UNIVERSITY OF NAIROBI

IMPACT OF KENYAN AND EAC LEGAL REGIMES ON KENYA'S PARTICIPATION AND INVESTMENT IN GLOBAL VALUE CHAINS

BY

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DECLARATION

I, **Ibrahim Emali Otiende**, do hereby declare that this thesis, which I submit to the University of Nairobi for the award of Maters Degree in law, is a product of my intellectual property, original work and all references acknowledged in the text. I have not submitted it to any other learning institution for any award.

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DEDICATION

I dedicate this masterpiece to my parents, Joshua Otiende and Veronica Apiyo. I also dedicate this thesis to my supportive brother, Howard Otiende and my lovely cousin Betty Minayo Amunga. I would not have made it without them. I thank God.

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LIST OF ABBREVIATIONS

AfCFTA	Agreement establishing African Continental Free Trade Area
ASEAN	Association for Southeast Asian Nations
AU	African Union
BUBU	Buy Uganda Build Uganda
CBK	Central Bank of Kenya
CoC	Certificate of Conformity
COIs	Certificate of Inspection
CO	Certificate of Origin
CORs	Certificate of Roadworthiness
CEOs	Chief Executive Officers
COMESA	Common Market for Eastern and Southern Africa
C.I.F	Cost insurance and Freight
CSD	Customs Services Department
DTA	Double Taxation Agreement
EPZ	Export Processing Zone
FTZ	Free Trade Zones
FDI	Foreign Direct Investment
GATT	General Agreement on Tariffs and Trade
GVCs	Global Value Chains
IDF	Import Declaration Fees
ISM	Import Standards Mark
ICDC	Industrial and Commercial Corporation

ICC	International Chamber of Commerce
IMF	international Monetary Fund
KAM	Kenya Association of Manufacturers
KEBS	Kenya Bureau of Standards
KEINIVEST	Kenya Investment Authority
KNBS	Kenya National Bureau of Statistics
KEPHIS	Kenya Plant Health Inspectorate Service
KEPSA	Kenya Private Sector Alliance
KRA	Kenya Revenue Authority
LDCs	Least Developed Countries
MUB	Manufacturing under Bond
MFN	Most Favoured Nation
MoITED	Ministry of Industrialization, Trade and Enterprise Development
MERCOSUR	Southern Common Market
NT National	Treatment
NTBs	Non-tariff Barriers
NTMs	Non-Tariff Measures
OECD	Organisation for Economic Co-operation and Development
PVoC	Pre-export Verification of Conformity
RDL	Railway development Levy
RECs	Regional Economic Communities
RVCs	Regional Value Chains
RoO	Rules of Origin
SAPs	Structural Adjustment Programmes

SEZ	Special Economic Zones
TREO	Tax Remission for Exports Office
TBTs	Technical barriers to trade
UNCTAD	United Nations Conference on Trade and Development
USA	United States of America
USD	United States Dollar
VAT	Value Added Tax
WTO	World Trade Organisation

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Industrial and Commercial Development Corporation Act Chapter 445

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Excise Duty Act No. 23 of 2015

Export Processing Zones Act Chapter 517

Foreign Investments Protection Act Chapter 518

Income Tax Act Chapter 470

Investment Promotion Act No. 6 of 2004

Registration of Business Names Act Chapter 499

Special Economic Zones Act No. 16 of 2015

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Agreement Establishing the African Continental Free Trade Area

COMESA Protocol on the Rules of Origin

East African Community Customs Management Act, 2004 2009

East African Community Elimination of Non-Tariff Barriers Act, 2017

General Agreement on Tariffs and Trade (GATT 1994)

Protocol on the Establishment of the East African Customs Union

The East African Community Customs Union (Rules of Origin) Rules

Treaty establishing The Common Market for Eastern and Southern Africa 1994

Treaty for the Establishment of the East African Community 2006

WTO Agreement on Rules of Origin

WTO Agreement on Technical Barriers to Trade

Abstract

The overall objective of this study is to address four legal questions*: first, should Kenya should liberalise its laws to encourage investment in Global Value Chains (GVCs) or should it restrict its laws to protect its economy? Second, what laws affect Kenya's participation and investment in GVCs? Third, how do the identified laws affect Kenya's participation and investment in GVCs? Fourth, how should the identified laws be designed to ensure effective participation and investment in GVCs? To address these questions, this study pinpoints problematic Kenyan laws. Bearing in mind that GVCs involves value addition in several countries, this study examines two regional legal regimes that Kenya is party to mainly COMESA and EAC to find out how they affect Kenya's investment in GVCs. The study then uses the provisions of the AfCFTA and select WTO agreements as yard sticks to find out how Kenyan and regional laws should be designed to ensure effective investment in GVCs.*

This study argues that the law plays three main roles in GVCs: first, investment laws determines entry, retention or exit of investors. Secondly, the design of tax laws attracts or repel investors. Thirdly, a law that imposes non-tax barriers or one that eliminates non-tax barriers impacts investment environment. The study argues that whereas Kenya has various factor endowments, it is unable to attract GVCs investors because it does not have proper laws on GVCs. The available laws are archaic, repels and expels investors.

The study also demonstrates that a country does not need to be resource endowed to achieve industrialisation. For example, developed countries import raw materials such as tea from Kenya, add value on the same, then export it back to Kenya at high prices leading to trade imbalances. Lack of raw materials to engage in manufacturing should not be an excuse for Kenya's underdevelopment. As opposed to importing finished products, the country should be importing relevant raw materials for value addition. This is doable by fine-tuning the laws to attract investors who may utilise comparative advantage that Kenya offers. Therefore, Kenya and EAC should enact special laws to govern investment in GVCs.

Since GVCs involve at least two countries, Kenya and EAC should apply the tenets of International Cooperation Theory, which reveals that having resources and good laws is irrelevant in absence of international cooperation. Cooperation is necessary in removing tariffs and NTBs that affect custom transactions. Ultimately, investments in GVCs leads to economic growth and development, creation of employment as well as development in infrastructure in the involved country.

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1.0.0. CHAPTER ONE

1.1.0. Introduction

"Designed by Apple in California, assembled in China" is a tagline on Apple's iPhones. Apple designs iPhones in California, USA while manufacturing of its components takes place in various countries across the globe including but not limited to Germany, Japan, South Korea and China.[1] Major suppliers of iPhone components include Toshiba, Samsung, Numunyx, Infineon, Broadcom, Cirrius Logic, Murata, and Dialog Semiconductor among other suppliers who process respective components.[2] Apple has invested in an assembling plant in China that produces iPhones. Apple then exports iPhones to USA for marketing.[3] The process is like a chain.

Another good example of a product that goes through similar chain is Airbus aircraft. Airbus is domiciled in France but various countries such as Germany, United Kingdom, Spain, USA, Canada and China are involved in manufacture of its planes such as theA320, A330, A350 and A380 aircraft.[4]

Apple and Airbus are some of the examples that indicate that the world is moving away from the archaic and old era labels of '*Made in*' to '*Made in the World*' because various countries are now taking part in production of a single product.

These two examples indicate that investors invest in fragmented production of goods across a number of countries along a chain to take advantage of various factors such as affordable labour, favourable legal environment or general availability of resources. The chain like production where investors in multiple countries are involved in production is known as Global Value Chain (GVC) or value chain.[5] GVC is a process of manufacturing goods for domestic use or for export upon value addition which differentiates it from the conventional international trade in that conventional international trade involves import and export of finished products. Since GVCs is a manufacturing process, various factors such as

[1]Yuqing Xing and Neal Detert, *How the IPhone Widens the United States Trade Deficit with the People's Republic of China* (Asian Development Bank 2010) <https://www.adb.org/publications/how-iphone-widens-united-states-trade-deficit-peoples-republic-china> accessed 17 April 2021.

[2] Ibid

[3] Ibid

[4]'Technology and Innovation' (*Airbus*) <https://www.airbus.com/aircraft/passenger-aircraft/technology-innovation.html> accessed 17 April 2021.

[5]Saon Ray and Smita Miglani, *Global Value Chains and the Missing Links: Cases from Indian Industry* (Routledge 2018).

availability of raw materials, infrastructure, technology, labour and legal environment matters. This research focuses on legal factors that influence participation and investment in GVCs.

1.2.0. Background to the Study

Drawing from Apple and Airbus examples above, GVCs involves the fragmentation in production stages involving value addition in various countries across the globe to produce components for manufacturing complete products.[6] Upon receipt of the value-added component, the importing country adds value to the component to export it, or to manufacture a final product for export.[7] Simply put, GVCs involves export and import of value-added intermediates necessary for producing final products for export. When this type of production is localised within countries in a region say the East Africa Community (EAC), then, the resultant value chain is Regional Value Chains (RVCs).[8]

The World Bank's 2020 World Development Report indicates that effective participation in GVCs has benefited many economies across the world such the economies of China, South Korea, Thailand, and Vietnam because they have been able to attract and retail FDI.[9] Similarly, IMF, WTO, UNCTAD, and OECD assert that optimum participation in GVCs leads to economic development and creates employment for citizens.[10] Due to these benefits, these multilateral institutions have been advising Kenya and other African countries to invest in GVCs by reviewing legal regimes. Despite the associated benefits, the World Bank study of the year 2019 indicates that Kenya and EAC states have not invested in value chains even though these countries are rich in resources.[11]

Manufacturing under GVCs is a complex affair which is not only affected by availability of capital but it is also affected by municipal and international laws. This is so since

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[6]Jaime de Melo and Anna Twum, 'Supply Chain Trade in East Africa: Prospects and Challenges' (HAL 2020) hal-02493410 <https://ideas.repec.org/p/hal/wpaper/hal-02493410.html> accessed 2 January 2021.

[7]Pol Antràs, *Conceptual Aspects of Global Value Chains* (The World Bank 2020) <https://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-9114> accessed 6 January 2021..

[8] De Melo and Twum (n 6).

[9]World Bank (Washington, District of Columbia) (ed), *World Development Report 2020: Trading for Development in the Age of Global Value Chains* (World Bank Group 2019).

[10] See for example, ''Participation of Developing Countries in Global Value Chains: Implications for Trade and Trade-Related Policies', Vol 179 (2015) OECD Trade Policy Papers 179 <https://www.oecd-ilibrary.org/trade/participation-of-developing-countries-in-global-value-chains_5js33lfw0xxn-en> accessed 18 April 2021.

[11]Stefan Pahl and others, *Jobs in Global Value Chains: New Evidence for Four African Countries in International Perspective* (World Bank, Washington, DC 2019) <http://hdl.handle.net/10986/32155> accessed 18 April 2021..

manufacturing takes place in various jurisdictions with different legal environments. It then follows that the law affects participation and investment in GVCs. Therefore, proper regulation is mandatory.

One of the emerging issues is whether Kenya has proper laws that govern investment in GVCs. Secondly, bearing in mind that production through GVCs process requires substantial investments, another issue that arises is whether Kenya has resources and sufficient investments to participate in GVCs, if not, whether the country has the ability to attract and retain Foreign Direct Investment (FDI).[12] Finally, since at least two countries are involved in GVCs, the third issue that whether there is impact of export and import laws on participation and investment in GVCS.

The legal environment must be conducive for GVCs to prosper. There is a close proximity between effective participation and investment in value chains and the law—both municipal and international law. This is so because the municipal law may be prohibitive to protect domestic industries. Secondly, since production in GVCs involves at least two countries in export and import transactions, conflict of laws and regulations is inevitable. Consequently, countries that are desirous to benefit from GVCs must avail conducive legal environment to the participants who may be local or international investors.

Considering the benefits associated with GVCs and the need to create a conducive legal environment for African integration, the African Union (AU) commenced negotiations to have a law on free trade area for Africa to encourage investment in value chains. Consequently, the AU agreed to enact the Agreement establishing African Continental Free Trade Area (AfCFTA). The AU State parties signed the agreement at Kigali, on 21stday of March 2018 and entered into force on 30th May 2019. Kenya and EAC states ratified the AfCFTA together with its two protocols on Trade in Goods and Services.[13]

One of the objectives of the AfCFTA and its protocols is to achieve regional cooperation through participation in value chains. In this regard, Article 3(g) of the AfCFTA; Article 2 (e) of Protocol on Trade in Goods; and Article 3 (2)(d) of the Protocol on Trade in Services calls

[12]Alessandro Borin and Michele Mancini, *Measuring What Matters in Global Value Chains and Value-Added Trade* (World Bank, Washington, DC 2019) <http://hdl.handle.net/10986/31533> accessed 18 April 2021.
[13] AfCFTA Protocol on Trade in Goods and AfCFTA Protocol on Trade in Services

upon members states to take part in value chains.[14] Since value chains thrive in liberal markets, Article 3 (b) of the AfCFTA requires member states to liberalise their markets to facilitate trade among member and non-member sates. AfCFTA requires Member States to eliminate or reduce tariffs and non-tariff measures to encourage participation in value chains. Therefore, it is necessary to find out how laws of Kenya measures up to the provisions of AfCFTA.

Apart from being party to AfCFTA, Kenya is also a party to regional treaties. In this regard, Kenya is party to Treaty Establishing the Common Market For Eastern and Southern Africa (COMESA treaty) and EAC treaty. The common objectives of the two regional treaties is to achieve co-operation among the partner states for mutual benefit.[15] Unlike the AfCFTA, the COMESA and EAC treaties are silent on the issue of participation in GVCs but the two regimes calls for gradual liberalisation of markets. For example, Article 74 of the EAC treaty mandates member states to take measures to liberalise trade including removal of tariff and non-tariff barriers to international trade.[16]

Contrary to the spirit of Article 74 of the EAC treaty and in what appears to be an affront to the spirit of AfCFTA and Article 74 of the EAC treaty, Kenya has *'buy Kenya, build Kenya Strategy*' while Uganda has Buy Uganda Build Uganda (BUBU) policy which are some of the non-tariff measures that seeks preferential treatment of domestic goods and services to protect them from external competition.[17] Kenya's State Department for Industrialization is in fact, proposing to codify *'buy Kenya, build Kenya Strategy'* into a statute. This paper argues that the proposed codification may affect investors already in Kenya and those who intend to make their entry.

The dilemma on whether to restrict or liberalise trade is not restricted to Kenya. Uganda and Tanzania have non-tariff statutes for protecting domestic markets. As aforementioned,

[14] 2021 See also the paragraph 5 of the preamble to Protocol on Trade in Services

[15] Article 5 of 'Treaty for the Establishment of the East African Community | East African Court of Justice' <https://www.eacj.org/?page_id=33> accessed 18 April 2021. See also Article 3 and 4 of the Treaty Establishing the Common Market for Eastern and Southern Africa.

[16] See also Article 3 and 4 of the Treaty Establishing the Common Market For Eastern and Southern Africa.

[17]State Department for Industrialization, 'CS Adan Promises to Fast-Track "Buy Kenyan Build Kenya" Draft Into Law - Ministry of Industrialization, Trade and Enterprise Development (MoITED)' <https://www.industrialization.go.ke/index.php/media-center/blog/413-new-regulations-set-to-boost-economy> accessed 5 April 2021.

Uganda has BUBU policy,[18]while section 54 of the Tanzania's Public Procurement and Disposal Act gives preference to domestic goods.[19] These policies take away freedom of investment thereby prohibiting entry of investors. Consequently, it is important to identify Kenyan laws that maybe hindering investors from participating and investing in GVCs with view of suggesting reforms. It is also important to find out how Kenya and EAC states may balance the provisions under AfCFTA that calls for liberalisation of trade one hand, and the local laws that seek to protect domestic industries.

1.3.0. Statement of the Problem

A key legal issue that this study seeks to address is whether Kenya should liberalise its laws to encourage investment in GVCs or restrict its laws to protect its economy. This legal dilemma arises because whereas Kenya has ratified the AfCFTA that calls for investment in value chains, and whereas Kenya is party to the EAC Treaty that calls for liberalisation of trade, Kenya has laws and policies that restrict freer trade. This paper argues that the inability to invest in GVCs is due to three main reasons: there is little focus on law as an important tool that determines levels of investment in GVCs; there is lack of special law to address issues relating to GVCs, and Kenya laws including some EAC and COMESA laws are archaic, stiff and contradictory. For example, in Kenya, the Income Tax Act is capable of subjecting GVC investors to double taxation,[20] while Value Added Tax Act impose high and multiple internal taxes not on value added, but on gross output.[21] Apart from that, Foreign Investments Protection Act does not recognise intellectual property as an asset while Investment Promotion Act contains provisions setting minimum investible funds for one to qualify as an investor. Apart from that, Kenya applies EAC and COMESA Rules of Origin that are so strict that it is practically impossible for GVCs investors to benefit from the rules.

Kenya has substantial resources necessary to take part in GVCs but its legal framework is restrictive and lacking when viewed within the prism of the AfCFTA. Skewed Kenyan laws including some EAC and COMESA laws protect domestic industries excessively to the detriment of other sectors such as GVCs that require foreign inputs. For instance, whereas Kenya's Draft National Automotive Policy recommends that Kenya should participate in

[18]'Buy Uganda Build Uganda Policy – Ministry of Trade Industry and Cooperatives' <http://www.mtic.go.ug/download/buy-uganda-build-uganda-policy/> accessed 18 April 2021.
[19] The Gazette of the United Republic of Tanzania No. 52 Vol. 92 dated 30th December, 2011The Public Procurement Act, 2011 Printed by the Government Printer, Dar es Salaam by Order of Government
[20]Chapter 470 laws of Kenya
[21] No. 35 of 2013

GVCs, it contradicts itself by recommending imposition of restrictions on imports of motor vehicle parts and components to protect local industries. Protectionism and participation in GVCs do not go hand in hand because protectionism affects entry of foreign investors and facilitates exit of existing investors as demonstrated in chapter two. Scarcity of investors to invest in GVCs translates to low FDI which is a key component for investing in value chains.

Consequently, this study seeks to address four legal issues: firstly, whether Kenya should liberalise its laws to encourage investment in GVCs or restrict its laws to protect its economy. Secondly, the research seeks to identify laws that affect Kenya's effective participation and investment in GVCs. Thirdly, the research seeks to find out how the identified laws affect Kenya's participation and investment in GVCs. Fourthly, the research seeks to find out how the identified laws should be designed to ensure effective participation and investment in GVCs.

1.4.0. Research Objectives

The objectives of this study include:

i. To initiate a paradigm shift in studying GVCs by asserting that the law is the single most important determinant in investing in GVCs.

ii. To study Kenyan law to find out how it affects investments in GVCs. To achieve this objective, the research analyses Kenyan, EAC, COMESA and AfCFTA legal regimes in view of the international trade theory, General Theory of Law and Development and international cooperation theory.

iii. To explore possibilities of enacting a special law and substantive law in Kenya to address issues related to GVCs and RVCs.

iv. To find out how Kenya and EAC can strike a balance between the insatiable need to protect domestic industries on one hand, and the call for freer trade under AfCFTA and similar laws.

v. To propose legal and regulatory strategies on how to make Kenya and the EAC effective participants in GVCs and RVCs.

1.5.0. Research Questions

This research aims to answer the following main questions:

i. Is the law relevant in participation and investment in GVCs?
ii. How does the existing Kenyan legal regimes affect participation and investment in GVCs?
iii. What are the appropriate legal and policy changes that Kenya should initiate to encourage participation and investment in GVCs?
iv. Should Kenya and EAC enact a specific law to govern RVCs?

1.6.0. Hypothesis

Whereas Kenya and by extension the EAC States are endowed with resources, investors are not investing in value chains because the existing law is a barrier.

1.7.0. Justification of the Study

This study is necessary to policy makers because it identifies laws and policies for review, which will not only assist Kenya to comply with AfCFTA and other international obligations, but it will also enable investors to invest in value chains in Kenya. Participation and investment in value chains is important because it has potential to fulfil aspirations under Kenya's vision 2030 such as creation of employment, industrialisation, and leads to better balance of payments and general economic development.

Apart from that, the research provides legal solutions on how Kenya and EAC can strike the balance between the call for freer trade under AfCFTA and the need to protect local economies from competition from developed nations. This will take care of the needs of local and foreign investors. For example, Kenyans will be able to generate better incomes from local products upon value addition while foreign investors will be able to invest in Kenya without threats such as double taxation.

In addition, this research calls for enactment of a Kenyan statute on GVC as well as 'Regional Value Chains Agreement' for EAC to define and provide for operation and management of value chains in Kenya and EAC respectively. Such laws will ensure fulfilment of the spirit of cooperation and integration under Article 5 of the EAC treaty.

1.8.0. Theoretical Framework

Three theories forms the basis of this study. The three theories are the International Trade Theory, General Theory of Law and Development, and International Cooperation Theory.

Economists are the proponents of the International Trade Theory which argues that availability of endowment factors determines participation in international trade. However, the theory under plays the role of law in international trade. Therefore, this research argues that law is the most important aspect in international trade that in absence of the law, a country cannot engage in trade even if it is resource endowed. Consequently, the research adopts general theory of law and development to explain the relationship between the law and international trade. Finally, since a country cannot participate in GVCs or RVCs on its own, this research relies on International Cooperation Theory to emphasise that whereas a country may have the resources and good laws, cooperating with other countries is vital. The three theories are analysed below.

1.8.1. International Trade Theory

International trade theory is a sub-field of economics that analyses the patterns of international trade. The theory has various models or sub theories propounded by various economists but this research focuses on Mercantilism theory, Absolute cost Advantage theory, Heckscher–Ohlin theory, and comparative cost advantage theory in its extended format because the said sub theories are connected to GVCs.

1.8.1.1. Mercantilism Theory

Mercantilism theory was very popular in the 16th and 18th Century but that is not to say that its underpinnings have disappeared in 21st Century. During 16th and 18th Century, the wealth of the nation only consisted of gold or other kinds of precious metals.[22] Consequently, the theorists of the time advised countries to start accumulating gold and other kinds of metals and the European nations headed to this call. During this period, these precious minerals denoted the wealth of a given nation. The mercantilist believed that a country would strengthen only if the nation imports less and exports more to have a favourable balance of trade.[23] This theory was prominent back then because there was a rise in new nation-states and the rulers of these states wanted to strengthen their nations. The only way to do so was by

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[22]Tong-sŏng Cho and Hwy-Chang Moon, *From Adam Smith to Michael Porter: Evolution of Competitiveness Theory* (Reprinted, World Scientific 2008).3

[23]'International Trade Law Theories' <http://www.legalserviceindia.com/legal/article-2758-international-trade-law-theories.html> accessed 15 April 2021.

increasing exports and trade, Consequently, these rulers were able to collect more capital for their nations. The rulers also encouraged exports by putting limitations on imports.[24] This paper argued that this system is still in use today in form of "protectionism."

Countries have implemented protectionist policy in one way or another to protect their economies. For instance, Kenya is at it and considering enacting *'Buy Kenya build Kenya'* initiative into law to protect its industries from imports, which is the same reasoning under the old Mercantilism theory,[25] while Uganda has similar policy called 'buy Uganda build Uganda (BUBU),[26] and Tanzania already has restrictions under its procurement Act.[27] Whereas protectionism my seem advantageous to protect local industries, import restrictions leads to higher prices of goods and services which discourages participation in GVCs. Secondly, if every country embraces protectionisms, then it means that international trade will extinct because countries might decide to retaliate by banning imports from other countries under the reciprocity principle.

1.8.1.2. Absolute Cost Advantage Theory (Adam Smith's Model)

Adam Smith was the proponent of this theory. The theory is as a strong reaction against the protectionist mercantilist views on international trade wherein, Smith advocated for concepts specialization and free trade through his book, '*The Wealth of Nations'* published in 1776.[28]According to Smith, trade takes place when countries have absolute advantage in production of specific goods, relative to each other and the advantage arises from the division of labour that extrapolates to international level. He argued that absolute advantage enables a country to produce a unit of a product using less labour than another country. Smith also was concerned that States would interfere in international trade through imposition of taxes on imports and subsidising exports.[29] Indeed, States are now interfering in international trade today.

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[24]Cho and Moon (n 22).3.
[25]State Department for Industrialization (n 17).
[26]Ministry of Trade, Industry and Cooperatives, 'Buy Uganda Build Uganda Policy' <www.mtic.go.ug/wp-content/uploads/2019/08/BUBU.pdf#:~:text=The%20Buy%20Uganda%20Build%20Uganda%20%28BUBU%29%20policy%20is,goods%20is%20integrated%20into%20their%20policies%20and%20procedures.>.
[27]OECD, *OECD Investment Policy Reviews: Tanzania 2013* (OECD 2013) <https://www.oecd-ilibrary.org/finance-and-investment/oecd-investment-policy-reviews-tanzania-2013_9789264204348-en> accessed 13 September 2021.
[28] Tong-sŏng Cho and Hwy-Chang Moon, *From Adam Smith to Michael Porter: Evolution of Competitiveness Theory* (Reprinted, World Scientific 2008) 4.
[29] Ibid

To demonstrate the concept absolute advantage, Smith used an example of growing grapes in Scotland and noted that whereas it may be possible to grow grapes and produce wine in Scotland, the investments in the factors of production would cost thirty times more than the cost of importing similar product. He demonstrated how each nation would benefit economically just by concentrating on what it could do best rather than following the mercantilist doctrine of national self-sufficiency. This theory was persuasive enough that England reduced the policy protection of trade.[30] Pursuant to Adam Smith's Model, it is plausible that Apple assembles iPhones in China because it may be expensive to manufacture them in USA.

Smith's theory may resonate with developing countries such as Kenya that are endowed with resources but import finished products because it does not have resources to set up industries to manufacture goods. Secondly, the theory encourages international division of labour, which resonates with participation and investment in GVCs that are all about fragmented production of goods across international borders. Thirdly, Smith's theory recognises that taxes on imports reduces competitiveness of goods. Similarly, GVCs cannot survive where there is heavy taxation on imports.

Whereas the theory is relevant, this research identifies three weaknesses in Adam Smith model. First, and most importantly, the model does not consider law as a condition precedent for international trade to take place. The law determines whether production environment is friendly or unfriendly, the law governs the relationship between the employer and the employee (labour laws) as well as governing relationships between trading nations. Secondly, the theory is a true mirror of today's conventional international trade as practised in the developing countries that export raw materials without value-addition, only to import finished products leading to trade imbalances. Thirdly, if one country commands absolute advantage in both goods, then such a country would not benefit from international trade.

1.8.1.3. Heckscher–Ohlin Theory (H-O Theory)

Eli Filip Heckscher (1919) and Bertil Ohlin (1933) are two Swedish economists who advanced this theory. The theory studies the pattern of foreign trade in order to answer which commodities will be exported and imported.[31] The H–O theory indicates that differences in

[30] Ibid

[31] Branko Horvat, *The Theory of International Trade: An Alternative Approach* (Macmillan [u.a] 1999). 10.

factor endowments affects patterns of international trade. The theory postulates that a country would export capital-intensive goods by utilising locally abundant factors, but imports goods that make intensive use of factors that are scarce locally.[32]This theory is a reflection of today's conventional international trade in finished goods and is not concerned with manufacturing process. In addition, the theory does not recognise the role of law and technology in production of goods.[33]

Whereas the theory focuses on the trade in finished goods, we can deduce that availability of factor endowments in developing countries such as Kenya allows investors to participate in forwards GVCs linkages by adding value to the available raw materials. Where the raw materials are scarce, investors will still participate in GVCs through backward linkages by importing raw materials for value addition to manufacture final products. Backward GVC participation is more profitable than forward participation because it involves export of locally value added product plus foreign value.

This research identifies three weaknesses in Heckscher–Ohlin model. First, just like Adam Smith model, the model does not consider that the law is a condition precedent for any trade to take place. Secondly, the theory is a true mirror of today's conventional international trade in developing countries that have abundant raw materials but export them to developed nations at low prices without or with very little value addition. The developed nations process the goods and sale them back at a high price leading to the current trade imbalances. Thirdly, the model focuses on final goods while GVCs is more concerned with value addition to intermediary goods or services for export.

1.8.1.4. Comparative Cost Advantage Theory and Its Extension

The outstanding proponent of this theory is David Ricardo (1772-1823) who was a student of Adam Smith. Scholars such as Jeremy Bentham and James Mill the father of John Stuart Mill influenced Ricardo's thinking. J. S. Mill polished the theory later on.[34]

Ricardo argued that countries engage in international trade due to comparative advantage, which arises due to differences in technology or natural resources. Due to existing conditions,

[32]Eun Kwan Choi and James Harrigan (eds), *Handbook of International Trade* (Blackwell Pub 2003).33
[33] Ibid
[34]'David Ricardo | Biography, Theory, Comparative Advantage, & Works' (*Encyclopedia Britannica*) <https://www.britannica.com/biography/David-Ricardo> accessed 10 April 2021..

Ricardo noted that some countries have the ability to produce some goods relatively more efficiently, which results to specialization if trade is allowed.[35] Unlike Heckscher–Ohlin model that focuses on factor endowments, Ricardian model does not directly consider factor endowments such as the relative amounts of labour and capital within a country. The theory suggests that each country should concentrate in the production of those products in which it has the utmost advantage or the least disadvantage.[36] The original Ricardian theorem focused on two countries goods trading in two goods and one factor being labour.[37]

Ricardian theory is important in this study as it explains that countries would still benefit from international trade even without absolute advantage.[38] This postulation resonates with GVC participation in that a country does not need to have resources to become a manufacturing powerhouse. With proper laws and policies, a country can become a manufacturing powerhouse by importing value added intermediaries for further manufacturing followed by exports.

It is important to note that the Ricardian framework is applicable in 21st century because investors in international trade invest in technology,[39] leading to increased specialisation. This suits participation in GVCs process. In additions, Eaton and Kortum argue that the theory also has been extended to include many-country and many-products situation where countries specialise in various products. Apart from that, the expansion of the theory now includes intermediates wherein investors are able to utilise technologies to improve quality products and choice of production techniques.[40]

Whereas the extended Ricardian theory provides a new basis that treats trade of input goods and the emergence of global value chains, it does not recognise the role of the law in GVCs, which creates a gap. The general theory of law and development attempts to fill this gap.

[35] Istvan Konya, 'Lecture notes in International Trade, (Boston College 2001) 3-4
[36]'International Trade Law Theories' (n 23).
[37] Robert C. Feenstra, Advanced International Trade: Theory and Evidence (University of California, Davis, and National Bureau of Economic Research 2002) 1-2
[38]Cho and Moon (n 19)7.
[39]Jonathan Eaton and Samuel Kortum, 'Putting Ricardo to Work' (2012) 26 Journal of Economic Perspectives 65.65.
[40]ibid.

1.8.2. General Theory of Law and Development

Professor Yong-Shik Lee advances the General Theory of Law and Development theory.[41] The theory recognises that scholars have not developed a theory that systematically explains the interrelationship between law and development. Therefore, the theory attempts to fill the gap by providing a framework that defines the disciplinary parameters of law and development, and explains the mechanisms by which law influences development. Most importantly, the theory also explains the role that the law played in the development process of South Korea (1962– 1996).[42]

In this theory, Lee argues that law directly affects development through three Regulatory Impact Mechanisms namely: regulatory design, regulatory compliance, and quality of implementation.[43] Consequently, bearing in mind that the AfCFTA and its two protocols on Trade in Goods and Services calls for participation in value chains to encourage development, this research relies on this theory to demonstrate how the law is important in GVCs. Therefore, the study considers the three Regulatory Impact Mechanisms: regulatory design, regulatory compliance, and quality of implementation to understand the nexus between law and development in terms Yong-Shik Lee's theory.

1.8.2.1. Regulatory Design

Regulatory design determines whether the law archive its regulatory objective. The theory maintains that before a legislation is undertaken, the state must have a policy and the anticipated policy outcomes; there must be institutions to enforce the law and the enacted law should conform to the socioeconomic conditions of the society to be effective.[44]According to this theory, the enacted law should then reflect the policy followed by examination of the outcome of the law. The theory suggests that the government and governmental institutions should be involved to create a balance amongst the industry players. The government should then make modifications to the law to suits the prevailing needs.[45]

Kenya is party to AfCFTA that calls for elimination of tariffs and other NTBs to encourage free trade. The application of this theory means that Kenya should not only enact laws to

[41]'Professor Yong-Shik Lee' <https://www.lawanddevelopment.net/people/lee.html> accessed 15 April 2021.
[42]Yong-Shik Lee, 'General Theory of Law and Development' (Social Science Research Network 2017) SSRN Scholarly Paper ID 2951317 <https://papers.ssrn.com/abstract=2951317> accessed 13 April 2021.
[43] Ibid
[44]Lee (n 42).
[45] ibid

encourage freer trade or but should review existing laws in consultation with stakeholders such as investors.

1.8.2.2. Regulatory Compliance

Regulatory compliance is the second element of the regulatory impact Mechanisms under the General Theory of Law and Development. Regulatory compliance postulates that compliance with the law is a precondition to development. It identifies two forms of compliance with the law—the general and specific compliance. Concerning general compliance, the theory provides factors that encourage general compliance with the law. The general factors include: the ability of the law to address legal cultural concerns which involves addressing a peoples' common history or tradition in the legal system; citizens' knowledge and understanding of the law; having a quality and well-designed law which complies with socioeconomic conditions of the society; and the law should contain penalties in case of its breach.[46]

On the other hand, various factors such as resources influence specific regulatory compliance. The theory maintains that scares resources inevitably compel governments to prioritize laws for enforcement. Due to scarcity of resources, the theory states that the government is likely to enforce laws that have strong political support. Second, consistency between a particular law and the socioeconomic conditions on the ground determines compliance with the law. Yong-Shik Lee argues that any conflict be weighed against the regulatory benefit, as perceived by the public, in adopting the law. Thirdly, the theory suggests that a particular law may be beneficial to a particular group of people but may cause a net loss to another group. Shik Lee further argues that such law may be one that calls encourages free trade wherein pro-free trade persons will benefit while pro-protectionism persons will suffer hence the law will be complied with or opposed along those lines. He however opines that the government should step in and implement the law to minimise losses.

It could be argued that Yong-Shik Lee's theory attempts find a balance between pro-free trade and pro-protectionism laws through the involvement of the government which is tasked to ensure that the 'perceived losers' are taken care of.

[46]Lee (n 42).

1.8.2.3. Quality of Implementation

Quality of implementation is the third and final facet of the regulatory impact Mechanisms under the General Theory of Law and Development. According to this theory, quality of implementation evaluates the extent to which the state ensures adherence to the law to achieve the objectives of the law. For example, in international trade, Yong-Shik Lee asserts that if the law requires the removal of customs tariffs on imports, the law would not be effective if customs officials at the border undermined the law by requiring informal payment equivalents contrary to the law. The theory also argues that the state should have capacity to implement the law.[47]

In light of Lee's theory, the developing countries such as Kenya lack capacity to implement laws. Secondly, EAC has not embraced freer trade. For example, whereas there are laws such as Article 3 (b) of AfCFTA and Article 74 of EAC treaty that advocates for freer trade, Kenya and the EAC States have failed to eliminate them. Kenya is about to enact '*Buy Kenya Build Kenya*' into law while Uganda, Tanzania and Rwanda have a similar law in place already. Thirdly, the custom officials maybe corrupt and may not implement the law. All these affects effective participation in GVCs because value chains thrive where there is free trade and when the law has created conducive environment for participation.

1.8.2.4. Application of the General Theory in South Korea

Lee notes that South Korea was absolute poor and underdeveloped county in early 1960s. He notes that South Korea reversed the situation by taking active role by enacting specific legislations to promote industries and export activities, to promote development by developing manufacturing industries. For example, Lee notes that South Korea took deliberate measure and enacted Tax Exemption and Reduction Control Act (1961), the Act on Temporary Measures for the Grant of Export Subsidies (1961), and the Export Promotion Act(1962, replaced by the Trade Transactions Act of 1967). The enacted laws reduced taxes and barriers to trade in South Korea.

1.8.3. International Cooperation Theory

Whereas a country may have factor endowments as theorised under the international trade theories, and whereas the countries may have specific law that govern a specific area as advanced under the General Theory of Law and Development, those in themselves are not

[47]ibid.

sufficient in value chains world. Countries involved in value chains need to cooperate in order to enforce the laws and agreements and to ensure that trading entities in those countries are benefiting by effectively utilising the available resources and laws. With this in mind, the countries involved need to cooperate.

Keohane defines International Cooperation Theory as the adjustment of the actors' behaviour to the actual or anticipated preferences through a process of policy coordination. Policy coordination is the adjustment of the policy of each state to reduce negative impact on another state.[48] The theory of international cooperation assumes that each actor's behaviour is directed toward a specific goal and that the cooperation leads to gains or rewards. Cooperation opposes competition, conflict and unilateral actions.

Cooperation can occur tacitly among the states without communication or agreement.[49] In this regard, EAC has a negotiated cooperation. Article 5 (1) of the EAC Treaty provides that, 'the objectives of the Community shall be to develop policies and programmes aimed at widening and deepening co-operation among the Partner States in political, economic, social and cultural fields, research and technology, defence, security and legal and judicial affairs, for their mutual benefit.' Consequently, the study asserts that cooperation is necessary for GVCs and RVCs to take place.

1.9.0. Research Methodology

Due to Covid-19 pandemic and the health risks associated with the pandemic, the research exclusively relied on desktop review of the existing literature. The research relied on qualitative and doctrinal research where statutes and library material are the sources of information. The study critically analysed legal doctrines and legal reasoning by examining the existing Kenyan, EAC and COMESA laws to ascertain how they influence participation and investment in GVCs. The researcher also carried desktop analysis of relevant secondary materials including online information to understand how the law influences investments in value chains. The whole process involved formulation of the research questions by carrying out detailed literature review; and identification, examination and analysis of relevant laws and policies to identify inconsistencies and gaps to generate recommendations.

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[48]Helen Milner, 'International Theories of Cooperation among Nations: Strengths and Weaknesses' (1992) 44 World Politics 466 <https://www.cambridge.org/core/product/identifier/S0043887100015677/type/journal_article> accessed 16 April 2021..

[49]ibid.

Qualitatively, the study analysed municipal and international laws that have impact on investment in GVCs. Some of the examined and analysed municipal laws include but not limited to the Constitution of Kenya 2010, Companies Act, Foreign Investments Protection Act, Investment Promotion Act, Industrial and Commercial Development Corporation Act, Special Economic Zones Act, as well as Income Tax Act and Value Added Tax Act. The study also analysed international laws such as the East African Community Customs Management Act, EAC Treaty and its protocols and annexes, the Treaty for the establishment of COMESA together with its protocols and annexes, AfCFTA together with its protocols and annexes, and GATT 1994 together with its protocols and annexes.

In addition, the study relied on secondary data sources such as books, eBooks, online journals, electronic journals, and official reports to interpret the identified laws and policies.

The statistics in the study were derived from official sources only mainly from the KEBS, KNBS, CBK, MoITED, KEINVEST, EAC, COMESA, World Bank, UNCTAD, IMF, WTO, OECD, and ICC libraries.

1.10.0. Literature Review

1.10.1. Introduction

The importance of value chains has been emphasised by multilateral institutions. WTO notes that GVCs allows developing countries to engage in global economy, which results to development of a country. Similarly, Rodrik argues that the developing countries can produce components of goods through GVCs that facilitates access global markets.[50] However, since most scholars in GVCs are economists, they study the area from economics perspective while alienating the role of law in GVCs.[51] Whereas the law plays a key role right from the entry of an investor, to setting up and running the business, most economists have not made law a focal point of their theoretical or empirical analyses. When they do, they do so summarily or incidentally.[52] This may explain the limited legal scholarship on this topic be it in Kenya or across the globe. As a result, there is very limited analysis on how the laws of Kenya affects

[50]Dani Rodrik, 'New Technologies, Global Value Chains, and Developing Economies' (National Bureau of Economic Research 2018) w25164 <http://www.nber.org/papers/w25164.pdf> accessed 18 April 2021.
[51]'The Role of Law in Global Value Chains: A Research Manifesto' (2016) 4 London Review of International Law 57.
[52] Ibid.

participation and investment in value chains, which may explain Kenya's negligible participation and investment in value chains. Therefore, the aim of this research is to contribute to the development of literature by studying value chains in legal prism by identifying, examining and analysing laws that hinder Kenya and the larger EAC region from investing in GVCs.

1.10.2. Undermined Role of Law in GVCs

This study aim to initiate a paradigm shift when considering factors that determine investment in GVCs. As already noted, economists including the World Bank have alienated role of law when studying value chains. They underplay the fact that the law governs all relationships and is a precondition that must be satisfied before any commercial transaction is undertaken. Consequently, one would expect the law to be at the top of the food chain when considering factors that determine effective participation and investment in GVCs. This is not the case. For example, the World Bank ranks key determinants of GVC participation in the following order of importance: (i) factor endowments, (ii) geography, (iii) domestic industrial capacity, (iv) trade policy and foreign direct investment (FDI), (v) institutional quality, (vi) connectivity, and (vii) macroeconomic factors.[53] The ranking reveals that the law is not included.

One might argue that 'trade policy' covers the role of the law in the above World Bank ranking. However, this study asserts that 'law' and 'policy' are not the same. To this end, Kreis and Christensen correctly argue that policies are discretionary instruments used by societies to regulate themselves.[54] A policy may also represent what a government does or what it intends to do. Consequently, a country can use trade policies, which Smith calls trade measures or instruments to liberalise or restrict trade.[55] The policy maybe codified to become law.[56] Until Codification happens, a policy remains discretionary and lack force of law. On the other hand, 'law' is a body of binding rules, principles, standards and procedures that are not discretionary.[57]

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[53]Ana Fernandes, Hiau Looi Kee and Deborah Winkler, *Determinants of Global Value Chain Participation: Cross-Country Evidence* (The World Bank 2020) <https://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-9197> accessed 2 January 2021.
[54]Anthony Michael Kreis and Robert K Christensen, 'Law and Public Policy' (2013) 41 Policy Studies Journal S38.
[55]Pamela J Smith, *Global Trade Policy: Questions and Answers* (Wiley Blackwell 2014).
[56]Kreis and Christensen (n 54).
[57]ibid.

Consequently, a country such as Kenya may have excellent trade policies to encourage participation in value chains but might have retrogressive and outdated laws that hinder participation and investment in value chains. Therefore, this study develops literature on GVCs by studying the impact of the law in participation and investment in GVCs. It is important to focus on the law as tool for development and a key ingredient in investment in GVCs.

1.10.3. Inefficient and Contradictory Laws

GVCs thrive when laws and policies are efficient. It is one thing to have laws and it anther to have efficient laws. Zeidy identifies lack of efficient regulation as the first challenge that hinders Africa from effective participation and investment in GVCs. He argues that the existing laws and the policies are not in harmony to allow the continent to scale up value chains.[58] However, the author does not single out the contradictory laws.

On the other hand, Gibbon and Stefano assert that regulation and trade policy instruments are important in order to participate in value chains. They argue that lobbying to bring about proper regulations is necessary when the law in a certain arena does not exist or when the existing regulation is insufficient. Such lobbing may lead to modifications in rules such as a change in tariffs and quota allocations that may influence participation in value chains.[59]

Pursuant to insights from Zeidy, Gibbon and Stefano, this research has identified various gaps and inconsistencies in Kenyan laws that hinder it from participation and investment in value chains. For example, the Income Tax Act is capable of subjecting GVCs investors to double taxation, which discourages investors from investing in GVCs in Kenya. Apart from that, various laws in Kenya are inconsistent with AfCFTA, which this research seeks to address. This will be beneficial to the government, as it will enable it to reform its laws to conform to AfCFTA and similar laws. Apart from that, whereas Kenya has laws on conventional trade, the country does not have an express law on GVCs. Consequently, this research recommends that Kenya should enact a specific and a substantive law on value chains. Similarly, the research aims at encouraging the EAC to come up with an agreement on RVCs to provide specific legal framework under which Kenya and EAC states will invest

[58]Ibrahim A Zeidy, 'Global Value Chain as a Vehicle for Development in Africa – Common Market for Eastern and Southern Africa (COMESA)' <https://www.comesa.int/38492-2/> accessed 5 April 2021.
[59]Peter Gibbon and Stefano Ponte, *Trading down: Africa, Value Chains, and the Global Economy* (Temple University Press 2005).85

in value chains. Such an agreement will enable EAC to fulfil its objective of achieving cooperation under Article 5 of the EAC Treaty.

1.10.4. Inability to Attract and Retain Investors

A good law determines levels of investments be it by local or foreign investors. Foreign investors contribute to foreign direct investment (FDI) which has a number of benefits. Farole and Winkler note that FDI is key to participation in GVCs because it supplements domestic investments and leads to technology transfer.[60] However, due to benefits associated with FDI, McCormick et al argue that whereas the Kenyan government seeks to attract investments, it has been focusing on foreign investors while ignoring local investors. They also argue that Kenyan policies do not provide sufficient incentives to local investors as compared to foreign ones yet local investors play huge role as well. They conclude that the government should improve the business environment for example, by offering incentives to investors, both local and foreign, to attract investments.[61] Local and foreign investors should benefit from incentives because critics of FDI argue that FDI has less contribution to development as compared to input from local investors.[62]

Larossi identifies tax as one of the incentives that the state should provide to attract and retain investors. Larossi notes that whereas businesses across the worldwide do complain about tax levels, complaints about taxes in Kenya is prominent as Kenya has the highest tax rates in sub-Saharan Africa that the country becomes unattractive to potential investors and force the existing ones to flee.[63] It is with such assertions that this study seeks to identify and analyse tax laws in Kenya that may be repelling investors.

This study contributes to the existing literature by analysing Kenya's investment laws to find out how they influence investment in value chains. To achieve the aim, the study identifies and examines local and foreign laws that determine entry and protection of investors in Kenya.

[60]Thomas Farole and Deborah Winkler, *Making Foreign Direct Investment Work for Sub-Saharan Africa: Local Spillovers and Competitiveness in Global Value Chains* (The World Bank 2014).
[61]Dorothy McCormick, Patrick O Alila and Mary Omosa (eds), *Business in Kenya: Institutions and Interactions* (University of Nairobi Press 2007).
[62]Farole and Winkler (n 60).
[63]Giuseppe Iarossi, *An Assessment of the Investment Climate in Kenya* (World Bank 2009).

1.10.5. Numerous Tariffs and Non-Tariff Barriers

Kenya and other EAC states are grappling with how to balance between the call for freer trade under AfCFTA, and the need to protect domestic industries for external competition. The governments protect domestic industries through tariffs and other non-tariff measures. Lunati opines that reduction in tariffs results to increased offshoring.[64] On the other hand, Melo and Twum identify high tariffs on imports of intermediates and restrictive rules of origin as some of the obstacles hindering GVC participation and investment in EAC because the region and Africa at large still imposes high tariffs on intermediaries in pursuit of an inward-looking industrialisation strategy.[65] They argue that these trade barriers were abandoned long time ago by the developed nations because they hindered participation in GVC due increase in cost of trade.[66] However, the existing literature does not shed light on how Kenya and EAC at large should balance the call for freer trade under AfCFTA and the need to protect domestic industries.

Consequently, this research seeks to identify means through which Kenya and EAC countries at large may balance the request for freer trade under AfCFTA and the need to protect domestic industries. Further, the study develops the literature by pinpointing laws and administrative actions that hamper participation and investment in GVCs. The study also pinpoints how the laws influences investment in GVCs and pinpoints necessary laws reforms to encourage investment in GVCs.

1.10.6. Non-Tariff Barriers

Kummritz, Taglioni and Winkler suggest that good policies allow freer trade by removal of non-tariff barriers to stimulate GVC participation. EAC Partner States have all implemented the EAC tariff schedule, eliminating tariffs on each other's goods. However, they have adopted non-tariff measures, which according to the latest East Africa Common Market Scorecard of 2016, are counterproductive.[67] For example, Kenya's Draft National Automotive Policy calls upon imposition of restrictions on imports of vehicle components to protect domestic industries.[68]Apart from that, Kenya's *'Buy Kenya, Build Kenya Strategy*" is

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[64]M Teresa Lunati and others (eds), *Enhancing the Role of SMEs in Global Value Chains* (OECD 2008).21
[65]Melo and Twum (n 6).
[66]Ibid 21
[67]The World Bank and EAC, 'East African Common Market Scorecard 2016: Tracking EAC Compliance in the Movement of Capital, Service and Goods' (World Bank; EAC 2017) Report <http://repository.eac.int/handle/11671/1819> accessed 30 March 2021.
[68]State Department for Industrialization, 'Draft National Automotive Policy - February 2019 - Ministry of Industrialization, Trade and Enterprise Development (MoITED)'

one of the non-tariff measures that seeks to grant preferential treatment to Kenyan goods and services as means of supporting the domestic industries that the State Department for Industrialization is proposing to enact it into a law.[69] Just like Kenya, Uganda and Tanzania have exact same policies. Enacting such proposals into law translates to violating principles under the EAC Industrialisation Strategy of 2012-2032 that calls for elimination of NTBs.[70]

With *'buy Kenya, build Kenya Strategy,'* Martin Mulwa expresses fears that such policies are reverting back to protectionist measures which could potentially hamper efforts towards EAC regional integration by locking out products from neighbouring counties.[71]

Strict Rules of origin constitutes another non-tariff barrier that affects participation in value chains. Melo and Twum asserts that rules of origin play an important role in preventing trade deflection in Free Trade Areas (FTAs) but they are counterproductive if they are too restrictive. They argue that there are various and diverse Rules of origin across the RECs in Africa which are hindering participation in Trade. Therefore, they opine that finding common and simpler Rules of origin will be a major boost to fulfilment of the AfCFTA's objectives. It appears that there is a lot to be done even if Rules of Origin are reviewed because whereas EAC eased the rules to satisfy the 'substantial transformation' requirement for intra-EAC trade, the latest East Africa Common Market Scorecard of 2016 reveals that EAC states are not recognising EAC rules of origin certificates as was the case in 2014. Therefore, this study identifies Rules of origin that hinder Kenya and EAC at large from effectively participating in value chains.

1.10.7. Conclusion

The study has demonstrated that this areas is largely studied by economist who do not place emphasis on the role of law in investment of GVCs. This research seeks to seal this gap in literature by studying and analysing the law to find out how it affects participation and investment in GVCs.

<https://www.industrialization.go.ke/index.php/downloads/538-draft-national-automotive-policy-february-2019> accessed 2 January 2021.

[69]State Department for Industrialization (n 17).

[70]EAC, 'East African Community Industrialisation Strategy 2012 - 2032' <http://repository.eac.int/handle/11671/542> accessed 2 January 2021.

[71]Martin Mulwa, 'Buy Kenya, Build Kenya: Preserving EAC Regional Integration,' (CUTS International, Geneva 2018).

1.11.0. Scope of the Study

The study focuses majorly on Kenya's commercial laws to find out what laws and do those laws affect Kenya's participation and investment in GVCs.

Bearing in mind that GVCs involves value addition in several countries, recognising that Kenya is also bound by regional laws and agreements, and taking into account the provisions of Article 2(6) of the Constitution of Kenya which provides that treaties or conventions ratified by Kenya are laws of Kenya, this study also examines regional legal regimes that Kenya is party to mainly COMESA and EAC treaties to find out how the regional regimes affect Kenya's participation and investment in GVCs.

The study then uses the provisions of the AfCFTA and select WTO agreements as yard sticks to find out how Kenyan and regional laws should be designed to ensure effective participation and investment in GVCs. The study of these laws is necessary and enables the research to make sound and well informed point of views leading to excellent recommendations.

1.12.0. Chapter Breakdown

This study has five chapters. Chapter one covers the background to the research, the statement of the problem, justification of the study, the theoretical framework, literature review, objectives of the research, hypothesis, research question sought to be answered, methodology to be used, limitation to the study and the chapter breakdown.

Chapter two analyses of impact of Kenya's investment laws to determine whether they encourage or discourage entry of investors who are instrumental in supplying factors of production such as capital, knowhow and technology which are necessary in GVCs. Some of the considered laws include but not limited to Companies Act No. 17 of 2015, Foreign Investments Protection Act Chapter 518, Investment Promotion Act No. 6 of 2004, Industrial and Commercial Development Corporation Act Chapter 445 among other laws. The chapter concludes that Kenya's investment laws are constitute some of the barriers to entry of investors.

Whereas as chapter two analyses laws that determine entry of investors who play a key role in GVCs, Chapter 3 addresses legal opportunities, challenges and threats that those investors

face once they have invested in Kenya. In particular the chapter considers tariffs that the investors in GVCs must contend with once they have invested in Kenya. The chapter analyses various laws such as Income Tax Act, Value Added Tax Act, The East African Community Customs Management Act, 2004, EAC and COMESA Treaties together with protocols thereunder, AfCFTA, as well as the General Agreement on Tariffs and Trade (GATT 1994) among other laws. The chapter concludes that Kenya has imposed high tariffs that repel potential investors who may have wanted to invest in GVCs.

Apart from tariffs as discussed under chapter three, chapter four addresses other barriers to entry and retention of investors. Such other factors includes non-tariff barriers to participation and investment in GVCs. The chapter analyses various non-tariff barriers and how they affect effective participation in GVCs. Consequently, the chapter considers various laws on non-tariff barriers including but not limited to the East African Community's Elimination of Non-Tariff Barriers Act, 2017 and the Rules of Origin under the EAC, COMESA and AfCFTA. The chapter concludes that Kenya has non-tariff barriers that affect effective participation and investment in GVCs even though AfCFTA calls for reduction of non-tariff barriers.

Finally, chapter five presents findings, recommendations and the conclusion to the study.

2.1.0. CHAPTER TWO: IMPACT OF KENYA'S INVESTMENT LAWS ON PARTICIPATION AND INVESTMENT IN GVCS

2.2.0. Introduction

The World Bank ranks key determinants for GVC participation in the following order of importance: (i) factor endowments, (ii) geographical location, (iii) domestic industrial capacity, (iv) trade policy and foreign direct investment (FDI), (v) institutional quality, (vi) connectivity, and (vii) macroeconomic factors.[72] Contrary to World Bank ranking, this research takes the view that conducive legal environment is a condition precedent to effective participation and investment in GVCs. This is so because most of the Least Developed Countries (LDCs) are resource endowed but are unable to participate in value chains effectively.

Sessional paper no. 9 of 2012 on the National Industrialization Policy Framework for Kenya 2012 – 2030 confirms that Kenya is resource endowed.[73] However, Kenya's participation in value chains is negligible and when it does, it is along forward linkages by exporting raw material at low prices without or with little value addition. Conversely, whereas most developed countries lack some raw materials, they participate in GVCs along backward linkages because they import raw materials at low cost from LDCs for value addition. The developed nations add value to the products then export the finished goods back to LDCs at high prices. Therefore, this study takes the position that availability of conducive legal environment opens doors to GVCs participation and investments. This chapter concludes that friendly and consistent laws attract local and foreign investors who exploit factor endowment.

2.3.0. Relationship between Law, Investments and GVCs

The Wold Bank opines that availability of factor endowment is key to participation in value chains.[74] On the other hand, Sessional Paper No. 9 of 2012 indicates that Kenya is resource endowed but the country is unable to participate in value chains. This means that availability of factor endowment is not, in itself, a ticket to effective participation in value chains. This research maintains that there must be investors to exploit and add value to the available factor endowments. This research further takes the position that investors provide FDI therefore,

[72]Fernandes, Kee and Winkler (n 53).

[73]Ministry of Industrialization, Trade and Enterprise Development, 'Sessional Paper No. 9 Of 2012 On the National Industrialization Policy Framework for Kenya 2012 - 2030' 6.

[74]Ana Fernandes, Hiau Looi Kee and Deborah Winkler, *Determinants of Global Value Chain Participation: Cross-Country Evidence* (World Bank, Washington, DC 2020) <http://hdl.handle.net/10986/33519> accessed 18 April 2021.

Kenya must have good legal environment to attract and retain investors. In fact, the World Bank suggests that FDI provide capital, technology, infrastructure and know-how for exploitation of the available resources.[75]

FDI is key to participation value chains. Melo and Twum agree that availability of FDI has a positive impact on participation in GVCs especially in LDS.[76] The World Bank also reports that FDI benefits the host state if well harnessed since it leads to transfer of managerial skills, and enhance access to market which leads to production of more competitive goods.[77] Further, Fernandes, Kee and Winkler report that availability of FDI contributes to intensity of backward GVC participation.[78] It then follows that it is vital for Kenya to attract and retain FDI.

Sornarajah's view that FDI can be attracted and retained if the laws protect foreigners and their properties is accurate.[79]Antràs agrees and adds that countries that enact FDI friendly laws and policies including laws that reduce the risk of expropriation and laws that offer tax breaks for new foreign investors have higher chances of participating in GVCs.[80] These assertions may be true considering the way some Asian countries such as South Korea, Malaysia, Singapore, Vietnam developed fasters. Faster development of some of these Asian countries is attributable to laws and policies that cut tariff leading to attraction and retention of FDI from Japan.[81] This resonates with Professor Yong-Shik Lee's general theory of law and development as discussed in chapter one. In the theory, Lee argues that South Korea deliberately enacted laws to attract investments including laws that reduced taxes. This confirms that there is direct relationship between law and development.

Therefore, to understand why there is less investment in GVCs in Kenya, it is vital to consider the relationship between Kenya's investment laws. This chapter discharges this mandate by examining the impact of investment laws right from attraction, entry, and retention of investments. The laws and policies are analysed below beginning with National Industrialization Policy.

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[75]ibid.
[76]Jaime de Melo and Anna Twum, 'Supply Chain Trade in East Africa: Prospects and Challenges*' 53, 26.
[77]Fernandes, Kee and Winkler (n 53) 8–9.
[78]ibid 16.
[79]Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (3rd ed, Cambridge university press 2010).
[80]Antràs (n 7) 22.
[81]Melo and Twum (n 75) 10.

2.4.0. The National Industrialization Policy Framework for Kenya 2012 - 2030 (Sessional Paper No. 9 of 2012)

The policy seeks to transform Kenya into a globally competitive regional industrial hub. One of the specific objectives of the policy is to increase the share of locally produced industrial components, spare parts, and machine tools by 25%. To realise the objective, the policy puts forward strategies including facilitating the creation of a business-friendly environment for private sector-led industrialization; attracting local and foreign direct investment in manufacturing and related services; promoting value-addition in the industrial sector for both local and export markets; and by creating legal and regulatory framework to support vibrant industrial sector.[82] Whereas this policy has good strategies, it has not been implemented fully which is contrary to Professor Yong-Shik Lee's general theory of law and development as discussed in chapter that laws and policies should be implemented to achieve growth and development in a country.

2.5.0. Registration of Business Names Act Chapter 499

Persons who wish to register business names under Registration of Business Names Act feel the positive impact of National Industrialization Policy. The Act governs the registration of firms, individuals and corporations carrying on business under a business name. It is affordable to register a sole proprietor under the Act. At the time of this study, business name registration fees was Kshs 850.00. Upon registration, the registered entity can transact in Kenya as a sole proprietor.[83] Kenya has done well on this aspect because it is easy to register a business name that may be a vehicle of investing in Kenya.

However, registration the Act has various cons. For example, sole proprietorship is an affordable vehicle of investment for young and start up entities that do not have deep pockets to set up sophisticated companies. However, the registered entity and the owner are the same. Consequently, the owner is liable to liabilities that the entity incurs. Therefore, operating a sole proprietorship may not be an appropriate means of investment for foreign investors as it may directly expose the investor to all manner of liabilities. An investor may therefore opt for a company as a vehicle of investment.

Secondly, whereas Kenyans and foreigners who have work permit and desirous to invest Kenya can easily do so by registering a business name, a foreigner who intends to invest in

[82]Ministry of Industrialization, Trade and Enterprise Development (n 73) 5.
[83] Sections 4 and 14 of the Registration of Business Names Act

Kenya yet has not obtained a work permit cannot benefit from this statute because one of the requirements for issuance class G work permit is that the investor should have registered a company.[84] Therefore, the Act does not have any use to foreign investors who intend to invest in Kenya but are yet to obtain work permits or residence permit. It is necessary to recall that application and obtaining work permit takes a long time while obtaining residence permit takes even longer because residence permit cannot be issued if a work has not been issued. Therefore, a foreign investor may opt to invest in another country where it is easier to obtain these permits.

2.6.0. Companies Act No. 17 of 2015

The Companies Act, 2015 revolutionised company law in Kenya. The objects of the Act include facilitating commerce, industry, and other socioeconomic activities by enabling one or more natural persons to incorporate entities with perpetual succession, with or without limited liability, and to provide for the regulation of those entities in the public interest, and in particular, in the interests of members of the entities and creditors.[85]

The Act has facilitated ease of doing business in Kenya and by extension, ease in registering foreign companies. For example, one person can now incorporate a company with perpetual succession, with or without limited liability,[86] which is an improvement of the repealed Companies Act Cap 486 which required at least two persons to incorporate a company. In addition, the Act now allows adoption of model articles as the constitution of the entity,[87] it makes company seal optional,[88] and it is not mandatory for a private company to have a company secretary if it has a paid-up capital is less than Kshs 5,000,000.[89] In addition, Part XXXVII of the Act provides details for registration and regulation of foreign companies registrable under the Act. Apart from that, companies are not required to pay duty on capital during registration pursuant to section 39 of the Stamp Duty Act Cap 480. The duty was waived vide Legal Notice No. 60 of 2015.

[84] Directorate of Immigration Services, 'Class G: (Specific Trade, Business or Consultancy)' (*Directorate of Immigration Services*) <https://immigration.go.ke/work-permits-passes/class-g-specific-trade-business-or-consultancy/> accessed 2 October 2022.
[85] Section 2 of the Act
[86] See section 11
[87] Section 20(3)
[88] See Sections 37 and 38
[89] Section 243 (1)

From the foregoing provisions, this study argues that Kenya has done well under Companies Act because the Act has made it easier for local and foreign entities to invest in Kenya. It means that it is easier to set up entities both local and international to participate in GVCs. Upon registration, if the investor is foreigner, then the investor must adhere to other conditions under other laws such as Foreign Investments Protection Act.

2.7.0. Foreign Investments Protection Act Chapter 518

In attempt to attract, protect and retain FDI, Kenya enacted Foreign Investments Protection Act, which contains various provisions on protection of investors and their properties in accordance with the provisions of the Constitution of Kenya. Those rights includes the right to repatriate profits.[90] The Act also bars deprivation of the property unconstitutionally.[91] However, the Act has some glaring loopholes that may hamper attraction and retention of investments. For example, the Act does not address the role of intellectual property in investment.

This research takes a position that there is a close relationship between GVCs and utilisation and protection of intellectual property rights. However, the role of intellectual property under the Act is not clear for two reasons. Firstly, even though the Act defines foreign asset to include 'rights,' it is not clear whether such rights include intellectual property rights.[92] Secondly, section 3(4)(c) of the Act limits foreign assets to capital or 'funds' in form of a fixed amount representing the equity of the holder in an enterprise and which should be expressed either in Kenyan currency or the relevant foreign currency. The above two reasons means that the Act does not recognise intellectual property as capital that is investable by a foreigner yet the same deserve protection. This research argues that notwithstanding that, Kenya has intellectual property laws such as the Industrial Property Act,[93] Copyright Act,[94] and Trade Marks Act;[95] the Foreign Investments Protection Act should expressly provide that intellectual property is investible and protectable. To cure the challenge, section 3(4) (c) (i) of the Foreign Investments Protection Act, the Act should be amended by deleting and replace it with the phrase, 'description of the property invested.'

[90]Laws of Kenya, Foreign Investments Protection Act Chapter 518 2017 s 7.
[91]ibid 8 and the Schedule.
[92]ibid Section 2(1).
[93] No. 3 of 2001
[94] No. 12 of 2001
[95] Cap. 506

To understand the impact of omitting intellectual property under the Act, it is important to revisit Professor Lee's regulatory design aspect under the General Theory of Law and Development theory. Under Lee's theory, regulatory design determines whether the law achieves its regulatory objectives. This study argues that one of the regulatory objectives under the Foreign Investments Protection Act ought to have provisions that expressly protect intellectual property. This research opines that no foreigner will be willing to invest in Kenya if there is no guarantee and express protection of intellectual property under the Act.

2.8.0. Investment Promotion Act No. 6 of 2004

The purpose of Investment Promotion Act is 'to promote and facilitate investment by assisting investors in obtaining licences necessary to invest and by providing other assistance and incentives and for related purposes.'[96] The Act allows both the local and foreign investors to invest in Kenya.[97] This plausible. However, the Act makes it hard to invest in Kenya due to various barriers.

The first barrier is clear under section 3 of the Act. Section 3 imposes the requirement that the investor is required to apply and obtain investment certificate from the Kenya Investment Authority, as well as other licenses from various institutions upon payment of fees.[98] Whereas the government earns revenue from such fees, this research opines that it is unreasonable to require an investor to pay fees to invest in Kenya when the investor will create employment and generate revenue to the government inform of taxes. In other words, the investor must pay to invest in Kenya. These licenses, permits, and associated fees are some of the non-tariff barriers (NTBs) to participation and investment in GVCs as discussed under chapter four. It is counterintuitive to seek FDI on one hand, but on the other, instituting barriers to investment through NTBs that create barriers to entry of investors.

The second barrier is evident under Section 4 of the Act. Section 4 poses impediment to investment in various ways. To begin with, section 4(b) and (c) of the Act contains direct barrier to investments. Issuance of investment certificate under the impugned section cannot happen unless the foreigner invests at least one hundred thousand United States of America dollars ($100,000) or the equivalent in any currency, while the minimum investable amount for a local investor is at least one million Kenya shillings (Kshs 1,000,000.00). Whereas the

[96]ibid see the Preamble.
[97]ibid 3.
[98]ibid Section 12 (3).

state may have intended to weed out foreign vagabonds through the threshold under section 4, the said law means that persons with less than minimum financial threshold are not investors and cannot be investors under the laws of Kenya. This means that such person will avoid Kenya in favour of other locations. Such thresholds are what Fernandes, Kee and Winkler term as impediments to entry of FDI, which in turn hinder a country's participation in GVCs.[99]

Further, the impact of impediment under section 4 of the Act is that the minimum amounts set under the said section means that investors with less than the minimum investible amounts cannot lawfully purchase shares in local entities. Doing so means that the investment is not protected. Apart from that, a foreigner who would have invested say $95,000 in an infant industry to boost it cannot do so because the laws of Kenya do not recognise such investments. This means that an infant industry which may not have sufficient resources cannot benefit from capital injection therefore, maybe unable to add value to its products meaning that its products may not be competitive enough to take on products from other countries. As such, Kenya's 'protecting infant industries' policies are likely to continue for years due to investment stifling laws.

Apart from the examples above, section 4 of the Act is also inconsistent with Article 159(2)(b) of the COMESA Treaty. The COMESA Treaty recognise shares and any other rights of participation in the management or economic results of a company or a firm, whether incorporated or not, including minority shares, corporate rights, and any other kind of shareholding as investments that should be protected.[100] Section 4 of the Act is inconsistent with the said treaty in that a foreigner cannot buy shares whose value is less than $100,000 yet a relevant company may be offering shares but less than $100,000.

Just like Foreign Investments Protection Act, Investment Promotion Act is silent on the role of intellectual property in investments. GVCs thrive in countries where there is recognition and enforcement of intellectual property rights. This research finds that the Act is an impediment to participation in GVCs because it does not recognise intellectual property as human capital. The financial thresholds under section 4 of the Act and the definition of

[99]Fernandes, Kee and Winkler (n 74).
[100]Treaty establishing The Common Market for Eastern and Southern Africa 1994 See Article 159.

'investment' under section 2 of the Act does not recognise intellectual property. The Act defines 'investment' as:

> *The contribution of local or foreign capital by an investor, including the creation or acquisition of business assets by or for a business enterprise and includes the expansion, restructuring, improvement or rehabilitation of a business enterprise.*[101]

Considering section 4 together with the definition of investment under section 2 of the Act means that intellectual property is not an investment for the purposes of investments in Kenya because the Act defines investments in monetary terms only. This narrow definition of investment is contrary to the to the meaning of investments under Article 159 (2) (e) of COMESA Treaty which recognises that intellectual and industrial property rights, technical processes, know-how, goodwill and other benefits or advantages associated with a business are investments and should be protected.[102] Whereas Kenya is party to the treaty, its definition of investments does not recognise intellectual property rights. Consequently, Kenya's focus on tangible assets in form of cash as the key ingredient for issuance of investment certificates means that intellectual property holders who own patents or designs or know-how cannot invests GVCs in Kenya even if Kenya has factor endowments.

Apart from the financial impediments, section 4 (2) of the Act imposes additional mandatory requirements before issuance of investment certificate. For example, the Act requires that the investment must create employment for Kenyans; and that must the investment lead to acquisition of new skills or technology for Kenyans.

This study opines that whereas the requirements on creation of employment for Kenyans and contribution to tax revenues or other Government revenues may not be a problem, the study opines that the condition that investments must lead to acquisition of new skills or technology for Kenyans may not be achievable to some investors. This is so because not all investments involve transfer of skills or technology. For example, some technologies may be part of intellectual properties and not transferable. In addition, a person may be desirous of injecting $100,000 in a start-up company in Kenya to boost its capital without transferring skills or technology to Kenyans. Therefore, the Act has unreasonable and unnecessary barriers to entry of investors who may have invested in GVCs.

s[101]Laws of Kenya Investment Promotion Act No. 6 of 2004 Section 2.
[102]Treaty establishing the Common Market for Eastern and Southern Africa.

To sum it up, the Investment Promotion Act does not promote investment in Kenya. Secondly, the focus on cash as the only form of capital locks out holders of intellectual property rights from investing in Kenya which may explain low FDI in Kenya and negligible participation in value chains. Thirdly, review of the Investment Promotion Act is necessary to reflect the provisions of Article 159 COMESA Treaty. Finally, amendments to section 4 of the said Act is necessary to eliminate the monetary thresholds.

2.8.1. Contradictions under Foreign Investments Protection Act and Investment Promotion Act

In chapter one, the study revealed that Kenya has contradictory investment laws. This is evident because Kenya has two regimes that attempts to regulate foreign investments—the Foreign Investments Protection Act and Investment Promotion Act. The two Acts are contradictory. Under the Foreign Investments Protection Act, a foreign investor is required to obtain investment certificate from the Minister in charge of finance. The minister has wide discretion in issuance investment certificate.[103] On the other hand, under Investment Promotion Act, the investor is supposed to obtain investment certificate from the investment authority.[104] It is not clear under what circumstances should investor obtain investment from the minister or from the investment Authority. It is necessary to merge the two Acts to solve the issue.

2.9.0. Industrial and Commercial Development Corporation Act

The purpose of the Industrial and Commercial Development Corporation Act (ICDC Act) is to establish a corporation known as the Industrial and Commercial Development Corporation (ICDC).[105] Pursuant to section 3 of the ICDC Act, the purpose of the Corporation is to facilitate the industrial and economic development of Kenya by the initiation, assistance, or expansion or by aiding in the initiation, assistance or expansion of industrial, commercial or other undertakings or enterprises in Kenya or elsewhere.

This study opines that by virtue of section 3 of ICDC Act, ICDC has a legal duty to ensure that Kenya creates conducive environment for investors to invest in GVCs. This is so because the ICDC has mandate to initiate, assist, or expand industrial, commercial or other undertakings or enterprises in Kenya or elsewhere. One form of assistance that ICDC could

[103]ibid Section 3.
[104]Laws of Kenya Investment Promotion Act No. 6 of 2004 See Section 3.
[105]Law of Kenya Industrial and Commercial Development Corporation Act Chapter 445 2012 See the Preamble.

offer is marketing products manufactured through value chains. However, this is not the case because the ICDC markets products that are manufactured from local raw materials.[106] This is contrary to the spirit and values that govern GVCs because GVCs products contain components made from not only from local raw materials, but also from material from other countries.

Since GVCs involve import and export of goods, this research argues that ICDC should not only focus on marketing products made with local raw materials, but it should also assist in marketing products produced from a mixture of local and imported materials. Secondly, focusing on marketing finished products made with local raw materials means that ICDC is in breach of Most Favoured Nation (MFN) and National Treatment (NT) principles under Article I and Article III of GATT.[107] Therefore, ICDC has a legal obligation to ensure enterprises such as GVCs are thriving through supporting exiting ventures and setting up new ones.

2.10.0. Special Economic Zones Act No. 16 of 2015

The broad purpose of the Act is to establish Special Economic Zones (SEZ) mainly, Free Trade Zones (FTZ), Industrial Parks, Free Ports, Information Communication and Technology Parks (ICT Parks), Science and Technology Parks, Agricultural Zones, Tourist and Recreational Zones and Business Service Parks.[108]

Objectives of the Act includes providing an enabling environment for the development of all aspects of special economic zones including development of integrated infrastructure facilities; and creation of incentives for economic and business activities in areas designated as special economic zones. The Act also aims at removing impediments to economic or business activities to generate profit for enterprises in areas designated as special economic zones and to regulate and administer of activities within the special economic zones.[109] The zones are declared and remains in force until the cabinet secretary responsible for matters relating to industrialization revokes them.[110]

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[106] 'About ICDC' <https://icdc.co.ke/index.php/about-us/who-we-are/about-icdc> accessed 14 July 2021.
[107] General Agreement on Tariffs and Trade (GATT 1994).
[108] Laws of Kenya, Special Economic Zones Act No. 16 of 2015 2017 See the First Schedule.
[109] ibid Section 3.
[110] ibid Section 4.

Whereas the intentions of the Act are noble, the Act imposes various bottles necks in form of NTBs that investors shy away from entering the Zones. For example if an investor intends to carry on business as a special economic zone developer, operator or enterprise, the investor must obtained a licence from the Special Economic Zones Authority.[111] The license cannot be issued unless the Commissioner of Customs approves the application and upon payment of the prescribed fee.[112]

Apart from license application fees, the investor must provide financial plans before issuance of the license.[113] This means that if foreigner intents to invest in Kenya but within SEZ, the person must qualify as an investor first within the meaning of Investment Promotion Act No. 6 of 2004 under which this research has established that it is one of impediments to investments in Kenya. The result is that potential investors may not invest in Kenya and cannot benefit from waiver of taxes and free participation in international financial markets associated with SEZs.

2.11.0. Export Processing Zones Act Chapter 517

The overall purpose of the Act is to establish export processing zones and the Export Processing Zones Authority. The Act also aims to promote and facilitate export-oriented investments by developing enabling environment for such investment within Export processing zones.[114] For the purposes of import duties and taxes, Export Processing Zone (EPZ) is a controlled and designated part of Kenya where goods into and out of the zone are treated as being outside the customs territory.[115] Consequently, the goods or services manufactured in the EPZ are for export outside Kenya,[116] or for export into the customs territory (into Kenya) but with the approval of the Minister and subject to the import and customs procedures and payment of import duties.[117]

There are advantages attached to EPZ such as tax exemptions when importing into and exporting goods from EPZ.[118] Such exceptions are helpful in GVCs in particular for enterprises that seek to export goods from EPZ. However, section 25 (1)(b) of the Act

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[111]ibid Section 27(1).
[112]ibid Section 27(2).
[113]ibid Section 27(3).
[114]Laws of Kenya, Export Processing Zones Act Chapter 517.
[115]ibid Section 2.
[116]ibid Section 25(1)(a).
[117]ibid Section 25(1)(b).
[118]ibid See section 29.

imposes duties on goods from EPZ into Kenyan market meaning that there is no deference between importing goods from EPZ and importing from a foreign country because goods are subjected to taxes in equal measure.

Therefore, section 25 (1) (b) of the Act is an impediment to participation in value chains because goods from EPZ are subject to import duties and procedures which hinder participation in value chains. In fact, section 9A of the Miscellaneous Fees and Levies Act provides that duty on goods for home use from EPZ enterprise are subject to an additional duty of 2.5% of the customs value over and above the import duties payable under section 110 of the East African Community Customs Management Act, 2004.[119] It then follows the Kenya's investment laws should be reviewed.

2.12.0. Conclusion

This chapter has analysed various laws such as Sessional Paper No. 9 of 2012, Registration of Business Names Act, Companies Act No. 17 of 2015, Foreign Investments Protection Act, Investment Promotion Act, Industrial and Commercial Development Corporation Act, Special Economic Zones Act and Export Processing Zones Act. The research has pinpointed various advantages and loopholes in the said laws and how they affect investment GVCs. What is clear is that Kenya's investment legal regime especially the Foreign Investments Protection Act and Investment Promotion Act are barriers to entry of investors. The two Acts do not recognise the role of intellectual property in investments. On the other hand, Investment Promotion Act locks out potential investors who may not meet minimum financial thresholds under section 4 of the said Act. Therefore, the country may have factor endowments but may not have investors to exploit the resources.

[119]Laws of Kenya, The Miscellaneous Fees and Levies Act No. 29 of 2016 2016.

3.0.0. CHAPTER THREE: TAX BARRIERS TO PARTICIPATION AND INVESTMENT IN GVCs

3.1.0. Introduction

Chapter two of this study has discussed laws and policies that affect investments and how they influence participation in value chains. It is one thing to set up a business entity but it is another to run it. Upon investment, the investor has to contend with matters such as tax. Since GVCs involve cross border transactions, it involves imports and exports of goods and services. Consequently, imports and exports tariffs are some of key taxes that firms in GVCs must address. Different taxes serve different purposes but can be a blessing or a curse depending on how a country deals with them. Generally, tax is a top barrier to domestic or international trade. In fact, the East African Community Development Strategy for the Period 20161/17-2020/21 confirms that slow harmonisation of domestic taxes is a threat to existence of EAC.[120] This chapter discusses various tax laws and how they impact Kenya's participation n GVCs or RVCs.

3.2.0. General Impact of Taxes on Participation and Investment in GVCs

Countries impose taxes for various purposes. Many countries including Kenya impose tariffs to control imports and exports to protect internal markets. Whereas tariffs maybe helpful in short run, the overall outcome is that they hurt economies in long run when used for the wrong purpose. According to Melo and Twum, whereas Regional Economic Communities (RECs) in other continents such in Asia impose lower taxes, Africa impose high tariffs on intermediates in pursuit of inward-looking industrialisation which explains high trade barriers and limited access to markets within RECs such as EAC or COMESA.[121]

According to Melo and Twum's 2020 research, Association for Southeast Asian Nations (ASEAN) and the Southern Common Market (MERCOSUR) have abandoned or substantially reduced trade barriers. Melo and Twum's research further indicates that tariffs in African regions have been reducing for the past 15 years; the average tariff on intermediates across African countries is around 10%, twice as high compared to other developed countries.[122] Melo and Twum argue that high tariff is a top barrier to participation and investment in GVCs because tariffs have a higher impact on the cost of vertical

[120]East African Community, 'East African Community Development Strategy for the Period 20161/17-2020/21' <http://repository.eac.int/handle/11671/1952>.
[121]Melo and Twum (n 6).
[122]Jaime de Melo and Anna Twum, 'Supply Chain Trade in East Africa: Prospects and Challenges*' 53, 20.

specialization compared with regular trade on grounds that a product is subject to multiple tariffs every time it crosses custom boarders. The two researchers also note that goods are subject to tariffs based on gross output and not on value-added. Therefore, even small tariffs have a large effect on costs of goods.[123]

Fernandes, Kee and Winkler agree with Melo and Twum that regulatory barriers on imports and exports through tariffs or quotas increase trade costs, which affect participation and positioning in GVCs. They argue that reducing barriers lowers the price of input costs and final goods hence it is beneficial to participation and investment in GVCs.[124] Apart from that, Fernandes, Kee and Winkler report that lower tariffs and larger FDI inflows are associated with higher backward GVC participation shares across countries.[125] Low tariffs and high FDI inflows are important in increasing levels of backward GVC participation of a country.[126]

3.3.0. Specific Tax Laws Affecting Investment in GVCs

The Central Bank of Kenya (CBK) conducted a monetary survey targeting CEOs of private sector firms comprising members of the KEPSA and KAM and released the report dated May 2021. The report indicates that 9.6% of the respondent said that high taxes and unpredictability of tax laws is a threat to survival of businesses.[127] At the same time, 26.5% of the Responded stated that improving regulatory environment concerning tax regime would improve business performance.[128] Therefore, to verify these fears, this chapter critically analyses Kenyan tax laws and policies law as well as other applicable tax laws within EAC. This part also considers other EAC tax related laws to ascertain their impacts on participation in GVCs within the region. One of the tax laws in Kenya is the Income Tax Act.

3.3.1. Income Tax Act Chapter 470

As discussed in chapter one and two, there is direct relationship between taxation and participation in value chains. Income tax is one of the taxes that hinder entry and sustainability investments as demonstrated in this chapter. In Kenya, the Income Tax Act governs income tax matters. The Act provides for the charge, assessment, and collection of

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[123]ibid 21.
[124]Fernandes, Kee and Winkler (n 53) 8.
[125]ibid 16.
[126]ibid 20.
[127]Central Bank of Kenya, 'Monetary Policy Committee CEOs May 2021' (Central Bank of Kenya 2021) Monetary <https://www.centralbank.go.ke/uploads/market_perception_surveys/859518685_MPC%20CEOs%20Survey,%20May%202021.pdf>.
[128]ibid.

income tax, the ascertainment of the income to be charged, and the administrative and general provisions relating thereto.[129] Under section 3(1) of the Act, investors are liable to pay income tax for each year of income upon all the income—whether resident or non-resident, which accrued in or was derived from Kenya. Further, section 3(2) (a) (i) of the Act provides that income upon which tax is chargeable includes gains or profits from any business, for whatever period carried on. Whereas paying income tax is vital to any country, there are circumstances under which income tax repels investors. A good example is section 4(a) of the Act.

Section 4 (a) of the Act has direct impact on participation and investment in GVCs. It provides that where a business is carried on or exercised partly within and partly outside Kenya by a resident person, the whole of the gains or profits from such business shall be deemed to have accrued in or to have been derived from Kenya. Take for example, investor X LTD that resides in Kenya and seeks to utilise factor endowments in Kenya. X exports raw carbon fibre to its facility in France for further processing under GVCs because it does not have capacity to process carbon fibre locally. In light of section 4(a) of the Act, the investor will pay multiple taxes—in Kenya and in France as explained in examples below.

First, X LTD will have to pay income tax in Kenya and in France in absence of Double Taxation Agreement (DTA) between Kenya and France because income is generated in two jurisdictions pursuant to GVCs transaction. Even though taxes paid in France maybe deemed to be expenses in light of section 15 and 16 of the Act therefore deductible, the whole process leads to double taxation since production expenses increase as viability of investing in GVCs reduce. Double taxation reduces income to levels that existing investments maybe unsustainable leading to winding up and exit Kenyan market altogether. At the same time, potential investors may avoid investing in GVCS due to double taxation under section 4 (a) of the Act.

Second, while exporting raw carbon fibre to France, X LTD will have to pay export tariffs on the item. On arrival, France may impose import tax on the same item before it accepts it. Upon value addition, France may impose export tax to the same item and on arrival at Mombasa port; Kenya subjects the item to import tax. Such multiple taxes kill attractiveness of investing in GVCs in Kenya. To this end, the USA Commerce Department indicates that

[129]Laws of Kenya, Income Tax Act Chapter 470 2018.

since there is no double tax treaty between Kenya and the United States, some USA investors may be unwilling to invest in Kenya.[130]

The theoretical examples above confirms that multiple taxes in multiple jurisdictions affect investment in GVCs unlike investment in conventional trade in which traders pay taxes on final product only. Multiple taxes leads to losses hence discouraging initiation, growth and development of value chains. Melo and Twum assert that GVCs collapse when the gains from specialization in tasks and economies of scale become less than the tariffs collected along the supply chain.[131] When governments increases taxes as the source of revenue, investors exit.

As already noted, whereas taxation is a source of revenue for any government, taxation stifles businesses. The stifling has direct negative impact on economy as investors exit in search of countries that have favourable tax regimes. For instance, brands such as Colgate Palmolive, Reckitt Benckiser, Procter & Gamble, Bridgestone, Johnson & Johnson and Unilever exited Kenya due to high costs of production. Cadbury Kenya ltd maybe on the exit list to Egypt or South Africa due to high taxes and high costs of production in Kenya.[132] When investors exit and when potential investors avoid investing in a country due to high taxes, governments lose revenue while citizens suffer from unemployment.

Therefore, since the whole of the gains or profits, arising from investing in GVCs is subject to section 4(a) of the Income Tax Act and maybe subject to double taxation, entities in Kenya are discouraged from participating in value chains. Consequently, the parliament should review section 4(a) of the Income Tax Act to eliminate over taxation on firms that participate in GVCs. Secondly; Kenya may consider negotiating for Double Taxes Agreements (DTA) with various countries, which should provide tax incentives to GVCs businesses to taxes on such businesses.

[130]International Trade Administration, U.S. Department of Commerce, 'Kenya - Trade Barriers' (13 September 2021) <https://www.trade.gov/country-commercial-guides/kenya-trade-barriers> accessed 30 September 2021.
[131] De Melo and Twum (n 76) 24.
[132]Nyabiage, 'Cadbury Mulls Exiting Kenya after Takeover by Rival | Kenya' (29 June 2020) <https://nation.africa/kenya/life-and-style/smart-company/cadbury-mulls-exiting-kenya-after-takeover-by-rival--628606?view=htmlamp> accessed 31 August 2021.

3.3.2. Value Added Tax Act No. 35 of 2013

Apart from Income Tax Act, investors in Kenya pay Value Added Tax under the Value Added Tax Act.[133] The Act provides for the law relating to value added tax; the imposition of value added tax on supplies made in, or imported into Kenya, and for connected purposes.[134] The Act affects participation in GVCs as the payable tax is not on the value added, but on gross output.

Section 5 of the Act charges value-added tax on a taxable supply made by a registered person in Kenya; importation of taxable goods; and on supply of imported taxable services. Under the Act, goods and services can be zero-rated or subject to 16% tax,[135] depending on classification of goods or services. VAT affects investment in GVCs because investing in GVCs involves imports and export of good and services as the components. The components are subject to import tax unless the components are expressly zero-rated or if there tax waiver. In fact, Section 5(5) of the Act provides that the imported goods are subject to import tax as if they were duty of customs and the tax become due and payable by the importer at the time of importation. The act has various impact on participation value chains as highlighted hereunder.

3.3.2.1. High and Multiple Taxes on Imports under VAT Act

Concerning GVCs, VAT Act imposes VAT not on the value-added, but on gross output that leads to high taxes resulting to losses. The net effect is that it discourages investments in GVCs as production of goods becomes expensive which translates to expensive and uncompetitive products.[136] To illustrate this issue, the study examines the provisions of section 14 (1) of the VAT Act which is instrumental in determining payable VAT on imported goods.

Section 14 (1) of the Act provides that the value of tax on imported goods is a sum of the following:

(a) the value of the goods ascertained for the purpose of customs duty, in accordance with the East African Community Custom Management Act, 2004, whether or not any duty of customs is payable on the goods;

[133] Act No. 35 of 2013
[134] Laws of Kenya, Value Added Tax Act No. 35 of 2013 2018 See the Preamble.
[135] See section 5(2) of the Act.
[136] De Melo and Twum (n 76) 21.

(b) the cost of insurance and freight incurred in bringing the goods to Kenya if not included;
(c) the cost of services treated as part of the imported goods; and
(d) The amount of duty of customs, paid on those goods.

Section 14 (1) of the VAT Act charges tax not on the value added, but on all expenses incurred in relation to the goods. These expenses include custom duty tax which section 2 of the VAT Act defines as '*import duty, excise duty, export duty, countervailing duty, levy, cess, tax, or surtax charged under any law for the time being in force relating to customs or excise*.' Therefore, section 14 (1) amounts to imposing tax on another tax when dealing with VAT on imports. This is over taxation has negative effect of increasing the cost of goods to the benefit of the state but to the detriment of importers and ultimate consumer of the goods. This taxation makes goods uncompetitive in international trade because the product is expensive in relation to products from other countries.

The provisions of section 14 (1) of the VAT Act confirms that the payable tax is not on the value added, but the total costs for importing the item which is then subjected to 16% tax. In fact, components meant for GVCs are subject to VAT before actual value addition. After value addition, those components will still be taxed during export. This study argues that the design and the architecture of section 14(1) determines VAT for finished goods, and it does not take care of components meant for GVCs.

This research recommends that section 14 (1) of the VAT Act be amended because it focuses on the value of finished products and not material or components that used in GVCs. This means that various components meant for GVC are subject to VAT even though they are not final products. In addition, the National trade policy also recommends that the government should review and rationalize all taxation laws and regulations to enhance competitiveness in production.[137] It is time to amend the VAT Act to allow Kenya to participate in GVCs and RVCs.

Apart from the foregoing, firms are entitled to recover input VAT. However, the process of recovering it is complicated affair and takes long time. A research conducted by UNCTAD in

[137]Ministry of Industry, Trade and Cooperatives State Department for Trade, 'National Trade Policy "Transforming Kenya into a Competitive Export-Led and Efficient Domestic Economy"' 32.

October 2020 on Kenya's non-tariff measures reveals the refund could take up to six months. The research also indicates that the respondent were unhappy with lengthy procedure leading to wastage of time leading to extra operational costs for firms participating in cotton value chains.[138]

The VAT Act also provides for exemptions when applicable. The investor has to obtain exemption certificate. However, the UNCTAD research reveals that the firms were not happy with the procedure for obtaining exemptions because the process is lengthy and complicated. The research indicates that importers are required to make an application for exemption to the State Department of Industrialization including submitting a "master list of items." The State Department of Industrialization then forwards the application to the National Treasury for processing and approval. When the Treasury approves the application, it sends it back to the State Department of Industrialization that issues the exemption certificate. Finally, State Department of Industrialization forwards the certificate to Kenya Revenue Authority (KRA). The respondents in the UNCTAD research stated that this process takes about four months and that they must repeat the process for each consignment that is imported. The respondents complained that the process is uncertain, time consuming, and requires many pre-planning processes. Therefore, the respondents stated that they lose business opportunities. Consequently, the process results to diminished competitiveness leading loss of competitive advantage.[139]

3.3.3. Excise Duty Act No. 23 of 2015

The Excise Duty Act provides for the charge, assessment, and collection of excise duty. It also to make administrative provisions in relation to excise duty.[140] Section 5 (1) (c) of the Act imposes a tax, known as excise duty on excisable goods imported into Kenya. The tax is payable by the importer of the excisable goods,[141] and it is payable at the time of importation.[142]

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[138]United Nations Conference on Trade and Development, 'Assessing Cost-Effectiveness of Non-Tariff Measures – A Toolkit: A Case Study in Kenya' (2020) UNCTAD/DITC/TAB/INF/2020/8 <https://unctad.org/node/29723>.
[139]ibid.
[140]Laws of Kenya, Excise Duty Act No. 23 of 2015 2020 The Preamble.
[141]Section 5 (3) (c) of the Act.
[142] Section 6 (4) (b) of the Act see also section 36 (3) of the Act.

Section 3 (1) of the Act provides that the value of goods and services of the excisable goods or services at a particular time is the price that the goods or services would reasonably be expected to fetch in an arm's length transaction at that time at the wholesale level. If the open market value of excisable goods or services at a particular time cannot be determined, section 3(2) of the Act provides that the open market value is the price, which is an objective approximation of the price of the goods or services according to the Fourth Schedule of the East African Community Customs Management Act.

The provisions of section 3(1) and (2) of the Act introduces uncertainty in determining payable excise duty in that the tax may not be based on actual price, but maybe based on approximate price that the goods or services would reasonably be expected to fetch in an arm's length transaction. This uncertainty means that investors are unable to determine costs and profits of investments therefore, this may hinder investors from investing in Kenya.

3.3.4. The Miscellaneous Fees and Levies Act No. 29 of 2016

Apart from the above highlighted Acts, investors have to contend with taxes under Miscellaneous Fees and Levies Act. The Act provides for duties, fees and levies imposed on imported or exported goods.[143] Section 5 of the Act imposes export levy on all goods under the First Schedule to the Act. It is interesting that whereas section 6 exempts imposition of export levy on all goods to EAC Partner states, the exemption does not extend to goods exported to COMESA Partners states yet Kenya is party to COMESA Treaty, which under Article 46 mandates member states to liberalise trade by eliminating taxes by the year 2020. This means that an investor participating value chains is subject to taxation under Section 5 of the Act yet such taxation ought to have stopped in the year 2020.

Consequently, pursuant to Section 5 of the Miscellaneous Fees and Levies Act, investors have a limited access to markets, which hinders development. Going by Nobel Prize winner, Amartya Sen who describes development as a right or a freedom to access markets, it means that taxation under Section 5 of the said Act hinders development as investors do not have free access to COMESA market.

[143] See the preamble Laws of Kenya, the Miscellaneous Fees and Levies Act No. 29 of 2016.

The following are some of taxes and charges that investors face under Miscellaneous Fees and Levies Act:

Import Declaration Fee

Section 7(1) of the Act imposes Import Declaration Fee (IDF) on all goods imported into the country for home use. The fee is 3.5% of the customs value of the goods and is payable by the importer of the goods at the time of entry of the goods.[144] If the imports consist of raw materials and intermediate products approved and recommended by the Cabinet Secretary responsible for matters relating to industry, the import declaration fee is 1.5% of the custom value of the goods.[145] On the other hand, goods imported under the East African Community Duty Remission Scheme are subject to import declaration fee at a rate of 1.5% of the customs value.[146] The purpose of the import declaration fee is for the payment of Kenya's contributions to the African Union and any other international organisation to which Kenya has a financial obligation.[147]

A publication of 13 September 2021 by International Trade Administration, a U.S. Department of Commerce publication indicates that obtaining waivers or approvals from the Cabinet Secretary responsible for matters relating to industry is cumbersome marred with delays that the US investors hesitate to invest in Kenya.[148]

Railway Development Levy

Apart from the foregoing, section 8 of the Act imposes railway development levy at the rate of 2.5% of the customs value of the goods on all goods imported into the country for home use. The importer pays the levy at the time of the entry of the goods. On the other hand, if the imports consist of raw materials and intermediate products approved and recommended by the Cabinet Secretary responsible for matters relating to industry, the levy is 1.5% of the custom value of the goods. The purpose of the levy is to provide funds for the construction and operation of a standard gauge railway.

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[144]ibid Section 7(2).
[145]ibid Section 7(2A) (b).
[146]ibid Section 7(3) (b).
[147]ibid Section 7(7).
[148]International Trade Administration U.S. Department of Commerce, 'Kenya - Import Requirements and Documentation' (13 September 2021) <https://www.trade.gov/country-commercial-guides/kenya-import-requirements-and-documentation> accessed 30 September 2021.

The study has established that raw materials and intermediate products are subject to tax under the Miscellaneous Fees and Levies Act. This means that investors in GVCs must pay taxes for goods used to manufacture other foods. Apart from that, for investors to benefit from the 1.5%, they must obtain clearance from Cabinet Secretary responsible for matters relating to industry. These requirements are cumbersome for investors who intend to invest in Kenya through GVCs or RVCs.

3.3.5. The East African Community Customs Management Act, 2004

The East African Community Customs Management Act is an Act of the East African Community. Its purpose is to make provisions for the management and administration of Customs and for related matters.[149] The Act has various vital provisions such duty drawback and Imports for inward processing that affect participation value chains in various ways. The provisions are discussed below.

Duty Drawback

East African Community Customs Management Act allows drawback of import duty on goods imported for the manufacture of goods for export, for transfer to a free port or to EPZ.[150] However, whereas section of 138 (1) as read with section 139 (a) of the Act allows drawback of import duty on goods imported for use in the manufacture of goods for export, there various conditions that must be met. The conditions include:

i. The goods must be a direct result of the imported goods used in the manufacture of such goods;
ii. The owner of goods must have obtained authorisation from the Commissioner of domestic taxes prior to manufacture of the goods;
iii. the Commissioner must fix or agree to the rate of yield of the operations; and
iv. The investors must specify the description, quality, and quantity of various compensating products.

[149] The Preamble to the East African Community Customs Management Act, 2004 2009.
[150] Almaco Management Consultants Ltd and Emerging Market Economics, *Trade Facilitation Project in Kenya: Handbook on Importing and Exporting in Kenya* (Ministry of Industrialization, Trade and Enterprise Development 2005) <https://www.industrialization.go.ke/images/downloads/handbook_importing_exporting.pdf>.

Upon fulfilling these conditions, the Commissioner prescribes duty drawback coefficient applicable.[151] It is not difficult to pinpoint challenges facing GVC participation arising out of section 138 and 139.

The first challenge is that the two provisions especially section 139 (ii) introduce more bottle necks and procedural technicalities to ease of doing business in that they require potential investors to make applications to the commissioner before adding value to imported goods. This has two implications: the commissioner has discretion to grant or reject the application for manufacturing certain goods for export. Secondly, the Act is silent on timelines within which the commissioner must hear and determine the application. This wide discretion means that the commissioner can take minutes to approve the application or can take years to grant the approval. Instead of battling with the commissioner, potential investors may opt to invest in Malaysia, Vietnam or any other country for that matter where there is efficient trade policies.

The second problem arising out of section 139 (iv) is that it gives the commissioner wide discretion to determine and prescribe duty drawback coefficient applicable which this study argues that is the mandate of the parliament because any tax obligation or waiver cannot in law, be determined by any person other than the legislature. Investors prefer where the trade systems are predictable and not where one person such a commissioner of domestic taxes has wide discretion in determining what is taxable or refundable and what is not. That may lead to abuse of discretion. Therefore, tax matters should not be discretionary at all.

The third legal challenge arising out of section 138 and 139 is that the partner states have different commissioners pursuant to section 5 of the Act. Therefore, Uganda's Commissioner of domestic taxes may arrive at a different decision compared to a decision of Tanzania's commissioner yet the transactions maybe the same or similar. At the same time, the wide discretion means that the commissioners Kenya's commissioner may prescribe duty drawback coefficient that is different from the one determined by Uganda's commissioner in similar business applications. That would be discrimination or unfair treatment of businesses whichever way this issue is examined. These uncertainties are injurious to participation in value chains since investors are not aware of what to expect.

[151] See section 139 of EACCM Act

This study argues that the proper regulation to cure the mischief under section 138 and 139 should provide that if the imported goods are raw material or intermediates then, drawback be automatically. Seeking authorisation from the commissioner of domestic taxes prior to manufacture of the goods serves as an NTB discouraging investments. NTBs reduce participation and investment in GVCs. Apart from that, the legislature and not an individual should determine all matters concerning payable or refundable taxes.

Imports for Inward Processing

Section 172 of the Act allows duty free imports from foreign country to member states for inward processing. However, the section grants the commissioner wide discretion to determine the conditions under which such goods can be imported into member states. However, as noted above, EAC Partner States have different commissioners of domestic taxes, which may lead to imposition of different conditions for similar goods. Consequently, similar goods and for similar purpose maybe treated differently. This may lead to infringement of MFN and National treatment within EAC because similar imports maybe treated differently.

This research recommends amendments to section 172 of the Act to provide express conditions that an investor should satisfy in order to benefit from duty free imports. Secondly, the amendment will ensure that the member states are operating under the same conditions. These amendments will ensure that existing and potential GVC investors are aware of the goods that can be imported duty free.

Apart from the highlighted issues, whereas section 181 (1) of the Act provides that compensating goods can be imported duty free or under partial waiver, the said section provides that such goods cannot be duty free or benefit from tax waiver if the goods have been altered. This provision goes against the very definition of the GVCs because a business in GVCs import unfinished product, adds value, and exports to another country for further value addition. Does addition of value amount to altering? If the answer is yes, then firms in GVCs cannot benefit from duty free imports under the Act. In addition, section 181(2) of the Act prohibits granting total or partial relief from duty before fulfilment of the conditions or obligations relating to the outward processing procedure. In short, section 181 of the Act has

zero relationship with GVCs. In conclusion, the East African Community Customs Management Act, 2004does not have provisions in support of GVCs or RVCs.

3.4.0. Treaty for the Establishment of the East African Community

The main objective of the Treaty for the Establishment of the East African Community (EAC treaty) is to achieve co-operation among the Partner States.[152] The treaty requires Partner states to co-operate in political, economic, social, and cultural fields, research and technology, defence, security, and legal and judicial affairs, for mutual benefit.[153] In furtherance to objectives of the treaty under Article 5, Article 74 of the treaty calls upon member states to co-operate and liberalise trade. In addition, Article 75 calls upon Partner states to eliminate internal tariffs and other charges of equivalent effect; elimination of non-tariff barriers; establishment of a common external tariff; formulation of rules of origin; and advocates for duty drawback, refund and remission of duties and taxes among other provisions. The Article also calls for simplification and harmonisation of trade documentation and procedures to make it easier for entities to trade.

Article 74 of the treaty attempts to create an enabling environment for value chains as it advocates for co-operation and liberalisation of trade within the region. In addition, Article 75(1)(b)(c)(j)(k) and (m) of the treaty partially creates a legal environment for participation in RVCs because it calls for elimination of tariffs and non-tariff measures, encourages duty drawback, refund and remission of duties and taxes, calls for co-operation and advocates for simplified cross border transactions.

Whereas Articles 74 and 75(1)(b)(c)(j)(k) and (m) appears to create a conducive legal environment for participation in RVCs, Article 75(1)(e) advocates for creation of rules of origin which are also provided for under the Protocol on the Establishment of The East African Customs Union.[154] This study demonstrates in chapter four that numerous and complicated rules of origin have a negative impact cross border business since it takes long and resources to obtain compliance certifies. This could partly explain why EAC Partners states do not participate in RVCs effectively.

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[152]Treaty for the Establishment of the East African Community 2006 Article 5 (1).
[153]ibid.
[154] Article 14 of the Protocol

Whereas Article 74 and 75 of the Treaty appears to favour participation in RVCs, the same is not applicable to participation in GVCs. Article 75 discourages participation and investment in GVCs. This so because the elimination of tariffs and non-tariff measures does not apply to foreign goods from non EAC countries. In addition, Article 75(1) (d) expressly calls for establishment of external common tariffs. Consequently, potential GVCs entities must shy away from investing in EAC due to imposed tariffs by the EAC Partner States. Apart from that, Article 75(1) (e) requires establishment of rules of origin. As pointed out, these rules complicate ease of doing business and increase costs of doing business that Kenya through the National Trade Policy admits that import and export procedures are very cumbersome due to numerous documentation requirements, customs processing delays and perhaps most importantly, non-transparent importation rules.[155]

3.4.1. Protocol on the Establishment of the East African Customs Union

Article 75 of the EAC Treaty provides for enactment of Customs Union. The Protocol contains various provisions including regulation of tariffs, rules of origin, and Non-tariff Barriers (NTBs). Article 2 (4) of the protocol advocates for: (a) elimination of customs duties and other charges of equivalent effect imposed on imports within the custom union; (b) removal of non-tariff barriers to trade among the Partner States; and (c) charging of a common external tariff in respect of all goods imported into the Partner States from foreign countries. However, Article 2(5) (d) of the protocol expressly establishes common external tariff.

Just like the Treaty, Article 2(4) of the protocol is vital to participation in GVCs and RVCs but it is also problematic on various grounds. First, whereas it is right to eliminate custom duties and tariffs, the elimination is applicable to the member EAC States only. This hinders international trade and in particular, investment in GVCs. This study recommends revision of the external tariff to allow zero-rating of essential raw materials.

Secondly, Article 2(4) (c)of the protocol limits Partner States rights to determine external tariff because common tariff binds Partner States. This means that the law bars Partner States from liberalising their markets because doing so would be contrary to the protocol. Therefore, even though the provision may be friendly to RVCs it is hostile to GVCs. Consequently, if

[155]Ministry of Industry, Trade and Cooperatives State Department for Trade (n 137) 36.

Kenya or any other partner state wishes to liberalise its market to attract GVCs investors, it will be in breach of protocol.

Thirdly, Article 2(4) (c) of the protocol is not progressive in nature because it does not foresee gradual elimination of these trade barriers in relations to non-member states. This renders Article 2(4) (c) incompatible with the provisions of AfCFTA that calls for gradual liberalisation of markets. Therefore, the protocol is an impediment to participation and investment in GVCs.

Finally, according to Kenya's National Trade Policy, raw materials, and intermediate products that are necessary for manufacturing competitive exports should be exempt from import duty. However, this is not the case in some sectors in EAC because the yardstick for determining whether raw material or intermediate product qualifies for import duty under the Protocol is the existence of regional capacity to supply the product to meet regional industrial demand. This requirement affects participation in value chains bearing in mind that GVCs are concerned with value addition and an investor may want to blend local tea with tea from India to make a superior blend. In such a case, tea from India will be subject to taxation because Kenya has capacity to supply tea.

3.5.0. Agreement Establishing the African Continental Free Trade Area (AfCFTA)

Kenya and EAC Partner States are party to AfCFTA. Article 3 thereof provides for the general objectives of the agreement. Article 3 (g) provides that one of the general objectives of the AfCFTA is to promote industrial development through diversification and regional value chain development, agricultural development and food security. Other general objectives includes creating a liberalised market for goods and services through successive rounds of negotiations;[156] and contributing to the movement of capital and natural persons and to facilitate investments building on the initiatives and developments in the State Parties and RECs.[157]

Article 4 of AfCFTA provides for specific objectives of the agreement. They include but not limited to progressive elimination of tariffs and non-tariff barriers to trade in goods, progressive liberalisation of trade in services, and to achieve cooperation on all trade-related

[156]Article 3(b)
[157] Article 3(c)

areas. However, whereas the agreement represents a step in the right direction in attempts to achieve freer trade, the agreement is weak in that it does not provides for timelines within which its provisions should be implemented. Therefore, some states may not feel bound to eliminate trade barriers.

3.6.0. The General Agreement on Tariffs and Trade (GATT 1994)

Anti-dumping and Countervailing Duties

Kenya and EAC Partner States are employing tariffs measures to protect local industries from imports from foreign countries. Since GVCs are highly linked to imports and exports, high tariffs stifle GVCs survival. Kenya and EAC apply tariffs and non-tariff measures to prevent dumping.

Article VI (1)of the GATT 1994 defines dumping as introducing products of one country into the commerce of another country at less than the normal value of the products. Dumping deserves condemnation when it threatens material injury to established industries in the territory of a contracting state or when it materially retards the establishment of a domestic industry.[158] In GVCs world, dumping in terms of Article VI (1) may occur when a product is imported at less than its normal value in relation to similar product prices in the importing country; and when the production costs together with reasonable addition for selling cost and profit is less than the value of the product.

This study argues that GVCs is not concerned with final products because it is concerned with the intervening processes of manufacturing value added products. Therefore, damping should not be a problem. However, the final product for consumption is subject to conventional international trade. The final product may be subject to dumping rules. Therefore, GVCs process does not lead to dumping as defined under Article VI (1) (a) of GATT 1994 because goods are imported for value addition and not for immediate sale or consumption.

However, this research argues that anti-dumping rules may affect GVCs pursuant to Article VI (1)(b) (ii) of GATT 1994 when the costs of the manufacturing the imported components in the country of origin plus a reasonable addition for selling cost and profit is less than the value of the product. To avoid this problem, a law may be enacted to provide that imported

[158]Article VI (1)

components should not be sold at a throw away price just because the costs of production is low in the country of origin.

3.7.0. Conclusion

From the foregoing analysis, Kenyan laws as well as EAC law have contributed to underinvestment in GVCs through high taxes and double taxation. As A result, Kenya does not attract investments in GVCs. At the same time, it not easy to establish RVCs within EAC because there is common external tariff meaning that goods from foreign territories are subject to heavy taxation. These taxes drive away investors. This study concludes that these taxes kill the urge to participate in GVCs even if EAC states have factor endowments.

4.0.0. CHAPTER FOUR: IMPACT OF NON-TARIFF BARRIERS ON PARTICIPATION AND INVESTMENT IN GVCs

4.1.0. Introduction

The study has so far examined legal barriers to entry and retention of investors in Kenya under chapter two while chapter three examined and analysed laws that stifle Kenya's participation in GVCs through tariffs. This chapter examines and analyses non-tariff barriers (NTBs) that hinder Kenya from effective participation in value chains. It should be recalled that one of the objectives of AfCFTA includes progressive elimination of non-tariff barriers to trade in goods,[159] and to promote industrial development through diversification and regional value chain development.[160] Therefore, it is essential to understand what NTBs are and how they affect participation and investment in GVCs.

4.2.0. Elements of NTBs

The EAC has the East African Community's Elimination of Non-Tariff Barriers Act, 2017 which defines "non-tariff barriers" as laws, regulations, administrative and technical requirements other than tariffs imposed by a Partner State, whose effect is to impede trade.[161] On the other hand, the EAC Treaty defines NTBs as administrative and technical requirements imposed by a Partner State in the movement of goods.[162] Apart from that, AfCFTA defines NTBs as barriers that impede trade through mechanisms other than the imposition of tariffs.[163] AfCFTA's Annex 5 on Non-Tariff Barriers goes a step further to classify NTBs as government participation in trade and restrictive practices tolerated by Governments; customs and administrative entry procedures; technical Barriers to Trade (TBTs); Sanitary and Phytosanitary Measures (SPM); specific limitations; charges on imports as well as Rules of Origin (RoO).[164] While States eliminate tariffs, they put in place NTBs to protect their economies from goods and services from other States.[165]

4.3.0. Laws and Regulations that Impede Trade

According to the East African Community Elimination of Non-Tariff Barriers Act, 2017 laws and regulations can be part of the NTBs. Therefore, there are various laws that contain regulations that amount to NTBs. Therefore, this chapter discusses some of them.

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[159]Agreement Establishing the African Continental Free Trade Area Article 4(a).
[160]ibid Article 3(g).
[161]East African Community Elimination of Non-Tariff Barriers Act, 2017 2017 s 2.
[162]Treaty for the Establishment of the East African Community Article 1(1).
[163]Agreement Establishing the African Continental Free Trade Area Article 1.
[164]Annex 5 on Non-Tariff Barriers See Article 3 and Appendix 1 of Annex 5.
[165]East African Community (n 120) 35.

The East African Community Elimination of Non-Tariff Barriers Act provides a legal framework for the identification, monitoring, removal of non-tariff barriers, and removing restrictions that make importation or exportation within and outside the Community difficult or costly.[166] The Act prohibits Partner States from imposing activities that create NTBs.[167]

For instance, section 6 East African Community Elimination of Non-Tariff Barriers Act is important. It prohibits public officers or institutions of a Partner State from engaging in unauthorised activities under the laws of the Community or Partner State. Prohibited activities includes delays in clearing imports and lengthy testing and certification procedures; activities that leads to ban on market entry and loss of potential markets; corruption; restriction of business transactions in the Partner State; and failure to recognize the East African Rules of Origin which leads to additional cost for verification of the goods and loss of business.[168]

Whereas this research louds the provisions of section 6, chapter 3 of this study has identified various loopholes under the East Africa Community Customs Management Act 2004 under which public officers and institutions of a Partner State might exploit without being caught under the provisions of section 6 of the Act. For example, section 139 (iv) of East Africa Community Customs Management Act 2004 grants the commissioner of domestic taxes wide discretion to determine and prescribe duty drawback coefficient that is applicable to a transaction. Therefore, the commissioner may exploit the discretion with impunity yet the safeguard under section 6 the East African Community Elimination of Non-Tariff Barriers Act will not apply. This demonstrates entrancement of NTBs in our laws.

Apart from the foregoing, section 139 (ii) of East Africa Community Customs Management Act 2004 provides for bottlenecks and procedural technicalities which hamper ease of doing business. The impugned section requires potential businesses to make applications to the commissioner of domestic taxes before engaging in manufacturing of imported goods that are subject of drawback. These restrictions are entrenched in the law yet they are harmful because they discourage entry and retention of investors who would otherwise invest in value chains.

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[166]East African Community Elimination of Non-Tariff Barriers Act, 2017 s 3.
[167]ibid section 5.
[168]ibid section 6(1).

Even though the East African Community Elimination of Non-Tariff Barriers Act prohibits technicalities, delays in clearing imports and lengthy testing and certification procedures,[169] this chapter demonstrates that the EAC Rules of Origin makes it impossible for potential GVCs investors to obtain Certificate of Origin. This hampers participation in value chains since imports are subject to high tariffs strict Rules of Origin.

The provisions of East African Community Elimination of Non-Tariff Barriers Act are promising. However, the Act has been inforce since 2017 yet NTBs are still a problem in EAC. Member States continue to advocate for policies such as BUBU and Buy Kenya Build Kenya, which seeks to implement inward looking development, and discourage freer movement of goods and services. Such policies are some of barriers to participation and investment in GVCs. The policies also fall within World Trade Organization categories of NTBs. This means that whereas there are laws that discourage imposition of NTBs, the laws are not enforced.

As discussed in chapter one, Professor Lee through the general theory of law and development theory asserts that designing goods laws, adhering and enforcing the laws leads to development. Lee Argued and correctly so that if the law requires the removal of customs tariffs on imports, the law would not be effective if customs officials at the border undermined the law by requiring informal payment equivalents.[170] It is easy to agree with Lee's theory because Kenya and EAC has laws barring imposition NTBs but implementation is a challenge. Perhaps failure to recognise certificate of Origin is one key impediments in EAC.

4.4.0. Customs and Administrative Entry Procedures

Participation in value chain means involvement in export and import business. Therefore, customs and administrative entry procedures as well as Rules of Origin (RoO) play a key role. Various custom procedures and documentation are necessary when exporting goods. The process varies depending on nature of the export. The general import and export process is as indicated below.

[169]ibid Section 6(1).
[170]Lee (n 42).

4.4.1. Process of Exportation in Kenya

An exporter is required to acquire the services of a licensed customs clearing agent mandated to process the exportation documents.[171] Exportation documents includes but not limited to the following: commercial invoice; certificate of origin; permits or license for restricted goods; taxpayer identification number; purchase orders or contracts; and packing List.[172]

As discussed under chapter three, the exporter pays export levy as provided for under the first schedule to the miscellaneous Fees and Levies Act of 2016 if the goods are subject to a levy. When documentation and due process is well done, customs department clears the goods for export.

4.4.2. Goods Clearance Process

The exporter, through the appointed agent makes customs declaration (entry) as provided for under Section 73 of the East Africa Community Customs Management Act 2004. The clearing agent is supposed to present the original entry and supporting documents to the customs discharge station for stuffing and verification. If the declaration is compliant with the law and regulations, customs department process the documents, after which compliant declarations are cleared and released. Upon completion of the process, a certificate of export is issues.[173]

4.4.3. Process of Importing in Kenya

Article 1 of the Protocol on the Establishment of the East African Customs Union defines 'importation' as bringing or cause goods to be brought into the customs territory. Just like during exporting, the importer acquires services of a licensed customs clearing agent to process the import documents in the customs system.[174]

As demonstrated under chapter three, unless goods are expressly exempt from taxation, all imports are subject to taxes and charges before release from Customs.[175] The importer is required to pay duties and taxes including import duty ranging between 0%, 10% and 25% as

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[171]Kenya Revenue Authority, 'Importing & Exporting - KRA' (2021) <https://kra.go.ke/en/business/companies-partnerships/companies-partnerships-pin-taxes/company-partnership-imports-exemptions> accessed 8 October 2021.

[172]ibid.

[173]ibid.

[174]ibid.

[175]Kenya Revenue Authority, 'How to Import - KRA' (2021) <https://kra.go.ke/en/individual/importing/learn-about-importation/how-to-import> accessed 30 September 2021.

provided by the East Africa Community Common External Tariff.[176] However, some imports attract duty higher than 25% as those specified under the schedule 2 of the EAC Common External tariff. The importer is also required to pay Value Added Tax (VAT) capped at 16% unless the imports are zero-rated. If the goods are exercisable, Excise Duties is payable.

Apart from the above taxes, an import declaration fees (IDF) of 3.5% of the customs value of the goods and Railway development Levy (RDL) of 2.5% of the customs value of the goods must also be paid as provided by the miscellaneous Fees and Levies Act of 2016. The rates vary depending on the nature of the import. Section 34 of the East Africa Community Customs Management Act 2004 requires the importer to enter or declare imported goods within twenty-one days after the commencement of discharge or in the case of vehicles, on arrival.

The process, documentation and obtaining permits, licenses or clearances during export or import all constitute NTBs. Clearly, from above explained export and import process, Kenya has plenty of these NTBs. These NTBs are further discussed below.

4.4.4. Import Clearance Documents

To clear any imported goods, importation documents must be availed. Subject to the nature of import, the following documents are required:

- Import Declaration Form (IDF);
- Certificate of Conformity (CoC) from the PVoC agent for regulated products;
- Import Standards Mark (ISM);
- Valid Commercial Invoice from the exporting firm;
- Valid pro forma invoices from the exporting firm;
- Bill of lading (sea cargo) or airway bill (air cargo);
- Certificate of origin (CO);
- Freight invoice for sea cargo
- Logbook and its translation if it is not in English (for motor vehicle)
- Permit/License for restricted goods
- Personal or taxpayer identification number
- Exemption letter (where applicable)
- Purchase orders or contracts

[176]Kenya Revenue Authority (n 171).

Certificate of roadworthiness for motor vehicles

Packing list

Letter of Credit (if available).[177]

Out of the above list, Certificate of Origin (CO) is an important document when exporting importing goods. However, owing to strict Rules of Origin EAC and COMESA regions, firms that participate in GVCs in Kenya EAC and larger COMESA regions may encounter legal and technical barriers when attempting to procure the certificate. That is not all. Upon obtaining the certificate, it maybe be rejected by the custom officials in the importing county. It is therefore important to analyse Rules of Origin that bind Kenya. Therefore, the research analyses how Rules of Origin under EAC, COMESA and AfCFTA's influences Kenya's participation in GVCs and RVCs.

4.5.0. How Rules of Origin Affect Investment in GVCs

Rules of Origin are laws, regulations and administrative determinations of general application applied by a country to determine the country of origin of goods.[178] Certifying rules of origin entitles the exporter or the importer to obtain preferential treatment such as tax waivers in accordance with the applicable laws. Melo and Twum note that rules of origin are important because they prevent trade deflection, arbitrage and to prevent superficial assembly.[179] For this reason, most RECs have a value content requirement, in many cases a maximum of 35% non-originating materials though fulfilling the threshold is an uphill task.[180]

However, Rules of Origin within COMESA and EAC are complex both for producers and customs officials in equal measure.[181] For example, in the case of the EAC, despite revisions easing the rules to satisfy the 'substantial transformation' requirement for intra-EAC trade, the Common Market Scorecard (2016) report indicates that the number of cases of non-recognition of Certificates of Origin remained the same as in 2014.[182] AfCFTA's Annex 5 on Non-Tariff Barriers identifies Rules of Origin as one of the NTBs.

[177]ibid.
[178]WTO Agreement on Rules of Origin See Article 1(1).
[179]De Melo and Twum (n 75) 21.
[180]COMESA Protocol on the Rules of Origin See for example Rule 2(b). See also Rule 4 of The East African Community Customs Union (Rules of Origin).
[181]De Melo and Twum (n 75) 21.
[182]Bank and EAC (n 67).

4.5.1. Impact of EAC Rules of Origin on GVCs Participation

Article 75 of the Treaty advocates for the elimination of non-tariff barriers on imports from EAC States.[183] Similarly, Article 13 of the Protocol on the Establishment of the East African Customs Union (the Protocol) requires each of the Partner States to remove, with immediate effect, all the existing non-tariff barriers to the importation into their respective territories of goods originating in the other Partner States and, thereafter, not to impose any new non-tariff barriers.[184] In addition, the Protocol mandates Partner States to formulate a mechanism for identifying and monitoring the removal of non-tariff barriers.[185] The East African Community's Elimination of Non-Tariff Barriers Act, 2017 provides the mechanisms for identifying and monitoring the removal of non-tariff barriers.

Whereas Article 10 of the protocol mandates the Partner States to liberalise markets and eliminate all internal tariffs and other charges of equivalent effect on trade among them, the liberalisation is subject to rules of origin under Article 14 of the Protocol. Goods originating from the Partner States benefit from Community tariff treatment in accordance with the Rules of Origin as provided for under the Protocol.[186] Pursuant to section 111(2) of the East African Community Customs Management Act, persons trading across borders are required to produce Certificate of Origin and other documents as proof of origin of goods. Article 14 (2) of the protocol provides that goods must meet the criteria set out in the Rules of Origin under in Annex III to the Protocol. The Certificate of Origin is issued when goods meet the requirements under the East African Community Customs Union (Rules of Origin) Rules.

Since GVCs involves import and export of value addition goods, imports must undergo substantial transformation to comply with the EAC Rules of Origin for the Certificate of Origin to issue. To covert imported goods to meet the rules of origin under Rule 4 of the EAC Rules of Origin, transformation must meet the following conditions:

i. The c.i.f. value of those materials should not exceed 60% of the total cost of the materials used in the production of the goods;

ii. The value added resulting from the process of production should account for at least 35% of the ex-factory cost of the goods; and

[183]Treaty For the Establishment of The East African Community Article 75(1)(c).
[184]Protocol on the Establishment of the East African Customs Union Article 3(1).
[185]ibid Article 3(2).
[186]East African Community Customs Management Act, 2004 Article 111.

iii. The goods are classified or become classifiable under a tariff heading other than the tariff heading under which they were imported as specified.

This research opines that it almost impossible to satisfy Rule 4 even if the produced items are classified or become classifiable under a tariff heading other than the tariff heading under which they were imported. This is so bearing in mind that GVCs involve multiple value addition in multiple countries notwithstanding amount of value added. The formula for determining value added under the First Schedule of the EAC Rules of Origin makes it nearly impossible to participate in value chains because various elements of ex-Factory costs, charges and expenses are considered.

Custom officers consider various costs when determining the ex-factory costs, charges and expenses for the purposes of RO. Such costs include costs of imported materials including the cost of waste materials and materials lost in the process of manufacture as represented by landed costs of these materials at the factory. Other costs include charges incidental to the delivery of such materials to the factory but excluding customs duties and other duties and charges of equivalent effect on the cost of the imported materials.[187] However, it should be recalled that Chapter 3 of this study pointed out that section 14(1) of the VAT Act is imposes VAT not on net value-added, but on all costs including taxes paid. This demonstrates a skewed law in favour of the State to the detriment of investors.

Other costs include gross cost of local materials; the cost of direct labour; the cost of direct factory expenses; the cost of factory overheads; administration expenses; selling expenses represented; distribution expenses; and charges not directly attributed to the manufacture of the goods including any customs duty and other duties and charges of equivalent effect paid on the imported raw materials.[188]

Basically, the import of Rule 4 of EAC Rules of Origin as read with First Schedule to the said rules is that when determining the value added, all imaginable expenses must be considered regardless how petty they are. No doubt, that it is in the best interest for a business to be cautious of expenses incurred in the production of goods. However, why should the law be

[187]The East African Community Customs Union (Rules of Origin) Rules First Schedule Paragraph 1(a).
[188]ibid.

petty in order to grant a benefit? The provision that 'the goods are classified or become classifiable under a tariff heading other than the tariff heading under which they were imported' should be sufficient for granting certificate of origin instead of subjecting traders to such painstaking process. It is due to such issues that Melo and Twum argue that the EAC Rules of Origin are complex to traders as well as to customs officials.[189]

That is not all. Whereas the EAC Rules of Origin require unimaginable substantial transformation of material, there is no guarantee that the Member States will accept the Certificate of Origin even if the criteria the criteria is satisfied. In fact, the latest EAC Common Market Scorecard of 2016 reports that non-recognition of Certificates of Origin is a major problem.[190]

The conditions imposed by Rule 4 (1) (b) of The EAC Rules of Origin as read together with the First Schedule of the said rules amounts to subjecting imported materials to unnecessary restrictions. This is contrary to Article 3(c) of the WTO Agreement on Rules of Origin, which prohibit imposing stringent and discriminatory rules against imports. Such stringent rules are contrary to MFN principle under Article 1 of GATT.

This research maintains that the EAC Rules of Origin create restrictive, distorting, or disruptive effects on international trade contrary to the spirit of WTO Agreement on Rules of Origin, which prohibits creation of Rules of Origin that are restrictive, distorting, or disruptive effects on international trade.[191] This research also asserts that contrary to WTO Agreement on Rules of Origin, the EAC Rules of Origin are instruments for pursuing inward-looking development.

The study argues that the EAC Rules of Origin are in breach of the doctrine of legitimate expectation. This is so because once a member state, say Kenya imports components from a foreign country in compliance with East African Community Customs Management Act, 2004, there is legitimate expectation that those components cease to be foreign components but become Kenya's goods or components. Therefore, it is necessary for other EAC States to treat subsequent export of imported value-added goods or components to EAC states as

[189]De Melo and Twum (n 75) 21.
[190]Bank and EAC (n 67).
[191]WTO Agreement on Rules of Origin See Article 2 and the Preamble of the Agreement.

imports of Kenyan goods or components but not as import of foreign value-added goods from Kenya. Therefore, there is no need to subject such goods to further stringent measures under Rule 4 of the EAC Rules of Origin.

Consequently, the EAC Rules of Origin discourages effective participation in RVCs within the EAC and discourages Kenya from participating from in GVCs because accepting goods that do not comply with EAC rules will amount to breach of the EAC Rules.

This research further argues that conditions imposed by Rule 4 (1)(b) of The East African Community Customs Union (Rules of Origin) Rules amounts to discrimination of goods imports in favour of domestic goods which is not only against MFN principle under Article I of GATT, but against the National Treatment under Article III of GATT as well. To cure this challenge, Rule 4 (1) (b) (i) and (ii) of the East African Community Customs Union (Rules of Origin) Rules and the First Schedule should deleted. Instead, the said rule should recognize the fact that once Kenya imports components from a foreign country in accordance with the EAC laws, then imports become Kenyan goods in the importing State and followed by similar treatment as domestic materials.

4.5.2. Impact of COMESA Rules of Origin on GVCs Participation

The Treaty Establishing the Common Market for Eastern and Southern Africa (COMESA) is part of the laws of Kenya pursuant to Article 2 (6) of the Constitution of Kenya.[192] Article 4 of the COMESA Treaty calls upon Part States to liberalise markets by simplifying and harmonizing trade documents and procedures;[193] and by elimination of non-tariff barriers to trade among themselves.[194] In fact, Article 49 of the treaty requires immediate elimination of the existing non-tariff barriers to the import into Member State of goods originating in the other Member States and thereafter refrain from imposing any further restrictions or prohibitions the moment the Treaty entered into force.[195] However, since 1994 when COMESA Treaty replaced Preferential Trade Area (PTA),[196] member states are still imposing restrictions, which brings into focus the efficacy of COMESA regime.

[192]The Constitution of Kenya, 2010 2010.
[193]Treaty establishing The Common Market for Eastern and Southern Africa Article 4(1) (b).
[194]ibid Article 4 (1) (a).
[195]ibid Article 49(1).
[196]COMESA Secretariat, 'What Is COMESA – Common Market for Eastern and Southern Africa (COMESA)' (2021) <https://www.comesa.int/what-is-comesa/> accessed 1 September 2021.

Rule 2 of the Protocol on the Rules of Origin for products to be traded between the Member States of the Common Market for Eastern and Southern Africa (COMESA protocol on Rules of Origin) contain provisions on rules of origin. However, investors have an uphill task to fulfil the rules to have their goods accepted as originating from a Member States. The investors have to meet the COMESA protocol conditions:

a. The goods must be wholly produced in the Member States in accordance with Rule 3 of the protocol;[197] or

b. If the materials have been produced in the Member States wholly or partially from materials imported from outside the Member States, the imported goods must be substantially transformed to meet the following conditions:
   i. The C.I.F. value of those materials should not exceed 60% of the total cost of the materials used in the production of the goods;

   ii. The value added resulting from the process of production should accounts for at least 35% of the ex-factory cost of the goods; and

   iii. The goods are classified or become classifiable under a tariff heading other than the tariff heading under which they were imported as specified.[198]

The requirement that the C.I.F. value of the materials should not exceed 60% of the total cost of the materials used in the production of the goods has a problem. It does not anticipate the fact that investors in member states may produce goods from 100% imported materials, which means investors who produce wholly from materials imported from outside the Member States cannot benefit from COMESA protocol.

The protocol adds more conditions under Rule 5(1) (b) part (i) which provides that notwithstanding the provisions of sub-paragraphs (b) and (c) of paragraph 1 of Rule 2 of the Protocol, simple assembly of components and parts imported from outside the Member States to constitute a complete product does not confer origin. Further, Rule 5(1)(b) part (ii) provides that 'simple mixing and assembly where the costs of the ingredients, parts and

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[197]Rule 2 (1)(a) of the COMESA protocol on Rules of Origin
[198] Ibid Rule 2 (1)(b)

components imported from outside Member States and used in any of such processes exceed 60% of the total costs of the ingredients, parts and components used,'[199] does not confer origin.

However, the protocol does not define what 'simple assembly' means. Then question is what happens when entity XYZ LTD imports value added components from its subsidiaries located in France or Ghana for assembly to produce a complete product that is classified or becomes classifiable under a tariff heading other than the tariff heading under which they were imported as Rule 2(1) (b) (ii) of the protocol states? To illustrate this point, iPhones are not made in USA but the design is conceptualised in USA and the product is assembled in China using components from various parts of the world. For argument purposes, let us consider the impact of Rule 5(1) (b) part (i) to the manufacturing process of iPhones.

Applying Rule 5(1) (b) part (i) to the manufacturing process of iPhones, and in absence of definition of that 'simple assembly' entails, it means that China, where assembly of iPhones takes place does not participate in the value chains. Alternatively, for China to be considers to be part of the value chain therefore the assembled iPhones qualify to benefit from the COMESA rules of Origin, then officers granting the certificate of origin will have to determine whether the assembly is a complex assembly or 'simple assembly.' This means that products manufactured through GVCs are less likely to benefit from COMESA rules of origin because 'simple assembly' is not defined therefore, officers granting or tasked to accept certificates of origin have wide discretion on whether to grant or reject the certificate of origin as the case maybe.

Clearly, Rule 5(1) of the COMESA protocol is bad news for entities that would like to participate in GVCs and RVCs. The protocol is not alive to the fact an entity may want to execute comparative advantage theory by importing value added components from Japan or Zambia for simple assembly in Kenya, which may have affordable factor of production such as affordable labour or affordable land. Therefore, the may company decides that it is economically reasonable to set up assembly line in Kenya and import value added components for assembly than it is to set up assembly line in Japan or any other country for that matter. Therefore, rule 5(1) means if an entity whose role is to assemble components at

[199] Rule 5(1)(b) part (ii)

the end of the value chain, will not benefit from the COMESA protocol rules of origin. Rule 5 of the COMESA protocol is disastrous to participation in GVCs.

Apart from the above, Rule 8 of the COMESA's protocol Rules of Origin encourages Member States not to recognize mixtures, not being groups, sets or assemblies of goods dealt with under Rule 6 of the Protocol. According to the Rules, any product resulting from the mixing together of goods, which would qualify as originating in the Member States with goods which would not qualify, if the characteristics of the product as a whole are not different from the characteristics of the goods which have been mixed. The question that follows is what happens to hybrid products that are manufactured by combining imported components together with local components to manufacture a new product that is not possible to separate local components from imported ones.

As demonstrated, entities desirous of engaging in GVCs and RVCs within COMESA will encounter challenges under the COMESA Rules of Origin.

4.5.3. Impact of AfCFTA Rules of Origin on Investment in GVCs

AfCFTA Agreement introduced revolutionary Rules of Origin even though they are not perfect. This study has considered Rules of Origin under COMESA and EAC laws and established that those rules hinder not only participation in GVCs and RVCs, but they also discourage conventional trade. The good news is that AfCFTA Agreement may save the situation through its simpler rules under Annex 2 on Rules of Origin.[200]

4.5.3.1. **Annex 2 on Rules of Origin**

One of the objectives of the Annex 2 is to promote regional and continental value chains and foster economic transformation of the continent through industrialisation.[201] A product benefits from Rules of Origin if it originates from a State Party, or if it has been wholly obtained in the State Party or if the product has undergone substantial transformation in the concerned State Party.[202] Pursuant to Article 6 of the Annex, a product undergoes substantial transformation when it is sufficiently worked, or processed to fulfil any one of the following

[200]AfCFTA Protocol on Trade in Goods Article 13.
[201]Annex 2 on Rules of Origin Article 3.
[202]ibid Article 4.

criteria: it is value added; or it contains non-originating material; or the products result to a change in tariff heading; or specific process is used.[203]

Article 6 of the Annex 2 is overhauling Rules of Origin in Africa more so the stringent EAC and COMESA Rules of Origin. Annex 2 represents a step in the right direction and is favourable to participation in value chains as it is far much better than the process conferring origin under the COMESA and EAC Treaties.

However, Annex 2 is not perfect. Article 7 of the Annex is still a barrier to participation in GVCs because whereas the conditions under Article 6 may have been fulfilled, certificate of origin cannot be issued for 'simple assembling' of parts of articles to constitute a complete article and among other activities. The Annex does not define what constitutes 'simple assembly.'

The drafters of Article 7 of the Annex must have imagined that value addition must constitute a complex and technical process. That is not the case. For example, bicycles can be and are manufactured through value chains yet the process involves simple assembly of parts compared to assembly of a motor cycle that is more technical. 'Simple assembly' may also require intellectual skills or expertise to assemble.

Apart from the foregoing, the drafters of the Article 7 did not consider that participation in GVCs is not merely about value addition. An investor may set up an industry in a country to take part in GVCs to benefit from competitive advantage by exploiting the readily available and affordable factors of production such as land or labour. For example, a Kenyan company, call it Triple-S Ltd, which assembles bicycles. Triple-S Ltd may export unprocessed carbon fibre to France for further processing because Kenya does not have necessary equipment to process it into a bicycle frame. At the same time, since Ghana has sufficient rubber, Triple-S has set up its subsidiary in Ghana to manufacture bicycle tires, which it imports to assemble a bicycle. Triple-S Ltd then imports back the value added carbon fibre in form of bicycle frame from France and tires from Ghana to complete a simple assembly of the bicycle using skilled, affordable and abundant labour in Kenya. Article 7 (1) as read with Article 7(3) means that

[203]ibid Article 6.

the assembled bicycles will not benefit from the rules of origin under Annex 2 when Triple-S Ltd exports the bicycles to Eswatini for sale. That is absurd.

In other words, exclusion of 'simple assembly' from the rules of origin excludes the last country in the chain of manufacturing process under value chains.

Whereas Annex 2 is not perfect, the rules thereunder are much better than the outdated COMESA and EAC Rules of Origin. Consequently, African states including Kenya should start applying the rules under Annex 2 by virtue of Article 19 of the AfCFTA, which provides that in the event of any conflict and inconsistency between the Agreement and any regional agreement, the Agreement prevail to the extent of the specific inconsistency.[204]

EAC State Parties have not aligned domestic tax laws and that Rules of Origin to AfCFTA.[205] This poses a challenge to participation in value chains.

4.6.0. Government Participation in Trade and Restrictive Practices Tolerated by Governments

AfCFTA's Annex 5 on Non-Tariff Barriers identifies government participation in trade and restrictive practices tolerated by Governments.[206] The impact of governments' participation in trade may result to positive or negative impact. Whereas governments attempt to create conducive business environment, they also enact laws and policies that hinder trade. In some instances, governments delay or fail to eliminate trade restrictive practices to protect domestic industries. It is essential to analyse how government's participation in trade affects Kenya's participation in GVCs.

4.6.1. The Import Substitution Policies

Kenya's government involvement in trade is not a novel issue. For example, Kenya government adopted import substitution policies between 1963 and 1989. The objective of the policies was to stimulate rapid growth of manufacturing industries to ease balance of payment pressure.[207]Tanzanian government and other EAC States also adopted the similar policies.[208] Kenyan government also aimed to increase domestic control of the economy and

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[204]Agreement Establishing the African Continental Free Trade Area.
[205]East African Community (n 120) 35.
[206]Annex 5 on Non-Tariff Barriers See Article 3 and Appendix 1 of Annex 5.
[207]Ministry of Industrialization, Trade and Enterprise Development (n 73) 11.
[208]OECD (n 27).

to generate employment. Whereas the manufacturing sector grew at an average rate of 8% per year, the strategy led to various challenges including inefficiencies in the domestic industries; resulted to inward looking economy; and bias against exports.[209] These issues led to a decline in economic performance. Therefore, Kenya abandoned import substitution policies and adopted Structural Adjustment Programmes (SAPs) to remedy the situation.[210]

4.6.2. Structural Adjustment Policies and Export-Oriented Policies

The Government adopted Structural Adjustment Policies (SAPs) in the late 1980s to eliminate administrative controls, rationalization of import tariffs, and decontrol of prices as well as liberalization of exchange rate. However, the policies did not achieve the desired results leading to adoption of export-oriented policies.[211] The government adopted a number of strategies to achieve this strategy and to encourage traders to engage in international trade. Some of the adopted strategies include Manufacturing under Bond (MUB), drawback of duty provided for in the East African Community Customs Management Act, 2004 and Tax Remission for Exports Office (TREO) schemes.[212] Export oriented policies are in force to date and have seen increased trade liberalization. Consequently, number of exports have been rising but has not improved balance of payments. Kenya Export Promotion & Branding Agency 2020 report indicates that Kenya's exports in 2020 were valued at Kshs 642 Billion compared to Kshs 595 Billion in in 2019 representing an increased by Kshs 46 Billion (7.8%).[213]

Whereas exports increase is below the required standard, this research maintains that the little increase may be deceptive because Kenya's exports are majorly composed of agricultural products or raw materials with little or without value addition. In fact, the Economic Survey of 2020 indicates that Kenya's main exports earners are horticulture; tea; articles of apparel and clothing accessories; coffee; and iron and steel, collectively accounting for 59% of the total value of domestic exports, which is not sufficient to achieve trade balance due to increasing imports. The report also indicates that imports of used cars contribute to trade

[209]Ministry of Industry, Trade and Cooperatives State Department for Trade (n 137).
[210]ibid (n 73).
[211]ibid.
[212]Almaco Management Consultants Ltd and Emerging Market Economics (n 150) 9.
[213]Kenya Export Promotion & Branding Agency, 'Kenya Export Performance in 2020' (2021).

imbalances in Kenya.[214] It appears that the incentives and strategies that the government has put in place to boost exports are not working.

The government is focusing on wrong priorities by placing barriers on imports. The focus should be on advocating for value addition to local products including allowing blending of local goods with imports to manufacture value added and competitive products. This study argues that advocating for consumption domestic products may not and has not led to increase in consumption and exports of domestic goods. Increased in consumption and export of domestic products will be achieved through value addition by participating in value chains which allows blending of local goods with imports to manufacture better quality products.

Government's focus on placing barriers on imports while advocating for consumption of local products is a wrong strategy. There is a Swahili saying that, '*Chema chajiuza*, *kibaya chajitembeza'* (loosely translated whatever is good sells itself). Continued advocacy to consume local goods is similar to forcing Kenyans to consume what they do not want which explains why the imports of used cars is high yet there is a local car manufacturing company making Mobius cars. Consequently, Kenyans must be convinced that local brands such as Mobius car (or any other local brand) has the same or superior features to a Mercedes-Benz G-wagon. To achieve such a paradigm shift, the government may borrow from Jeremy Bentham's utility principle. Achieving the utility principle is not by increasing taxes and barriers on importing Mercedes-Benz G-wagon, but through adding value to Mobius cars so that a Kenyan will feel the pain of buying a Germany made car when a Kenyan made car is of superior quality. The utility principle also means that failure to add value to Mobius car means that a Kenyan would endure the pain of paying import taxes but find pleasure in spending 30 Million shillings by importing Mercedes-Benz G-wagon from Germany than buying a Mobius car that costs 1 Million Kenya shillings.

4.6.3. Restrictive Practices Tolerated By Governments

EAC governments seems to be keen on reverting to inward looking kind of economies. Whereas Kenya abandoned import substitution policies, which introduced protectionism, it seems that government has embraced protectionism once again. For example, Kenya is pushing for adoption of strategies and policies such as 'buy Kenya build Kenya' which seeks

[214]Kenya National Bureau of Statistics, 'Economic Survey 2020' (2020) <https://www.knbs.or.ke/?wpdmpro=economic-survey-2020>.

to protect domestic industries from imports,[215] while Uganda has Buy Uganda Build Uganda Policy with the same purpose.[216] On the other hand, section 54 of the Tanzania's Public Procurement and Disposal Act gives preference to domestic goods.[217] Such policies have negative impact on regional integration and are a hindrance to growth of RVCs within EAC because each Member States gives preference to its own goods and services.

Whereas the EAC has regulations prohibiting imposition of NTMs, individual countries still impose trade barriers, which leading to high costs of doing business.[218] These measures include government's participation in trade through imposing discriminatory NTMs for example, by favouring domestic over foreign suppliers.[219] Kenya has been restless in attempt to create inward looking economy through strategies like buy Kenya build Kenya to protect local industries. The latest attempt to grant favours to local producers was through the Public Procurement and Asset Disposal (Amendment) Bill 2020, which aimed to boost the local industries by requiring foreign tenderers who participate in local tenders to source their locally manufactured supplies from local contractors. The Parliamentary finance Committee rejected this proposal for being unfeasible.[220] Further, the committee rejected the proposal requiring granting of all tenders below Kshs One Billion to Kenyans because there is a similar provision under regulation 163(a) of the Public Procurement and Asset Disposal Regulations, 2020.[221]

[215]State Department for Industrialization (n 17).
[216]ibid.
[217] The Gazette of the United Republic of Tanzania No. 52 Vol. 92 dated 30th December 2011, the Public Procurement Act, 2011 Printed by the Government Printer, Dar es Salaam by Order of Government.
[218]Marion Jansen and others (eds), *Connecting to Global Markets: Challenges and Opportunities: Case Studies Presented by WTO Chair-Holders* (WTO Publications 2014).
[219]ibid.
[220]John Mutua, 'MPs Reject Bill to promote local suppliers in tenders' (*Business Daily*, 17 August 2021) <https://www.businessdailyafrica.com/bd/corporate/companies/mps-reject-bill-promote-local-suppliers-in-tenders-3513958> accessed 1 October 2021.
[221]Departmental committee on finance and national planning, 'Report on the Consideration of Public Procurement and Asset Disposal (Amendment) Bill (National Assembly Bill No. 20 of 2020)' (National Parliament 2021) <https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&cad=rja&uact=8&ved=2ahukewjernlnzkjzahxyx4ukhqq9b8aqfnoecasqaq&url=http%3a%2f%2fwww.parliament.go.ke%2fsites%2fdefault%2ffiles%2f2021-05%2freport%2520-%2520public%2520procurement%2520and%2520asset%2520disposal%2520%2528amendment%2529%2520bill%252c%25202020.pdf&usg=aovvaw0n8ha8aaox7ukckvh7l-oe>.

4.6.4. The National Industrialization Policy Framework for Kenya 2012 - 2030 (Sessional Paper No. 9 of 2012)

Current laws and policies discourage backward value addition by imposing tariffs and non-tariff measures on imports originating outside EAC. The government policies are not assertive on value addition. The National Industrialization Policy identifies shortage of clear laws and policies to coordinate business in Kenya and to regulate commercial transactions amongst government agencies as a major weakness to Kenya's effective participation in trade.[222] Whereas the policy discourages export of resources in raw primary state and encourages value addition through forward and backward linkages and the advocates for strengthening value chains, the policy is silent how to achieve these good goals. Apart from that, even though the policy seeks to provide incentives for investment in high value processing of agricultural products, the policy does not mention the applicable incentives.[223] If the government does not review the laws, backward value addition will remain just that—a dream.

The government is still imposing high tariffs and non-tariff measures on imports due to poor coordination of the existing laws. As demonstrated in chapter three, imports are even subject to multiple taxation which seems to boost the government's revenue in short term but harms Kenya's attractiveness to investors in the long run. The National Industrialization Policy also recommends enactment of a law to known as the National Industrialization Act to streamline business laws in Kenya. However, enactment of the proposed law had not been as at the time of this research meaning that the business laws in Kenya may continue to contradict one another for some time.

4.6.5. Kenya's Trade Policy

Import and export laws and regulations are key determinants in participation in value chains. Kenya Trade policy recognises that measures such as tariffs and NTBs including non-recognition of the Certificate of Origin topping the list of the impediments limits intra-regional trade in EAC and COMESA.[224] Further, cumbersome and numerous customs documentations, delays at border crossings, un-harmonized transit charges and procedures,

[222] Sessional Paper No. 9 of 2012 on the National Industrialization Policy Framework for Kenya 2012 - 2030 2012.
[223] ibid.
[224] Ministry of Industry, Trade and Cooperatives State Department for Trade (n 137) 28.

and irregular standards and stringent application of Sanitary and Phytosanitary SPS requirements affects intra-regional trade.[225]

Whereas Kenya's trade policy calls for elimination of all national NTBs, the policy is silent on whether Kenya will eliminate import barriers and how it will do so.[226] Since participation in GVCs relies on imports and export it is important to eliminate barriers that affect import and exports.

4.7.0. Technical Barriers to Trade

Technical barriers to trade (TBTs) are some of the NTBs that hinder freer trade.[227] Consequently, the WTO through the Agreement on Technical Barriers to Trade calls upon Party States to eliminate TBTs by ensuring that technical regulations and standards including packaging, marking, and labelling requirements, and procedures for assessment of conformity with technical regulations and standards do not create unnecessary obstacles to international trade.[228]

4.7.1. Legal Framework on TBTs

WTO through Article 2(2.2) of the Agreement on Technical Barriers to Trade requires Members States to avoid preparing, enacting, adopting, or applying technical regulations with a view to or with the effect of creating unnecessary obstacles to international trade. However, the Agreement provides it may be necessary to impose restrictions to protect national security; to prevent deceptive practices; and to protect human health or safety, animal or plant life or health, or the environment.[229] The Agreement also provides that trade barriers should not be permanent. The WTO advocates for elimination of barriers when the circumstances or objectives giving rise to their adoption ceases to exist or if it is possible to address the objectives in a less trade-restrictive manner.[230]

When there is need for positive assurance of conformity with technical regulations or standards, Article 5 of the Agreement mandates State Parties to apply MFN principles to

[225]ibid 31–32.
[226]ibid (n 136).
[227] AfCFTA's Annex 5
[228]WTO Agreement on Technical Barriers to Trade See the recitals.
[229]ibid Article 2 para 2.2.
[230]ibid Article 2 (2.3).

assess conformity,[231] and that conformity assessment procedures should not be prepared, adopted, or applied in a manner that creates unnecessary obstacles to international trade.[232]

Regional Bureaus of Standards play key role in harmonizing standards of trade. Article 13 of the EAC Protocol on Customs Union mandates Bureaus of Standards to facilitate removal of the existing NTMs affecting imports and thereafter, not to impose new NTMs.[233] Similarly, Article 6 of AfCFTA's Annex 6 on Technical Barriers to Trade requires Regional Bureaus of Standards to develop and promote the adoption of international standards. The annex recommends adoption of the standards developed by the African Organization for Standardization (ARSO) and the African Electro-technical Standardization Commission (AFSEC). The next question that follows is whether State Parties' through respective Bureaus implement these agreements.

4.7.2. The Role of Standards Bureau and Custom Agents

Kenya Bureau of Standards (KEBS) and Kenya Revenue Authority through Customs Services Department (CSD) have imposed various technical trade processes and documentation that contributes to barriers to international trade. They include, but not limited to the obligation to subject the intended imports to Pre-export Verification of Conformity (PVoC) done by PVoC Agents that are appointed by KEBS; obtain a certificate of conformity (CoC) from PVoC Agents, import standard marks (ISM) for some products, import license for some imports, and strict compliance with packaging and labelling requirements. The USA Commerce Department has claimed that some USA firms find it difficult to comply with packaging and labelling requirements imposed by KEBS.[234]

Kenya started quality inspection of imports on 1st July 1995 through Legal Notice No. 227 of 14th June 1995 to ensure that imports meet the required standards and to eliminate threats associated with dumping of goods. Further, Legal Notice No. 66 of 10th June 1999 requires compliance with the set standards otherwise, the imports are illegal and prohibited. To protect consumers' health and safety to protect environment and to promote fair trade practices, KEBS uses the highlighted documents to ensure that only quality goods gain entry into the country as provided for in the Standards Act Cap 496, and the Verification of Conformity to

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[231]ibid Article 5.1.1.
[232]ibid Article 5.1.2.
[233]Jansen and others (n 218).
[234] ibid (n 130).

Kenya Standards of Imports Order, 2005 (Legal Notice No. 78 of 15th July 2005).[235] This study evaluates some of these technical and procedural barriers to find out how they affect Kenya's participation in GVCs.

4.7.3. Pre-shipment Inspection PVoC and CoC Requirements

KEBS initiated PVOC program on 29th September 2005 through Legal Notice No. 78 of 15th July 2005. PVOC is a conformity assessment applied to products at the exporting countries, to ensure the products are compliant with the applicable Kenyan Technical Regulations and Mandatory Standards and specifications. KEBS has appointed various PVoC Agents to do tests on intended imports in the country of origin by inspecting, sampling, testing, sealing of full-load containers and issuance of COCs, COIs and CORs.[236] The PVOC inspection attracts charges between USD 265 and USD 2700.[237]

Therefore, before shipment, importers in Kenya have an obligation to ensure that intended imports are compliant with regulations and quality requirements of Kenya by carrying out tests based on applicable Kenya Standards or approved specifications.[238] This is by subjecting the intended imports to tests with assistance from PVoC agents. If the goods are in conformity with the required standard, the importer is then required to obtain CoC from PVoC Agents.[239]

This study asserts that PVoC is vital process. It ensure that the importer gets imports goods that meets specified specifications. Unfortunately, Kenyan legal regime allows re-inspection of imports at the port of entry but without clear rules for that purpose. The Verification of Conformity to Kenya Standards of Imports Order, 2005 provides that imports may re-inspected at the port of entry by the Bureau if it is deemed necessary.[240] The Order does provide conditions that may invoke re-inspection. This means that KEBS has leeway to re-

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[235] Kenya Bureau of Standards, 'Import Inspection' (2021) <https://www.kebs.org/index.php?option=com_content&view=article&id=33&Itemid=150> accessed 30 September 2021.

[236] Kenya Bureau of Standards, 'PVoC Overview' (20221) <https://www.kebs.org/index.php?option=com_content&view=article&id=87&Itemid=344> accessed 30 September 2021.

[237] Kenya Bureau of Standards, 'PVoC Certification Routes & Fees Structure' (2021) <https://www.kebs.org/index.php?option=com_content&view=article&id=115&Itemid=348> accessed 30 September 2021.

[238] The Verification of Conformity to Kenya Standards of Imports Order, 2005. 2005 para 3.

[239] Kenya Bureau of Standards, 'PVoC Responsibilities' (2021) <https://www.kebs.org/index.php?option=com_content&view=article&id=201&Itemid=346> accessed 30 September 2021.

[240] The Verification of Conformity to Kenya Standards of Imports Order, 2005 para 5.

inspect imports with impunity making international trade cumbersome. KEBS also maintains that, the purpose of pre-shipment inspection is to ensure that goods meet the quality standards in accordance with the importer's specifications while KEBS inspection is to ensure that goods meet Kenya's standards.[241] This reasoning provides avenue for KEBS to re-inspect imports at will.

The October 2020 research by UNCTAD confirms that investors who participate in Cotton value chains are subject to multiple inspections by KEBS and KEPHIS.[242] The Respondents also asserted that sometimes re-inspection results to rejection of the imported cotton lint due to lack technology for inspection. 70% of the respondent firms stated that re-inspections are costly.[243] These processes and costs discourage firms from participating in value chains. This confirms the narrative that there is no harmony amongst the agencies.

The issue that emerges upon analysing paragraph 5 of the Verification of Conformity to Kenya Standards of Imports Order, 2005 in light of Article 6(1) of the WTO TBT Agreement is whether it is right to subject imports to re-inspection at the port of entry after pre-shipment inspection by agents approved by KEBS. Re-inspections are discouraged under Article 6(1) of the WTO TBT Agreement, which in part provides as follows:

> Members shall ensure, whenever possible, that results of conformity assessment procedures in other Members are accepted, even when those procedures differ from their own, provided they are satisfied that those procedures offer an assurance of conformity with applicable technical regulations or standards equivalent to their own procedures.

KEBS legitimately argues that the purpose of pre-shipment inspection is to ensure that goods meet the quality standards in accordance with the importer's specifications.[244] However, it is absurd to subject the same item to inspection twice when Article 6(1) of the WTO TBT agreement provides that assessment in a foreign member state is sufficient and acceptable. Therefore, since the Verification of Conformity to Kenya Standards of Imports Order, 2005 does not reveal when re-inspection may be necessary, and until such rules are developed and published, production of CoC should be sufficient evidence of conformity to reduce custom clearance delays.

[241]Kenya Bureau of Standards, 'Import Inspection' (n 235).
[242]United Nations Conference on Trade and Development (n 138).
[243]ibid.
[244]Kenya Bureau of Standards, 'Import Inspection' (n 235).

Re-inspection is just one of the activities that cause delays and inefficiencies at the points of entry. Antràs correctly argues that GVCs thrive on efficiency therefore, the strength of the weakest link determines the performance of the GVCs and issues such as custom clearance delay is particularly harmful in GVCs.[245] Therefore, this study maintains that the CoC should be final for five reasons. First, due Article 6(1) of the WTO TBT Agreement which seeks to reduce inefficiencies at entry points. Second, there is no need to re-inspect imports because agents appointed by KEBS issue CoC. Third, making CoC a final document will reduce NTBs by increasing efficiency at points of entry. Fourth, since re-inspection attracts fees,[246] avoiding re-inspection will ensure that investors reduce costs related to re-inspections. Fifth, pre-shipment inspection is a matter of contract law between the importer and exporter enforceable in court of law and if imports do not meet contractual terms, the aggrieved party is at liberty to file a suit to settle the matter.

Consequently, making CoC a final and acceptable document will reduce unnecessary delays, technicalities and costs that hinders participation in GVCs. KEBS should only step in to assess imports where CoC is not availed. Doing so will effectively eliminate technicality and reduce costs of re-inspection in favour of investors who may be willing to invest in GVCs.

4.7.4. Import Standardization Mark of Quality

Apart from the mandatory PVoC and CoC, KEBS requires Import Standardization Mark (ISM) to ensure that consumers can directly authenticate the validity of certification of goods before purchase.[247] The mark targets all imported products intended for sale in the local market.[248] All importers of goods for sale in Kenya are required to purchase ISM stickers directly from KEBS. The importer obtains the marks by applying and submitting Copies of Certificate of Conformity, Import Declaration Form and Customs Entry to KEBS.[249] Since the ISM is required for all goods for sale in Kenya, it is not clear whether the marks are required for raw materials that are imported to manufacture other goods.

[245]Antràs (n 7) 10.
[246]Kenya Bureau of Standards, 'PVoC Certification Routes & Fees Structure' (n 237).
[247]Kenya Bureau of Standards, 'KEBS Marks of Quality (SMark, DMark, ISM, and Fortification)' <https://www.kebs.org/index.php?option=com_content&view=article&id=32&Itemid=339> accessed 30 September 2021.
[248]Kenya Bureau of Standards, 'Import Standardization Mark Guidelines: Issuance of Import Standardization Mark (Ism) For Imported Products Intended for Sale in Kenya' (28 July 2015) <https://www.kebs.org/images/pdf/new/IMPORT_STANDARDIZATION_MARK_GUIDELINES.pdf>.
[249]Kenya Bureau of Standards, 'KEBS Marks of Quality (SMark, DMark, ISM, Fortification)' (n 247).

4.7.5. Limited Cooperation between Cross Border Agencies

One way of reducing TBTs is by having single Custom Territory for quick clearance of imports. Compared to other RECs, EAC is at advanced stages in implementing the WTO's Agreement on Technical Barriers to Trade through single Custom Territory.[250] Whereas the community has commenced implementation of single Custom Territory that has enhanced clearance of goods through reduced turn around period and reduced documentation for goods in transit, procedural impediments in applying NTMs is still a problem to EAC trading system.[251] This is partly due to unilateral application of NTMs to protect domestic industries, which translates to administrative and bureaucratic inefficiencies,[252] and due to the EAC has different national customs systems that hamper uninterrupted sharing of information and integration of cross-border processes leading to wastage of time at border points.[253] The UNCTAD research attests to this.

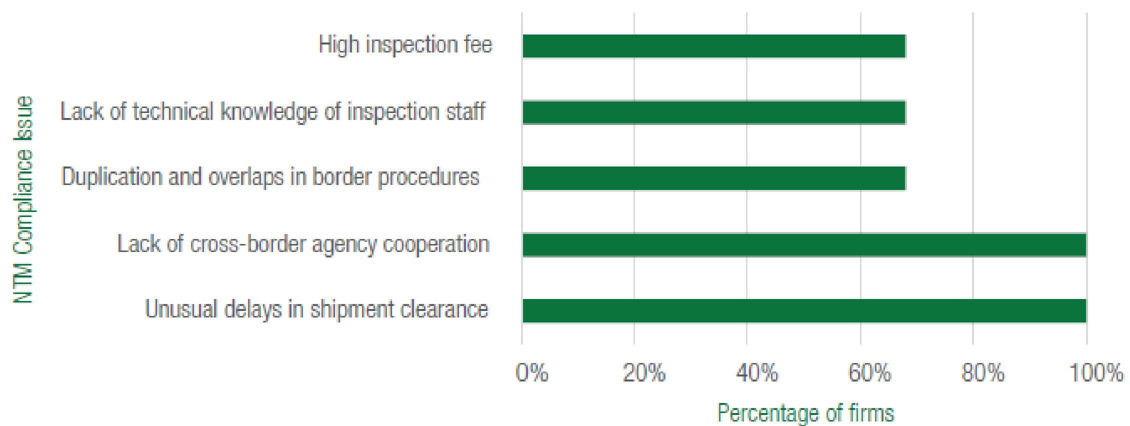
According to UNCTAD research of October 2020, 100% of the respondents participating in cotton value chains stated that it takes about three weeks to clear goods at the EAC boarders, which increased costs of trade while profits diminish.[254] The respondents asserted that there is no coordination between the Kenyan, Tanzanian and Ugandan standards bureaus and that the bureaus or not familiar with each other's custom documents. The Respondents also stated that even where documents are harmonised, Kenya inspects the documents anyway.[255] The research also indicates that 100% of the Respondent firms stated that custom clearance delays and lack of corporation among customs agencies is a huge barrier to participation and investment in cotton value chains.[256] These impediments leads to costly, lengthy and time-consuming clearance process. Consequently, administrative and procedural technicalities at border points hinder effective participation and investment in GVCs.[257]

4.7.6. Summary of Challenges Arising from NTBS.

The chat below gives a brief reaction from investors in cotton value chain arising from regulatory and administrative actions in Kenya. The chart indicates the outcome of the

[250]East African Community (n 120).
[251] Second East African Community Development Strategy (2001-2005)
[252]Jansen and others (n 218).
[253]East African Community (n 120).
[254]United Nations Conference on Trade and Development (n 138).
[255]ibid.
[256]ibid.
[257]East African Community (n 120) 35.

research conducted in Kenya by UNCTAD in October 2020 concerning the NTMs affecting cotton value chain in Kenya.



Adopted from UNCTAD survey of October 2020.

4.7.7. Conclusion

This chapter has demonstrated that NTBs prevent participation and investment in GVCs and RVCs. In light of International Cooperation Theory, Non-tariff barriers within the Partner States can be eliminated by mutual agreement of the concerned Partner States; implementation of the East African Community Time Bound Programme for Elimination of Identified Non-Tariff Barriers; and through laws, regulations, directives, decisions or recommendations of the Council.[258] Therefore, the study finds that International Cooperation Theory is relevant in GVCs.

[258]East African Community Elimination of Non-Tariff Barriers Act, 2017 s 9.

5.0.0. CHAPTER FIVE: FINDINGS, RECOMMENDATIONS AND CONCLUSION

5.1.0. General Findings

Considering the research questions and the hypothesis, this study has established that the law vital in participation and investment in GVCs because all transactions must comply with the law. The study has established that the existing Kenyan laws affect participation and investment in GVCs through barring entry of investors, through tariffs, and through NTBs. Consequently, Kenya should amend various laws as highlighted in this study. In addition, the study has established that Kenya does not have a special law to govern GVCs bearing mind that GVCs is not similar to conventional international trade. Therefore, Kenya should enact an Act of parliament on GVCs. In addition, EAC does not have a law that govern RVCs. It would be prudent for the EAC states to form, participate and invest in RVCs. That would require enacting of EAC agreement on RVCs.

5.2.0. Findings on the Role of Law on Entry and Retention of Investments

Whereas Kenya has factor endowments, the study finds that laws of Kenya prevent entry of investors. This explains why GVCs are not common in Kenya. For example, the Foreign Investments Protection Act and the Investment Promotion Act are contradictory. The two Acts do not recognise intellectual property as investible property. On the other hand, Investment Promotion Act has minimum funds for investment, locking out potential investors from entering the country. Apart from that, the Industrial and Commercial Development Corporation Act has been underutilised. In fact, ICDC documents and website indicates that it promotes and markets goods produced using local goods, which is good, but in light GVCs, the ICDC should market all goods bearing in mind that goods manufactured through GVCs maybe a blend between the local and foreign goods.

The study also finds that whereas investors can invest in Kenya through SEZ under Special Economic Zones Act and EPZ under Export Processing Zones Act, the minimum financial thresholds under the Investment Promotion Act means that ordinary Kenyans cannot obtain investment certificate to invest through SEZ and EPZ. Therefore, they cannot enjoy privileges attached to SEZ and EPZ because investment certificate is one of the required before entry into SEZ and EPZ.

5.3.0. Findings on Tax Barriers to Participation and Investment in GVCs

The study has found that laws of Kenya contain tax barriers to participation and investment in GVCs. For example, the Income Tax Act is capable of subjecting GVCs investors to double taxation where there is no DTA. On the other hand, the VAT Act charges tax on gross expenses and not on value added which affects viability of GVCs. The study also finds that there are numerous taxes and charges based on the Miscellaneous Fees and Levies Act**.** On the other hand, the study finds that whereas the East African Community Customs Management Act, 2004 allows Duty drawback and duty free imports for inward processing, the conditions attached thereto are strict and the Commissioner wields wide and discretionary powers in determining duty drawbacks and applications on duty fee imports. Finally, the EAC Treaty and the Customs Union Treaty thereunder establish common external tariff meaning that Kenya cannot go beyond the common tariff to allow duty free imports for goods meant for GVCs. Therefore, the EAC treaty and Customs Union Treaty thereunder prevents investors to invest in GVCs in Kenya. These laws are inconsistent with AfCFTA.

5.4.0. Findings on Non-Tariff Barriers to Participation and Investment in GVCs

The study has established that Kenya laws contain NTBs, which prevents participation and investment in GVCs. The study has pinpointed the barriers arising under the East African Community Customs Management Act, 2004 as well as the Standards Act Chapter 496. The study has also pinpointed the strictness of the EAC and COMESA Rules of Origin and that they negatively affect investment in GVCs. The study found that whereas the Rules of Origin under AfCFTA may not suit GVCs, they are much better than the EAC and COMESA Rules of Origin. Therefore, Kenya should implement AfCFTA's Rules of Origin.

5.5.0. Recommendations

Based on the findings, this study recommends as follows:

5.5.1. Proposed Amendments to Foreign Investments Protection Act

Intellectual property is vital in participation value chains. However, chapter two has revealed that Foreign Investments Protection Act the does not expressly recognise the role intellectual property. For example, the definition of phrase 'foreign asset' under section 2(1) of the Act is ambiguous because mere inclusion of the words 'rights,' does not mean that intellectual property is recognised. Secondly, section 3(4)(c) of the Act limits foreign assets to capital or 'funds' in form of a fixed amount representing the equity of the holder in an enterprise and

which should be expressed either in Kenyan currency or the relevant foreign currency. The said section does not recognise that intellectual property is investable.

The Foreign Investments Protection Act and Investment Promotion Act are contradictory. Whereas foreign investors under the Foreign Investments Protection Act can obtain investment certificate from the Minister in charge of finance,[259] foreign investors under Investment Promotion Act are required to obtain investment certificate from the investment authority.[260] It is not clear under what circumstances should investor obtain investment from the minister or from the investment Authority. This legal duplicity makes investment process unclear and uncertain meaning that investors who may have invested in value chains may hesitate to do so.

Therefore, the research recommends amendments to the Act by amending the phrase 'foreign asset' to include intellectual property. In addition, the research recommends that section 3(4) (c) of the Act be amended to recognise the role of intellectual property.

5.5.2. Proposed Amendments to Investment Promotion Act No. 6 of 2004

Chapter two of the study has pointed out that section 4 of the Investment Promotion Act is a direct impediment to investment, which results to low investments, and participation I GVCs. Section 4 of the Act imposes minimum amounts that a person should invest in Kenya. The threshold under the said law means that persons with less than minimum financial threshold are not investors. Such persons are likely to avoid investing in Kenya in favour of other locations.

His study has been emphatic that GVCs and RVCs thrive in countries where there is recognition and enforcement of intellectual property rights. However, the study has also revealed that the Act is blind to the impact of intellectual property in investments because section 2 of the Act does not recognise intellectual property in attempt to define composition of investment. As such, the Act is an impediment to participation in GVCs and RVCs because it does not recognise intellectual property as human capital. Apart from that, the thresholder under section of the Act locks out input from intellectual property.

[259] Section 3
[260]Laws of Kenya Investment Promotion Act No. 6 of 2004 See Section 3.

Consequently, the study recommends amendments to the definition of 'investment' under section 2 of the Act to recognise intellectual property as investible assets. In addition, section 4(b) and (c) of the Act should be amended to eliminated the minimum financial thresholds.

5.5.3. Proposed Amendments to Industrial and Commercial Development Corporation Act

By virtue of section 3 of ICDC Act, ICDC has a legal duty to initiate, assist, or expand industrial, commercial or other undertakings or enterprises in Kenya or elsewhere. However, the Corporation focuses on creating markets for products manufactured using local raw materials. This leaves out GVCs because GVCs products contain components made from not only from local raw materials, but also from material from other countries.[261] This research calls for the amendment of ICDC Act to mandate the ICDC to assist in development and participation in GVCs by marketing products manufactured through GVCs.

5.5.4. Proposed Amendments to Export Processing Zones Act

The Act allows imports duty free. However, the goods or services manufactured under EPZ are for export only. As demonstrated under chapter four, an investor who participates in GVCs cannot benefit from EPZ unless the investor obtains permits and licences, which are not easy to obtain. The current state of EPZ Act means there is no deference between importing goods from EPZ and importing from a foreign country because goods from EPZ are subject to import duties in equal measure. This means that local investors who cannot meet the requirements for manufacturing under EPZ cannot benefit from duty free imports.

Therefore, the study recommends that section 25 (1) (b) of the Act be amend to allow duty free movement of goods and materials for use in GVCs.

5.5.5. Proposed Amendments to Income Tax Act Chapter 470

Taxation is a source of revenue for governments. However, high and multiple taxes stifles businesses more so participation in GVCs and RVCs. Chapter three of the study has singled out section 4 (a) of the Act as one of the impediments to participation in GVCs. The said law is capable of subjecting an investor to double taxation in absence of DTA.

Therefore, the study calls for review of section 4(a) of the Act to eliminate possibility of double taxation for investor who may invest in value chains in multiple countries. Secondly,

[261] 'About ICDC' (n 106).

the government should fast-track negotiation of DTA with other countries to avoid double taxation.

5.5.6. Proposed Amendments to Value Added Tax Act No. 35 of 2013

High and multiple internal taxes on imports under the VAT Act affects participation in GVCs. The Act imposes taxes on gross output and not on the value added. This leads to high taxes resulting to losses to investors. Consequently, the Act discourages investments in GVCs because production of goods becomes expensive which translates to expensive and uncompetitive products.[262]

To cure the issue, the research recommends that section 14 (1) of the VAT Act be amended to achieve two goals. First, to ensure that only value added is subject to VAT and not the gross output. Secondly, VAT on products that are part of GVC should be zero-rated.

5.5.7. Review of the East African Community Customs Management Act

Chapter two discussed salient provisions on drawback of import duty under the East African Community Customs Management Act. The study found that the Act has stringent rules, which amounts to NTBs. The study also found that the Act donates to the commissioner wide discretion that hinders ease of doing business. Therefore, EAC States should amend the East African Community Customs Management Act by deleting section 139 (iii) (iv) (v).

To reduce technicalities, to improve ease of doing business, and to one stop shop service for firms in value chains, the study recommends that amendment to the East African Community Customs Management Act by deleting the provisions of section 138 and 139 (i) (ii).

Section 139 (iv) of EACCMA purports to donate to the commissioner, the discretion to determine and prescribe duty drawback coefficient applicable. This research has pointed out in chapter three that only the Parliament has legal authority to determine payable taxes or tax waivers. This mandate belongs to the legislature. The legislature should then set the applicable percentage depending on the value of the transaction.

It is important to note that section 172 of the East African Community Customs Management Act allows imported goods be imported to member states for inward processing duty-free.

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[262]de Melo and Twum (n 76) 21.

However, the said section grants the Commissioner wide discretion to determine the conditions for importing such goods into a country yet the EAC Partner States have different commissioners. Consequently, chances of having different conditions for similar goods are quite high. Therefore, the study recommends amendments to section 172 to specify the conditions that investors should satisfy. Doing so will ensure that member states are operating under the same conditions.

5.5.8. Review of Rules of Origin

The study has analysed the EAC, COMESA and AfCFTA Rules of Origin. It has established that the EAC and COMESA Rules of origin are similar, rigid, and are an impediment to participation in GVCs. On the other hand, AfCFTA Rules are better and modern but are not perfect.

This research recommends that the Kenya and EAC states hasten adoption and implementation of the AfCFTA Rules pursuant to Article 19 of the AfCFTA.

5.5.9. Review of Customs and Administrative Technical Entry Procedures

The study has found that non-recognition of Certificate of Origin, requirement to produce Certificate of Conformity (CoC) from the PVoC agents, the need to comply with import standards mark (ISM) among other requirements impacts commercial transitions at customs.

Non-recognition of Certificate of Origin makes Kenya unattractive to investors because they incur unnecessary expenses, which are upon production of the certificate. It is with this reason that the study recommend adoption and implementation of uniform rules of Origin under AfCFTA.

Apart from the above, Kenya subject goods to multiple inspections even if imports are accompanied with CoC from the PVoC agents. Therefore, the study recommends that Kenya should adopt a single inspection procedure to ensure clearance of imports within the shorted time preferably within 24hours upon arrival to boost participation in value chains. Apart from that, EAC standard Bureaus should harmonise custom documents to ensure that export and import process is swift.

5.6.0. Proposed Enactment a Law on Value Chains

The study has established that there is no single Act of Parliament that deals with GVCs. Kenya should enact a dedicated Act of parliament on value chains to define, regulate participation and to provide for rights and obligations relating to value chains. Similarly, the EAC should endeavour to enact EAC agreement on RVCs to boost and encourage EAC citizens to participate and invest in RVCs.

The proposed law should establishment of value chains Authority to ensure that the proposed law to implement the law. In addition, the proposed laws should Establishment of value chains Tribunal to ensure quick dispute resolution.

5.7.0. Conclusion

This study has tested the hypothesis and has established that the existing Kenyan law is the main barrier to Kenya's participation in value chains. The study has demonstrated that whereas Kenya and by extension the EAC States are resource endowed, participation in value chains is negligible because the existing law prevents entry of investors by imposing minimum investible funds; and discourages retention of investors by imposing high tariffs and numerous NTBs. Consequently, Kenya and the EAC States should amend various laws as highlighted in this study.

The study has also demonstrated that a country does not need to be resource endowed to participate in GVCs. The study has demonstrated that developed countries that do not have raw materials import raw materials such as tea from Kenya, add value to it then export it back to Kenya at high prices leading to trade imbalances. Therefore, lack of raw materials is not an issue but the current law is the problem. Consequently, Kenya can fine-tune its laws to attract and retain investors who may want to invest in GVCs to utilise comparative advantage that Kenya may have.

The study has also established that Kenya does not have a special law to govern investment in GVC. Therefore, Kenya should enact an Act of parliament on GVCs. In addition, since EAC does not have a law that govern RVCs, it would be prudent for the EAC to form, participate and invest in RVCs. This will lead to fulfilment of the Objectives of the AfCFTA. Therefore, EAC States should enact EAC agreement on RVCs.

Finally, bearing in mind that GVCs involve participation of at least one country, Kenya, EAC and third party States should fine-tuned custom laws to ensure that there is smooth custom operations between the involved States. This objection is achievable by applying the International Cooperation Theory, which reveals that having resources and good laws is irrelevant if there is no international cooperation.

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