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DEVOLUTION AND ITS IMPACT ON REGIONAL TRADE IN EAST AFRICA: A CASE STUDY OF KENYA

BY

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DECLARATION

This research project is my original work and has not been presented for a degree/diploma in any other University or any other award

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ABSTRACT

The new devolved system of government in Kenya, though viewed by many as a political step to decentralize power; it is actually an economic tool for the country to spur economic development in order to reap the full benefits of liberalized trade within a regional integration setting.

Kenya's main objective of adopting a devolved system of Government was to bring services closer to the people and enhance development through development friendly legislation and policies. It was anticipated that with devolution as a key development tool, the country's economy would grow and the cost of doing business would go down because the services would be closer to the people.

Two years into Devolution, the regional traders are confronted with multiple taxes while traversing counties in Kenya. They are forced to pay identical charges and levies in each of these counties or in other situations make payment to the national Government and to County Governments for concurrent services or no services at all in some instances. This multiplicity is not only affecting the intra-county trade in Kenya but also trade within the EAC at large. In raising an alarm on the multiple taxes, fees and charges in the new devolved system and their effect on intra EAC trade, Tanzania reported Kenya to the EAC in 2013 as having introduced non tariff barriers (NTBs) through the levies charged by the counties in total disregard of Kenya's obligations in the EAC.

This research reviews devolution in Kenya and its impact on EAC regional trade and also suggests suitable measures to address the existing challenges.

ABBREVIATIONS

AU	African Union
CBK	Central Bank of Kenya
CET	Common External Tariff
CMP	Common Market Protocol
COMESA	Common Market for East and Southern Africa
CTH	Change in Tariff Heading
CU	Custom Union
EABC	East African Business Council
EAC	East African community
ECOWAS	Economic Commission for West African States
EPA	Economic Partnership Agreement
EU	European Union
FDI	Foreign Direct Investments
GATT	General Agreement on Trade and Tariffs
IBEC	Intergovernmental Budget and Economic Council
KAM	Kenya Association of Manufacturers xi
KEPSA	Kenya Private Sector Alliance
KNBS	Kenya National Bureau of Statistics
KRA	Kenya Revenue Authority
NTB	Non-Tariff Barriers
OECD	Organization for Economic Co-operation and Development
RTA	Regional Trade Agreements

SADC	South African Development Community
SPS	Sanitary and Phytosanitary
TBT	Technical Barriers to Trade
USAID	United States Agency for International Development
WB	World Bank
WTO	World Trade Organization

DEDICATION

To my husband Samson and daughter Wanjiku for their love, patience and encouragement while I advance my career.

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Many people have contributed to this piece of work;

To God for the gift of life and knowledge, grace and mercy through all stages of my learning culminating in this research paper. For His grace, mercy and provision, I'll be eternally indebted and thankful. May His name always be praised.

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CHAPTER ONE: RESEARCH PROPOSAL

1.1 Introduction

The East African Community (EAC) comprises of five Partner States which are Kenya, Uganda, Tanzania, Rwanda and Burundi (the partner states). The five economies came together and integrated to form one regional bloc commonly known as EAC. The EAC Partner States have over time internally organized themselves on a basis of preference and what works best for their individual economies while upholding the tenets of the EAC Treaty[1].

The partner states are together implementing an Integration programme premised on the objective of deepening economic, social and political cooperation. Through the undertaking, the partner states seek to achieve balanced growth and development, which is focused on enhancing the standards of living and alleviating poverty among its peoples. The EAC integration process is in progress with achievements of the Customs Union (2005), Common Market (2010) and culminating into the signing of the Monetary Union Protocol in November 2013. The process of laying down the foundation of the political federation is on-going.[2]

The year 2013 marked the ninth year of the implementation of the EAC Customs Union with significant and profound achievements being made. A key aspect of these

[1] Treaty Establishing the East Africa Community, (1999 as amended on 14th December, 2006 and 20th August, 2007)

[2] East African Community Trade Report 2013, East African Community Secretariat, published in December 2014, pages 14, 16, 17, 18, 42-46

achievements is the agreement reached on the policy and institutional framework for the Single Customs Territory. The Single Customs Territory, launched in 2014, will facilitate unhindered movement of goods within the EAC thus unleashing the growth and development potentials. Additionally, the enactment of the EAC Elimination of Non-Tariff Barriers to Trade Bill, passed by the East African Legislative Assembly (EALA) in 2015 and awaiting presidential assent by the five Presidents will balance and strengthen the regional trading environment by eliminating trade distorting practices which add to the cost of doing business.

The gross domestic product (GDP) growth of the region has remained strong averaging 5.1 percent where Tanzania recorded the highest economic growth rate of 7.1 percent. Inflation remained within a single digit range with Rwanda registering the lowest rate of 4.2 percent while both Tanzania and Burundi registering highest rates of 7.9 percent. The Intra-EAC trade[3] growth slowed to 6.4 percent in 2013 from the 21.9 percent recorded in 2012. On the Intra-EAC investment flows side, the total value increased by 9.8 percent to US$ 236.6 million in 2013 from US$ 215.4 million recorded in 2012. In the same period, Kenya was the main source of intra-EAC investment while Uganda was the major destination.[4]

EAC is an important market for Kenya, it takes about 28.4% of Kenya's total exports and about 48.3 % of Kenya's export goes to Uganda. Kenya's exports to the East

[3] Intra-EAC trade refers to trade which focuses on economic exchange primarily between the five partner states that is Kenya, Uganda, Tanzania, Rwanda and Burundi.
[4] Ibid note 2

African Community dropped from Kshs.137.1 billion in 2011 to Kshs. 134.9 billion in 2012. Export values improved marginally in 2013 from Kshs. 124.9 billion to Kshs. 125.7 billion in 2014.[5]

Kenya adopted a devolved system of Government in the year 2010 through a new Constitution. Devolution is one of the values and principles recognised in Article 10 of the Constitution of Kenya 2010 (the Constitution). The main objective of adopting a devolved system of Government was to bring services closer to the people and enhance development through development friendly legislation and policies. It was anticipated that with devolution as a key development tool, the country's economy would grow and the cost of doing business would go down because the services would be closer to the people.

Two years into Devolution, the regional traders are confronted with multiple taxes while traversing counties in Kenya. They are forced to pay identical charges and levies in each of these counties or in other situations make payment to the national Government and to County Governments for concurrent services or no services at all in some instances. This multiplicity is not only affecting the intra-county trade in Kenya but also trade within the EAC at large. In raising an alarm on the multiple taxes, fees and charges in the new devolved system and their effect on intra EAC trade, Tanzania reported Kenya to the EAC in 2013 as having introduced non tariff

[5] Economic Survey 2015, Kenya National Bureau of Statistics, page 3

barriers (NTBs) through the levies charged by the counties in total disregard of Kenya's obligations in the EAC.

In Kenya, Narok, Migori, Homa Bay, Kisumu, Bungoma, Busia, and Trans Nzoia Counties border other EAC partner states. Mombasa is considered as one of them too mainly due to the fact that it is the coastal County and since among the five partner states, only Kenya and Tanzania have coastal lines. That leads to Uganda, Rwanda and Burundi importing products either through the Kenyan or Tanzanian ports.

1.2 Background

After the collapse of the first EAC, the new EAC was revived on 30 November 1999, by the signing of the treaty for its re-establishment. The Treaty came into force on 7 July 2000, 23 years after the total collapse of the defunct former community and its organs. A customs union was signed in March 2004 and commenced on 1 January 2005. Kenya, the region's largest exporter then, continued to pay duties on goods entering the other four countries on a declining scale until 2010. In the same year, Kenya promulgated a new constitution which marked a shift from its former centralized system of government to a devolved system of government but continued to recognize Kenya's international and regional obligations entered into under the old constitution.

At present, Kenya's exports to Uganda have reduced from Kshs 75.9 billion in 2011 to Kshs 67.4 billion in 2012 and reduced further in 2013 to Kshs 65.3 billion and Kshs 60.7 billion in 2014. Kenya's exports to Tanzania reduced from Kshs 46 billion in 2012 to Kshs.40.9 billion in 2013 and increased to Kshs.42.7 billion in 2014. Kenya's export to Rwanda increased from Kshs. 13.5 billion in 2011 to Kshs 16.1 in 2012 and then reduced to Kshs 13.4 billion in 2013, increasing again to Kshs 14.4 billion in 2014 while Kenya's exports to Burundi reduced from Kshs 5.9 Billion in 2011 to Kshs 5.3 billion in 2012, increased to Kshs 5.3 billion in 2013 and to Kshs.7.8 billion in 2014. [6]

The declining trend on Kenya's export in the EAC market is mainly attributed to various trade hindrances such as charging full Common External Tariff (CET) duty rates by Customs Authorities from other Partner States on Kenyan goods manufactured by companies registered under the EAC Duty Remission Scheme, lack of recognition of the EAC rules of origin certified by KRA, restrictive and red tape registration and testing requirements by Tanzania Food and Drug Authority(TFDA); numerous levies and charges including discriminatory duties such as excise duty, county taxes, fees and charges; deliberate technical barriers to trade such as lack of mutual recognition Standard Marks issued by the Kenya Bureau of Standards (KEBs) among other challenges, has led to high cost of doing business. All these tariff and

[6] Kenya Association of Manufacturers, Position Paper to the Kenyan Ambassadors and Trade Officers in the EAC on "How to enhance Kenyan market access in EAC", June 2014. Pages 2 and 3

non-tariff barriers have led to Kenya's exports become less competitive in the region.[7]

The economic integration milestones realized by EAC only challenge the Partner States to put up measures that will lead to full integration by removing all barriers to trade. This is enshrined in the economic theory of integration which is a process that encompasses measures designed to abolish discrimination between economic units belonging to different national states commonly known as barriers.

Being in a regional set up, all players in the economy are expected to conduct their affairs without discriminating any goods, services or persons from the other partner states. This includes all levels of Government right from the smallest units now considered as Counties or Local Authorities. EAC Partner States' Local Authorities have for a long time been a common feature of most Partner States' internal set ups leading to the formation of the East African Local Governments Association (EALGA) in 2005. EALGA has been the Umbrella Organization for National Associations of Local Governments in Rwanda (RALGA), Tanzania (ALAT), Uganda (ULGA) and Kenya (ALGAK). However the Kenyan system of Local Authorities no longer exists as the country adopted a new devolved system of

[7] Ibid

Government that did away with the Local Authorities and introduced the County system of Government after the 2013 General Elections.[8]

Devolution refers to a transfer of jurisdiction and authorities to territorial, indigenous and self governments, from the central government ranging from authority over such areas of health, to the regulation of lands and resources.[9] Through devolution, new units of government are created outside direct control of national government. The ceding of power by the Central Government to the County Governments in Kenya differs from the former system of Local Government where the Local Authorities were centrally managed by the Central Government.

The promulgation of the Constitution of Kenya in 2010 vested County Governments with substantial powers. It uplifted the former local Governments from subordinate level of Government to a significant sphere with its own right with constitutionally entrenched functions, powers and finance. Apart from promoting good governance, local democracy, provision of services at the local levels and decentralization by devolution, county governments in Kenya have a critical role to play in the regional economic integration process.

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[8] Ostman K., "*Local Government Association Capacity Building – Rationale, co-operation practices, and strategies for the future*" The Association of Finnish Local and Regional Authorities, North-South Local Government Co-operation Programme, 2010, 22.

[9] Kenya Association of Manufacturers (KAM), The Kenyan Constitutional and Legal Framework and its implication on business and the five freedoms under East African Common Market, 2012 see also Kimathi W & Kimotho R, (eds) , The devolution Issue *Nguzo ya haki* (2012, KNCHR

With the foregoing in mind, the private sector was eager to receive the new Constitution and even supported its drafting with the hope that it would be a solution to the trade challenges experienced, before that increased Cost of Doing Business in the Country. The hope here was that the Constitution would provide a conducive environment for doing business in the Country and would enhance the competitiveness of Kenya in the regional front as opposed to slowing down the movement of goods and services and compromising Kenya's regional obligations in as far as the EAC Common Market and EAC Customs Union are concerned.[10] While the aforesaid remained the private sector's most priced hope and word, letter and spirit of the Constitution, the implementation of devolution which is far from what is envisioned has thwarted the hopes and presented an even larger problem by making business logistics a nightmare.

The County Governments are empowered to collect entertainment taxes, property taxes and other taxes as may be permitted by an Act of Parliament. Further, counties are centralized to impose charges for the services they provide. Article 209 (5) of the Kenyan Constitution requires that taxation and other revenue-raising powers of a County must not be exercised in a way that prejudices national economic policies, economic activities across County boundaries or the national mobility of goods, services, capital or labor. The counties have been unable to follow the requirements of this Article thereby imposing problematic taxes, levies and charges on traders delivering or passing goods through their counties. The experience has been viewed

[10] Kenya Association of Manufacturers, 'Promise and Prospects of Devolution' (2011)

as the introduction of barriers to trade by the County Governments, taking Kenya steps behind in the implementation of the EAC Common Market Protocol.

In order to realize the promise of constitutional democracy, implementation of devolution in Kenya remains a key factor and one that cannot be wished away if the country is to realize economic development within a regional set up with devolution as a developmental tool. Kenya faces the challenge of correcting any negative impact caused by devolution on the economic development of the country in light of the achievements made in the EAC regional integration process. The region is far into embracing full economic integration through elimination of barriers to trade and it is undesired for Kenya to introduce any new barriers through the new devolved system of Government that only back tracks the integration process in the region.

1.3 Research Problem

As Kenya works towards enacting its Regional Integration Policy, it has already been appreciated that successful regional integration requires the participation and buy-in at all levels of government (national and county), from civil society and the private sector and support from Kenya's development partners. At present some of the County Governments are imposing charges of tariff equivalence effects on transit goods contrary to the spirit or commitments made in regional integration agreements. These county imposed charges also hurt the competitiveness of Kenya's products and of Kenya itself as a regional transit hub and business base.

Article 209(5) of the Kenyan Constitution guides the counties on how to exercise their taxation and other revenue raising duty. It provides that the taxation and other revenue-raising powers of counties must not be exercised in a way that prejudices national economic policies, economic activities across county boundaries or the national mobility of goods, services, capital or labor. Kenya being a member of the East African Community (EAC) is also bound by the EAC instruments such as the Treaty for the establishment of the EAC, The EAC Common Market Protocol,[11] as well as the EAC Customs Union Protocol.[12]

The EAC Treaty requires member states to come up with policies that encourage free trade[13]. On its part, the Protocol on the Establishment the EAC Customs Union obligates member states to pursue liberal trade practices.[14] The same is emphasized in Article 6 and 16 of the Protocol on Establishment of the EAC Common Market Protocol.

The Kenyan County Governments have introduced revenue raising measures that disregard Article 209(5) as well as Kenya's regional obligations as a result of which

[11] The Protocol on the Establishment of the East African Community (EAC) Common Market (adopted 20 November 2009, entered into force 1 July 2010)
[12] Protocol on the Establishment of the East African Customs Union (Enacted: 2004-03-08 came into force; 2005-01-01)
[13] Treaty on Establishment of the EAC, Article 11
[14] Ibid Note 11, Part D, Articles 10,11,12 and 13.

the measures have increased the cost of doing business[15] and have been interpreted as causing trade barriers by other EAC member States.

This research seeks to analyze the challenges caused by devolution as a development tool for Kenya while the country works towards full realization of EAC regional integration. This research shall recommend suitable solutions to address these challenges including opportunities of strengthening existing intergovernmental mechanisms to deal with the issue.

1.4 Objectives of the Research

This research shall be guided by the following objectives:

i. To evaluate the progress made by Kenya in the EAC Regional Integration process;
ii. To examine the role Devolution has played in spurring Economic Development in Kenya;
iii. To suggest suitable measures for Kenya to improve its business environment and investment climate under a regional setting.

1.5 Justification of the Study

The study will seek to evaluate devolution in Kenya as a tool for economic development while in the process of embracing full regional integration. It will seek

[15] KAM, 'Businesses bleed from County woes and double charges.' Business Daily 30 July 2013

to evaluate performance of Kenya in the EAC regional trade since inception of devolution in 2013.

The study will be important because it will also evaluate the different measures that the Government of Kenya has undertaken to boost the positive impact of devolution in boosting regional trade and in addressing any negative impact. The study will further propose suitable mechanisms to address the challenges discussed in the study. The study will be significant to the Government of Kenya as it continues to address the challenges being faced by traders while moving their goods across the devolved units and into the regional market and also in strengthening existing intergovernmental institutions to handle the challenges to be discussed.

1.6 Literature Review

1.6.1 Introduction

Regional trade is the cornerstone of EAC Partner States' trade policies. Regional trade results to the strengthening of public institutions and private sector organizations involved in international trade and this in turn strengthens regional integration. Regional integration is a major development strategy for the countries of Africa, which all share the aim of continent-wide economic, social and cultural integration by 2028. An important aspect of this is trade liberalization. This has been achieved through regional free trade areas, progressing towards customs union, a common market and ultimately monetary union. The East African Community (EAC) is one of eight regional economic communities recognized by the African Union (AU), and the only one that has a vision of political federation. In the treaty establishing the EAC, the partner states decided to expand and intensify their economic, political, social and cultural integration.[16]

The deepening and expansion of regional integration and bilateral trade agreements have widened the scope of trade opportunities for Kenya. The constitutional choice by Kenya to adopt a Devolved system of Government has led to decentralization of services leading to opening up of the devolved units to foreign and domestic investors, development of infrastructure and improved Kenya's prospects for growth and shared prosperity. Kenya's devolution is unique and it is viewed as a developmental tool for the country towards realizing economic development. In fact, the general belief among Kenyans is that devolution will yield then democracy and development.

1.6.2 Status of Regional Trade in the East African Community

Within the EAC, the Kenyan economy is the anchor. Mwangi S. and Josephine K. in their article "Africa's Powerhouse" state that the overall performance of the EAC region to a great extent depends on what happens in Kenya. Kenya's economy is the largest in the region and is much more dynamic than those of other member countries. The country's economy is much better linked to the other economies in terms of investment flows and trade. Thanks to its more advanced human capital base, its more

[16] Support to the EAC integration process, Secretariat to the East African Community, Project commissioned by German Federal Ministry for Economic Cooperation and Development (BMZ), https://www.giz.de/en/worldwide/15766.html, viewed on 19 August 2015

diversified economy, and its role as a leader in the information communication revolution in the region, Kenya's economy is expected to remain strong, creating salutary benefits to the other member countries. The prospects for a stronger economy for Kenya are boosted by the institutional reforms that culminated in the adoption of a new constitution that provides for devolved governance.[17]

Kenya's economic dominance in the region is based on a strong private sector that has evolved under relatively market-friendly policies for most of the post-independence era. Kenya's record of relative political stability and its lack of dramatic ideological shifts over the same period having done much to cement its position.[18] The partner states[19] have diverse political histories. The five countries attained their independence in the 1960s. Tanzania was the first (1961), followed by Uganda, Burundi, and Rwanda in 1962, and Kenya in 1963. Despite achieving political independence at the same period, the countries' political development has been somewhat heterogeneous. Only Tanzania and Kenya escaped major internal conflict and military rule with Tanzania maintaining its African Socialism status popularly known as "Ujamaa" while Kenya its Capitalistic status. Burundi has been marred by civil unrest evident to date.[20]

[17] Africa's Powerhouse, Mwangi S. Kimenyi and Josephine Kibe, http://www.brookings.edu/research/opinions/2013/12/30-kenya-economy-kimenyi, viewed on 21st August 2015

[18] Ibid

[19] The EAC Partner States that is Kenya, Uganda, Tanzania, Rwanda and Burundi.

[20] Ibid note 11

Kenya’s GDP[21] accounts for 40 percent of the region’s GDP, followed by Tanzania at 28 percent, Uganda at 21 percent, Rwanda at 8 percent and lastly Burundi at 3 percent[22]. Kenya's GDP increased to 55.2 billion US dollars in 2013 after rebasing from 44.1 billion US dollars, a 25.3 per cent jump.[23] The World Bank however warn that even with this statistics Kenya’s expansionary fiscal position remains worrisome, as public debt continues to build up. The size and trend of fiscal indicators remain big concerns. The government’s commitment to fiscal discipline is proving to be a challenge. Tax revenues have been rising, but increased spending has made narrowing both the overall fiscal deficit and the primary balance difficult. Large increases in government spending relative to revenue have been fueled mainly by expenditures associated with devolution, constitutional offices, and the infrastructure necessary for high sustainable growth.[24] This will ultimately have an impact on Kenya’s performance in the EAC regional trade both in its contribution to the regional GDP as well as in tax revenue collection from partner states traders in the wake of a Common Market allowing free movement of goods, services, labor and capital.

Kahenu M., in his research paper,[25] recommends that the legal framework governing the elimination of NTBs[26] and regional integration is properly enshrined in the

[21] Gross Domestic Product
[22] This is as at January 2014
[23] Economic Survey 2015, Kenya National Bureau of Statistics, page 3
[24] Kenya Economic Update, World Bank, December 2014, page vii.
[25] Kahenu Mwangi, Non-Tariff Barriers in EAC Customs Union: Implications for Trade in Manufactured goods in Kenya, a Research Paper for the award of Master of Arts degree in International Studies, The University of Nairobi, 2014, pages 57 and 58

national laws of partner states. The partner states must therefore ensure that the laws are clearly understood by all government agencies responsible for enforcement of intraregional trade regulation and administration. He further recommends the strengthening of the EAC committee on trade remedies under Article 24 of the customs union to make it more effective. One of the key steps is to design an effective non-tariff barriers legal framework and mechanisms for identifying and verifying information about non-tariff barriers and prioritizing and ensuring their elimination. This proposed mechanism would work best if partner states themselves implemented country level mechanisms that track their nation's progress in eliminating barriers to trade in the region.

Mwaura P. in his academic research paper on "*Strategic National Interests in Regional Integration in East Africa - Case Study of Kenya*"[27] recommends that Kenya review its foreign policy as regards the EAC integration. He further recommends that Kenya should work towards making the country a preferred destination of goods and services in the region and a reliable friend and trade partner rather than a con. It should work towards streamlining its institutions to rid of corruption which impedes business transactions in the region. This is because with a lot of rent seeking it only perpetuates a culture of impunity which derails implementation of various protocols that member countries have alluded to.

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[26] Non-Tariff Barriers to Trade

[27] Mwaura Patrick, Strategic National Interests in Regional Integration in East Africa-Case Study of Kenya, a Research Paper for the award of Master of Arts degree in International Studies, The University of Nairobi, 2013, pages 103 and 104.

1.6.3 Devolution as a developmental tool for Kenya to Advance Regional Trade in the East African Community

Murkomen K. in his report on The Kenyan Constitutional and Legal Framework and its Implication on Business[28], he states that the system of devolved government under the Constitution is bound to change the image of the country and how things are done at regional levels. He however challenges the drafters of the Constitution that the provisions on taxation should have been emphatic that the tax regime is unified. Taxation powers of the national government and county governments are well defined in the Constitution. However recent media report evidence otherwise through published news articles that have brought out counties as sourcing revenue from unconstitutional sources and in turn affecting the business community.

Kenya Association of Manufacturers, in an article published in Business Daily[29]. The article titled "*Businesses bleed from County woes and double charges*" detailed the challenges that manufacturers are facing while trading in the new devolved government system due to the taxes, fees and charges that the County Governments are levying. The article provided that the ugly side of devolution had begun to rear its head in an unprecedented move tantamount to creating illegal trade barriers, over 10 Counties that had introduced illegal fees and charges without consultation in a manner that will kill industry in Kenya. The Counties mentioned in the article included Machakos, Kwale, Malindi, Taita Taveta, Mombasa, Kilifi, Homabay, and

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[28] Onesimus Kipchumba Murkomen, the Kenyan Constitutional and Legal Framework and its Implication on Business, for Kenya Association of Manufacturers, page 18, 2012

[29] Kenya Association of Manuacturers, Opinion Edition "Businesses Bleed from County woes and double charges", Business Daily, 30 July 2013, page 23

Kajiado among others. This, the article stated, was against the Constitution Article 209 (5) which provides that *"Taxation and other revenue raising powers of a county shall not be exercised in a way that prejudices national economic policies, economic activities across county boundaries or national mobility of goods, services, capital or labor."*

It is argued that Kenya's devolution process was drastic and that a sequential process should have been adopted in order to cushion the citizens and all other stakeholders in Kenya and in the region time to adapt to the new system. It would have also given the national and county governments more time to understand and implement their roles. Tulia Falleti proposes a *sequential theory of decentralization* that has three main characteristics: a) it defines decentralization as a *process*; b) it takes into account the *territorial interests* of bargaining actors; and c) it incorporates *policy feedback effects* in the analysis of bargaining situations. She argues that the sequencing of different types of decentralization (fiscal, administrative, and political) is a key determinant of the evolution of intergovernmental balance of power. She measures this evolution in the four largest Latin American countries and applies the theory to the two extreme cases; Colombia and Argentina and establishes that contrary to commonly held opinion, decentralization in Argentina did not increase the power of Governors and Mayors relative to the President. In contrast, in Colombia, a different sequence of decentralization reforms led to higher degrees of autonomy of the Governors and Mayors relative to the President.[30]

Falleti establishes that decentralization does not always transfer power to governors and mayors. Decentralization policies such as unfunded administrative decentralization make sub-national executives more dependent on the national government for fiscal resources. The national Government in return remains in control of the fiscal and political decentralized policies. This is a true reflection of the Kenya situation whereby upon devolution of the fourteen functions, Counties continue to rely on the national Government for revenue in order to execute their functions. In return, the National Government remains an overseer of the activities undertaken by counties a good example being the annual Auditor General's reports that reports on the annual expenditures by County Governments. This situation then translates to the fact that in the national Government's influence on fiscal policies, there needs to be greater influence and guidance. Falleti further establishes that the sequential theory of decentralization through sequencing of the different types of decentralization; fiscal, administrative and political leads to more economically independent devolved units. Her article relates to this research in that as the researcher tries to establish possible solutions to inter-county trade challenges that have affected trade in the EAC region, County Governments need to re-consider the

[30] A Sequential Theory of Decentralization and its effects on the Intergovernmental Balance of Power: Latin American cases in comparative perspective, Tulia G. Falleti, Working Paper # 314 - July 2004, The Helen Kelogg Institute for International Studies.

decentralization process that was adopted in the country and how best it should work for them to yield economically independent devolved units.

Institute of Economic Affairs (IEA) hold the view that the Kenyan model of fiscal decentralization is that it is not comprehensive; lacks coordination mechanism and autonomy from political interference.[31] In addition, it is not self sustaining as it is highly controlled by the central government, which therefore explains why the County Governments are eager to collect revenue from the available sources in the Counties, businesses being the main target, in order to create some fiscal independence from the control of the national government.

In a study report by KAM, it established that although the Licensing Laws (Repeals and Amendments) Act, 2006 attempted to cut down the number of business-related licenses required by distributors of goods or providers of services in Kenya, nearly 300 licenses survived the 2006 World Bank Licensing reforms experienced in Kenya. While some of these licenses are justified, there is needed to make the process of obtaining them simple. For instance, there is need to consolidate them so that they can be obtained without having to conduct multiple visits to various offices. To simplify the process, it could be through establishing a one-stop shop for licenses, for instance. The study further states that the challenges to the EAC freedom on free movement of goods and capital concerns ignorance among business people, some government officials and citizenry at large. The ignorance denies many the benefits

[31] Devolution in Kenya Prospects, Challenges and the Future, IEA Research Paper Series No. 24.

of the EAC Customs Union.[32] The KAM study does not delve into suitable mechanisms to address inter-county trade challenges that have affected trade in the EAC region. It is this gap that this research shall seek to fill.

1.6.4 Summary of Literature Gaps

From the foregoing, it is evident that a lot of scholars have addressed the regional trade subject with a lot of them focusing on key components of trade such as barriers to trade. A lot of them too have addressed the subject of devolution by mainly trying to demystify the subject hover none has written on its impact on any regional trade. For EAC, this research shall contribute to new knowledge on the impact of devolution in the EAC regional trade.

1.7 Theoretical Framework

The theoretical framework for this research is the theory of Economic Integration as advanced by Francois Perroux,[33] M.A. Heilperin,[34] and Bella Balassa.[35] The meaning and basic assumptions of the theory and its key role in international relations shall be of great importance in this research in establishing the basic tenets of economic integration and the expectations from Partner states in each stage of integration in so far as each advances different developmental tools to grow their economies.

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[32] The Kenyan Constitutional and Legal Framework and its implication on business and the five freedoms under East African Common Market, KAM, 2012

[33] Francois Perroux, L'europe sans rivages (Paris: Presses Universitaires de France, 1954), p. 419

[34] M.A. Heilperin, "Economic Integration: Commercial and Financial Postulates," in European Integration, ed. C.C. Haines (Baltimore: Johns Hopkins Press, 1957), p.126

[35] Bella Balassa, The Theory of Economic Integration, 1962

Integration is the bringing together of parts into a whole. It is a process and a state of affairs that encompasses measures designed to abolish discrimination between economic units belonging to different national states; viewed as a state of affairs, it can be represented by the absence of various forms of discrimination between national economies.[36]

In interpreting this definition, distinction should be made between integration and cooperation. The difference is qualitative as well quantitative. Whereas cooperation includes actions aimed at lessening discrimination, the process of economic integration comprises measures that entail suppression of some forms of discrimination, for example, international agreements on trade policies belong to the area of international cooperation, while the removal of trade barriers is an act of economic integration. In distinguishing between cooperation and integration, the main characteristic of the latter – the abolition of discrimination within an area – is put into clearer focus and it gives the concept clearer definite meaning without unnecessarily diluting it by the inclusion of diverse actions in the field of international cooperation.[37]

Economic integration can take several forms that represent varying degrees of integration. These are a free-trade area, a customs union, a common market, an economic union and a complete economic integration. In a free trade area, tariffs (and quantitative restrictions) between the participating countries are abolished, but each

[36] Ibid
[37] Ibid

country retains its own tariffs against non-members. Establishing a customs union involves, besides the suppression of discrimination in the field of commodity movements within the union, the equalization of tariffs in trade with nonmember countries. A higher form of integration is attained in a common market, where not only trade restrictions but also restrictions on factor movements are abolished. An economic union, as distinct from a common market, combines the suppression of restrictions on commodity and factor movements with some degree of harmonization of national economic policies, in order to remove discrimination that was due to disparities in these policies. Finally, total economic integration presupposes the unification of monetary, fiscal, social and countercyclical policies and requires the setting up of a supra-national authority whose decisions are binding for the members states.[38] The EAC has successfully gone through three stages of Integration and this is Free Trade Area, Customs Union and Common Market and is currently working towards realizing a Monetary Union and a Political Federation.

In adopting the above definition, the theory of economic integration will be concerned with the economic effects of integration in its various forms and with problems that arise from divergences in national monetary, fiscal and other policies. The theory of economic integration can be regarded as a part of international economics, but it also enlarges the field of international trade theory by exploring the impact of a fusion of national markets on growth and examining the need for coordination of economic policies in a union. The theory of economic integration

[38] Ibid

should incorporate elements of location theory too. The integration of adjacent countries amounts to the removal of artificial barriers that obstruct continuous economic activity through national frontiers, and ensuing relocation of production and regional agglomerative and deglomerative tendencies cannot be adequately discussed without making use of the tools of locational analysis

1.8 Hypothesis

This study shall test the following hypotheses:

I. Empowering of intergovernmental mechanisms is the ultimate solution to resolve inter-county trade challenges that have impacted on regional trade.

II. In order for the devolved units to thrive and raise their desired revenue, they have to provide a conducive environment for businesses to thrive.

III. Devolution in Kenya has a negative impact on the EAC Regional Trade

1.9 Research Methodology

This research shall use data from reliable secondary sources mainly from existing scholarly literature, including books, journals, research papers, official government and Non – Governmental Organizations' reports and gazette articles and qualitative method to analyze data. Qualitative method typically relies on four methods for information: analyzing documents and material culture, observing directly, participating in the setting and interviewing.

The framework for the collection and data analysis to be employed by this research shall be case study research design. This is a scientific tool that is used to explore phenomena in a single case. It is a detailed and intensive analysis of a case that is used to draw conclusions.

The researcher's main mode of data collection shall be through, interviews, secondary information that will be largely obtained from the following; publications, news paper articles and journals, policy positions, textbooks, law reports that is, from reported cases and from the guidance and instructions of my Supervisor.

1.10 Chapter Outline

1.10.1 Chapter 1:- Research Proposal

This will basically include the proposal as laid out herein above. It sets out a detailed background of the study, objectives and the justification of the study among others.

1.10.2 Chapter 2:- The Progress made by Kenya in the EAC Regional Integration process

This chapter shall evaluate the progress made by Kenya and the various measures taken to ensure that the country implements regional integration.

1.10.3 Chapter 3:- The role Devolution has played in spurring Economic Development in Kenya

This chapter shall examine the role that devolution has played over the last two years and seven months as a development tool aimed at spurring economic development for the country.

1.10.4 Chapter 4:- Suitable Measures for Kenya to improve its business environment and investment climate under a regional setting

This chapter shall suggest suitable mechanisms to address the various challenges posed by devolution on regional trade within EAC from an academic point of view. This chapter shall include academic recommendations that the Government of Kenya can adopt in order to ensure that the country remains compliant with the regional Treaty and its protocols while upholding the Kenyan Constitution.

1.10.5 Chapter 5:- Conclusion

The conclusion shall provide a summary finding of the research in a paragraph or two. It shall contain the main recommendations made based on the findings of this research.

CHAPTER TWO: PROGRESS MADE BY KENYA IN THE REGIONAL TRADE INTEGRATION PROCESS

2.1 Development of EAC Regional Trade Integration

Regional trade integration is a cornerstone of EAC Partner States' trade policies. Within the African context, the Eastern and Southern Africa region has several regional integration arrangements in addition to membership into the continental African Union (AU). These include the East African Community (EAC), the Common Market for East and Southern Africa (COMESA), the Intergovernmental Authority on Development (IGAD) and the Southern African Development Community (SADC). At present, the EAC is viewed as the most progressive regional bloc.

After the collapse of the former EAC in 1977, efforts to revive it can be traced to the 1993 Agreement Establishing the Permanent Tripartite Commission for East African Co-operation. In 1999, this was upgraded into a Treaty for the Establishment of the East African Community. Since then, key milestones have been reached and achievements made, including: the establishment of sectoral councils and committees to articulate each of the co-operation areas agreed upon; launching of the Second East African Community Development Strategy (2001-2005) by the Heads of State on 24 April 2001; commissioning of the EAC Statistical Database; launching of the EAC Customs Union on 1st January 2005; establishment of various organizations including the East African Business Council (EABC) to facilitate the participation of civil society, professionals, women and the private sector in the regional integration process, the joining of Rwanda and Burundi into the EAC Customs Union among others.

In addition to these, some of the specific and important achievements made to date include: internal tariff elimination in accordance to the EAC Customs Union Protocol implementation which is on course. Reduction of non-tariff barriers on cross-border trade; harmonization of more than three hundred standards, enactment of the Standards Quality Measurement and Testing Law in 2007, paving the way for mutual recognition of standard marks from national bureaus of standards, initiation of harmonization of investment incentives and codes, and publication of the Investors Guide to East Africa; positive progress in harmonization of customs policies and procedures, including adoption of a standardized single entry document, adoption of a common external tariff for the region, harmonization of banking rules and regulations, pre-shipment requirements, institutionalization of pre- and post-budget consultations and regular sharing of information.

Notable progress has been made in the area of transport and communications, including implementation of the East African Road Network Project, establishment of task forces to harmonize road transit charges and address road safety, identification of regional railway transport projects, various projects in posts and telecommunications, implementation of the East African Civil Aviation Safety project, and various projects on inland waterways transport.

Other major milestones on immigration, including the introduction of the East African Passports and Temporary Passes, reintroduction of the Interstate Passes, abolition of charges for temporary importation of private vehicles across the borders, and the establishment of special immigration counters at the airports for East African travelers. The development of the EAC Private Sector Development strategy, in line with EAC Treaty's recognition that the private sector should be at the heart of the EAC strategy for accelerating regional growth, creating wealth, elimination of poverty and enhancing international competitiveness, is also notable.[39]

In 2010/11, the average economy in the EAC ranked 115th, globally, in the ease of doing business. Compared with other regional blocs, the EAC ranked better than the COMESA which was 126th, but fell slightly behind the SADC which was ranked 114th. Yet performance across the EAC economies evidenced varied results. Rwanda was ranked 45th globally in the ease of doing business, followed by Kenya (109th), Uganda (123rd), Tanzania (127th), and Burundi (169th).[40]

As at December 2014, only twenty non-tariff barriers (NTBs) were reported as unresolved; four new NTBs were reported one being the introduction of county

[39] Deepening Regional Integration through greater Private Sector Involvement, East African Business Council, pgs 5, 6, 7, 14, 15; 2008
[40] The East African Community after 10 Years – Deepening Integration, the World Bank, 2009 publication, pg 3

related taxes, fees and charges in Kenya. Seventy one NTBs were reported as resolved cumulatively. Among the twenty existing NTBs, Kenya had six, Uganda five, Tanzania nine, Rwanda none and Burundi none.[41]

2.2 Liberalized Trade under the East African Community

Trade liberalization refers to the removal of obstacles to free trade. The Protocol on Establishment of the East African Community Customs Union was signed by three East African Heads of State on 2 March 2004. Thereafter the Republics of Rwanda and Burundi joined the Customs Union in 2008 and started applying its instruments in July 2009. The objectives of the EAC Customs Union include to further liberalize intra-regional trade in goods on the basis of mutually beneficial trade arrangements among Partner States, to promote efficiency in production within the Community, to enhance domestic, cross-border and foreign investment in the community; and to promote economic development and diversification in industrialization in the Community.

With the coming into force of the Customs Union Protocol, partner states agreed to eliminate all internal tariffs and other similar charges on trade between themselves. It was further agreed that the establishment of a Customs Union would be progressive in the course of a transitional period of five (5) years.

[41] EAC Time Bound Programme on Elimination of Non-Tariff Barriers, EAC Secretariat, December 2014, pgs 2,3 and 4

Partner States immediately agreed that goods to and from Uganda and Tanzania into Kenya shall be duty free, however goods from Kenya from Kenya were grouped into two categories that is category A goods were eligible for immediate duty free treatment. Category B goods had the then present tariffs phased out over a five year period. A three band Common External Tariff (CET) was also established with a minimum rate of 0%, a middle rate of 10% and a maximum rate of 25%. Partner states undertook to review the maximum rate of the CET after a period of five years from the coming into force of the Customs Union. This year, the CET is undergoing a review after the lapse of five years since the last review and partner states are working on their positions to inform the revised CET, with the intension of encouraging investment and backward linkages to create economic interdependence.

Further partner states agreed to remove all non-tariff barriers and that no new non-tariff barriers would be imposed. They also undertook to formulate a mechanism for identifying and monitoring the removal of all these NTBs, which mechanism is currently in place and referred to as the EAC Time Bound Programme on Elimination of Non-tariff Barriers to Trade[42].

[42] East African Community overview of the Protocol on the Establishment of the EAC Customs Union, http://www.customs.eac.int, viewed on 3 August 2015.

2.3 Measures undertaken by the Government of Kenya to Promote Regional Integration within the East African Community

Kenya has been at the fore front in championing the implementation of the EAC Customs Union, Common Market and other regional instruments aimed at full integration of EAC. Kenya has always been viewed as the big brother by the other partner states. This has led to other partner states borrowing from Kenya best practices in policy development, setting up of governance structures as well as borrowing various administrative models. Kenya has also ensured that there is a Ministry responsible for handling EAC matters. The country's vibrant private sector and civil society has also helped to ensure that the integration process is efficient and beneficial to the country's economy.

2.3.1 National Policy Frameworks on Regional Integration

2.3.1.1 National Regional Integration Strategy and Implementation Plan for Kenya

In order to further enhance regional integration, Kenya embarked on a major project whose main objective is to develop a Regional Integration Strategy (the strategy) and Implementation Plan. The full implementation of the strategy is expected to facilitate coherence, and thus a common government-wide approach, in carrying out regional integration activities. Ultimately, the strategy should lead to increased market access and investment opportunities for Kenya by addressing certain critical issues in the regional integration environment.[43]

[43] National Regional Integration Strategy and Implementation Plan for Kenya, 2013, pgs 6, 10, 24

The strategy recognizes the critical role of economic development played by the county governments and states that matters of international relations, and in particular regional integration, shall be factored at the national level into the operations of county governments to ensure compliance with commitments. The strategy makes provision for building the capacity of County officials on trade facilitation. It places a burden on Ministry responsible for Trade, Ministry responsible for EAC, Ministry responsible for Industry, Ministry responsible for Planning, Office of the President /Public Service, Ministry responsible for Foreign Affairs, National Parliament and State Law Office; to ensure that the concepts of EAC regional integration are integrated into the county systems and processes. All these have been realized due to the fact that constitutional reforms experienced in Kenya were aimed at boosting the country's economic development and devolution is one of the key tools/vehicles for realization of this.[44]

Kenya's trade regime is currently defined by the EAC tariff structure of zero per cent for capital goods and raw materials, ten per cent for intermediate goods, and twenty five per cent for final goods. There is also a shortlist of negative products consisting of select textiles, sugar, rice, wheat flour, and milk and milk products that are excluded from trade liberalization. The net effect of this kind of structure is stability and the predictability of the regional trade regime. The widely spread benefits from the EAC Customs Union was a major boost to the speedy negotiations and conclusion

[44] Ibid

of the EAC Common Market Protocol in a record two years. This has been a major strength for Kenya in the regional integration process however the County Governments seem not to be on board with the milestones realized so far by the country.[45]

The strategy notes that Kenya has not reaped the full benefits of regional integration. The challenges to effective regional integration by Kenya include prevalence of non-tariff barriers, trade facilitation limitations, and a weak and inefficient institutional infrastructure coupled with inadequate enforcement machinery and sanction mechanisms. It identifies that Kenya lacks coherence in the coordination of regional integration activities among government ministries and departments, and between the public and private sectors leading to less than optimal benefits from the country's regional integration initiatives. The current silo-based management arrangement results in segmented regional integration activities that inhibit cross regional economic community programme partnerships and information sharing between implementing bodies and beneficiaries. Further, the lack of coordination among key stakeholder's results in limited dialogue and involvement in the programme cycle of regional integration activities. These doubled with the absence of a national character enforcer challenge the implementation of regional integration in the Kenyan devolved County Governments.

[45] Ibid

2.3.1.2 Regional Integration Policy for Kenya

The overall objective of the Regional Integration Policy is to enhance Kenya's ability to maximize on the opportunities in the Regional Economic Communities it participates in, and to enable Kenya's ability to better integrate into the global economy. To achieve this objective will require a sustained coherent government wide approach to harness regional integration to address national challenges like poverty, unemployment, insecurity, inadequate infrastructure, energy deficit, trans-boundary resources.[46]

The policy identifies that the international community is moving towards economic diplomacy where the use of the full spectrum of economic and cultural tools of the State are applied to achieve national interests. Economic diplomacy activities include export and import relationships, investment, lending, aid, and entering free trade agreements. A country uses economic resources, either as rewards or sanctions, in pursuit of a particular foreign policy objective. These can be heightened with cultural diplomatic activities to support the exchange of ideas, values, traditions and sharing aspects of diverse cultures and identity to strengthen relationships, enhance socio-cultural cooperation and promote national interests.

[46] Regional Integration Policy for Kenya, April 2014, pages iv, 3, 5, 7, 25, 32

The policy objective on advancing Kenya's interests through innovative diplomacy is to deepen economic and commercial diplomacy for strengthened relations with partners, and enhanced market access for labor, goods, services and capital, and protect Kenya's external investments. In order to achieve these, Kenya will pursue economic and cultural diplomacy initiatives to leverage its strategic location and secure its economic and political interests. In this regard, the government shall: promote market access for labor, goods, services and capital through economic cooperation and strategic partnerships and agreements; deepen economic and commercial diplomacy to stabilize markets and improve relations with partners; leverage regional economic communities in solving regional challenges using regional political economy frameworks; enhance cultural exchange programmes; and Promote facilitative regional integration immigration policies that enable easy movement of labor across the region.[47]

The national regional integration policy brings on board all sectors of the economy and both the national and county governments and further takes on board the tenets of open regionalism, greater private sector participation, rationalization of regional integration activities, adoption of the multi-speed/variable geometry approach, encouragement of member countries to support regional integration initiatives, compensation mechanisms, promotion of collaborative work with other institutions; and promotion of regional and multilateral cooperation on cross-cutting issues.

[47] Ibid

2.3.1.3 Kenya Foreign Policy

Kenya's Foreign Policy is barely one year old since its enactment. The Policy seeks to pursue the national objectives of; protecting Kenya's sovereignty and territorial integrity, promoting sub-regional and regional integration and co-operation, enhancing regional and global peace and security, advancing the economic prosperity of Kenya and her people, projecting Kenya's image and prestige, promoting international cooperation and multilateralism, promoting and protecting the interests of Kenyans abroad; and enhancing partnership with the Kenya Diaspora and descendants. These objectives will be pursued through five key inter-linked pillars of Kenya's Foreign Policy which include economic, peace, environmental, cultural and Diaspora. The guiding principles The execution of Kenya's Foreign Policy and the conduct of her international relations are guided by the principles of sanctity of sovereignty and territorial integrity of the Republic of Kenya, peaceful co-existence with neighbors and other nations, resolution of conflicts by peaceful means, promotion of regional integration, respect for the equality, sovereignty and territorial integrity of states; and respect for international norms, customs and laws.[48]

The policy identifies that Kenya's quest for a peaceful and stable environment is linked to its socio-economic development and prosperity, and that of the region. A robust economic engagement is necessary to secure Kenya's regional and overall economic objectives in line with the Kenya Vision 2030. The objectives of the

[48] Kenya Foreign Policy, November 2014, pages 5, 6, 11, 12, 13, 21, 22, 23

economic pillar in the policy include to: (a) increase capital flows to Kenya and the East African region; (b) support export promotion and investment by Kenyan enterprises within the region and beyond; (c) promote the country as a favorite destination for foreign direct investment, tourism, and conferencing; (d) expand access to traditional markets and explore new destinations for Kenya's exports; (e) enhance technological advancement by exploring new sources of affordable and appropriate technology; (f) support the exploration of alternative sources of traditional and renewable energy; (g) strengthen regional economic communities and organizations to serve as competitive spring boards to emerging and global markets; and (h) promote fair trade and equitable bilateral, regional and multilateral trade agreements.

In order for Kenya to achieve its Foreign Policy objectives and priorities, County Governments have been identified as fundamental institutions towards this. This therefore means that the administration of County Governments' functions and the general processes has a direct impact on the implementation of the Country's Foreign Policy and the realization of its objectives.

2.3.1.4 National Trade Policy

The national trade policy for Kenya aims at promoting and expanding of Kenya's exports of goods and services; and the development of an efficient and competitive domestic market.[49] The Policy identifies the fact that for trade sector to play its

[49] National Trade Policy, April 2009, pages 7, 8, 10, 21, 34

important role in economic growth, industrialization and hence poverty reduction, several elements need to work together in synergy: better national development strategies that integrate trade as a key component; increased and effective national and international financial and technical assistance for developing production and trade capacities; and a more enabling national and international trade environment. Improvements in the international and domestic trade will have an impact on economic growth and poverty reduction only if the government has sound integration plans for both the international and domestic trade policies.

The previous chapters have discussed the ways in which the international trade policy and domestic trade policy could be supportive in the economic development. This chapter focuses on the other key elements of a National Trade policy: linkages between national and international trade policies; prioritization and sequencing of issues; monitoring and evaluation; overall institutional structures and responsibilities and the review mechanisms.

Though the Policy was enacted before the inception of the devolved system of Government, it identified that the challenge to government then, was to rationalize the trade licensing regime and reduce the tax burden without compromising the provision of public amenities that are necessary for the growth and development of business enterprises in the country.

CHAPTER THREE: THE ROLE DEVOLUTION HAS PLAYED IN SPURRING ECONOMIC DEVELOPMENT FOR KENYA

3.1 Devolution in Kenya

Devolution refers to a transfer of jurisdiction and authorities to territorial, indigenous and self governments, from the central government ranging from authority over such areas of health, to the regulation of lands and resources.[50] Through devolution, new units of government are created outside direct control of national government. Devolution is understood from the broader concept of decentralization. Decentralization Theory relies on the notion of *"Fiscal federalism"*[51] which contends that the Central Government should have the basic responsibility for the macroeconomic stabilization function and income redistribution in the form of assistance to the poor.

According to Musgrave[52], there are three economic functions that should be assigned to the Government: *stabilization, distribution and allocation*. Oates[53] formulated the decentralization theorem which confirms the inefficiency of uniform service provision by central Government. He argues that if there are no economies of scale from centralized provision, welfare can be maximized by diversifying services in accordance with local needs.

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[50] The Kenyan Constitutional and Legal Framework and its implication on business and the five freedoms under East African Common Market, Kenya Association of Manufacturers (KAM), 2012
[51] Richard Musgrave's (1959)/1989, Wallace Oates (1972)/1991
[52] Ibid
[53] Oates (1991)

Decentralization is therefore regarded as a process through which powers, functions, responsibilities and resources are transferred from central to local Governments and/or to other decentralized entities. Decentralization may take different forms which include Privatisation, Deconcentration, Delegation and Devolution.

It is argued that Kenya's devolution process was very ambitious and that a gradual process ought to have been followed in especially the transfer of powers from the central Government to the county governments. The day after the March 2013 general elections in Kenya, counties were expected to commence their operation. Later in the same year, all the fourteen functions listed in the fourth schedule of the Constitution as belonging to the counties, were transferred vide a single Legal Notice.[54] The transfer of these powers led to the need for the counties to generate their own revenues in order to be able to undertake the functions devolved in light of the fact that the money allocated to the counties annually is not enough to meet county operations. The Kenyan situation is a pure case of fiscal decentralization which refers to the devolution of power and responsibilities of national (central) government towards sub-national (local) governments.

In proposing a sequential theory of decentralization, Falleti argues that political decentralization takes place first, it enhances the bargaining power of sub national actors in subsequent rounds of negotiations over other types of decentralization. In this case, fiscal decentralization is likely to follow, with administrative

[54] Legal Notice No. 16 of 2013

decentralization occurring last. This sequence of reforms leads to a higher degree of autonomy for governors and mayors. At the other extreme, if administrative decentralization takes place first and is followed by fiscal decentralization and then political decentralization, this sequence of reforms enhances the power of the national executive and sets serious fiscal constraints on sub national executives.[55] An end result of the later would be introduction of revenue streams that affect the county citizenry, while in a rush to meet the revenue deficits. Some of the revenue streams could be in the form of levies, fees, charges and taxes.

3.2 Local Governance in the EAC Region

Local governments or local government authorities are a system whereby the national government allows the establishment of local levels of government with powers and authority to make decisions on local priorities and actions and to mobilize local resources for development. This definition identifies local governments as spheres of government with a level of autonomy over decisions, planning and resource mobilization and application. By this definition local governments in East Africa still have progress to make as they remain in most cases largely dependent on their national governments. However, the decentralization process is also seen and reflected in how the policy, regulatory, institutional and financial arrangements are organized between levels of government. This distribution has a significant impact on the efficient and equitable provision of public services and this, in the five partner states of the EAC, ranges from mundane technical adjustments to public

[55] Supra note 29

administrations that are largely agents of the state (Burundi and Tanzania) to radical redistribution of political power between central governments and relatively autonomous local governments (Rwanda, Uganda and now Kenya), resulting in national policy frameworks and entrenchment in country constitutions.

The rationale for promoting and effecting a people-centered and market driven EAC integration process that is anchored on the vibrant role of local government is premised within the EAC treaty itself. The Treaty emphasizes the strengthening and consolidation of traditionally existing political, socio-economic and cultural ties between partner states peoples in the promotion of a people centered mutual development. It further lays out the operational principles including (a) people-centered and market driven co-operation; (b) the provision by the partner states of an enabling environment such as conducive policies and basic infrastructure (d) the principle of subsidiarity with emphasis on multi-level participation and the involvement of a wide range of stakeholders in the process of integration (f) equitable distribution of benefits and measures to address economic imbalances and (g) the principle of complementarity. This role of the local government should be cognizant of the free market the region has adopted that encompasses free movement of labor, goods, services and capital across the East African Community. The Treaty further sets the ground for creating an enabling environment for the civil society and private sector. It calls for promotion and continuous dialogue to improve the business environment, and to stimulate market development through infrastructural linkages and the removal of barriers and constraints to market development and production[56]. But it is not be enough to have the legal frameworks and dispensation without any focus on its practical application to the prevailing reality on the ground and in particular the task of mainstreaming local government within the broad framework of the integration process to avoid being found to be the organs derailing the regional integration progress.

It is from this background that the East African Local Governments Association EALGA was formed as an umbrella organization for National Associations of Local Governments in the partner states. It was expected that each partner state would form a National Association of Local Government Authorities who are considered as the founder members of EALGA. The EALGA is considered as a useful forum for civic education towards strengthening Local Authorities as important levels of government that require to be fully on board in the regional integration process. The vertical re-organization of tasks between the central government and the local authorities (decentralization) and the horizontal re-adjustment of competences as between local authorities and markets, both improve the suitability of local authorities as forums for civic engagement within an integrated common market dispensation. These forums require being fully onboard of any integration process in order to facilitate trade and the full realization of regional economic integration.

[56] The Treaty on Establishment of the EAC, 1999 as amended on 14th December 2006 and 20th August 2007, Articles 5, 3(d), 7, 76, 127, 128

3.3 Milestones realized by the devolved units in Kenya since their Inception

Counties successfully commenced operations immediately after the 2013 general elections. They all inherited the former local authorities systems and so far, all counties have managed to establish themselves as strategic hubs for investment. Counties have successfully legislated on revenue raising frameworks such as the Finance Act though challenges have been experienced relating to double taxation.

There have been conflicts on the role of each level of government plays in relation to taxes applied in counties hence this has led to double taxation. Double taxation has largely affected traders in the country as well as in the EAC region. Progressive consultations between the national and county governments have taken place to deliberate on the matter so as to ensure an effective tax regime at each level of government. This is an ongoing process as the issue has not been resolved.

The County Governments in order to promote effective taxation regimes, are working towards ensuring that the licensing regime is business friendly within the country by application of rationale in the licenses and fees where licenses issued are related to service provision. Counties are trying to work together to adopt a common code of business licensing. Though establishment of County Budget and Economic Forums (CBEF), counties are putting up mechanisms in place for consultations with the business community in the county and the general public in the development of all the plans and legislation in the counties. Currently 35 counties have established the Forums with 12 being work in progress.

Through the help and guidance of the Council of Governors, counties are working towards establishing an “Open County "platform. This will be an online platform for sharing of information on the performance of the counties in the execution of their functions with the objective of learning and promoting of best practice and where necessary, initiating preventive or corrective action. This platform shall also be an accountability tool as it shall be accessible by the public.

Counties now appreciate the need for an effective performance management system and some have initiated processes of establishing and institutionalizing performance management tools such as performance contracts, citizen score cards among others.

3.4 Impact of Devolution in Kenya on the free mobility of goods in the EAC Region

Two years into Devolution, the business community in the EAC region is confronted with the issue of inability to freely move their goods through Kenya because they are forced to pay similar charges and levies in multiple counties while trading through Kenya. The multiplicity of taxes, fees and charges in the new devolved units in Kenya was first reported at the EAC level by Tanzania during the 12th EAC Regional Forum on Non-Tariff Barriers to Trade held in October 2013, as an introduction by Kenya of new non tariff barriers to trade through its new devolved system of Government. Double taxation has largely limited revenue collection by county governments resulting in reduced service delivery.

The Constitution of Kenya entered into force on 27th August 2010 after a long process of review. It has been hailed as 'one of the most progressive' constitutions in the world. In a radical departure from the repealed Constitution, the 2010 Constitution has introduced far reaching reforms in the structure and organization of government, key among them being introduction of a devolved system of Government, introduction of sweeping checks and balances on governmental power, enhanced individual freedoms, and increased probity over public finance, among other changes.

The connection between decent politics, open, accountable and democratic government on one hand, and economic progress on the other, cannot be over emphasized. In business and investment, political stability, business-friendly environment and promise of economic prosperity are essential. A good constitution is one that sets the stage for these fundamentals to exist. Fortunately the drafters of our Constitution envisioned this and made provision stating that the taxation and other revenue-raising powers of a county government shall not be exercised in a way that prejudices national economic policies, economic activities across county boundaries or the national mobility of goods, services, capital or labor.[57]

This provision hails and implements that EAC Treaty as well as the Common Market Protocol[58] which the later, among other things, makes provision for the free movement of goods, services, labor and capital across the region. The EAC treaty

[57] Article 209 (5) of the Constitution of Kenya 2010
[58] Articles 2 and 6 of the Protocol on Establishment of the EAC Common Market.

makes provision for co-operation in trade liberalization and development[59]. The East African Community Protocol on the Establishment the EAC Customs Union[60] makes provision on trade facilitation by all Partner States. In doing so, it is expected that partner states reduce the number and volume of documentation required in respect of trade among the Partner States, adopt common standards of trade documentation and procedures within the Community where international requirements do not suit the conditions prevailing among the Partner States, ensure adequate co-ordination and facilitation of trade and transport activities within the Community, regularly review the procedures adopted in international trade and transport facilitation with a view to simplifying and adopting them for use by the Partner States, collect and disseminate information on trade and trade documentation, promote the development and adoption of common solutions to problems in trade facilitation among the Partner States and establish joint training programmes on trade.

In light of the regional integration milestones realized by Kenya and by the entire EAC region, the introduction of multiple charges, fees and levies by the County Governments in Kenya evidences a backward step for Kenya in the realization of the full EAC integration through removal of trade barriers. Noteworthy is the fact that devolution is only two years old and the situation can be rectified. The impact though is on both Kenyan traders as well as traders from the other EAC Partner states.

[59] Article 74 of the Treaty on Establishment of the East African Community

[60] Part D, Articles 6, 10, 11, 12 and 13 of the East African Community Protocol on the Establishment the EAC Customs Union.

Management of business licenses and general trade regulation after devolution is still constrained in the pre-devolution era and worse still; the new regime's procedures affect both national and regional traders while they move their goods across the region. Multiple and different fees and charges introduced by the devolved units include demands for multiple single business permits for distribution of goods, vehicle branding charges in each county that tracks pass through, entry charges, pass through charges, port levies in Mombasa among others. These challenges continue to affect traders and absence of a national character enforcer of business regulation in the Country presents more challenges in ever having the issues resolved soon.

CHAPTER FOUR: SUITABLE MEASURES FOR KENYA TO IMPROVE ITS BUSINESS ENVIRONMENT AND INVESTMENT CLIMATE UNDER THE EAC REGIONAL SETTING

4.1 Introduction

A private sector-led economic growth, both by local and foreign investors, has since the early 2000s, been Kenya's Priority. The Government's business-friendly stance has rolled over into Vision 2030, which sets development benchmarks for a number of priority sectors. This has been complemented by the integration of the EAC and the establishment of an EAC customs union and an EAC common market.[61]

The sectors that mainly contribute to economic growth are building and construction, infrastructure development, manufacturing, transport and services, and tourism particularly from emerging markets; agriculture, and wholesale and retail.

Doing business in Kenya has hardly improved according to a World Bank (WB) report released late 2014. The 2015 WB ranking of countries on the basis of how easy it is to do business in them, ranked Kenya 136th among the 189 countries evaluated.

While Kenya enjoys several advantages such as its strategic location, good economic performance across all sectors a strong demography with an emergence of a new middle class. The country faces certain challenges especially in food security due to its dependence on rain fed agriculture. There are also concerns and uncertainty over

[61] Kenya Investment Authority, http://www.investmentkenya.com/doing-business/business-environment , 20 May 2015

political stability and implementation of key economic reforms following the promulgation of a new constitution in 2010. Other issues revolve around governance and infrastructure. This however is mitigated by a strong political and social will to implement changes. Through devolution, Kenya intended to be able to mitigate these challenges by taking services closer to the people thus stimulating economic growth and development of the country. The purpose for which counties came into existence can still be realized through government embracing certain measures.

4.2 Measures undertaken by Kenya to Promote Regional Integration in a Devolved System of Government

The State Department of East African Affairs under the Ministry of EAC, Commerce and Tourism is the mandated to oversee the EAC integration process in Kenya. In 2014, the State Department, in collaboration with Border Counties of Narok, Migori, Homa Bay, Kisumu, Bungoma, Busia, and Trans Nzoia organized a forum to scale up awareness creation and sensitization programmes on EAC Integration Process, commitments and obligations. The meeting resolved that key components of the Customs Union needed to be upheld especially the free movement of goods manufactured in the region and establishment of the Single Customs Union. This is because the objective of the Single Customs Territory is to speed up circulation of goods within the Region by collapsing national borders. This means that goods entering the region will pay duty at the first port of entry and thereafter circulate freely within the region. This then means that the county to county charges would stifle this major milestone and that Counties needed to be alive to this fact.

The same year, the Commission on Revenue Allocation (CRA) held a national conference on ease of doing business in the country in light of the devolved system of government. CRA's involvement in resolving trade challenges emanates from the mandate given to the Commission by the Public Finance Management Act[62] which provides that in imposing a tax or other revenue raising measure, a county government shall ensure that the tax or measure conforms to Article 209(5) of the Constitution and any other legislation, and before imposing any tax or revenue raising measures under this Article, shall seek views of the Cabinet Secretary National Treasury and the Commission on Revenue Allocation.

The conference established that Counties had developed laws that introduced revenue streams that affected the free mobility of goods across the country. Key recommendations from this meeting included the findings that there was need to appraise the County Government executives and legislature on regional obligations that regulate inter-county and inter-country trade in the region.

The challenges affecting the free mobility of goods in the region, as a result of introduction of trade barriers by County Governments in Kenya through tariffs, was reported to the Intergovernmental Budget and Economic Council (IBEC) in late 2014. IBEC is a forum for consultation and cooperation between the national government and county governments chaired by the Deputy President. Upon this reporting, IBEC

[62] Public Finance Management Act, 2012, Section 161

mandated the National Treasury and CRA to organize a national conference aimed at developing a National Policy on County Own Source Revenue to mitigate the challenges faced by traders that were affecting the free mobility of goods in the region. This was held in 2015 and the conference resolved that an a legal review be conducted to ensure that principle legislation at national level on imposition of various collections by Counties were aligned to the Constitution, the Public Finance Management Act and the regional instruments. It was also resolved that the counties' existing laws be reviewed under the same purpose and that any new county laws should go through the Kenya Law Reform Commission for scrutiny before enactment to avoid exposure of the country to non-compliance with regional obligations. It was also recommended that the National Treasury be the national enforcer and regulator of business activities in the country as well as the main adviser on various levies and charges to be imposed by the Counties before they commence any collection.

4.3 Improving the Business and Investment Climate

4.3.1 Corruption and Political Patronage

Corruption has long been a challenge for private sector development in Kenya. Corrupt behavior from both private and public representatives (especially in public procurement, licensing and land administration) increases the cost of doing business, creates unfair competition, favors inefficient and larger firms to the detriment of smaller players, and generally impedes private sector investment. Collection of revenue in counties is also marred by revenue loss through corruption leading to counties having to levy more taxes, fees and charges in order to bridge the revenue gaps created by corruption. Despite the ultimate decision makers at county levels being politicians, some independence is needed of the revenue policy formulators and collectors who are technocrats and who would best implement regional instruments when collecting revenue thus enhancing regional integration.

To realize a corruption and political patronage free society, automation of government processes would need to be fast tracked (that is processes relating for example to fees, tax and procurement) to increase transparency and close avenues for corrupt behavior.

4.3.2. Investment in Critical and Enabling Infrastructure

In order for Kenya to improve its business environment and investment climate under a regional setting, the government would need to accelerate investment in critical and enabling infrastructure such as energy, ICT and transportation. Lagging infrastructure increases the cost of doing business, and lowers the country's private investment appeal and competitiveness.

4.3.3 Manage Anticompetitive Behavior

This may arise due to a number of factors such as entry into Kenya of goods from other EAC states produced under incentivized schemes that then have to compete with local ones produced under non-incentivized schemes. Such goods from neighboring states will be more attractive to a consumer, even though the importer may meet some of the country's regulatory requirements. The ultimate result would be the other partner states being more attractive to invest in than in Kenya.

4.3.4 Business - Friendly Regulatory Environment

Another suitable measure would be to foster a business friendly regulatory environment. Challenges in the regulatory environment relate primarily to outdated legislation, business permit and licensing procedures that do not reflect constitution and regional obligations, taxes and levies that introduce barriers to trade among others. Furthermore, by not including Regulatory Impact Assessments (RIA) into the legislative process to ensure regulatory rigor and consistency across national and county government, the result may be the "Balkanization" of business regulation across 47 counties. This perpetuates investment uncertainty and increases the complexity and cost of doing business. The Statutory Instruments Act[63] requires that any statutory instrument that may affect business to be informed by an impact assessment. The Kenyan Government should ensure proper implementation of this law so that the country benefits from a good business regulatory environment that promotes the business environment and investment climate in the country

4.3.5 National Logistics System

A poorly developed and maintained national logistics system increases the cost of doing business, diminishes a natural advantage in the region as a central trade hub, and impinges on Kenyan business' ability to maximize EAC common market

[63] Act No. 13 of 2013

opportunities. The government of Kenya should create and drive a continuous improvement in a Single National Window to harmonize government (both at national and county levels) processes and create electronic systems in import/export; and ports efficiency and goods clearance procedures.

4.3.6 Structure national and country level regulatory and licensing frameworks

The governments should properly structure the national and county level regulatory and licensing frameworks for businesses to ensure realization of good licensing practices while at the same time addressing the revenue optimization mandates of counties. This calls for high level dialogue bringing together all key stakeholders to clarify mandates and functions in order to devise frameworks devoid of regulatory and licensing duplication and overlaps. This high level dialogue should bring together all key decision makers at national and county levels and should be informed by, among others, national and regional benchmarking, assessments of Kenya's competitiveness, the constitutional provisions and principles that inform revenue sharing including equity, need to strengthen the domestic market, and other factors.

Businesses' contribution to financing local service delivery should be delivered in form of a consolidated levy or fee. Determining fee / levy rates would then be considered within the context of the burden of tax on businesses (effective tax rate) and would be based on principles of good taxation[64].

4.3.7 Citizen Engagement and Public Participation

Kenya's constitution provides a good foundation for citizen and public participation in framing policy and legislation. However, there is need to ensure that systematic stakeholder consultation is sufficiently embedded in Government's decision making frameworks at both national and county levels. This may include requirements that regulatory entities provide evidence of systematic consultation when submitting memoranda to Cabinet at national level and equivalent instrument at county level.

[64] Principles of Good Tax Administration Practice, www.oecd.org/tax/administration/1907918.pdf

CHAPTER FIVE: CONCLUSION

It is the researcher's observation that the Government of Kenya has realized that the introduction of various levies, fees and charges by the various County Governments will stifle trade in the region which will in turn affect the free trade in the region and negatively impact the country's economy. This realization and the initial measures taken, especially of resolving the challenges through intergovernmental means, prove that the issue is being mitigated from the highest level of government. These steps confirm that empowering of intergovernmental mechanisms is the ultimate solution to resolve inter-county trade challenges that have impacted on regional trade. It also confirms that in order for the devolved units to thrive and raise their desired revenue, the government has to provide a conducive environment for businesses to thrive. Lastly, the research outcomes confirm that devolution in Kenya has some negative impact on the EAC Regional Trade that the government of Kenya is addressing.

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