formal importing/ exporting; enhancing compliance levels with existing regulations; and improving trading opportunities and services for traders in the formal sector.

It is however not suggested that the authorities will be able to fully eliminate the incidence of informal cross-border trade in Malaba. Individuals with low literacy levels, trading very small amounts of low-value goods with their family members across borders, often through unofficial routes with no border posts, usually do not declare any of their business activities and are thus unlikely to formalize their cross-border trade transactions. The measures in place therefore mainly concern individuals or firms that have (partially) registered their activity and/or are partially compliant with trade-related regulations.

In relation to the effect of Protocol on cross border trade, it can be concluded that there was no effect at all of EAC Protocol on informality of the cross border trade and that EAC Protocol has increased cross border trade. In relation illegal cross border trade it can be concluded that it is not to circumvent official markets but it is attributed to family links, ignorance and insufficient level of civic awareness, among other factors. Price disparity for identical products due to differences in tax regimes is one of the major incentives for illegal cross border trade. The differences in fiscal and trade policies lead to the tremendous and perhaps unprecedented illegal cross border

trade between Kenya and Uganda, in addition smuggling, under-declaration, and false declarations are the common illegalities in cross border trade between Kenya and Uganda.

5.4 Recommendations

The following measures were identified as having the potential to boost cross-border trade at Malaba.

Formulation of the EAC Customs Management Act, 2004 and the EAC Customs Management Regulations outlining standard forms and fees payable across the region

Simplifying and reducing documentation requirements and formalities; lowering the levels of fees and charges for importation and exportation; expediting the release and clearance of goods from customs custody; enhancing transparency and predictability of trade-related regulations and fees; and improving border agency coordination (both within and across countries) will lower both direct trade transaction costs arising from compliance with trade-related regulations and the payment of fees and charges, and indirect costs arising from waiting times at the border and lack of predictability of the trading environment.

Furthermore, they can lower the incidence of corruption and significantly enhance the efficiency of controls at the border (e.g., through risk management techniques and enhanced regional border coordination), thus improving compliance with trade-related regulations. Such measures bear a particular importance for smaller firms which often do not have the necessary capacity nor resources to deal with complex documentation requirements; cannot easily absorb trade-related fees and charges and might be

subject to additional inspections at the border (due to the lack of rich track records with Customs authorities).

A simplified trade regime consisting of simplified documentation formalities, lower trade-related fees and charges, and immediate release from Customs custody for goods under a certain threshold has been introduced to encourage micro-, small and medium-sized enterprises to formalize low value cross-border transactions for which they currently face a disproportionate compliance burden. For example a Simplified Certificate of Origin is in place for small scale traders at the border.

Moreover, *complementary measures* — such as *assistance* to help traders understand and comply with existing trade regulations (through targeted information material and training) and efficient *support services* for formal importing and exporting — could further act as strong incentives towards formalization. Kenya is consistently holding interactive forums with stakeholders, including small scale traders to enhance Customs-Business partnership and impress upon them the advantages they might gain from formalizing their international transactions. Such advantages may include access to up-to-date information on cross-border business opportunities and trading conditions, marketing and business development advice, participation in trade fairs, and enhanced access to trade finance, which is still a major concern for many African traders.

Finally, *improved interaction* between traders and border agencies (e.g., through systematic consultations) and *enhanced integrity* of Customs administrations, could also result in stronger trust among these parties and higher compliance levels with trade-related regulations.

Recently, there have been improved facilities and services for One Stop Border Post (OSBP) facilities at Malaba under a World Bank funded project, the East African Trade and Transport Facilitation Project (EATTFP), that comprise construction of new buildings and structures to perform as OSBP control centers on the Kenya side of the Border; with similar facilities being developed on the Ugandan side of the border at Malaba (Uganda).

This will significantly eliminate most of the NTBs identified thus boosting integration efforts. Trade at the border is expected to sky rocket once the project is complete.

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APPENDIX I

RESEARCH QUESTIONNAIRE

University of Nairobi

Towards World Class Excellence

PART A: Respondents Profile

1. Gender Male [ ] Female [ ]

2. Name of your business (trading name) (If any)________________________

3. When did you start the business?________________________________

4. Ownership structure of your business:
   a. Sole proprietorship [ ]
   b. Partnership [ ]
   c. Registered company [ ]

5. Nature of your business
   a. Exporting [ ]
   b. Importing [ ]
   c. Exporting and importing [ ]
   d. Agency [ ]

6. Which products do you trade in? ________________________________

   ____

7. How profitable is your business? ________________________________

   ____

PART B: Effect of the EAC Protocol on Volume of Trade with regard to Non-Tariff Barriers to trade

8. To what extent has the EAC Protocol affected the volume of your business activities across the border?

   Not at all [ ]
   To a less extent [ ]
   To a moderate extent [ ]
   To a large extent [ ]
   To a very large extent [ ]

9. How has EAC Protocol affected the volume of your business activities?

   Positively [ ] Negatively [ ]

10. To what extent have the following Non-tariff trade barriers been eliminated due to EAC Protocol? Use the key below and tick as appropriate.

1=Not at all, 2=To a less extent, 3=To a moderate extent, 4=To a large extent, 5=To a very large extent

i.	Domestic content requirements	[1] [2] [3] [4] [5]
ii.	Import licenses	[1] [2] [3] [4] [5]
iii.	Import state trading enterprises	[1] [2] [3] [4] [5]
iv.	Technical barriers to trade	[1] [2] [3] [4] [5]
v.	Exchange rate management policies	[1] [2] [3] [4] [5]
vi.	Poor transport and communication	[1] [2] [3] [4] [5]
vii.	Immigration procedures	[1] [2] [3] [4] [5]
viii.	Police checks and roadblocks	[1] [2] [3] [4] [5]
ix.	Duty and tax administration problems	[1] [2] [3] [4] [5]
x.	Customs procedures	[1] [2] [3] [4] [5]
xi.	Licensing procedures	[1] [2] [3] [4] [5]
xii.	Lack of information on trade opportunities	[1] [2] [3] [4] [5]
xiii.	Corruption	[1] [2] [3] [4] [5]

PART C: Effect of EAC Protocol on Informal Cross Border Trade

11. To what extent do you agree with the following statements about informal cross border trade between Kenya and Uganda? Use the key below and tick as appropriate.

1=Strongly Disagree, 2=Moderately Agree, 3=Indifferent, 4=Agree, 5=Strongly Agree

Statement	1	2	3	4	5
Informal cross-border trade between Kenya and Uganda mainly concerns individual dealers and micro-, small-, and medium-sized enterprises (MSMEs)					
Informal cross-border flows often consist of relatively small consignments of goods.					
A large share of informally traded goods is transported by vehicle, bicycle, push carts or by head/hand.					
Some informal traders are not registered at all.					
Informal cross-border trade is generally characterized by an important share of female traders.					
Most of the informally traded industrial commodities are re-exports, i.e., imports that are exported without much value addition.					
Almost all types of goods (i.e., agricultural and manufactured) are involved in informal cross-border trade between Kenya and Uganda.					
Goods traded informally often reflect many of those recorded in formal regional trade statistics and promoted through government export promotion schemes					

12. To what extent has the EAC Protocol affected the informality of cross border trade between Kenya and Uganda?

Not at all [ ]
To a less extent [ ]
To a moderate extent [ ]
To a large extent [ ]

To a very large extent [ ]

13. Has the EAC Protocol led to the reduction or increase of cross border trade between Kenya and Uganda?

Reduction [ ] Increase [ ]

14. To what extent do you agree with the following statements about illegal cross border trade between Kenya and Uganda? Use the key below and tick as appropriate.

1=Strongly Disagree, 2=Moderately Agree, 3=Indifferent, 4=Agree, 5=Strongly Agree

Statement	1	2	3	4	5
Differences in fiscal and trade policies lead to the tremendous and perhaps unprecedented illegal cross border trade between Kenya and Uganda.					
Illegal cross border trade is continued not to circumvent official markets but it is attributed to family links, Ignorance and insufficient level of civic awareness, among other factors.					
Price disparity for identical products due to differences in tax regimes is one of the major incentives for illegal cross border trade.					
Smuggling, under-declaration, and false declarations are the common illegalities in cross border trade between Kenya and Uganda.					

15. To what extent has the EAC Protocol affected the frequency of illegal trade practices between Kenya and Uganda?

Not at all [ ]
To a less extent [ ]
To a moderate extent [ ]
To a large extent [ ]
To a very large extent [ ]

16. Has the EAC Protocol led to reduction and increase of the frequency of illegal trade practices between Kenya and Uganda?

Reduction [ ] Increase [ ]

17. According to your assessment, how do you rate the success of the implementation of the EAC Protocol?

Not successful [ ]
Somehow successful [ ]
Successful [ ]
Very successful [ ]

18. Please give reasons/brief explanation for your response to Q.17.

____
____
____
____
____

Thank you for your time and cooperation

APPENDIX II

LIST OF TRADERS AT THE MALABA BORDER

1. Movit Products Ltd
2. Crown Gases Limited
3. Eagle Holdings Ltd
4. Hass Petroleum Uganda Ltd
5. Aam International
6. Toyota East Africa Limited
7. Tororo Cement Ltd
8. Megha Industries Uganda Ltd
9. Rwenzori Commodities
10. Steel Rolling Mills
11. Gapco UG Ltd
12. Robo Uganda Ltd
13. Kasese Cobalt Co Ltd
14. Tintro Trading Ltd
15. Pulmer Logistics Kenya Ltd
16. David Engineering Works
17. Nile Furniture and Office Suppliers Ltd
18. Plunda Tea Co
19. Mastermind Tobacco K Limited
20. Prime Steel Mills Limited
21. Woodmaker (K) Ltd
22. Rwanda Horticultural Development Authority
23. Britannia Allied Industries Ltd
24. Power Links Ltd
25. Elite Technologies (U) Limited
26. Hima Cement
27. Intra Africa Limited
28. East African Growers
29. Decase Chemicals Ltd
30. Aziz Tanneries Ltd