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REGIONAL INTEGRATION EXPERIENCE IN THE EASTERN AFRICAN REGION

by

Andrea Goldstein and Njuguna S. Ndung'u

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PREFACE

The Development Centre's research on Africa since 1997 has centred on the theme of Emerging Africa. An in-depth examination of six countries showing some potential for take-off has identified three ingredients leading to high and sustainable growth:

1) access to external non-debt financial resources;
2) legitimate political leadership;
3) a long-term regional focus.

With these tentative conclusions in mind, in 1999 the Centre launched a research project to pass from country-specific to region-wide analysis, to improve the flow of information for the implementation of co-operation efforts, and to derive policy recommendations for donors and other non-governmental development partners. Regionalism may be fashionable but it is not a new phenomenon in Africa. Indeed, the world's oldest customs union exists in Southern Africa, and the list of both past and present multilateral economic agreements is probably longer than that of any other continent. However, while some successful examples of regional co-operation do exist, Africa's record of creating and sustaining regional frameworks is generally poor. The pressing need for high output growth, industrialisation, employment creation, increasing export trade, higher social and human capital development, and above all lower poverty, is giving regional integration a new lease of life.

A small number of experts from Africa and Europe have been asked to provide the elements to structure our thinking around two, complementary issues:

1) What is the scope for increased intra-regional trade in sub-Saharan Africa, in the context of current trends towards freer regional trade?
2) Which are the most promising areas of regional co-operation?

The studies included in this special series of Development Centre Technical Papers, together with one by Andrea Goldstein, published in 1999, (TP 154), provide updated analyses on the progress of regional integration in sub-Saharan Africa and will contribute to the debate on this key issue for its development. The papers are also published in anticipation of the Second International Forum on African Perspectives, on the theme of Regionalism in Africa, organised by the Development Centre and the African Development Bank.

Jorge Braga de Macedo
President
OECD Development Centre
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RÉSUMÉ

S’il est relativement aisé d’évaluer les progrès, les réalisations et la possible évolution d’un accord d’intégration régionale existant, il est beaucoup plus difficile d’estimer les perspectives de rebond de la Communauté de l’Afrique de l’Est (East African Community — EAC), qui s’est effondrée en 1977. Ce Document fait le point sur les récentes tentatives de relance de l’EAC, en particulier en ce qui concerne l’harmonisation des politiques macro-économiques, des services d’infrastructure et des mouvements de populations, de biens et de services. En dépit des espoirs des pays partenaires, il semble qu’il n’y ait pas de solution évidente aux problèmes posés par le régionalisme en Afrique de l’Est, surtout si l’on considère que les raisons de l’effondrement de l’EAC dans les années 70 sont toujours. En outre, les partenaires disposent désormais d’une grande variété d’options d’appartenance : de nombreuses nations sont déjà membres du COMESA et un pays de la zone a rejoint la SADC. Pour les auteurs, ces nouvelles possibilités de choix donnent aux pays une stratégie de sortie si les avantages du régionalisme tardent à se manifester. Ils avancent que si les améliorations de la qualité des infrastructures et l’harmonisation des politiques monétaires, fiscales et de change peuvent renforcer les bénéfices du régionalisme, c’est bien de la volonté politique que dépendra le succès de l’initiative. Seul un engagement durable des dirigeants de chaque pays pourra amortir les difficultés économiques qui ne manqueront pas de se manifester et permettre à l’union de surmonter les problèmes attendus au cours des premières phases de l’intégration.

Ce Document technique propose un certain nombre de recommandations de politique économique. Premièrement, le régionalisme constitue une étape vers la résolution des défis économiques auxquels est confrontée cette région et un bon moyen de renforcer son pouvoir de négociation lors des futures négociations au sein de l’OMC. Tous les efforts devraient être consentis en vue de sa réalisation, sans pour autant perdre de vue les raisons qui ont conduit à la chute de l’EAC il y a plus de vingt ans. Deuxièmement, les pays d’Afrique de l’Est ont déjà montré des signes de convergence de leurs politiques. Les pays membres pourraient ainsi se spécialiser dans les domaines où ils disposent d’avantages comparatifs : le Kenya dans la fourniture d’une grande diversité de services échangeables, la Tanzanie dans l’exploitation de ses abondantes ressources naturelles, et l’Ouganda dans les produits agricoles et agro-alimentaires. Troisièmement, pour faire en sorte que l’intégration économique s’accompagne de gains d’efficacité, les membres devraient libéraliser les règles d’origine et adopter une politique commune à l’égard des IDE afin d’encourager les productions conjointes trans-frontalières. Quatrièmement, les mesures relatives aux infrastructures, aux réseaux de télécommunication et aux technologies de l’information devraient être harmonisées et la Banque de développement de l’Afrique de l’Est restructurée et recapitalisée pour être en mesure de jouer un rôle moteur dans le financement des projets d’équipement. Cinquièmement, il faudra encourager une plus grande mobilité de la main-d’œuvre dans la région et mettre l’accent sur les compétences dont la demande est élevée et qui tendent à fuir vers l’Afrique du Sud. Enfin, et en dépit de sa difficulté, la convertibilité des monnaies sera fondamentale. Le plus souvent, ces pays sont confrontés aux mêmes chocs économiques : des politiques monétaires similaires permettraient donc d’atténuer les fluctuations.

SUMMARY

It is relatively easy to assess the progress, achievements, and possible future direction of an existing regional integration pact. However, evaluating the prospects for a successful revival of the East African Community (EAC), a regional integration scheme that collapsed in 1977, is arguably a more difficult task. This paper examines recent attempts to revive the EAC, especially as it concerns the harmonisation of macroeconomic policies, infrastructure services, and movement of people, goods and services. Despite the hopes of the different partner countries, it appears there are no easy solutions to the problems posed by regionalism in Eastern Africa, especially when one considers that the problems that led to the EAC's collapse during the 1970s still exist today. Moreover, partners now have many options for multiple memberships: many East African nations are already members of COMESA, and SADC includes one East African member. The paper argues that the presence of these new choices means member nations have an exit strategy if the benefits of regionalism are not forthcoming. The paper further argues that improvements in the quality of infrastructures and harmonisation of monetary, fiscal and exchange rate policies can enhance the benefits of regionalism. But what is paramount for the success of the operation is political will. Only the dedicated support of each nation's political leaders can cushion the economic problems that would arise and take the union beyond the growing pains expected during the initial stages of integration.

The paper concludes with a number of policy recommendations. Firstly, regionalism is a step towards solving the economic challenges facing the region and a good way to strengthen the region's bargaining position at future WTO negotiations. It should be pursued vigorously, but without losing sight of the problems that led to the EAC's collapse more than 20 years ago. Secondly, East African countries have already shown some forms of policy convergence. It allows member countries to specialise in areas where they enjoy comparative advantages: Kenya in the provision of a wide range of tradable services, Tanzania in its vast natural resources, and Uganda in agro-industrial products and food. Thirdly, in order to ensure that efficiency gains accompany economic integration, members should liberalise rules of origin and establish a common policy towards FDIs so as to encourage cross-border joint production. Fourthly, policies on infrastructure, communication networks, and information technology should be harmonised and the East African Development Bank should be re-structured and refinanced to play a leading role in financing the infrastructure projects. Fifthly, it will be necessary to promote greater labour mobility in the region, with a focus on skills that are in high demand and that are currently being drawn to South Africa. Finally, even though it is difficult to achieve, currency convertibility will be essential. Most often, these countries are hit by similar economic shocks. Similar monetary policies would thus streamline currency fluctuations.

I. INTRODUCTION

Regionalism is now widespread in sub-Saharan Africa (SSA). The most important impetus for joining regional groupings has been the hope of addressing common challenges — improving economic policy, reducing poverty, and managing the process of liberalisation — in a collective and co-ordinated manner (Kasekende and Ng'eno, 2000). By pooling together fragmented domestic markets, regional co-operation may spur economic growth and development by promoting intra-regional trade and economies of scale. Three East African countries — Kenya, Tanzania and Uganda — are currently attempting to revive the East African Community (hereinafter referred to as EAC). They hope that doing so will support industrialisation and bring on economic reforms that may eventually spill over into neighbouring countries.

Eastern Africa has seen its economic development, infrastructure and progress in regional integration lag since the collapse of the EAC in 1977. There seem to be three main causes. First, these countries have experienced a drop in the quality of their domestic policies. Internal political tension and corruption have led to economic stagnation in Kenya, which is by far the largest economy in the region. In Tanzania, where wide-ranging reforms are being implemented, results have been limited by the lingering legacy of its socialist experiment. Second, cross-border tensions have risen in frequency and intensity. Continuing tensions in the Great Lakes region and the resulting domestic political tensions have affected Uganda, the most promising reformer in the region. Internal civil strife and interstate wars in countries like Sudan, Ethiopia, Uganda, Rwanda, Burundi and the former Zaire have weakened the potential benefits of regional co-operation. Finally, economic hardships have meant poor maintenance of local infrastructure, like road networks, railway lines, and postal services, thus increasing the cost of regional communication and production activities. In the interval, South Africa has emerged as a powerful alternative for many countries. Thanks to the flexibility of regional co-operation schemes that allow member countries to have multiple memberships, South Africa has become the main trade partner for many countries in the region, even those outside SADC.

Not unlike the rest of the continent, Eastern Africa requires high output growth, based on export-oriented industries to fight poverty (mostly rural) and unemployment (mostly urban). It would also bring external and domestic indebtedness to sustainable levels, and raise social and human capital development. The many obstacles to realising these goals is what is giving a new lease on life on the idea of regional integration. The key concern addressed in this paper is whether the chances of fulfilling the goals of regional integration in East Africa are better now than in the past.

We first trace the history of the EAC since the colonial period to identify the problems and constraints that led to its break-up in 1977. The paper then surveys developments over the last decade, which explain why regional integration is again being considered a feasible and viable development strategy, even though many of the difficulties that led to the end of the pact still exist today. We then look at current efforts to revive the EAC, analyse the importance of economic policy co-ordination, and assess the scope for convergence. The paper ends with a summary and some policy recommendations.

II. HISTORICAL BACKGROUND ON REGIONAL INTEGRATION IN EAST AFRICA

Efforts at regional integration in the Eastern African region have given rise to five sub-regional groupings:

- the East African Community (EAC, 3 members);
- the Common Market for Eastern and Southern Africa (COMESA, 20 members);
- the Preferential Trade Area (PTA) which superseded COMESA;
- the Southern African Development Community (SADC) (12 members, including Tanzania) (Jenkins, 2000);
- the Intergovernmental Authority on Development (IGAD) (6 members, including Kenya and Uganda)[1].

Except for the IGAD, whose mandate concerns political stability and reducing insecurity in the region, the other groups focus on trade. Under COMESA, all tariffs on trade among its Member States are scheduled to fall to zero by October 2000. Tanzania has formally notified the COMESA Secretariat of her intention to withdraw from COMESA membership effectively by September 2000. In the meantime, Tanzania continues to disregard her obligations in the COMESA Treaty. SADC members are very close to an agreement on a free trade area, which will bring import duties to zero, eight years from the signing date. In this section, we examine the evolution of the EAC, its goals, achievements and pitfalls, and conclude that the break-up of EAC was a significant loss for member countries and a blow to regionalism in Africa.

II.1. From Colonial Ties to the EAC

Ever since colonial times, Kenya and Uganda have co-ordinated their economic activities and policies. This started with inter-territorial services such as the Kenya/Uganda railway, the East African Currency Board, and the Postal Union. Tanganyika joined all of these at a later stage, as it did the postal union in 1933. In 1940, a Joint East African Income Tax Board and a Joint Economic Council were established for the three East African colonies. The East African shilling was set at parity with the British pound and later operated as a peg in the currency board. The external tariff was low and there were no trade restrictions, exchange controls or any regional licensing requirements within the region.

In 1948, two institutions were established by a British Council order to provide a legal basis for regional co-operation: the East African High Commission (EAHC), consisting of the Governors of Kenya, Tanzania, Uganda and the East African

Central Legislature Assembly. Laws issued by the EAHC were enforceable in the three territories. This made the establishment of inter-territorial departments responsible for areas of common interest like transport, communications, customs and industry much easier. The East African Common Services (EACSO) was established at the London conference in 1961.

By 1963, all three East African countries had attained their independence from British rule, but establishing a political federation proved problematic. The main disagreement centred on Kenya. The country had a disproportionate amount to gain from such a federation, to the detriment of her smaller neighbours. As a result, countries in the region moved towards a regional trade agreement instead of a political federation. The Permanent Tripartite Commission for East African Co-operation, known as the East African Community, began in 1967. Its main objectives were:

> *"To strengthen and regulate industrial, commercial and other relationships of the partner states to the end that there shall be accelerated, harmonious and balanced development and sustained expansion of economic activities the benefits whereof (were) to be shared equitably through the harmonisation of economic policy, formulation of joint projects and consultation in the plan preparation and implementation in areas such as agriculture, education and manpower, energy and power, industry, tourism, balance of payments, transport and communications, and so on" (EAC Co-operation Treaty, 1967).*

The EAC Co-operation Treaty set the following provisions for the East African Common Market. First, to establish a common external tariff and allow deviations from it for particular items. These were subject to agreement among Finance Ministers from the three countries. Second, to allow unrestricted freedom of transit goods between the three countries and to remit duties levied on such transit goods to the respective country of destination. Third, to control imports of goods from third party countries when such goods were also produced in East Africa. There was no internal tariff, except for a transfer tax within the region, and no other restrictions barring exceptional security, health and moral reasons.

But cracks in the EAC started appearing right away. In the EAC's first year, the East African Currency Board broke down, paving the way for the establishment of three separate central banks. This destroyed any hope for a monetary union. In addition, a new military government came to power in Uganda in 1971. The regime adopted the Common Man's Charter, which sought to Africanise production by expelling Asian entrepreneurs. The new government challenged the foundation of harmonised policy and rule of law. Tanzania did not recognise the new regime in Kampala and considered its participation in the EAC illegal. Furthermore, between 1971 and 1977, EAC countries reacted to external economic shocks such as the Kenyan balance of payments crisis in 1971-72 and the first oil price shocks in 1973 in very different manners.

Members reacted differently again to the commodity boom in 1976-77, adopting radically different economic management tactics, which made co-operation increasingly hard. Although Kenyan authorities argued at the time that their management of the boom was optimal, it led to a fiscal explosion and economic crisis between 1979 and 1985. Uganda did not even experience the boom due to domestic political turmoil, although her coffee growers swelled the Kenyan market. The divergence in policies was particularly clear between Kenya, which chose a mild form of market economy to attract foreign investment, and Tanzania, which adopted the *Mwalimu* policy. The move ushered in the *ujamaa* socialist experiment and a string of nationalisation in that country. These differing economic systems made the partnership more and more difficult. Kenya became impatient with the EAC and argued that an enlargement strategy was preferable to deeper co-ordination and co-operation mechanisms. Thus it proposed the constitution of a grouping extending from Sudan to Mozambique. Within a larger scheme, Kenya presumed that no single member could paralyse the community by taking a particular stand. But the EAC broke down in 1977, when member states failed to pay their dues to the community and Tanzania closed its border with Kenya.

II.2. The Deficiencies of Compensation Mechanisms

These political and external problems highlighted deep-seated underlying tensions, which largely resulted from the fact that Kenya was receiving a disproportionate share of the benefits of integration. Foreign corporations used Kenya as a base to export to the rest of the region, aggravating the trade imbalance and making it virtually impossible to secure an equal distribution of the benefits of trade. The compensation mechanism put in place to address this imbalance proved ineffective and didn't produce the results Uganda and Tanzania wished. In addition, expectations about compensation and balanced development differed within the community. The compensatory mechanisms were conceived to produce equitable distribution of benefits, while the aggravated parties hoped to achieve balanced development by slowing down Kenya's growth rate.

Various measures were tested to redistribute the gains from the common market (Kasekende and Ng'eno, 2000). An East African Development Bank (EADB) was established to promote industrial development. The three countries contributed equally to its capital base, but the bank was required to devote 38.75 per cent of its investments in each Tanzania and Uganda, against 22.5 per cent in Kenya. However, the EADB statutes contained a risk-adverse clause. It could only finance "viable" projects, most of which were in Kenya, especially during the 1971-73 period. This greatly limited its role as a redistributive institution. The absence of co-ordinated industrial planning in EAC further limited the bank's ability to effectively redistribute the benefits of the integration.

A tax transfer system also existed. It was meant to protect the industries of less developed members by imposing a tariff on imports from a country with which it had a trade deficit. The system was supposed to increase trade, but it provided such

a high degree of protection to import-competing industries that it prevented the development of complementary industries in the common market. Despite regulations encouraging the implantation of industries in Uganda and Tanzania, location advantages kept pulling investors to Kenya. In the end, the tax transfer system was finally replaced with mechanisms to distribute common services among member states.

II.3. What Lessons From the Collapse of the EAC?

The EAC's collapse followed the culmination of various failures or inadequacies. Some analysts, such as Fine and Yeo (1997), go further and argue that the EAC was never a true form of integration. Currency convertibility did not last long and movements of goods and services were subject to *de facto* tariffs in the form of transfer taxes between countries, so that EAC was never more than an instrument for (poor) supply of common services and joint revenue collection.

What implications can be drawn for the present and the future of regionalism in Eastern Africa? First, the co-ordination mechanisms envisaged in the treaty failed to achieve an orderly and equitable distribution of the fruits of industrial policy. These fruits also proved very meagre, as the industrial development plan, based on import/substitution, was not successful.

Second, political differences widened in the ten years from the creation to the collapse of the EAC and the political will to overcome difficulties disappeared. On policy makers' agendas, short-term survival clearly overshadowed any long-term economic issues, especially those related to the EAC. A compatible system of domestic policies and economic management is critical for convergence in key prices — such as goods prices, asset prices (interest rates), and the exchange rate — to occur at low levels.

Third and related to the above, differing political orientations all too clearly led to a divergence in economic management. The compatibility of the currencies was based on policy harmonisation and credibility. As Uganda saw its inflation rate explode soon after its military regime came to power and Tanzania started nationalising private enterprises, the Central Bank of Kenya declared the non-convertibility of the Ugandan and Tanzanian currencies, well before the EAC collapsed.

Finally, the provision of common services may be important not only for increasing intra-regional trade, but also when such services require huge investment and/or are needed by countries with special geographic characteristics, such as land lockness. Given Uganda's dependence on Mombasa, poor roads, railways and port facilities in Kenya punished its exporters and importers immensely.

III. DOMESTIC DEVELOPMENTS SINCE THE LATE 1980s

Since the collapse of the EAC, the region has weathered both political and economic shocks. In the last decade, the importance of ideology has receded and, following the failure of Soviet planning and the adoption of structural adjustment policies, the belief in market forces has become the standard in Eastern Africa. All three countries have followed broadly similar policies without any central co-ordination. But more "virtuous" policies have produced questionable results: domestic production has stagnated and poverty has increased. Even in Uganda, which is seen as a successful case of structural adjustment, poverty is still pervasive, and growth alone is not addressing the problem adequately. As intra-area trade has increased, Kenya has reinforced its dominance as a source of imports for both Tanzania and Uganda, which in turn only export minimal amounts to Kenya. Last but not least, liberalisation of capital accounts in the 1990s has made the risks of cross-border contagion from bad economic policies evident.

III.1. Economic Structure and Economic Convergence

On the basis of the endogenous growth theory and the literature on investment irreversibility, the empirical literature suggests that sustainable economic growth depends on three broad categories of variables:

- the macroeconomic policy environment, including the quality of public investment policy and the resilience to external shocks;
- human capital;
- the quality of institutions and other variables influencing the degree of political uncertainty.

Economic performance in sub-Saharan Africa has been disappointing since the early 1980s, and growth was persistently negative until 1994. The picture for East Africa has been slightly different, in the sense that growth has remained generally positive, although at rates far insufficient to reduce poverty (Table 1). Uganda's political landscape changed following the restoration of the rule of law under President Museveni and the broad support this change received in the international community. There was a strong recovery in the early 1990s, but a slowdown since 1996. In Kenya and Tanzania, the recovery only started in the late 1980s. It was halted by the global recession at the beginning of the 1990s and hesitantly resumed in 1993. Kenya has found itself in a low-growth trap since 1991 and efforts to revive the economy have only had only a short-lived success in 1995-96.

Table 1. **Growth Trends 1986-99**

Year	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Kenya	7.1	5.9	6.2	4.7	4.2	1.4	-0.8	0.4	2.6	4.4	4.1	2.1	1.8	1.4
Uganda	0.9	6.2	8.3	6.4	6.5	5.6	3.4	8.3	6.4	11.4	9.3	4.7	5.6	n.a.
Tanzania	5.5	4.8	4.1	3.9	5.4	4.5	-8.9	12.2	1.4	2.6	4.1	4.1	3.4	n.a.

Source: World Bank: African Economic Indicators, 1996, 1998-99

In any case, it is easy to identify a clear link with the growth of private investment (Table 2). An investment-growth mechanism may have been at play only in the case of Uganda, as a result of very substantial re-construction needs. The rate of gross capital formation in the three countries stagnated at around 10 per cent in the 1990s. In Tanzania, the increase in private investment is nothing less than spectacular (from 8.3 per cent of GDP in 1984 to 24.6 per cent in 1982, with a peak of 27.8 per cent in 1990) but growth has been much more subdued in Kenya and Uganda.

Table 2. **Private Investment Rates 1984-98**

Year	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Kenya	7.43	7.11	7.88	9.05	7.23	7.49	6.75	7.67	6.21	8.89	7.51	9.65	9.87	8.15	8.03
Tanzania	-	-	-	20.72	13.46	13.51	19.21	24.17	23.88	21.63	20.94	18.49	14.26	13.50	12.13
Uganda	-	5.33	5.22	5.37	5.24	5.69	6.47	7.76	8.52	8.49	9.15	10.03	10.45	10.31	9.75

Source: World Bank: African Economic Indicators, 1996, 1998-99

Most macroeconomic variables have been converging towards common values across the EAC (Table 3). The real effective exchange rate shows a certain equilibrium until 1995. Since then, Kenya has maintained a strong, and perhaps over-valued currency, while Tanzania has allowed the shilling to depreciate sharply in real terms. One interesting feature conerning these countries is that they have all moved from low to high inflation in the early 1990s, before returning back to low inflation (although in 1998 Tanzania had not achieved its single-digit target). Fiscal deficits are all below 1 per cent of GDP and even in surplus for Tanzania. This is surprising because the expectation would have been that Uganda, the most successful reformer, would have shown a stronger fiscal position than Tanzania.

Table 3. **Economic Structure of EAC Countries**
(basic indicators 1990-98)

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Real GDP growth									
Kenya	4.2	1.4	-0.8	0.4	2.6	4.4	4.1	2.1	1.8
Tanzania	5.4	4.5	-6.9	12.2	1.4	2.6	4.1	4.0	3.4
Uganda	6.5	5.6	3.4	8.3	6.4	11.5	9.1	4.7	5.6
Real effective exchange rate									
Kenya	90.09	88.38	92.34	80.45	100.9	100	97.93	85.32	122.4
Tanzania	103.09	101.86	89.48	96.91	96.49	100	121.44	138.66	156.6
Uganda	112.4	82.86	76.89	82.14	102.19	100	99.67	106.99	99.4
Inflation									
Kenya	14.1	14.4	20.9	46.0	28.8	1.6	10.8	8.3	9.6
Tanzania	-	22.2	23.1	25.3	35	27.7	21.1	16.1	9.4
Uganda	29.9	27.7	54.5	5.1	10.6	6.6	5.4	10.4	5.5
Fiscal deficit (inc. grants)% GDP									
Kenya	-5.1	-4.4	-7.0	-7.9	-3.6	-0.6	-1.3	-1.9	-1.2
Tanzania	-0.5	0.4	0.9	-5.3	-2.0	-3.9	-2.1	2.1	0.2
Uganda	-4.4	-3.4	-7.3	-3.2	-3.8	-2.9	-1.9	-1.8	-0.6

GDP per capita

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Kenya	338	304	285	174	305	273	302	300	385	298
Tanzania	172	184	157	134	160	194	217	252	254	246
Uganda	180	144	175	199	303	308	324	-	-	-

Source: IMF IFS; World Bank African Development Indicators, 1998-99

All three countries remain heavily dependent on agriculture, especially Tanzania and Uganda where it accounts for 56 per cent and 44 per cent of GDP respectively, but also in Kenya where it contributes 30 per cent of GDP. Weather vagaries tend to aggravate output fluctuations. Uganda's GDP growth, for example, fell in 1991-92 due to a prolonged drought in many areas. It recovered strongly in 1992-93 as rainfall returned to normal levels. In 1997, El Niño destructed crops and damaged infrastructure in Kenya. Manufacturing contributes minimally to GDP: 8 per cent in Tanzania, 9 per cent in Uganda, and 10 per cent for Kenya. The figures for manufactured exports are equally minimal. Non-traditional exports have recorded sluggish growth. Strong dependence on weather conditions and the price of primary products, such as tea in Kenya and coffee in Tanzania, translates into a high variability of foreign exchange earnings, national incomes, and employment levels. Aid dependence, especially for Tanzania, as well as high external indebtedness are also key characteristics of these economies.

III.2. Trade and Trade Liberalisation in East Africa

Trade liberalisation has been a central component of regional structural adjustment policies in the 1980s and 1990s. Trade regimes are far more open now than during the EAC days. However, the supply response has not been as swift and

positive as predicted. Reinforcing the capacity to trade thus remains a key policy priority (Bonaglia and Fukasaku, 2001). The latest intra-area commerce, export and import trade matrices for 1997, show a noteworthy picture (Tables 4 and 5). Some cells are almost empty: there is insignificant trade between Tanzania and Uganda and insignificant imports to Kenya from the other countries. On the other hand, Uganda (and Tanzania to some extent) is dominant export markets for Kenyan goods, comprising 29.4 per cent of Kenyan sales abroad. A fourth of Uganda's imports originated from Kenya, while 10.4 per cent of Tanzania's 1997 imports did. In the case of Uganda, the share of its imports originating from Kenya has fallen markedly in recent years, from 51.1 per cent in 1994 to 25.9 per cent in 1997[2].

Table 4. **Export Destination (1997)***

	Kenya	Tanzania	Uganda
Kenya	-	13.7	15.7
Tanzania	0.45	-	0*
Uganda	0.24	0*	-

* These are percentages of total exports for the respective country. In most cases, these are insignificant enough to be represented by a zero.

Source: Report of the permanent Tripartite Commission for East African Co-operation: 1996-98.

Table 5. **Import Sources (1997)***

	Kenya	Tanzania	Uganda
Kenya	-	0**	0**
Tanzania	10.4	-	0
Uganda	25.9	0**	-

* These are percentages of total imports for the respective country.
**The percentages are very small.

Source: *Report of the permanent Tripartite Commission for East African Co-operation:* 1996-98.

Intra-area trade is relatively limited, and the chances of increasing it are slim because export activities are complementary rather than competitive (Table 6). Most imports are in machinery, transport and equipment, which come from the industrial countries (Table 7). None of the countries in the region benefits from a comparative advantage in this area, which does not bode well for the chances of creating trade. Furthermore, South Africa has become the largest single trading partner for Kenya and Tanzania, supplying 11.4 per cent and 12.6 per cent of their imports, respectively. However, European Union countries still account for a much higher share collectively.

Table 6. **Main Exports**
(as percentage of total exports)

Export category	Kenya	Uganda	Tanzania
Tea	20.0	5.1	
Horticulture	11.4		
Petroleum products	5.9		
Coffee	14.9	46.9	13.1
Cotton			16.2
Manufactures			14.6
Cashew nuts			10.5
Minerals			12.9
Maize		2.9	
Fish and fish products		4.5	
Tobacco			1.8
Gold		12.3	
Others	47.8	28.3	30.9

Source: *Report of the permanent Tripartite Commission for East African Co-operation*: 1996-98

Table 7. **Main Imports**
(as percentage of total imports)

Import category	Kenya	Uganda	Tanzania (1996)
Machinery, transport and equipment	35.2	16.3	32.0
Manufactures		13.8	
Food and live animals	6.1	7.5	
Chemicals			9.1
Industrial raw materials			24.7
Petroleum products	24.1		11.0
Consumer goods			26.0
Iron & steel	8.9		
Artificial resins & plastic materials	6.1		
Others	19.6	43.5	6.3

Source: *Report of the permanent Tripartite Commission for East African Co-operation:* 1996-98

The continuing imbalances in trade are disquieting, since economic integration cannot succeed without adequate safeguards to protect and compensate weaker members. Unfortunately, the current debate in East Africa does not suggest that an efficient solution can be found. While Tanzanian and Ugandan industrial lobbies argue that Kenyan exporters might flood the other countries' markets thanks to their economies of scale, authorities in Nairobi say that such fears are largely unfounded and based more on politics and historical tensions than fact. Some analysts in Uganda do admit that Kenyan industries do not have the capacity to flood neighbouring markets.

IV. NEW ATTEMPTS

New attempts to revive the trading bloc could help create a policy environment conducive to reinforcing the motors of sustainable growth in the region. This may spur trade on, making it possible for member countries to take a common and stronger position in international negotiations. It would also encourage more efficient infrastructure policies and co-ordinated macro policies to offset the volatility of the international arena. Secondly, regional integration may allow members to profit from neighbourhood effects — that is, the opportunity to learn from the successes and failures of the most advanced reforming country, Uganda — and minimise negative contagion effects. But the success of the operation depends on policy co-ordination. Failure to provide a policy pre-commitment would hinder economic management and increase the perceived risk of investment.

IV.1. The Debate on "New" Regionalism in Africa

This brief discussion on trade patterns has shown that despite structural reforms, the prospects for trade-centred regional integration have not changed since the 1970s. But can regional integration still have a positive impact on the nations involved? The United National Economic Commission for Africa (UNECA) has long argued that, in order to support the process of industrialisation, regional integration should comprise the largest possible number of countries. Kenya adopted this position within the EAC in the 1970s, although for different reasons. The presumption was that the larger the number of countries, the more difficult for a single member to block decision making. But the strategy did not work at the time and in groupings where it has been adopted, such as COMESA, it has not produced any success either.

Regional integration in Africa has been beset with contradictions stemming from the absence of a clear consensus on the benefits of integration, the lack of political will necessary to make it work, and the proliferation of a variety of groupings with multiple membership. One could argue the conundrum exists because the structure of the African economy does not support regional integration. First, all countries in the continent are highly dependent on a small number of export commodities. Thus, they compete on third markets rather than complementing each other. Second, import-substitution has produced an industry structure where most local modern corporations are affiliates of multinational corporations. Since they are only present in certain countries, which they use as an export base for the rest of each sub-region, they contribute to the uneven distribution of costs and benefits of regional trade. These are very problems that led to the collapse of EAC in 1977. Until these issues are resolved, political will alone is not sufficient to restart the regional trading bloc.

This regional pessimism argument may be partially valid, but it leaves aside the 1994 signing of the WTO agreements. This pressured African countries to open their trade frontiers, but also highlighted their isolation at the negotiating table. UNECA has emphasised that regional integration should promote political cohesion and allow Africa to speak as much as possible as a single voice. The revival of past groupings like the EAC and the call to strengthen surviving ones also come out of the dismal performance of the "Washington consensus" in SSA. It is broadly acknowledged that SAPs failed to take institutions into serious consideration. Some therefore argue that regionalism may make it relatively easier to address what is considered the missing element in structural reforms.

A related issue concerns the need to establish a framework to "lock in" sound and stable macroeconomic policies. Doing so would induce the supply response needed to realise the benefits of economic opening. In the past, reforms have risked derailing because of politicians' short-term horizons, investors' insecurity concerning political leadership, and recurring ethnic conflicts. Collier and Gunning (1995) in particular, have argued that regional "agents of restraint" and strict commitments thanks to agreements with external actors such as the EU, may provide the necessary political checks. Appropriate mechanisms could tie the hands of politicians and minimise the effects of policy slippage.

IV.2. Re-launching East African Co-operation

In 1984, at a meeting called to oversee the equitable sharing of EAC assets and debts, Kenya, Tanzania and Uganda acknowledged that regionalism could still be mutually beneficial, despite the strains it had produced in the past. This turn of events, built on the apparent convergence of economic policies such as the floating of exchange rates, the liberalisation of foreign trade, foreign exchange transactions, and capital accounts, resulted in the adoption of SAPs.

The partnership started in earnest in 1986 with the formation of a tri-partite working group to work out modalities of renewed co-operation. But there was no progress until 1991. That year, the heads of the three countries directed their respective Ministers of Foreign Affairs to devise a pragmatic programme to reactivate co-operation for which they were to draw an appropriate institutional framework. The following year, a tri-partite committee of experts was formed to prepare a document that would identify spheres of common economic interest. This committee proposed to focus co-operation on the following areas:

— political co-operation;

— security matters;

— judicial co-operation;

— trade and industry;

— transport and communication;

— agriculture and animal husbandry;

— environment and natural resources;
— tourism and wildlife conservation;
— social and cultural co-operation;
— settlement of outstanding debts arising from the EAC Mediation Agreement.

However, the document was vague about economic integration and made no concrete suggestions on tariffs and non-tariff barriers.

In November 1993, a Permanent Tripartite Commission for East African Co-operation was established. It was to become the policy-making organ of the grouping. A Ministerial Forum heads the commission, with a subsidiary senior officials organ called the Co-ordination Committee of Officials, and a small secretariat in Arusha. The latter was not launched as scheduled in March 1995, but one year later. Kenya's failure to nominate the EAC's Executive Secretary, a power it was given to overcome its reluctance to revive the initiative, caused the delay. Head of State summits are now held every year in April. The declaration of closer East African Co-operation proclaimed the following areas priorities for the group:

— industry;
— science and technology;
— trade, transport and communication;
— security and immigration;
— tourism;
— health and animal disease control;
— education, culture and institutional matters.

The main objectives of the newly established East African Co-operation agreement are to strengthen and consolidate economic co-operation; promote sustainable use of the region's natural resources; put in place measures for effective protection of the environment; enhance the role of women in development; and, promote peace, security and good neighbourliness. The sequencing is a standard one: first the establishment of a customs union, then the creation of a common market, subsequently a monetary union, and ultimately a political federation. Achieving these goals is predicated on progress in policy harmonisation, macroeconomic stability, and development of infrastructure. The hope is that co-operation in these areas will open up investment and trade opportunities for local producers to enjoy economies of scale. But the treaty steered clear of customs union and common market issues, having only two articles on safeguards. The other 13 articles dealing with trade were left for further negotiations.

The EAC was initially developed on the basis of co-operative agreements between Kenya, Tanzania and Uganda. While it was initially intended that this

less-than-treaty-status arrangement would be in place for the first ten years, pressure mounted to upgrade EAC to a treaty for co-operation. One of the stated benefits of an upgrade is to allow member states to enter into future multilateral negotiations as one entity and to safeguard national and regional interests more effectively, particularly those relating to investment and trade articles in WTO/Uruguay Round. The Treaty establishing the East African Community was finally signed in Arusha on 30 November 1999 by Presidents Yoweri Museveni of Uganda, Daniel Arap Moi of Kenya and Benjamin Mkapa of Tanzania.

V. AN EARLY ASSESMENT

V.1. Targets and Early Results

Since its inception, the EAC has fixed explicit targets in a number of areas of mutual co-operation. With regard to the elimination of tariffs, non-tariff barriers and non-tariff measures, a trade protocol is to be negotiated within a time span of four years. The East African Co-operation Development Strategy 1997-2000 provides more precise medium-term guidelines for economic and social development. Convergent macroeconomic indicators include real GDP growth rate of 6 per cent, single-digit inflation by the year 2000, national savings rates of 20 per cent of GDP in the medium term and maintenance of stable, market-determined, exchange rates. Fiscal policy objectives include institutional mechanisms — in particular, pre- and post-budget consultations and tripartite agreements on double taxation — as well as an explicit numerical one: the reduction of budget deficits to 5 per cent by 1998. Furthermore, countries seek to achieve full currency convertibility. At present, Kenya has completely liberalised its capital account, but Uganda and Tanzania still keep various forms of control.

Specific milestones achieved in the first year included the following:

- implementation of the agreement on removal of all non-tariff barriers and of COMESA preferential tariff reduction — Kenya by 90 per cent, Tanzania and Uganda by 80 per cent;
- harmonisation of standards and specifications of goods and services and adoption of 133 of them as East African Standards, of which 41 have already been notified to the WTO;
- issuance of the East African Passport;
- setting up of a security committee to curb the proliferation of small arms in the region.

V.1.1. The Definition of the Common External Tariff

The first building block in the long process towards the creation of a common market is the definition of a common external tariff. This includes its level, the sequencing of its implementation, and exceptions. The expected benefits from regional integration must be weighed against the costs stemming from the loss of tariff revenues. The delays accumulated so far largely result from differences in the economic development and industrialisation, the success obtained in reaching macroeconomic stability and the varying degree of dependence on trade taxes[3]. To compound these challenges, the political commitment to surrender national sovereignty when regional decisions are perceived to go against national interests has been limited. The dilemma has come up in the case of the loss in fiscal revenue, the risk of incurring trade deficits, and the removal of protection to infant industries.

As President Benjamin Mkapa of Tanzania recently declared: "While I was undertaking reforms [in the tariff structure], government depended very heavily on imports for its revenues. If, suddenly, you tell me these have to go, where do I get a substitute source of revenue? We [the EAC members] may have had a common vision, but our starting points were different and we did not consult enough"[4].

Although differences in tax classification make it difficult to reach a firm conclusion, Kenya relies more on import duties and value-added/sales taxes on imports than the other countries (Table 8). Kenya's tax effort in relation to economic activity is also higher. Tables 9 to 11 provide additional longitudinal data on the reliance of fiscal revenue on international trade taxes. The case of Uganda — where trade taxes were trimmed from 42.2 per cent of total revenue in 1991-92 to 10.2 per cent in 1996-97 — illustrates a dramatic transition. Meanwhile, in Kenya, the trend is towards a stronger dependence on trade duties, whose share in total receipts has risen from 8.6 per cent in 1991-92 to 15.3 per cent in 1996-97. In addition to import duties, Tanzania introduced a 20 per cent VAT in 1997, but more than a quarter of total revenue still comes from international trade taxes. Reducing or eliminating VAT exemptions would help bring down trade taxes substantially[5].

Table 8. **Sources of Revenue in East Africa 1996-97**
(percentage of total revenue)

Revenue Source	Kenya	Uganda	Tanzania
Export duties	0	0.3	0
Import duties	15.3	9.9	13.7
Excise duties	16.6	41.2	16.0.
VAT/sales tax	19.5	28.7	21.3
On imports	*9.5*	*n.a.*	*9.6*
On domestic sales	*10.0*	*n.a.*	*11.7*
Income taxes	33.0	14.0	21.8
Other revenue	14.7	5.9	27.2
Total	100	100	100
Total revenue/GDP	26.3	11.6	13.9

Source: Rajaram *et al.* (1999), p. 10.

Table 9. **Kenya: Sources of Revenue 1991-97**
(share of total tax revenue)

	1991-92	1993-94	1996-97
Tax revenue	80.8	89.0	86.6
Taxes on international. trade	8.6	14.3	15.3
Import duties	*8.56*	*14.3*	*15.3*
Export taxes	*0.002*	*0*	*0*
Taxes on goods & services	43.1	39.2	37.0
Taxes on income and profit	29.1	35.6	33.0
Other taxes	0	0	1.3
Non-tax revenue	19.2	11.0	13.4
Total revenue	100	100	100
Total revenue/GDP	24.1	28.0	26.3

Table 10. **Uganda: Sources of Revenue 1991-97**
(share of total tax revenue)

	1991-92	1993-94	1996-97
Tax revenue	92.9	93.1	94.1
Taxes on international trade	42.3	41.9	10.2
Import duties	*41.2*	*41.9*	*9.9*
Export taxes	*1.1*	*0*	*0.3*
Excise taxes	8.1	11.1	41.2
Petroleum products	0	0	27.0
Other	8.1	11.1	14.2
Income taxes	12.7	14.6	14.0
VAT/sales taxes	22.1	24.9	28.7
Other taxes	3.6	0.6	0
Non-tax revenue	7.1	6.9	5.9
Total revenue/GDP	7.2	8.9	11.6

Table 11. **Tanzania: Sources of Revenue 1991-97**
(share of total tax revenue)

	1991-92	1993-94	1996-97
Taxes on imports	22.2	20.7	28.5
Custom duties	12.2	11.7	13.7
Sales taxes	7.9	8.0	9.6
Excise duties	2.1	1.0	5.2
Domestic indirect taxes	34.8	30.7	24.1
Income taxes	23.1	24.1	21.1
Payroll and property tax	1.1	1.4	1.6
Other taxes	7.0	13.9	13.9
Non-tax revenue	11.6	9.1	10.0
Total revenue	100	100	100
Total revenue/GDP	14.1	12.0	13.9

In addition, there are various unresolved trade conflicts:

— Uganda imposes a 10 per cent surcharge on COMESA imports. This takes aim at Kenyan goods, since 80 per cent of Uganda's imports from COMESA originate from there;

— Uganda also imposes non-COMESA tariffs on the imports of nails, bolts, screws, nuts, and leaf-springs from Kenya;

— there are also restrictions on Kenyan investment in Uganda and Tanzania;

— following Tanzania withdrawal from COMESA in June 1997, imports from Kenya do not enjoy any preferences. However, Kenya continues to provide COMESA preference to imports from Tanzania[6].

Regarding rules of origin, governments have been reluctant to liberalise re-exports, arguing that it would turn their industries into assemblers, with little added value. This, of course, contradicts the oft-heard desire to turn East Africa into an

important trading centre. With regard to trade imbalances and the future benefits of integration, the Treaty does not propose a clear solution. The Safeguard Clause for Article 78 vaguely states that:

> *"In the event of serious injury occurring to the economy of a partner state following the application of the provisions of this chapter, the partner state concerned shall, after informing the Council through the Secretary General and other partner states, take the necessary Safeguard measures. The Council shall examine the method and effect of the application of existing safeguard measures and take decisions thereon."*

V.2. Infrastructure Facilities to Enhance Regional Co-operation

By reducing transaction costs and thus increasing the profitability and the productivity of investments, more efficient infrastructure facilities enhance economic growth and the quality of life. These infrastructures are both physical in the case of telecommunications, power, transport, water and sewage systems, and institutional in the case of well-functioning financial markets. Various recent contributions in the literature on economic growth have indeed shown that geography and location are key reasons for Africa's dismal economic performance. The vast distances and low population density make the cost of providing efficient infrastructure prohibitive. Such inefficiencies — in terms of management, unreliability of communications, complicated customs and documentation procedures, and other unofficial costs related to lack of security and abuses — make conducting business very expensive. Regionalism and harmonised infrastructure policies are especially important for landlocked countries that have to rely on physical infrastructure provided by neighbours, whose policies they do not control.

Improving the Regional Transport System

The EAC intends to set up co-ordinated, harmonised, and complementary transport and communications policies to improve existing links and to establish new ones. It is hoped this will enhance physical cohesion and promote the free flow of goods and factors of production. In such an endeavour, the integration of each country's transport networks, adapting to the requirements of export-orientation (in particular as concerns inter-modality), and *ad hoc* provisions granting special treatment to landlocked countries are crucial to the success of the operation. But the results so far have not been very encouraging.

Mombasa, a deep-water port with 21 berths and a rated annual capacity of 22 million tons, is the trade artery for not only Kenya, but for the whole of East Africa. It handles consignments to and from Uganda, Rwanda, Burundi, eastern Congo and southern Sudan. Mombasa, which is managed by the Kenya Ports Authority (KPA), employs more than 7 000 people, making it one of Kenya's largest businesses. According to many industry participants, a combination of graft, theft, inefficiency, and political manoeuvring obstructs the port's operations and hinders speedy trade for the entire region. For example, only two of the four ship-to-shore gantries are in working order and stevedores are entitled to a 25 per cent unofficial "bonus"[7].

Plans to replace or refurbish some of the equipment at the port and to clean up its governance mechanisms have encountered much resistance. The port has had no less than seven managing directors over the course of the 1990s. The government announced in mid-2000 its intention of privatising the port by early 2003, but the KPA has promptly aired its opposition and preference for a slower pace of change. Productivity has somewhat improved, but still stands at 11 containers handled per hour, well below the international benchmark of 19.1, identified in a recent Drewry report.

The ports of Mombasa and Dar-es-Salaam have traditionally been at the centre of the East African transport network. The so-called Northern and Central Corridors link them to their respective hinterlands, where most production and extraction facilities are located. The Northern Corridor includes a 1 333 km rail line running from Mombasa to Kampala, a road running along the Kampala/Kasese railway and a road network going from Kampala to Rwanda through Kigali and Bujumbura. The 1 254 km Dar-es-Salaam-Kigoma railway makes up the Central Corridor, connecting to Bujumbura via Lake Tanganyika and to Rwanda by road.

Tanzania has two railway systems connecting Tanzania to Zambia: the Tanzania Railways Corporation and the Tanzanian/Zambian Railway Authority (TAZARA). The latter was established following the collapse of the EAC. They operate independently of each other and use different gauge track railway lines. With the end of apartheid in South Africa, TAZARA and the port of Dar es Salaam have been forced to compete with the South African Railway system and the ports of Durban and Port Elizabeth. While this competition has improved the quality and service of both the port and TAZARA, it has drastically reduced the amount of income generated by both operations[8].

Uganda's problems arise from its being landlocked. The corruption and inefficiency at Mombassa port and poor roads between Mombasa and Kampala greatly hinder the country's trade. Roughly two thirds of Uganda's trade pass at the Malaba and Busia border points. It is estimated that transporting a container of goods between Mombasa and Kampala takes twice the time and expenses as transporting that same container between London and Mombasa. In 1994, the government of Kenya legislated a road maintenance levy to raise additional funds. More recently, it launched, in collaboration with donors, Roads 2000, an ambitious project to link up all the major and minor roads countrywide[9]. Uganda also suffers from the poor condition of domestic roads and the inadequacy of the network of feeder roads in rural areas. Considerable effort is underway to improve the primary East-West road from the Kenyan border to Kabale and the highway between Kampala and Entebbe. Ugandan manufacturers have demanded that the government establish an inland port to ease border congestion, reduce the delays now being experienced in the clearing and forwarding of goods and improve inspection and verification of imports[10].

The EAC used to have a common regional airline. At the EAC's end, all three countries hastily created three national carriers. The economics of international air transport have changed a lot since the late 1960s. Liberalisation has shown the advantage of hub-and-spokes systems. The success of countries like Chile,

Colombia, and Mauritius in exporting high value-added agricultural products to OECD markets has shown the importance of air transport in the logistics of the supply chain. Despite repeated calls for greater regional integration, very little progress has been made. Kenya Airways was sold to a foreign strategic investor (KLM) in 1996, in what was possibly the country's most successful privatisation so far. But the company has been unable to make Nairobi a true regional hub. It faces stiff competition from Addis Ababa and, most importantly, the governments of Tanzania and Uganda opened their markets for international flights to South African Airways (SAA), which established an Entebbe-based joint-venture (Alliance)[11]. Politicians, who would prefer an agreement with Kenya Airways, have prevented Uganda Airlines from strengthening these links by opening its capital to SAA.

Investing in a Regional Energy Network

An area of priority for co-operation is the generation, transmission, and distribution of power[12]. In all three countries, scheduled power-cuts and rationing have been common occurrences for many years. The 1999-2000 prolonged drought has aggravated an already critical situation. Problems are particularly acute in Kenya, which gets 69 per cent of its power from hydroelectric generation[13]. Since September 1999, industrial consumers in Kenya have been supplied power for only 12 hours a day. So far, each country has developed its own strategy to secure supplies and imports. Uganda, which enjoys the best conditions for generating hydroelectric power, has been little affected by these power shortages. Impetus to improve the power situation has been lacking, since electricity concerns are vertically integrated state-owned companies with low productivity results and serious financial problems.

Bilateral and multilateral donors are exercising considerable influence in this area. Kenya negotiated a $72 million emergency energy loan with the World Bank in 2000 to reimburse the government for the emergency purchase of 105 MW of power from three independent producers (Aggreko, Deuz, and Cummins). According to conditions attached to the loan, full privatisation of both the Kenya Electricity Generating Company (KenGen) and the Kenya Power and Lighting Company (KPLC), including separation of the latter's transmission and distribution roles, is to be finalised by May 2002[14]. Uganda already plans to split and privatise on a long-term concession basis the generation, transmission, and distribution functions of the Uganda Electricity Board (UEB). Investment requirements for the Bujagali[15] and Karuma Falls hydroelectric projects, including the upgrade of transmission and distribution lines and rural electrification, are estimated at $1.7 billion over the next 10 years. In 2000, Uganda signed an agreement to multiply by five (to 145 MW by 2006 from the current 30 MW) its power exports to Kenya. To allow the transmission of this new energy, KPLC secured finance for expansion of the national grid from the Netherlands Development Finance Company and the East African Development Bank. Plans are also underway to raise Ugandan exports to Rwanda to 20 MW from one MW.

Building a Regional Financial System

Formed in 1954, the Nairobi Stock Exchange (NSE) was a regional bourse for Kenya, Tanganyika, Uganda and Zanzibar. However, after the EAC broke down, the NSE serviced only the Kenyan market. In July 1996, President Museveni visited the NSE and highlighted the need for closer co-operation in the development of the region's capital markets. The same year, the NSE and EAC arranged for a Memorandum of Understanding to be signed between the three EAC Member States covering the harmonisation of capital market laws and regulations.

However, instead of focusing their effort in creating a unified stock market in Nairobi, authorities in Uganda and Tanzania have preferred to build their own microscopic bourses. The unified bourse would have been the fourth largest in sub-Saharan Africa. The Kampala stock exchange opened for business in 1998, partly in response to concerns that Uganda's privatisation programme had no mechanism for local participation[16]. But trading remains basically limited to one instrument, a bond issued by the EADB. As for the Dar es Salaam stock exchange, it opened its doors in 1998, with trading limited to one stock, Tanzania Oxygen, and opening hours are … half an hour every Wednesday morning. Kenya asserted its financial adulthood in 2000 by opening up to market makers. While a regional stock exchange still does not exist, the three exchanges have since agreed on the principles of cross-border listing and are now focusing on developing regional products. An apex regional business organisation, the East African Securities Regulatory Authorities (EASRA) has also been formed.

VI. THE LIMITS

VI.1. The Lack of Economic Convergence

African economies are very vulnerable to external macroeconomic shocks from neighbouring countries, the so-called spillover effects. The severity of this vulnerability became clear in Eastern Africa during the 1980s, when the unco-ordinated adoption of trade-opening policies and the floating of currencies exposed them to the vagaries of the world business cycle. The restoration of the macroeconomic stability attracted capital flows (especially to Kenya and Uganda) and led to an appreciation of their currencies. The Kenyan authorities chose to stabilise the nominal exchange rate with a high interest rate. This has discouraged investment in what is the largest economy in the region. The move has greatly diminished Kenya's natural role as an economic locomotive for the region and has encouraged Kenyan investors to move to Uganda.

But groups of countries will only move to higher levels of integration once they have achieved some degree of macroeconomic convergence (Jenkins and Thomas, 1997). The pursuit of policies geared towards promoting a stable macroeconomic environment is a qualifying condition for membership. Credible sanctions must punish errant member states if the project is to succeed. In the EAC's case, indicators such as GDP, inflation and fiscal deficits do not show significant convergence (Table A.1). The European Union's Maastrich criteria offer a useful comparison. Critics point to the high cost of reducing inflation at single digit level in terms of national growth. In 1999, members reached an agreement to read budget proposals on the same day in order to create more harmony in policies. However, in the June 2000 budget, simultaneity of delivery did not translate into policy convergence. Tanzania and Uganda decided to raise taxes on fuel in an effort to reduce reliance on international trade taxes, while Kenya reduced excise duty on beer and imposed an across-the-board VAT, which also bears on imports.

VI.2. The Lack of Political Convergence

As argued above, regionalism can serve as a form of pre-commitment to a set of domestic liberalisation measures. But the "lock in" mechanism will only function to avoid slippage or reversals when the rules governing a regional scheme are stable and certain. One of the EAC's weaknesses is its vulnerability in the face of a political change. The Eastern African countries are fragile democracies, with weak institutions subject to political control. Under these circumstances, what happens once a government is removed after elections is uncertain. Most of the reforms implemented so far have been driven by the desire — or the obligation — to please donors and may not be sustainable. Kenya proves that governments that reform under the sword of conditionality are likely to lose their enthusiasm once external funds dry up.

A way to minimise these fears would be to transfer powers to supra-national bodies. But this assumes that countries are willing to give up their sovereignty. Short

of this solution, a clear prioritisation of the different goals would increase the chances of success of regional integration. Unfortunately, the 1999 EAC Treaty simply lists several areas of co-operation instead of identifying a few key starting points. The problem with multiple objectives is that none of them tend to be streamlined well enough for benefits to be tangible in the short run. A clear strategy, setting lowering tariffs and non-tariff barriers as the first and overriding objective, would have helped in breaking the negotiating impasse described above and avoiding the signs of fatigue that were due to emerge. This kind of progression would strengthen the integration process. Carrying on this momentum, new actors in society may become interested in the issues at stake and new members could show interest.

Overlapping membership is a further challenge for the future of EAC, since it dissipates energies and resources in activities that could be effectively managed under one organisation. Furthermore, members who are impatient to reap the benefits of regional integration, or who are faced with difficult decisions, have the option of choosing an easy exit strategy if they enjoy membership in different organisations. Kenya and Uganda are members of IGAD and COMESA, from which Tanzania exited in 1999. Tanzania is a member of SADC, which Uganda may also be invited to join. While the objectives may be similar, these regional integration groups choose conflicting routes to achieve them. COMESA, for example, has a timetable for tariff reduction, which may not be similar to that which EAC members will have to fix. Deciding on the rules of origin and the list of exceptions have also been thorny issues in COMESA and different criteria may be decided in the EACI region[17].

A further obstacle is the pessimistic view of what can be gained from joining the global economy. Some analysts are fearful of what lowering tariffs and opening up the country will do to national economies. What industrial activity there was behind high tariffs has basically disappeared. Car knocked-down kits (CKDs) used to be imported to be assembled in the region. This is no longer the case. Similarly, the textile and food industries went through a period of de-industrialisation in the 1990s. In order to allay these fears, the Treaty called for input from the private sector and civil society by establishing the East African Business Co-operation Council. A parallel concern is to create a regional identity. The East African Travel Document, though still not operational, was introduced in March 1997, but no steps have been taken on free movement of labour within the region. A public relations and marketing plan has been developed to create a sense of identity among the citizens of Kenya, Uganda and Tanzania and build trust and goodwill within the partnership.

VII. CONCLUSIONS AND POLICY RECOMMENDATIONS

Eastern Africa has a history of attempts at forging regional co-operation that is much longer than most other regions in the continent. This means that failures have left a deep legacy, which are difficult to overcome. In the past decade, Uganda and Tanzania have made important, if somewhat erratic advances in building the foundations for a market economy, while Kenya has dragged behind. The Kenyan impasse has imposed costs on the smaller partners, both in terms of more expensive infrastructure and higher risk premiums on investments. The current wave of regionalism is seen as a means of further economic liberalisation, an avenue towards greater outward orientation and a step towards global integration on more favourable terms. But, as Aryeetey (1998) has argued, proponents tend to focus on the potential benefits stemming from integration, such as greater self-reliance and other advantages, instead of the costs that must be incurred to achieve these objectives.

Various factors bode badly for Eastern African trade integration. These include dependency on agricultural exports, the small and inefficient industrial bases and the vulnerability to fluctuations in the world business cycle. In addition, the region does not have the means to minimise these weaknesses. To compound their dependency on similar sources of imports of capital goods and intermediate inputs, Uganda and Tanzania have unbalanced trade flows with Kenya. Uganda also relies heavily on Kenya for its extra-area commerce. According to Venables (2000), when countries with these characteristics integrate, income levels tend to diverge. Developing countries are hence likely to be better served by North-South, as opposed to South-South, free trade agreements.

But there are also some equally serious reasons why regional integration may be beneficial. First and foremost, the fact that tariffs and non-tariff barriers are less of a problem in the case of expanding trade — both within and a *fortiori* outside East Africa — than supply-side constrains such as weak infrastructure, costly transport, insufficient skills, and ubiquitous red tape. Second, the high opportunity cost of asymmetric responses to what are usually common shocks, strengthens the view that policy co-ordination is crucial to cushion against the vagaries of the world economy.

The experience of regionalism, in OECD and non-OECD countries alike, over the last two decades, allows identification of a core of necessary prerequisites for success. These include: *i)* an effective leadership with a political as well as an economic vision of what could result from cross-border integration; *ii)* simplicity and automaticity in policy implementation (in particular policies related to the removal of intra-area tariff barriers and the definition of the common external tariff); *iii)* early attention to mechanisms for compensating losers; and *iv)* the removal of restrictions on factor mobility. Unfortunately, the revamp of the EAC has been partly hindered by deficiencies on each of these fronts.

Effective leadership may take two different forms. Either it is explicit — the largest country in the region leading the way, proposing policies and implementing tariff reductions and other liberalisation measures — or it is implicit — one country, not necessarily the largest, setting a benchmark and inducing the others to follow and imitate. Both are currently lacking in the EAC. Kenya is not particularly committed to regionalism and Uganda's credibility as a role model is fading away for a number of reasons. A formula of "variable geometry", where countries willing to go faster can do so, and where the pace of regionalism is not dictated by the slowest member, could therefore be very appropriate for the EAC. Decisions should be decentralised as much as possible and civil society should be consistently involved in decision making. Even then, the absence of a credible agency to "lock in" reforms may constitute an almost insurmountable obstacle. In light of this challenge, an external partner, such as the EU, could be asked to guarantee market access as long as policy requirements are met.

Regional trade agreements may prove useful in lowering tariff and non-tariff barriers, but whether or not EAC will successfully do this depends on the degree of in-built automaticity in the schedule for liberalisation. The trade chapter, in its present state, fails to address in detail the need to eliminate all internal tariffs and other charges within the trading bloc — and is said to be a watered down version of what was originally contained in the draft treaty. This is not surprising in view of the resistance from interested groups who benefit from the current situation. The WTO recently completed Tanzania's Trade Policy Review, whose conclusions contain important messages of broader value. The country has now a simplified five-tier structure with a simple average of applied import duties of 16.2 per cent. This tariff structure is somewhat escalatory, with many processed products facing a higher effective rate of protection along the processing chain. Such a tariff structure provides substantial import protection to higher-level processing activities, causing resource misallocation and inflicting higher costs to Tanzanian consumers. To a large degree, this state of affairs is common to Kenya and Uganda. Due attention must be paid to mechanisms that compensate for loss of tax revenue from lower tariffs and other protectionist policies. This is made even more crucial given the existence of exit options[18]. Another policy imperative is simplicity in the rules of origin, to encourage joint cross-border production. Otherwise, the risk is to quickly dampen any hard-won enthusiasm for trade.

EAC is now considering inviting new members, starting with Rwanda and Burundi. The presumption is that the larger the membership, the higher the potential benefits of regionalism in creating intra-area trade and making exporters more competitive on world markets. In this paper, we have stressed that a focus on commerce may not be the most appropriate strategy for enhancing growth and development in Eastern Africa. If decisions on tariffs fall prey to powerful lobbies, regional integration can distort trade more than it creates it. On the other hand, if new regionalism is to make structural reforms more palatable and to reinforce the institutions needed to make it produce growth, the agenda for Eastern Africa's

policy makers is already full enough. As improving the quality of infrastructure is the first priority, restructuring and refinancing the East African Development Bank may allow it to play a leading role. But, in the longer run, regional integration will only work if civil society is involved. Unfortunately, in this part of the world, democracy is only now making timid progress and mutual distrust still infuses cross-border relationships.

NOTES

1. Tanzania is also a member of the Indian Ocean Rims-Association for Regional Co-operation (IOR-ARC). The grouping has the objective to facilitate and promote economic co-operation bringing together representatives of government, business and academic institutions.

2. One explanation for this is that most Kenyan companies have opened branches in Uganda and thus minimised export in Uganda by substituting production.

3. Studies aimed at harmonising tariffs and establishing the best methods of introducing collection of duties at the first points of entry, as a prelude to the establishment of common external tariffs, are underway.

4. “It is time to correct the mistakes of the past”, *Financial Times*, 24 July 2000.

5. In 1999, 42 per cent of duties were not collected on the mainland, while in Zanzibar, the corresponding rate was 33 per cent. VAT exemptions constituted 31 per cent of collections.

6. For example, Kenya’s exports to Tanzania are now subjected to an average tariff of 30 per cent plus a similar excise tax. In addition, the absence of transit bonds in Northern Tanzania impedes the entry of Kenya’s manufactured goods.

7. See “Mombasa tries to clean up trouble on the waterfront”, *Financial Times*, 15 December 1999.

8. Kenya Railways (KR), a parastatal organisation, manages Kenya's single-track railway system, which runs from Mombasa through Nairobi to the Ugandan border, with a branch to central Kenya. The corporation, like most Kenyan parastatals, experiences heavy operational losses with consequent deterioration of services. The government has designated it as strategic, only allowing the privatisation of maintenance services. South African Railways has provided on a lease-hire basis ten 1 200 ton haulage capacity locomotives for cargo shunting between Nairobi and Mombasa. The World Bank and the British Overseas Development Administration are funding a railways rehabilitation programme.

9. The project is expected to be completed in another 2-3 years, at a total cost of $245 million. Twenty thousand kilometers of roads in six urban centres will also be rehabilitated under the project. All bidders for the various components of the project were international companies, except four — one fully locally-owned and the other three having Kenyan interests.

10. Before the container depot sector was liberalised, all containerised cargo had to pass through the government-run inland port services at Nakawa, in Kampala port if not already cleared at Malaba or Busia. A contract to upgrade Nakawa was signed in 1996, but new investment was soon suspended. The government, instead of establishing an inland port, has licensed more inland container depots. More than eight container depots are currently in operation in Uganda. See “Uganda firms want inland port”, *The East African*, 20 October 2000.

11. The two countries each own a 30 per cent stake, with the balance held by Transnet, the part holding of SAA. Alliance Air suspended all operations in October 2000.

12. The EAC also aims at implementing the East African Digital Transmission Project.

13. Twenty seven per cent is generated from thermal and an insignificant 4.4 per cent from geothermal. The Kenyan government has encouraged companies to develop geothermal power to diversify the country’s electricity generation. So far, a few companies have been licensed to develop geothermal power projects at Olkaria site, feeding eight MW into the national grid. The Kenya Electricity Generating Company is also investing to generate another 64 MW. Independent power producers, who are getting support from the World Bank, are expected to generate another 75 MW.

14. This is a problematic case in Kenya and the current timetable has been shifted forward with open-ended clauses. For example, the KPLC board approved the review phase to end by February 2001, but the implementation would soon start, with no target date for completion. This is equally true for privatisation, which was approved in June 2000. Implementation is to start in August 2000 but there is no target for completion.

15. The Bujagali power plant will be built at an altitude of 1 100 meters along the Nile, near the outlet from Lake Victoria. The facility is a so-called run-of-the-river power plant that uses the natural fall height of the Nile. An environmental impact assessment has been made to ensure that the environmental effect is minimised. The project is scheduled to begin in summer 2001 and to be completed in 44 months.

16. Over 20 major enterprises are targeted for divestiture through public flotation, including the Uganda Posts and Telecommunication Corporation, Uganda Commercial Bank, Uganda Airlines, National Insurance Corporation, Uganda Grain Milling Company, Deffe Marketing Board, Uganda Consolidation Properties, and the National Housing and Construction Corporation. Under the public flotation scheme, individual investors are allowed to buy up to 51 per cent in a given enterprise, while the remaining shares must be offered to the general public either through off-the-counter transactions or through the stock exchange.

17. For example, on re-exports of petroleum and petroleum products from Kenya to Uganda, Rwanda and Burundi may not be traded in COMESA due to the rule of origin.

18. Tanzania case is important here. Tanzania has been a member of COMESA, EAC (and now EACI) and SADC. In recent months, it signalled its desire to exit from COMESA. It is believed that even EACI exit is possible, but made difficult due to the presence of EACI headquarters in Arusha. So multiple memberships allow a country to assess benefits but also to assess its exit options.

APPENDIX

Table 1. **Export Destinations 1994-97**

Kenya	1994	1995	1996	1997
Uganda	12.7	15.8	16.1	15.1
Tanzania	10.6	13.0	12.8	13.7
UK	11.6	10.0	10.4	11.5
Germany	7.8	7.6	7.5	6.4
Pakistan	6.9	6.5	4.4	4.3
Others	50.4	47.1	48.7	49.6
Tanzania				
Germany	9.6	9.8	-	-
Japan	8.5	8.8	-	-
India	8.3	10.3	-	-
Belgium-Luxembourg	2.2	7.4	-	-
UK	5.7	6.1	-	-
Others	65.6	57.6	-	-
Uganda				
Spain	5.8	20.6	21.1	
France	14.9	12.8	9.3	
Germany	12.5	12.6	8.8	
Italy	8.0	8.6	7.2	
Belgium	-	7.9	7.3	
Netherlands	-	7.5	7.2	
Others	58.9	30.0	39.2	

Source: Report of the permanent Tripartite Commission for East African Co-operation: 1996-98

Table 2. **Origins of Imports for EAC Countries**

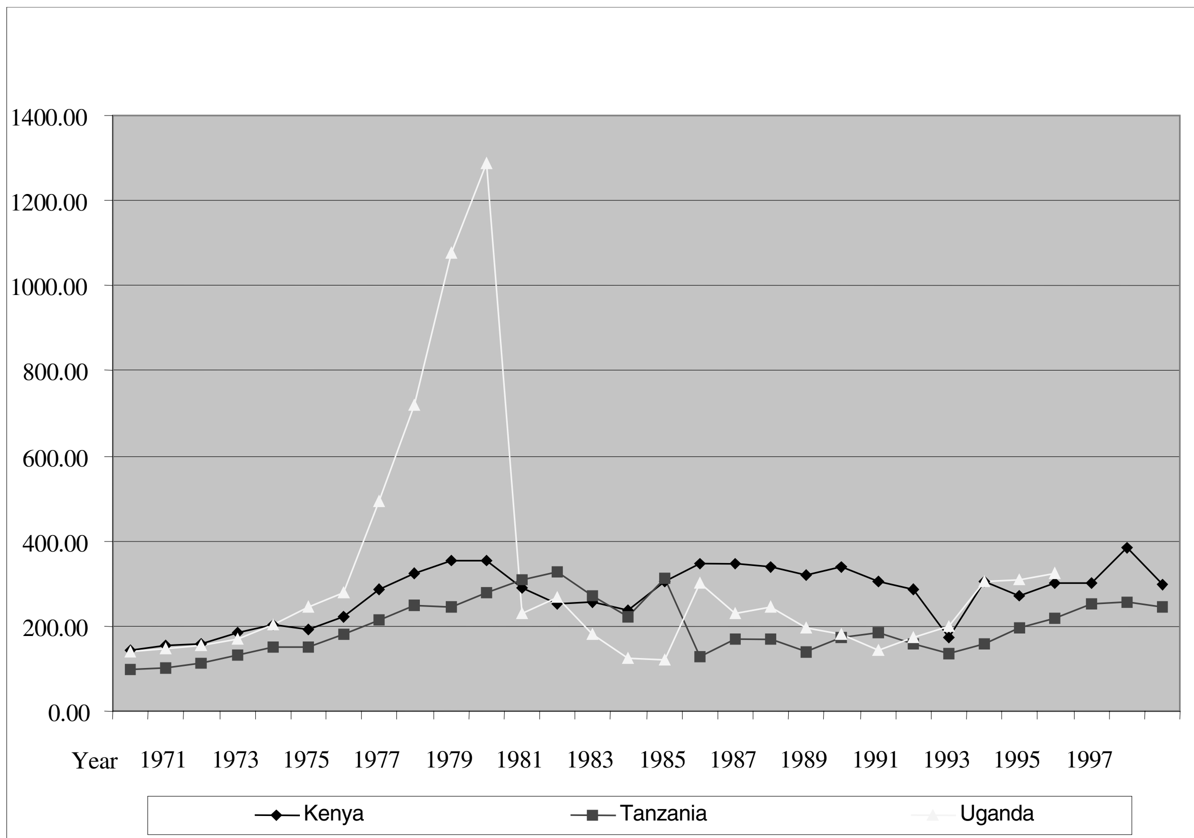
Kenya		1994	1995	1996	1997
	UK	13.2	12.6	13.2	11.3
	Japan	8.6	11.0	7.4	7.5
	Germany	6.2	6.8	6.1	6.7
	UAE	11.2	6.7	8.2	10.0
	USA	6.6	4.2	5.2	7.4
	A. Africa	10.8	7.8	7.6	11.4
	Others	43.4	50.9	52.2	45.7
Tanzania					
	UK	9.6	9.7	10.4	-
	Kenya	9.0	9.1	6.8	-
	Japan	7.2	7.2	6.8	-
	China	4.9	7.3	8.1	-
	Germany	6.8	3.6	6.1	-
	Others	62.5	63.1	61.8	-
Uganda					
	Kenya	51.1	46.8	35.1	25.9
	UK	19.0	21.2	17.0	13.6
	Japan	12.0	16.6	10.7	10.4
	Germany	6.5	6.2	4.4	4.4
	India	9.8	10.3	7.4	8.9
	UAE	7.4	10.3	6.3	7.1
	Others	26.2	36.3	19.1	29.7

Source: Report of the permanent Tripartite Commission for East African Co-operation: 1996-98

Table 3. **GDP Per Capita (1970-99)**

Year	Kenya	Tanzania	Uganda
1970	143.41	96.78	137.61
1971	154.16	100.80	146.24
1972	159.85	111.74	155.56
1973	183.37	132.12	171.14
1974	203.69	151.73	205.01
1975	190.85	150.32	243.51
1976	222.10	178.86	276.91
1977	286.63	214.35	491.60
1978	323.32	248.94	718.76
1979	351.90	245.47	1076.08
1980	353.81	277.13	1288.11
1981	289.42	307.85	230.88
1982	253.69	327.16	266.18
1983	255.64	269.44	179.84
1984	235.29	223.89	125.91
1985	304.65	312.96	121.12
1986	346.11	127.74	299.46
1987	346.33	169.49	231.21
1988	340.40	168.81	243.74
1989	319.42	137.95	196.80
1990	337.92	171.97	180.25
1991	304.21	183.78	143.75
1992	284.65	157.34	174.73
1993	174.12	134.52	199.15
1994	305.11	159.76	303.12
1995	272.74	194.07	307.47
1996	301.76	217.44	324.72
1997	300.09	251.47	-
1998	385.37	254.88	-
1999	298.21	246.00	-

Figure 1. **GDP Per Capita 1970-98**



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